MULTILATERALISM AND REGIONALISM:
The New Interface
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

MULTILATERALISM AND REGIONALISM
THE NEW INTERFACE

Edited by

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United Nations
New York and Geneva, 2005
NOTES

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UNCTAD/DITC/TNCD/2004/7
FOREWORD

There is a resurgence of regionalism in today’s international trading system. Regional trade agreements have multiplied worldwide; almost all countries are members of at least one agreement and many are party to multiple agreements. Existing agreements are re-invigorated and expanded while new ones are being negotiated and formed. Integration measures have extended their reach beyond traditional free trade in goods to a number of domestic regulatory sphere including services, investment and intellectual property rights, to deepen the integration among partner countries. Regionalism has gained a renewed dynamism and is no doubt here to stay as an element of the broader trading system.

Developing countries are active participants in the regionalism movement. They see regional integration as an essential avenue towards economic growth, development and poverty alleviation. The central policy issues for individual developing countries is how to ensure a positive contribution of regional integration to their economic development.

Such “regionalism renaissance” coincides with the evolution of the multilateral trading system through multilateral trade negotiations, including under the Doha work programme. In this complex, evolving and multi-layered trading system, benefits from trade increasingly hinge upon how one can effectively manage regional integration processes; conversely, any positive impact these regional integration processes may have are themselves contingent upon how multilateral trade negotiations are conducted and concluded. This requires that both processes be adequately factored in when approaching individual trade negotiations. Parallel negotiations at multilateral and regional levels make it a Herculean task for policymakers and trade negotiators to identify their national development interests and negotiating objectives.

How can developing countries maximize gains for their development from the totality of multilateral, inter-regional and regional trade agreements and negotiations? How can the interface between multilateralism and regionalism be turned into an effective instrument for development? What are the developmental impacts of regional trade agreements between developed and developing countries (“North-South agreements”) as well as those formed among developing countries (“South-South agreements”), and how can one maximize their beneficial impacts? These are some of the questions asked in this volume. The key policy challenge for developing countries is to ensure coherence, and to forge a positive interface, between multilateralism and regionalism for the sake of development and poverty reduction.

All these questions are complex and require in-depth research as well as collective reflection and policy dialogue. It is these considerations that informed the agenda of the eleventh session of UNCTAD, held on 13-18 June 2004 in São Paulo, Brazil. The overall Conference theme “Enhancing the coherence between national development strategies and global economic processes towards economic growth and development, particularly of developing countries”, as well as its sub-theme on trade “Assuring development gains from the international trading system and trade negotiations”, sought to draw policy attention to, and forge better understanding and consensus on, the issues at stake with regard to the coherence between national development policies on the one hand, and sub-regional, regional, inter-regional and multilateral trade negotiations on the other.

UNCTAD Member States responded to the challenge and agreed, through the São Paulo Consensus to “examine and monitor the interface between the multilateral trading system and
regional trade agreements”, and to “support regional integration and the promotion of South-South trade”. This publication is a first contribution to the development-oriented examination and assessment of the interface between the multilateral trading system and regional trade agreements.

As the focal point of the United Nations for the integrated treatment of trade and development and interrelated issues, and in accordance with the mandate given to it at UNCTAD XI, UNCTAD will continue to support beneficial and equitable integration of developing countries into the international trading system and the world economy. We hope that this publication will make a contribution to fostering a better understanding of the new and evolving interface between multilateralism and regionalism and prompt a collective reflection on ways to assure development gains from these two essential components of the world trading system.

Carlos Fortin  
Office-in-Charge of UNCTAD

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ACKNOWLEDGEMENTS

The volume contains papers delivered at a pre-UNCTAD XI Forum on “Multilateralism and Regionalism: The New Interface” held on 8 June 2004 at the BNDES, Rio de Janeiro, Brazil, organized during the Rio Trade Week, under the supervision of Lakshmi Puri, Director, Division on International Trade in Goods and Services, and Commodities, by a team led by Mina Mashayekhi, Head, Trade Negotiations and Commercial Diplomacy Branch. The team was composed of Bonapas Onguglo, Luis Abugattas and Taisuke Ito. The volume also draws on the ongoing substantive work of UNCTAD.

The volume was edited and prepared by Mina Mashayekhi and Taisuke Ito.

The major contributors are the authors of the individual chapters. Substantive contribution of the participants in the above Forum was no less significant, particularly from Carlos Fortin (Deputy Secretary-General, UNCTAD), Francisco Thompson-Flôres (Deputy Director-General, World Trade Organization) and Mario Mugnaini Jr. (Executive Secretary, the Chamber of External Trade, Brazil). A full list of participants is attached in Annex 3 to this volume.

Text editing and formatting was done by Mark Bloch and the cover page was prepared by Diego Oyarzun.
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ABBREVIATIONS

ACP  African, Caribbean, and Pacific Group of States (ACP Group)
AFTA  ASEAN Free Trade Area
ANCOM  Andean Community
ASEAN  Association of South-East Asian Nations
ATPDEA  Andean Trade Promotion and Drug Eradication Act
AU  African Union
CACM  Central American Common Market
CAN  Andean Community
CAFTA  United States-Central American Free Trade Area
CARICOM  Caribbean Community and Common Market
CEMAC  Communauté Économique et Monétaire de l'Afrique Centrale (Central African Economic and Monetary Community)
CET  common external tariff
COMESA  Common Market for Eastern and Southern Africa
CRTA  Committee on Regional Trade Agreements (WTO)
CTC  change in tariff classification
CU  Customs Union
DWP  Doha Work Programme (WTO)
EAC  East African Community
ECCAS  Economic Community of Central African States
ECO  Economic Cooperation Organization
ECOWAS  Economic Community of West African States
EU  European Union
FTA  Free Trade Area
FTAA  Free Trade Area of the Americas
GATS  General Agreement on Trade in Services (WTO)
GATT  General Agreement on Tariffs and Trade (WTO)
GCC  Gulf Cooperation Council of Arab States
GSP  Generalized System of Preferences
GSTP  Global System of Trade Preferences among Developing Countries
IOC  Indian Ocean Commission
IPR  intellectual property rights
LAFTA  Latin American Free Trade Area
MERCOSUR  Common Market of the South
MFN  most favoured nation
MTS  multilateral trading system
NAFTA  North American Free Trade Area
NAMA  non-agricultural market access
PICTA  Pacific Island Countries Trade Agreement
PACER  Pacific Agreement on Closer Economic Relations
PTA  preferential trade agreements
RIA  regional integration agreements
RoO  rules of origin
RTAs  regional trade agreements
RVC  regional value content
SAARC  South Asian Association for Regional Cooperation
SACU  South African Customs Union
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
</tr>
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<tbody>
<tr>
<td>SADC</td>
<td>Southern African Development Community</td>
</tr>
<tr>
<td>SAFTA</td>
<td>South Asia Free Trade Area</td>
</tr>
<tr>
<td>SDT</td>
<td>special and differential treatment</td>
</tr>
<tr>
<td>SPS</td>
<td>sanitary and phytosanitary measures</td>
</tr>
<tr>
<td>TBT</td>
<td>technical barriers to trade</td>
</tr>
<tr>
<td>TRIPS</td>
<td>trade-related aspects of intellectual property rights (WTO)</td>
</tr>
<tr>
<td>UEMOA</td>
<td>Union Économique et Monétaire Ouest Africaine (West African Economic and Monetary Union)</td>
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<tr>
<td>UMA</td>
<td>Union du Maghreb Arabe (Arab Maghreb Union)</td>
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<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Chapter I

MULTILATERALISM AND REGIONALISM: THE NEW INTERFACE

Mina Mashayekhi, Lakshmi Puri and Taisuke Ito

Introduction

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

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

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

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

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

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

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

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

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

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3 WTO, “The changing landscape of RTAs”, paper prepared for the seminar on Regional Trade Agreements and the WTO held in Geneva on 14 November 2003.
the world and virtually all WTO Members (the exception being Mongolia) today are party to, or are in the process of negotiating, at least one RTA. Thus, regionalism has become a policy option for most countries and is a permanent feature of the international trading environment for the foreseeable future.

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

### Table 1
Evolution of intraregional exports, and their share in world exports, of EU, NAFTA and FTAA (1990-2003, in millions of dollars and per cent)

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<tbody>
<tr>
<td>World</td>
<td>3 491 451</td>
<td>5 137 956</td>
<td>5 667 125</td>
<td>6 364 080</td>
<td>6 121 807</td>
<td>6 396 697</td>
<td>7 443 692</td>
</tr>
<tr>
<td>European Union (25)</td>
<td>1 022 932</td>
<td>1 385 805</td>
<td>1 587 418</td>
<td>1 618 929</td>
<td>1 623 480</td>
<td>1 732 227</td>
<td>2 063 450</td>
</tr>
<tr>
<td>NAFTA</td>
<td>226 273</td>
<td>394 472</td>
<td>581 161</td>
<td>676 441</td>
<td>639 137</td>
<td>626 985</td>
<td>651 213</td>
</tr>
<tr>
<td>FTAA</td>
<td>300 700</td>
<td>525 346</td>
<td>734 848</td>
<td>857 839</td>
<td>814 620</td>
<td>797 612</td>
<td>841 264</td>
</tr>
<tr>
<td>Share (%)</td>
<td></td>
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<tr>
<td>European Union (25)</td>
<td>29.3</td>
<td>27.0</td>
<td>28.0</td>
<td>25.4</td>
<td>26.5</td>
<td>27.1</td>
<td>27.7</td>
</tr>
<tr>
<td>NAFTA</td>
<td>6.5</td>
<td>7.7</td>
<td>10.3</td>
<td>10.6</td>
<td>10.4</td>
<td>9.8</td>
<td>8.7</td>
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<tr>
<td>FTAA</td>
<td>8.6</td>
<td>10.2</td>
<td>13.0</td>
<td>13.5</td>
<td>13.3</td>
<td>12.5</td>
<td>11.3</td>
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The expansion, widening and deepening of RTAs has resulted in a situation whereby intra-RTA trade accounted for some 40 per cent of world trade (merchandise imports) in 2000 and will account for over 50 per cent in 2005. The large proportion of “global” intra-RTA trade would be accounted for by the existing large RTAs, including EU, NAFTA and eventually the proposed FTAA. In 2003, intraregional exports of the EU alone accounted for some 28 per cent of world merchandise exports, while NAFTA intra-exports represented around 9 per cent (see Table 1).

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Table 2
Evolution of the share of intraregional exports in total exports of EU, NAFTA and FTAA
(1990-2003, per cent)

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<tbody>
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<td>European Union (25)</td>
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<td>68</td>
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<td>67</td>
<td>67</td>
<td>67</td>
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<tr>
<td>NAFTA</td>
<td>41</td>
<td>46</td>
<td>55</td>
<td>56</td>
<td>57</td>
<td>57</td>
<td>56</td>
</tr>
<tr>
<td>FTAA</td>
<td>47</td>
<td>53</td>
<td>60</td>
<td>61</td>
<td>61</td>
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<td>60</td>
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Furthermore, intra-RTA trade has been significant, or has become more important for RTA members. EU intraregional trade, for example, accounts for some 66-68 per cent of the EU’s total trade with the world, while in NAFTA the share of intraregional trade increased from 41 per cent in 1990 to 56 per cent in 2003 (see Table 2). Members of the proposed FTAA will trade among themselves over 60 per cent of their total trade. Thus, international trade flows are increasingly concentrated within regional groupings formed by large trading nations.

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

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

6 Egypt, Jordan, Morocco and Tunisia.
In addition to these subregional agreements, various bilateral preferential trade agreements (PTAs) have been launched among, or involving, developing countries, often on an interregional basis. This include recent initiatives for preferential agreements and closer cooperation under the India-Brazil-South Africa (IBSA) Dialogue Forum\(^7\), the EC-BIMSTFT Free Trade Agreement,\(^8\) and bilateral initiatives being studied and launched by ASEAN with its external partners, including China, Japan, the Republic of Korea and India. Other bilateral initiatives include Singapore-Japan, Singapore-New Zealand, Thailand-China, Thailand-India and India-Sri Lanka. In the Western Hemisphere, this involves the following bilateral agreements: Chile-Mexico, Costa Rica-Mexico, Mexico-Nicaragua, Bolivia-Mexico, CARICOM-Dominican Republic and CARICOM-Costa Rica. MERCOSUR maintains bilateral FTAs with Chile, Bolivia and Peru. The United States has accelerated negotiations and conclusion of bilateral agreements with six Central American countries (CAFTA),\(^9\) Chile, Bahrain, Singapore, Morocco, SACU and Jordan.

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

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

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

\(^{7}\) For a case study of South-South cooperation, see UNCTAD, “Regionalism and South-South cooperation: The case of Mercosur and India”, note by the UNCTAD Secretariat, prepared for a pre-UNCTAD XI Forum on the same title, 9 June 2004, Rio de Janeiro, Brazil.
\(^{8}\) Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal.
\(^{9}\) Costa Rica, Dominican Republic, El Salvador, Honduras, Nicaragua, Guatemala.
\(^{10}\) For a literature review of the debate, see, for example, Arvind Panagaria, “The regionalism debate: An overview”, \textit{The World Economy}, vol. 22, no. 4, June 1999, pp. 477-512.
\(^{11}\) The latter aspect of the issue-implications of MTS on RTA - is discussed more extensively in section III.
\(^{12}\) The theory of customs union was pioneered by the seminal work of Jacob Viner in 1950 (\textit{The Customs Union Issue}, New York: Carnegie Endowment for International Peace) and further improved by other trade theoreticians such as J.E. Meade, R.G. Lipsey and H.G. Johnson.
and institution building and governance. Such dynamic effects of RTAs have been observed most vividly in the EU and NAFTA, which not only increased their intraregional exports but also their trade with the rest of the world.

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

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

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

Furthermore, by enabling faster and deeper integration, new-generation RTAs may reduce incentives for countries to favour a multilateral approach to trade liberalization. In particular, in the areas of market access and standard-setting in new issues (IPR, investment or competition policy), such “WTO-plus” (or “WTO-minus” in the sense that developing countries enjoy a lesser degree of flexibility and policy space under these RTAs than under WTO) RTAs can act as negotiating forums virtually substituting for the WTO, thereby leading
to “forum shopping”, and posing a systemic risk to the viability of the MTS. The proliferation of RTAs, with more and more countries being members of several RTAs at the same time, could create competing and possibly antagonistic blocs that would erode the viability of the MTS. Such overlapping membership would also pose tremendous administrative burdens for small countries with limited negotiating and institutional capacities. RTA coverage and evolution of trade disciplines can pose the risk of fostering incompatibility with multilateral rules.

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

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

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

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

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

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

16 The reason why agricultural subsidies cannot be addressed in a regional context appears to pertain to the fact that agricultural subsidies, either domestic or export contingent, affect the trade of all countries, and are thus not limited to RTA partners. However, given that some regulatory measures and standards, such as IPR protection regime, are already being negotiated under RTAs and applied multilaterally to all countries to affect not only IPR rights of RTA partner nationals but also third country right holders, there seems to be no a priori reason why RTAs cannot address agricultural subsidies. The reason why some countries prefer to leave agricultural subsidies to multilateral negotiations appears to relate to rather political economic considerations, as in the case of tariff negotiations, whereby domestic producers need to be persuaded by reciprocity in reduction commitments by other (major subsidizing) trading partners which tend not to be their RTA partners.
enterprise development, diversification of production, rural development and poverty alleviation. WTO disciplines already place constraints on the use of some of these instruments although they do provide a certain flexibility, or policy space, including in the form of special and differential treatment. In this respect, more stringent commitments on a wider range of policy areas under RTAs may override such policy flexibility available under the MTS.

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

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

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

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

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

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

(i) WTO rules on RTAs

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

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

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18 Some perceive this differently; for example, the EC takes the view in the CRTA minutes that internally restrictive measures between RTA members are legal modifications (Vienna Convention on Law of Treaties, Article 41) and are permitted until third party rights are violated. The argument is that parties can freely modify WTO with internally restrictive measures in an RTA.
19 South-South RTAs notified under the Enabling Clause include the India-Sri Lanka FTA, EAC, CEMAC, SAPTA, AFTA, CAN, COMESA, ECO, MERCOSUR, the Trade Agreement among the Melanesian Spearhead Group Countries, the Lao People’s Democratic Republic-Thailand, GCC, LAIA, the Bangkok Agreement, PTN (Protocol Relating to Trade Negotiations among Developing Countries), GSTP, TRIPARTITE Agreement, and UEMOA. http://www.wto.org/english/tratop_e/region_e/provision_e.xls Caribbean Community and Common Market (CARICOM) were notified under GATT Article XXIV on 14 October 1974 most likely due to the non-existence of the Enabling Clause at the time. It has been reported that the SADC Trade Protocol would be notified under GATT Article XXIV despite the fact that its membership contains developing countries only.
20 MERCOSUR was notified under the Enabling Clause but is being examined in the CRTA under both the Enabling Clause and GATT Article XXIV, which is a unique situation that has not been applied to any other notified developing country grouping since 1979.
21 Some rulings by WTO judicial bodies have brought some clarification on aspects of systemic issues. See, for instance, Panel and Appellate Body reports on Turkey - Restrictions on Imports of Textile and Clothing Products (WT/DS34/R, DS34/AB/R).
also been raised. Systemic issues with regard to GATS include the interpretation of “substantial sectoral coverage” and “absence or elimination of substantially all discrimination”.22

**Table 3**

Comparison of requirements under GATT Article XXIV and the Enabling Clause23

<table>
<thead>
<tr>
<th>ARTICLE XXIV of GATT 1994</th>
<th>ENABLING CLAUSE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purpose</strong></td>
<td>To facilitate and promote the trade of developing countries and not to raise barriers to or create undue difficulties for trade of third country (para. 3).</td>
</tr>
<tr>
<td><strong>Trade coverage</strong></td>
<td>Not applicable.</td>
</tr>
<tr>
<td><strong>Level of barriers to third countries</strong></td>
<td>Not applicable. [Not to constitute an impediment to tariff reduction or elimination on a MFN basis.]</td>
</tr>
<tr>
<td><strong>Interim agreement/transitional period</strong></td>
<td>Not applicable.</td>
</tr>
<tr>
<td><strong>Notification</strong></td>
<td>Notification to the Committee on Trade and Development (CTD) when created, modified or withdrawn.</td>
</tr>
<tr>
<td><strong>Examination</strong></td>
<td>The CTD may establish a working party (or refer to the CRTA) to examine a RTA notified thereunder.</td>
</tr>
<tr>
<td><strong>Periodical reporting</strong></td>
<td>Not applicable.</td>
</tr>
</tbody>
</table>

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

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

**Box 1. Proposals for clarifying and improving GATT Article XXIV**

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

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

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

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

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(ii) RTAs and negotiations on agriculture and NAMA

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

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

(iii) RTAs and negotiations on services

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

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28 The positive list approach would allow for each country to strategically select the individual services sector or transaction that would be liberalized. See Mina Mashayekhi, “GATS 2000 negotiations: Options for developing countries”, Trade-Related Agenda, Development and Equity (T.R.A.D.E) Working Papers 9, South Centre, December 2000.
based on “GATS-plus” commitments, some under a negative list approach to provide preferential treatment to their RTA partners. Liberalization of services in the regional context may be beneficial in improving the cost efficiency of national economies as services account for a significant share of GDP for most developing countries and constitute major inputs to production of goods and services. Under GATS Article V, “flexibility” is allowed for developing countries forming regional integration agreements (RIAs), and additional flexibility is available for those RIAs formed among developing countries only.

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

(iv) RTAs and regulatory measures and standards

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

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


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

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

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

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


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

33 Such US bilateral initiatives include: FTAs concluded with Australia (May 2004), Morocco (March 2004), Central American countries (CAFTA) (December 2003), Chile (June 2003) and Singapore (May 2003). Negotiations were launched with Bahrain (August 2003), SACU (June 2003), Bolivia, Columbia, Ecuador, Peru (May 2004) and Panama (April 2004).
The underlying asymmetry between the two partners in size, conditions and capacity requires that corresponding asymmetry in obligations and commitments be embedded in the agreement so as to ensure equal treatment among “unequal” partners. Mechanisms including supply capacity and infrastructural, institutional and human capacity building for developing country partners would be a prerequisite for mutually beneficial arrangements and outcomes. In practical terms, this translates into ensuring market access and entry for exports of developing countries, while at the same time defining more carefully and clearly the coverage of the agreements and securing SDT under the agreement to address adjustment and social costs, including resource transfer through development assistance. There is also a preliminary asymmetry issue that would need to be taken into account, namely the capacity to choose a partner may often reside with the larger country. North-North regional integration arrangements, such as the EU enlargement, would also have implications for developing countries.

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

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

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

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

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

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

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

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

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

35 “Flexibility” is provided under GATS Article V; thus there is scope for more favourable treatment for developing country Members of regional integration agreements in trade in services. See also the ACP proposal on GATT XXIV, op. cit.
participation of a broader range of developing countries in South-South trade integration. Developing country exports increasingly cover new and dynamic sectors, including IT-enabled services (e.g. outsourcing).

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

Table 4
Evolution of the share of exports from developing countries by destination: The importance of South-South trade in exports of developing countries (1980-2002, per cent)

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Developed economies</td>
<td>69</td>
<td>58</td>
<td>57</td>
<td>58</td>
<td>57</td>
<td>56</td>
<td>55</td>
</tr>
<tr>
<td>Developing economies</td>
<td>26</td>
<td>34</td>
<td>39</td>
<td>38</td>
<td>39</td>
<td>40</td>
<td>42</td>
</tr>
</tbody>
</table>


Table 5
Evolution of the share of South-South exports in world exports: Importance of South-South trade in world total exports (1980-2002, millions of dollars and per cent)

<table>
<thead>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>World</td>
<td>2 000 949</td>
<td>3 436 380</td>
<td>5 383 780</td>
<td>5 571 175</td>
<td>6 287 738</td>
<td>6 065 269</td>
<td>6 306 330</td>
</tr>
<tr>
<td>South-South trade</td>
<td>155 144</td>
<td>278 327</td>
<td>592 597</td>
<td>624 873</td>
<td>784 462</td>
<td>749 845</td>
<td>836 467</td>
</tr>
<tr>
<td>Share (%)</td>
<td>7.8</td>
<td>8.1</td>
<td>11.0</td>
<td>11.2</td>
<td>12.5</td>
<td>12.4</td>
<td>13.3</td>
</tr>
</tbody>
</table>


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

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

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

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

Table 6
Evolution of the intraregional exports, and their share in the groupings’ total exports, of selected South-South RTAs (1990-2003, millions of dollars and per cent)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
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<td>1,312</td>
<td>4,812</td>
<td>3,929</td>
<td>5,116</td>
<td>5,461</td>
<td>5,070</td>
<td>4,781</td>
</tr>
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<td>CACM</td>
<td>667</td>
<td>1,594</td>
<td>2,175</td>
<td>2,418</td>
<td>2,394</td>
<td>2,598</td>
<td>3,288</td>
</tr>
<tr>
<td>CARICOM</td>
<td>456</td>
<td>877</td>
<td>1,146</td>
<td>1,076</td>
<td>1,231</td>
<td>1,252</td>
<td>1,538</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>4,127</td>
<td>14,199</td>
<td>15,313</td>
<td>17,910</td>
<td>15,760</td>
<td>10,573</td>
<td>13,383</td>
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<tr>
<td>COMESA</td>
<td>890</td>
<td>1,027</td>
<td>1,122</td>
<td>1,281</td>
<td>1,385</td>
<td>1,465</td>
<td>1,812</td>
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<tr>
<td>ECCAS</td>
<td>163</td>
<td>163</td>
<td>179</td>
<td>196</td>
<td>217</td>
<td>193</td>
<td>236</td>
</tr>
<tr>
<td>ECOWAS</td>
<td>1,532</td>
<td>1,875</td>
<td>2,285</td>
<td>2,811</td>
<td>2,767</td>
<td>3,192</td>
<td>3,541</td>
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<tr>
<td>SADC</td>
<td>1,058</td>
<td>4,124</td>
<td>4,224</td>
<td>4,453</td>
<td>4,122</td>
<td>4,240</td>
<td>5,345</td>
</tr>
<tr>
<td>CEMAC</td>
<td>139</td>
<td>120</td>
<td>126</td>
<td>101</td>
<td>119</td>
<td>120</td>
<td>157</td>
</tr>
<tr>
<td>UEMOA</td>
<td>621</td>
<td>560</td>
<td>805</td>
<td>741</td>
<td>775</td>
<td>857</td>
<td>1,043</td>
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<td>ASEAN</td>
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<td>79,544</td>
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<tr>
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</tr>
<tr>
<td>GCC</td>
<td>6,906</td>
<td>6,832</td>
<td>7,306</td>
<td>7,218</td>
<td>6,943</td>
<td>6,905</td>
<td>7,864</td>
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<tr>
<td>SAARC</td>
<td>863</td>
<td>2,024</td>
<td>2,180</td>
<td>2,593</td>
<td>2,827</td>
<td>2,998</td>
<td>3,869</td>
</tr>
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</table>

Share (%)  

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<td>ANCOM</td>
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<tr>
<td>CACM</td>
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<td>21.8</td>
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<td>14.8</td>
<td>15.5</td>
<td>11.0</td>
<td>11.9</td>
</tr>
<tr>
<td>CARICOM</td>
<td>8.0</td>
<td>12.1</td>
<td>16.3</td>
<td>14.4</td>
<td>13.9</td>
<td>12.5</td>
<td>12.5</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>8.9</td>
<td>20.3</td>
<td>20.6</td>
<td>20.0</td>
<td>16.9</td>
<td>11.3</td>
<td>11.8</td>
</tr>
<tr>
<td>COMESA</td>
<td>6.3</td>
<td>6.0</td>
<td>6.3</td>
<td>4.9</td>
<td>6.1</td>
<td>5.4</td>
<td>5.8</td>
</tr>
<tr>
<td>ECCAS</td>
<td>1.4</td>
<td>1.5</td>
<td>1.3</td>
<td>1.1</td>
<td>1.3</td>
<td>1.1</td>
<td>1.1</td>
</tr>
<tr>
<td>ECOWAS</td>
<td>8.0</td>
<td>9.0</td>
<td>10.3</td>
<td>9.5</td>
<td>9.6</td>
<td>11.5</td>
<td>9.8</td>
</tr>
<tr>
<td>SADC</td>
<td>3.1</td>
<td>10.6</td>
<td>11.9</td>
<td>12.0</td>
<td>10.2</td>
<td>9.3</td>
<td>10.0</td>
</tr>
<tr>
<td>CEMAC</td>
<td>2.3</td>
<td>2.1</td>
<td>1.7</td>
<td>1.0</td>
<td>1.3</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>UEMOA</td>
<td>13.0</td>
<td>10.3</td>
<td>13.1</td>
<td>13.1</td>
<td>13.6</td>
<td>12.1</td>
<td>12.8</td>
</tr>
<tr>
<td>ASEAN</td>
<td>19.0</td>
<td>24.6</td>
<td>21.7</td>
<td>23.0</td>
<td>22.4</td>
<td>22.7</td>
<td>21.2</td>
</tr>
<tr>
<td>ECO</td>
<td>3.2</td>
<td>7.9</td>
<td>5.8</td>
<td>5.6</td>
<td>5.6</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>GCC</td>
<td>8.0</td>
<td>6.8</td>
<td>6.7</td>
<td>4.5</td>
<td>4.5</td>
<td>4.6</td>
<td>4.2</td>
</tr>
<tr>
<td>SAARC</td>
<td>3.2</td>
<td>4.4</td>
<td>4.0</td>
<td>4.1</td>
<td>4.3</td>
<td>4.2</td>
<td>4.5</td>
</tr>
</tbody>
</table>


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

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

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

Table 7
Evolution of the value of intraregional and total exports of selected RTAs (1990 = 100)

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</tr>
</thead>
<tbody>
<tr>
<td>CARICOM</td>
<td>100</td>
<td>200</td>
<td>214</td>
<td>225</td>
<td>251</td>
<td>236</td>
<td>270</td>
<td>275</td>
<td>337</td>
</tr>
<tr>
<td>Intra-group</td>
<td>100</td>
<td>116</td>
<td>111</td>
<td>99</td>
<td>113</td>
<td>123</td>
<td>147</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>100</td>
<td>414</td>
<td>501</td>
<td>493</td>
<td>371</td>
<td>434</td>
<td>382</td>
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<td>138</td>
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<td>168</td>
<td>183</td>
<td>195</td>
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<tr>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>COMESA</td>
<td>100</td>
<td>139</td>
<td>134</td>
<td>129</td>
<td>126</td>
<td>144</td>
<td>156</td>
<td>165</td>
<td>204</td>
</tr>
<tr>
<td>Intra-group</td>
<td>100</td>
<td>138</td>
<td>136</td>
<td>118</td>
<td>126</td>
<td>188</td>
<td>161</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SADC</td>
<td>100</td>
<td>443</td>
<td>442</td>
<td>365</td>
<td>399</td>
<td>421</td>
<td>390</td>
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<td>116</td>
<td>101</td>
<td>94</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ASEAN</td>
<td>100</td>
<td>307</td>
<td>312</td>
<td>255</td>
<td>285</td>
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<tr>
<td>Intra-group</td>
<td>100</td>
<td>221</td>
<td>231</td>
<td>222</td>
<td>240</td>
<td>281</td>
<td>256</td>
<td>267</td>
<td>324</td>
</tr>
</tbody>
</table>


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

The product composition of intraregional trade tends to differ substantially from that of interregional trade with the rest of the world. In most cases intraregional trade is mainly...
composed of manufactured goods with higher value added in contrast with trade with the rest of the world, which is dominated by one or two basic commodities. In the case of ASEAN, the major product categories traded intraregionally in 2001 were machinery and electrical products (HS84-85) (54 per cent of the total), followed by mineral products (HS25-27) (11 per cent).\footnote{During the period between 1993 and 2001, the most dynamic products in intra-ASEAN trade include machinery and chemical (HS25-27) which increased by 148 per cent since 1993, followed by other (147 per cent); prepared food stuff (HS16-24) (135 per cent); chemicals (HS28-38) (122 per cent); optical, precision and musical instruments (HS 90-92) (98 per cent); and pulp and paper (HS47-49) (96 per cent).} In the case of MERCOSUR, it was reported that 47 per cent of total Brazilian exports to MERCOSUR covered durable goods and goods diffusers of technical progress, while its exports to the United States of those categories of goods represented only 30 per cent of its total exports. By contrast, commodities and traditional manufactures account for some 42 per cent of total Brazilian exports to the United States.\footnote{ECLAC, Latin America and the Caribbean in the World Economy 2003.} Thus, the importance of the share of intraregional trade aside, the significance of South-South RTAs lies in their potential for the diversification of exports towards higher-value-added products.

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

At the interregional level, the GSTP provides enhanced prospects for South-South cooperation. The GSTP was established in 1988 at a Ministerial Meeting of the Group of 77 held in Belgrade as a framework for the exchange of trade preferences among developing countries to promote trade among themselves.\footnote{The GSTP is based upon the following principles and features: (i) the GSTP is reserved for the exclusive participation of members of the Group of 77 and China; (ii) the GSTP must be based and applied on the principle of mutuality of advantages in such a way as to benefit equitably all participants, taking into account their respective levels of economic development and trade needs; (iii) the GSTP recognizes the special needs of the LDCs and envisages concrete preferential measures in their favour; (iv) tariff preferences are bound and form part of the Agreement; (v) the GSTP is negotiated step-by-step and improved and extended in successive stages, with periodic reviews; and (vi) the GSTP must supplement and reinforce present and future subregional, regional and interregional economic groupings of developing countries.} The agreement includes results of the first round of negotiations conducted between 1986-1988, and entered into force in 1989 after 44 countries ratified the agreement. Following a comprehensive review of the operations of the agreement, the GSTP Participants recently decided to launch a new round of negotiations to broaden and deepen the scope of tariff preferences. Ministers of GSTP participants met in São Paulo, Brazil, in June 2004 to launch the new negotiations.
VI. Conclusion: Positive coherence between multilateralism and regionalism

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

- Regional trade agreements have proliferated in number, expanded their membership, and deepened their integration since the creation of WTO, and in particular since the launch of the Doha Work Programme. Both developing and developed countries have been actively participating in these processes by establishing and reinvigorating North-South and South-South agreements, often on an inter-regional basis.

- The systemic interface between multilateralism and regionalism manifests itself in both positive and negative forms. On the positive side, RTAs promote quicker, freer and deeper integration with strong disciplines on trade-related policies, act as laboratories of new disciplines and serve as an incubator of export expansion and diversification for developing countries. Developing countries have adopted RTAs as the nucleus of national development strategies for their progressive and strategic integration into the world economy. On the negative side, RTAs may prove to be inward-looking, protectionist blocs, which reduce incentives for multilateral trade negotiations by enabling “forum shopping”; they may also lead to fragmentation of regional rules, and constrain developing countries’ negotiating and administrative capacities and business abilities to exploit preferences.

- The MTS affects RTAs at three levels: (i) through WTO rules on RTAs; (ii) market access commitments; (iii) and other trade-related rules and disciplines. Negotiations have been launched under the DWP on these aspects, thereby affecting the scope and viability of RTAs. An overarching negotiating objective for developing countries under both processes may be to ensure greater market access and entry opportunities while securing sufficient policy space for the implementation of domestic development objectives.

- As regards North-South agreements, the development dimension needs to be taken into account in respect of both market access and entry opportunities and domestic policy space. North-South RTAs may address market entry barriers, most notably rules of origin. They can also result in deeper Mode 4 commitments and facilitated recognition of qualification. Adjustment costs may be significant for developing countries, and this requires meaningful special and differential treatment, including resource transfer for development purposes, to be incorporated in the agreements.

- As regards South-South agreements, the potential for trade expansion is significant, while a number of South-South integration groupings have yet to exploit their full potential for export expansion and diversification. Deep integration would prove to be beneficial under South-South agreements.

- At the interregional level, the GSTP provides enhanced prospects for South-South cooperation.

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

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

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

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

It is my great pleasure to join you today. I bring greetings from the WTO Director-General, Dr. Supachai Panitchpakdi, along with his best wishes for a successful event. I offer warm congratulations also to Mr Ricupero, UNCTAD, partner organizations, panelists and participants for this valuable initiative of Rio Trade Week which has given unique opportunity for discussion and dialogue on some of the most important issues on the international trade agenda.

I am sorry I was unable to join you this morning and that I must return shortly to another meeting — also on trade and also part of Rio Trade Week. But I wanted to come here to lend support to UNCTAD and share with you a few thoughts on the issue of the interface between multilateralism and regionalism. I know you heard interesting and thought-provoking presentations this morning. I am pleased to contribute to the discussion.

Turning directly to the topic, my first comment would be that regional trade agreements (RTAs) are an integral part of international trade, they operate alongside global multilateral agreements under the WTO, and they have increased significantly in number and prominence recently.

As of May 2004, 303 RTAs have been notified to the GATT/WTO, of which 208 are currently in force. In the first four months of 2004 alone, 15 RTAs were notified to the WTO. A further 60 RTAs are estimated to be operational, though not yet notified, and approximately 30 are under negotiation or proposal. Only one of the WTO’s 147 Members - Mongolia - does not currently participate in RTAs. Imports on a preferential basis under RTAs are estimated to account for 43 per cent of merchandise imports (using trade data for 1999) and are estimated to reach 51 per cent in 2005.

Thus, while WTO Members are actively re-engaged in the Doha negotiations (as evidenced by a more constructive and positive atmosphere in Geneva and new political impetus given to the Round by Ministers in all parts of the globe — e.g., at the LDC Ministers' Meeting in Senegal, in Paris in the context of the OECD Ministerial Meeting, and in Pucón at the APEC Ministers Meeting), they continue to be drawn by the magnet of regional agreements.

Nor is it difficult to see the magnetism. The spread of regionalism, including among countries that have traditionally avoided this approach, is due to a range of factors, including (to quote OECD and others):
• a concern not to be left out of the growing web of preferential deals;
• a belief that, as product cycles get shorter and multilateral negotiating cycles get longer, quicker results may be obtained regionally;
• a belief that, as multilateral processes become more complex and unwieldy, stronger disciplines over a wider range of goods and services can be attained regionally;
• a desire to use regional liberalisation as a catalyst for domestic reform; and
• (in some instances), a tactic on the part of governments to use bilateral deals to promote political or strategic objectives.

These are just some examples. We should also acknowledge some of the other arguments often advanced in favour of regionalism. RTAs can act as laboratories for testing approaches to new issues; their operating experiences can provide the basis for future multilateral trade negotiations for developing rules applicable at the multilateral level; they can serve as building blocs for a more open and liberal multilateral trading system.

But there are considerable challenges posed by the increasing tendency towards regionalism, as I would now like to refer to. And I would also argue, as others have done, that the economic arguments show that regional deals are (by far) second-best to progress at the multilateral level.

The growing number of overlapping bilateral and plurilateral RTAs embodying diverse treatment of trade policy issues has increased the complexity of the trading environment. Increasing complexity raises the transaction costs of conducting trade, while inconsistent provisions create uncertainty and undermine transparency. The WTO offers the prospect of a transparent, single set of trading rules which apply to all members. RTAs, with their differing treatment of rules of origin, standards, rules on competition, investment, environmental and labour standards do not.

Economists are unanimous in considering that multilateral liberalization is superior to liberalization on a preferential basis. Preferential liberalization results in varying levels of protection against third parties, obscuring rather than clarifying the patterns of specialization among countries, and can engender a significant amount of net trade diversion. Trade liberalization on an MFN basis, on the other hand, allows the underlying pattern of comparative advantage to emerge, leading eventually to patterns of specialization among countries and regions that make the most efficient use of available resources.

Many RTAs provide for only limited coverage of agricultural and other sensitive products. A recent WTO study found that while most RTAs provide for the elimination of most, if not all, duties on industrial goods, the concessions on 'sensitive' sectors like agriculture and textiles are considerably less generous. The failure to tackle sensitive issues within the context of RTAs indicates that if, for example, agricultural trade liberalization is to be addressed more effectively it will need to be treated within a framework where there is a greater chance that appropriate trade-offs can be found.

Negotiating and administering multiple RTAs strains the institutional capacity of even the largest WTO Members, distracting attention and energy away from multilateral resources. Given scarce resources, the potential gains from multilateral liberalization which generate gains for the entire WTO membership (large countries as well as small) greatly exceed those that may result from preferential liberalization.
All this leads me to conclude that while RTAs are likely to remain a popular option no matter how well the multilateral system functions, WTO Members need to seek ways to maximize their compatibility with WTO objectives while minimizing any negative effects. Of course, Members recognized this challenge in Doha by agreeing to clarify and improve the disciplines and procedures of WTO provisions on RTAs, taking into account development aspects of RTAs. These negotiations are ongoing.

The interface between regionalism and multilateralism is complex and evolving. There are no ready-made answers in this area of our work. But the crucial first step is to talk and discuss. That is what is happening in Geneva. And that is what is happening here. I am grateful to UNTAD for taking the initiative of this session and I appreciate the opportunity given to share some thoughts.

Finally I should like to return to the Doha Development Agenda and refer to a comment made recently by our Director-General when he addressed the Third LDC Trade Ministers' Meeting in Dakar, Senegal. Dr. Supachai said:

"If governments and their constituents lose faith in the ability of the DDA to deliver results we shall, no doubt, see a growing imbalance between multilateral and bilateral deal making. This could rock the foundations of non-discrimination and transparency upon which the multilateral system is built. These core principles not only help level the playing field between developed and developing countries, but also make the international trading environment a more predictable and less complex place to do business. I am convinced that the world’s poorest and most vulnerable countries would be the biggest losers from a focus on bilateral deals at the expense of multilateralism."

Thank you.
Chapter III

COMMENTS ON DYNAMISM IN THE INTERFACE OF MULTILATERAL TRADING SYSTEM AND REGIONAL TRADE AGREEMENTS: A POST-CANCÚN PERSPECTIVE

Nathan Irumba

The adoption of the Uruguay Agreements and the establishment of the World Trade Organization in 1995 is acknowledged as a significant milestone in the Multilateral trading system. Prior to that, GATT laid down rules, which countries applied among themselves when trading in goods. In the Uruguay Agreements those rules were broadened to cover agriculture, trade in ‘services’, trade-related aspects of ‘intellectual property’ and trade-related aspects of investment measures.

The basic objective of WTO rules is to promote greater integration of the world economy by encouraging countries to pursue ‘open and liberal policies’. It is assumed that the resulting export-oriented growth would create more employment and in the long run result in poverty reduction.

It is recognized that regional trade arrangements are an important aspect of the strategy for development. Hence, the ministers gathered in Doha while stressing that the WTO ‘was a unique forum for global trade rule making’, also recognized ‘that regional trade arrangements can play an important role at promoting liberalization, expansion of trade and in fostering integration.1 Furthermore, it was agreed that negotiations aimed at clarifying and improving procedures under existing provisions applying to regional trade agreements be undertaken and that these negotiations would take into account their developmental aspects.2 The expectation was that both the multilateral trading system (MTS) and regional arrangements should be complementary and mutually reinforcing. There has been an exponential growth of regional trade arrangements. Virtually all members of WTO are today party to, or are in the process of, negotiating a regional trade agreement; this explains the need for coherence between the two processes if the potential benefits are to be maximized.

The failure of the Cancún Ministerial Conference, whose declared purpose was to take stock of progress in negotiations, provide the necessary political guidance and take decisions where necessary, was a great disappointment to all member states. While the breakdown was a major setback, its impact on the functioning of the multilateral system has been exaggerated. This is not the first time that the multilateral trade negotiations have failed to meet the agreed schedule. Some thought that this situation would result into the demise or serious impairment of the MTS. They envisaged that the major trading powers would resort to bilateral and regional trade arrangements which would be of great disadvantage to developing countries and which the Doha Round had been expected to forestall. The Economist Magazine3 observed that the Cancún outcome "is going to leave most of the people in the world worse off and that

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1 Paragraph 4 of the Doha Declaration.
2 Paragraph 29 of the Doha Work Programme.
3 Herald Tribune, 23 September 2003, "Failed Cancun Talks give impetus to bilateral deals", p.16.
those who would no doubt suffer the worst are the world’s poor”. It was further observed that, "The developing countries will come to regret the consequences”. This fear was reinforced by a flurry of activities to negotiate bilateral and RTAs (i.e., USA, Australia, Morocco, Bahrain, etc.).

The apprehension that the failure in Cancun would divert most countries and especially the USA and EU away from multilateralism to bilateralism and regionalism in trade negotiations was given reinforced by statements made by both EU and US. The US Trade representative was quoted as saying that they would more vigorously pursue bilateral agreements. The EU Trade Commissioner, on the other hand, described the WTO as medieval and wondered whether they should maintain multilateralism, which was the basic tenet of EU commercial policy as their privy.

While the failure of Cancún was disappointing, it should be put in perspective. It was not the first time that the multilateral trade negotiations have failed to live up to their agenda. Indeed the road to Cancún and the preparatory process was full of ‘bumps’ and ‘roadblocks’ coupled with missed deadlines on issues of development. Developed countries made numerous speeches supporting the Doha Round as a development agenda, they were extremely frugal when responding to proposals on special and differential treatment (SDT) and implementation on agriculture, both of which were seen as a lynchpin of success by developing countries. The ‘crash’ of Cancún has not, in itself, dented the credibility of the multilateral system.

Cancún simply highlighted the major concerns of developing countries, which the multilateral system had hitherto not addressed. Instead, the system has been used by major players to push their own policy agenda on other countries. As they continue to carry out highly protectionist policies in agriculture and textiles, which they are reluctant to liberalize, they were, at the same time, pushing developing countries to open up their markets to imports. However, a number of empirical studies on the trade liberalization experiences of developing countries at a lower stage of development and by least developing countries have showed that, unless the physical and human infrastructure necessary for development are first put in place, liberalization can lead to de-industrialization and unemployment. Yet these countries are being pressured to carry out substantial reductions of their tariffs. Those that are reluctant to carry out reforms in agriculture have been forcefully pushing for negotiation on new issues, such as the multilateral agreement on investment and competition policy whose impact on economies of developing countries remains to be clarified.

Developed countries have been reluctant to remove restrictions on the movement of national persons (mode four) in the In the negotiation of services, especially with regard to the movement of skilled and unskilled labour in which the developing countries have a comparative advantage. Whether it is this context of multilateral or bilateral arrangements these are the concerns of developing countries, which have to be addressed.

What the failure of Cancún showed was that the days are gone when the major powers could exercise full dominance over negotiations and impose solutions, which only served their objectives and interests, without taking into account the interests of developing countries. Developing countries have become more proactive, better informed, and better-organized players. This is due to the assistance of organizations like UNCTAD, South Center and Civil Society, who have provided informative studies and research. It has also become clear that the Doha Agenda round cannot successfully be concluded unless the problems with agriculture are satisfactorily addressed; those who have asked for new issues to be placed on the table should
also scale back their ambitions. Unfortunately, at the Fifth Ministerial Meeting in Cancún, developed countries lacked the political will to resolve the developmental aspects of the Doha agenda, which would make the multilateral trading system more fair and equitable.

What is needed after Cancun is not to engage in a blame game, but to pause and constructively consider how to move the process forward. This requires a genuine effort to address issues such as agriculture, cotton, implementation issues, special and differential treatment, etc., which developing countries have put on the table, rather than attempting to create divisions in the groups of developing countries. The leaders of developing countries have continuously reaffirmed their support of multilateralism. It is therefore encouraging that both the US trade Representative and the EU Trade Commissioner have since taken a leading role in ensuring that the discussion in WTO are back on track. This has paved the way for General Council to continue dialogue. Hopefully this will result into a solution that genuinely addresses the concerns of all countries.

As indicated above, the question of whether the Cancun failure could promote bilateralism or regionalism at the expense of multilateralism was, in my view, an exaggerated fear. Free trade, preferential and regional trade arrangements have always run parallel to WTO processes. These arrangements are now an integral part of international trade and they account for almost half of the world trade. The decision by USA and Latin America to negotiate free trade of the Americas and by the EU to negotiate partnership agreements with ACP were taken a decade ago. These arrangements are pursued for a variety of economic and underlying geopolitical and security interests. With or without Cancún, they would have been pursued anyway.

They, however, present both challenges and opportunities. An OECD study (Regionalism and the Multilateral Trading System) exploring the relationship between the MTS and RTAs concluded that these arrangements can compliment one another, but could not replace a coherent set of multilateral rules and a process of progressive liberalization. It is clear in the evolving world trade system regional arrangements and regional preferences will continue to play an important role. However it is necessary to ensure that they are consistent with the MTS, and are supportive of the development of developing countries.

There are three levels in which there is an interface between the MTS and RTAs. The first level of WTO rules define the specific conditions under which these arrangements are allowed to exist – namely article XXIV of GATT, Article V of GATS and the enabling clause as regards South-South preferential arrangements. At the second level, MFN market access commitments where the MTS determines the margin of preference that can be obtained at the regional level. At the third level, the multilateral disciplines constitute a floor which all members are committed to observe, and which determine the conduct of their trade policy. In short, the MTS provides the framework for negotiating RTAs. Within this framework, RTAs could impose certain obligations to parties or provide certain benefits, which go beyond existing multilateral rules. They may also divert or converge with the multilateral system and may impact on third parties if there is a trade diversion.

In parallel to WTO negotiations, the European Union and ACP countries have, within the framework of the Cotonu Agreement, been involved since 2002 in negotiations on economic partnership agreements with the aim of establishing new WTO-compatible trading arrangements. They are aimed at progressively removing barriers of trade between EU and

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4 Paragraph 25 of the issues paper
ACP countries which "would build on the regional integration initiatives of ACP States" and promote sustainable development and contribute to poverty eradication in ACP countries. This in essence would be a free trade agreement between the developed (EU) and developing ACP region or country. This would fall under the provision of Article XXIV of GATT requiring substantial coverage of all trade in a reciprocal manner within a period of "10-12 years". Furthermore, the negotiations are expected to cover investment, competition, trade facilitation, data protection and services. This would mean a WTO plus as there are no disciplines on some of those issues in WTO. The ACP countries in carrying out simultaneous negotiations in WTO and under Cotonu face considerable challenge of coordination and consistence of their positions in the two processes.

ACP countries are justifiably worried that the interpretation of "substantially all" under article XXIV may give more advantage to European producers given their advanced stage of development. Article XXIV of GATT assumes agreements between equals and it is not clear whether it allows SDT parties that are not equals. As originally envisaged SDT provisions were intended to enhance market access conditions of beneficiary countries and permitted derogation from certain multilateral disciplines. The derogation was intended to ensure that countries had the tools to strengthen their supply capacity and be able to take full advantage of the preferential market access that has been granted to them. It is in the light of this that the ACP countries have submitted a proposal for special and differential treatment in GATT Article XXIV in the negotiating group on rules. They proposed that members should agree that SDT treatment for developing countries be formally and explicitly made available to developing countries in meeting the criteria of paragraphs 5 to 8 of GATT Article XXIV in the context of regional agreements between developing and developing countries. They proposed appropriate flexibility with regard to duties covering substantially all trade and in interpretation of ‘other restrictive regulations of commerce.’

In the MTS negotiations on agriculture, the broad objective is to secure the complete elimination of export subsidies, substantial reduction in domestic support and substantial reduction of the MFN tariffs applied to imports. The proposals on the table with regard to Non-Agricultural products, Market Access (NAMA) aim to reduce MFN tariffs, and more especially at ensuring that high or peak tariffs applied by developed countries are substantially reduced, if not eliminated. The outcome of such negotiation would have a significant impact on the benefits that ACP countries could derive from Cotonu.

Both Cotonu and "Everything But Arms" (EBA) allow imports of both agriculture and industrial products in EU markets on preferential rates. The margin of preferences would be narrowed and affect the competitiveness of ACP countries. A joint study by UNCTAD and the Commonwealth Secretariat found that the benefits of preferential access to LDCs under the "Everything But Arms" proposal are likely to be significant especially in such products as horticulture, textiles and leather products.

This is why the ACP countries have insisted that the techniques and modalities to be adopted take account of the needs of preference beneficiary countries. This could for instance be achieved by exclusion from MFN reduction products on which the margins of preferences are meaningfully in trade terms providing longer terms for tariffs reductions agreed in the negotiations than the normal 5 to 8 years, and providing compensatory arrangements.

Whether in this context of EPA or MTS, it is crucial that the question of agricultural subsidies be addressed. Given the requirement of reciprocity between the Cotonu agreements and the WTO there is a danger that subsidized agricultural products could be dumped in ACP countries, thereby undermining their food security and competitiveness in their local markets. Developing countries should, therefore, not lose sight of their strategic objective of using trade for development, and not as an end in itself.

Services constituted a significant share of the GDP of developing countries and are a major input for production of goods and services. Liberalization in banking, insurance and telecommunication sectors could improve the capacities of manufacturing industries in marketing their products abroad. The issue, however, is whether liberalization should be achieved through MTN participation, other arrangements, or on autonomous basis. Despite the fact that Article V of GATS allows a measure of flexibility to developing countries, countries involved in MTN negotiations only make reciprocal commitments when they are able to get secure improved access for their services and products. In the case of developing countries particularly Africa, service products which could be exported in cross-border mode, have not yet been developed. The only services in which those countries have a comparative advantage are those that can be provided through the movement of natural persons.

Developed countries have been reluctant to liberalize mode 4, which allows movement of such persons. It appears that progress can be more forthcoming in a regional context. Within the context of RTA, arrangements have been made for mutual acceptance of each country’s qualification.

RTAs have acquired increased prominence in the context of rules development. As indicated earlier, the new trade agreements currently in the process of being negotiated envisage liberalism to encompass investment, competition policy, the protection of intellectual property, as well as trade and labour standards.

ACP countries have opposed these issues in the WTO. There is a clear danger that they will end up taking in a regional context of standards that are higher than the WTO and later on be pressed by the same rules at the multilateral level.

In the current multilateral trade negotiations the developed countries have emphasized that developing countries would gain most from tariff reductions of other developing countries. The question is the mechanism for achieving this objective of South-South cooperation. The preferred mechanism is the Global System of Preferences negotiated under UNCTAD. This system has two special benefits for the developing countries over the reducing tariffs in the WTO framework. Firstly, a developing country while reducing tariffs under the GSTP does not have to extend this benefit to the developed countries; thus there is less revenue loss for the committing importing developing country. Secondly the beneficiary exporting developing country will face less competition from the developed country, as the latter will not get the advantage of this lower tariff in the developing countries. Over a course of time, this process is likely to enhance investment in the developing countries in manufactures and agriculture, because of larger market access opportunities among the developing countries.

UNCTAD is the focal point in the United Nations system for the integrated treatment of trade and the interrelated issues of finance, technology and development. Developing countries in the post-Cancún period are faced with the challenges of concurrent negotiations at the
multilateral level, regional trade arrangements and in the case of ACP/EU, a new generation of trade agreements involving reciprocal rights and obligations.

Many developing countries need capacity strengthening for effective negotiations. In addition they need the necessary technical information to determine their negotiating options. UNCTAD through its research analysis and technical cooperation programs has an important role to clarify the implication of the interface between RTAs and MTS and help to ensure that these processes are complimentary, promote development and leave these countries with sufficient policy space to implement development measures.

Lastly I wish to take this opportunity to thank UNCTAD Secretariat, BNDES and Rio for organizing this forum, and facilitating our participation.
Chapter IV

ISSEUES REGARDING NOTIFICATION TO THE WTO OF A REGIONAL TRADE AGREEMENT

Bonapas Onguglo

A. The WTO provisions

Regional trade agreements (RTAs) have operated as legally permitted exceptions to the GATT/WTO, under various provisions, since the GATT was established in 1945. This permission for RTAs within the multilateral trading system that favours non-discrimination among members reflects the reality of trading situation among countries. At Doha Ministerial Conference launching a new round of negotiations, for example, WTO members stressed their commitment to the WTO as “the unique forum for global trade rule-making and liberalization, while also recognizing that regional trade agreements can play an important role in promoting the liberalization and expansion of trade and in fostering development.”

The examination and reporting on RTAs within the former GATT, and now the WTO, applies to both RTAs involving reciprocal exchanges of trade preferences, and agreements featuring non-reciprocal exchanges of preferences, mostly from developed countries (individually or jointly) to developing countries. The former type of RTAs, the subject of this paper, involve two broad and distinct categories; those affecting trade in goods and those affecting trade in services (Uruguay Round). In cases where the reciprocal exchange of trade preferences covers both goods and services, which is increasingly the norm for recent RTAs, the two regimes would be submitted to two separate WTO examination and review processes. RTAs involving reciprocal exchange of preferences are further sub-divided into those involving developing countries only, those involving only developed countries, those involving only countries with economies in transition, and mixed agreements between developed and developing countries and countries with economies in transition.

RTAs on goods constituted by developing countries are subjected to the provisions of the Enabling Clause agreed in the Tokyo Round of multilateral trade negotiations. Prior to 1979, developing country RTAs like the Latin American Free Trade Area (LAFTA), were notified to GATT under the terms of GATT Article XXIV or GATT Part IV.

GATT Article XXIV and the Understanding on the Interpretation of Article XXIV of GATT 1994 (Uruguay Round result) apply to non-developing country RTAs liberalizing trade in goods. There is no provision preventing a developing country member of a free trade area or customs union to notify and seek an examination of their RTA under the provisions of GATT Article XXIV. It could be argued that RTAs among developing countries could become stronger in respect of the attainment of free trade and customs union, if they conform to GATT Article XXIV.

RTAs affecting trade in services are subjected to GATS Article V (Uruguay Round result). This covers all RTAs including those formed by developing countries.
GATT Article XXV (on waivers) and the Understanding in Respect of Waivers of Obligations under the GATT 1994 (Uruguay Round result) provide the legal basis for a number of preferential trading arrangements, in particular non-reciprocal preferences provided by developed countries (individually or jointly) to developing countries. Recently the WTO Article IX has been used for waivers.

B.  GATT 1994 disciplines (RTAs in goods)

1.  GATT Article I:2 (Grandfathering)

During the course of work on tariff-cuts and trade rules from 1946-1947 in the framework of the drafting of a charter of the International Trade Organization, it was recognized that a number of the founding GATT contracting parties operated preferential trading schemes. These schemes were in clear violation of the MFN principle of non-discrimination (GATT Article I) that was being promulgated. It thus became apparent that some provision was required to cater for this anomaly, establishing the basis for the GATT Article I:2.

GATT Article I:2 explicitly exempts in perpetuity (grandfathers) from the MFN requirement certain preferential arrangements existing at the time the GATT came into force. These included the British Imperial Preferences, preferences granted by the Benelux customs union and the United States, preferences in force in the French Union, those exchanged between Chile and its neighbours, and the preferences granted by the Lebanon-Syrian Customs Union to Palestine and Transjordan. The grandfathered preferences were limited by a requirement that they could not be raised above existing levels (those in force in 1947). Moreover, their significance has been steadily eroded over the past few decades by successive rounds of GATT tariff negotiations and reductions, and some of them have since ceased to exist.

2.  GATT Article XXIV and the Understanding on Free Trade Areas, Customs Unions and Interim Agreements

GATT Article XXIV permits departures from the cardinal MFN obligation of non-discrimination within free trade areas, customs union or interim arrangement leading to the formation of free trade area or customs union. GATT Article XXIV grants a group of WTO members' permission to constitute themselves into a customs union or a free trade area and have totally free trade or reduced levels of duties and other trade restrictive regulations among themselves on trade in goods without the obligation of extending such treatment to other members. The permission is conditional; it is granted to RTAs, which promote trade among the participants without raising barriers to non-participants. This is the basic tenet of GATT Article XXIV, which is then clarified in the Article’s operative paragraphs 1 to 12 and improved upon in the Understanding on the Interpretation of Article XXIV of GATT 1994.

The provisions of GATT Article XXIV apply to RTAs among countries other than developing countries as the latter are covered by the Enabling Clause (see section below). GATT Article XXIV mentions RTAs as consisting of one of the following three variants: a customs union, the most advanced form recognized by the Article; a free trade area; and an interim agreement leading to the establishment of either a free trade area or a customs union.

A bona fide customs unions is defined in GATT Article XXIV:8(a) as a single customs territory substituting for two or more customs territories and having the following two essential characteristics:
IV: Notification to the WTO of an RTA

- Duties and other restrictive regulations of trade are eliminated on substantially all trade between the constituent territories of the union or at least with respect to "substantially all trade" in products originating in such territories (Article XXIV:8(a)(i)). Apart from this requirement, union members may still "where necessary" maintain duties or restrictions permitted under GATT Articles XI (quantitative restrictions); XII (restrictions applied for balance-of-payments reasons); XIII (non-discriminatory administration of quantitative restrictions); XIV (exceptions to the rule of non-discrimination), XV (exchange arrangements); and XX (general exceptions); and
- Substantially the same duties (essentially a common external tariff) and other trade regulations are applied by each of the members of the union to their trade with non-union members (Article XXIV:8(a)(ii)).

An authentic customs union with the above-mentioned features (or an interim agreement leading to the formation of such a customs union) would be permitted to operate in contravention of GATT Article 1 provided that it meets certain conditions.

One condition is the GATT Article XXIV:5(a) obligation stipulating that the duties (common external tariff) and other regulations of trade imposed on trade of non-participants shall not on the whole be higher, or more restrictive, than the general incidence of duties and other trade regulations applicable in the participants prior to the formation of the customs union or adoption of the interim agreement. In other words the single tariff of a customs union and other trade barriers should not be higher than the pre-union average. This “conformity test” under Article XXIV:5(a) is intended to ensure that customs unions or related interim arrangements perform their purpose of promoting trade among participants, while seeking to not unnecessarily raise trade barriers against non-participants. In the examination of most customs unions under the GATT/WTO, this “conformity test” has often been interpreted by some countries to mean an “economic test” relating to their trade creation and diversion impact of RTAs. In most cases, as in the EU customs union agreements, however, RTA participants have rejected the linkage while, at the same time, recognizing the importance of such an analysis, as there is no legal provision in place yet. They have emphasized that the examinations must be focused only on the conformity assessment. In the light of such differing interpretations, the economic test of trade creation/diversion has been identified as a systemic issue to be addressed by the WTO at a future date.

Another condition arises from the provisions of the Understanding in respect of the GATT Article XXIV:5(a) Obligation. The Understanding stipulates a quantitative measurement and attendant examination by the WTO of the general incidence of duties and regulations of commerce applicable before and after the formation of a customs union, to assess the conformity of the customs union to Article XXIV:5(a). The measurement in the case of duties and charges will be based on an overall assessment of the weighted average tariff rates and of custom duties collected, in accordance with the methodology used in the assessment of tariff offers in the Uruguay Round. For this purpose the duties and charges to be considered will be the applied rates of duty. The measurement will be undertaken by the WTO Secretariat on the basis of import statistics provided by the participants in a customs union or interim agreement. As regards non-tariff measures (other regulations of commerce), which are difficult to quantify or aggregate, a case-by-case examination may be required. Such as assessment have been conducted for some RTAs.
Another condition is the GATT Article XXIV:6 Obligation. If the adoption of a common external tariff by a WTO member of a custom union leads to an increase in its bound tariffs and thus becoming inconsistent with its previously negotiated schedules of tariff concessions as per GATT Article II, then the procedure for compensatory adjustment arising from the withdrawal or modification of schedules as set forth in GATT Article XXVIII (and the Understanding on that Article) shall apply. In essence, the procedure obliges participating custom unions to negotiate and agree with concerned WTO members, and consult other WTO members with a substantial interest in such concession, on adequate compensation. The understanding on GATT Article XXIV stipulates that the negotiations will be entered into in good faith with a view to achieving mutually satisfactory compensatory adjustments, including by way of compensatory tariff reductions in other products. In the negotiations due account shall be taken of the new market access opportunities created for the same product by decreases in tariffs of other union members. Should such negotiations fail to achieve any result within a reasonable period of time, the customs union shall be free to modify or withdraw the concession and other affected WTO members shall be free to retaliate by withdrawing substantially equivalent concessions. WTO members have invoked this provision; however, the use of this retaliatory provision has been rare owing either to successful compensatory negotiations or to the difficulty in targeting the offending country when the retaliation has to be done on an MFN basis.

A bona fide free trade area is defined in GATT Article XXIV:8(b) as a group of two or more customs territories within which the duties and other restrictive regulations of trade are eliminated on substantially all trade between the participants in products originating in their territories. It is, however, permitted that participants in the free trade agreement, “where necessary”, can maintain those restrictions permitted under GATT Articles XI, XII, XIII, XIV, XV and XX. In short, the free trade area must have the same characteristics as applied to internal trade within a customs union.

An authentic free trade area (or interim agreement leading to the formation of a free trade area) with the above-mentioned characteristic is accorded permission to operate in violation of the MFN principle provided that it promotes the trade of participants and does not raise barriers against trade with non-participants. This condition is stipulated in GATT Article XXIV:5(b) as follows: "the duties and other trade regulations in each of the FTA participants applied to trade with third countries at the formation of the free trade area or adoption of the interim agreement shall not be higher or more restrictive than the corresponding duties and other trade regulations existing in the same FTA participants prior to the formation of the free trade area or the interim agreement."

A bona fide interim agreement is defined in GATT Article XXIV:5 as an agreement that provides for the formation of a customs union or a free trade area as defined above. In reality the preponderant majority of RTAs consist of interim agreements, so for them the following GATT provisions pertaining to such agreements are particularly à propos.

The main obligation is stipulated in GATT Article XXIV:5(c) to the effect that an interim agreement can be permitted to operate as an exception to the MFN rule, provided that it shall include a plan and schedule for the formation of a customs union or free trade area within a reasonable length of time. This obligation is applied to curtail the potential for participants in interim agreements to use it as an excuse for introducing discriminatory trade preferences over an indefinite period. Some clarity has been introduced by the Understanding on GATT Article XXIV over the ambiguity on what constitutes a "reasonable length of time" for the duration of
an interim arrangement; the reasonable length of time should exceed 10 years only in exceptional cases, and in such cases a full explanation for a longer period should be provided to the WTO Council for Trade in Goods.

In addition, GATT Article XXIV:7(b) provides for WTO members together with the participants to an interim agreement to examine the above mentioned plan and schedule and make recommendations as to whether the interim agreement is likely to result in the formation of a customs union or free trade area within the foreseen period or whether such a period was unreasonable. Moreover, participants shall not maintain or implement the interim agreement if they are not prepared to modify it in accordance with the recommendations. This provision is difficult to enforce in practice as it implies that participants in the interim agreement should be, which is more often not the case, amenable to changing the consensus results of their internal RTA negotiations upon the recommendation of WTO. Past GATT practice, and one which is likely to continue under the WTO, shows that interim agreements are notified only after they have been agreed to and ratified by the participants, leaving no room for further changes.

A further obligation is stipulated by GATT Article XXIV:7(c) to the effect that parties to an interim agreement shall communicate any substantial change in the plan or schedule to WTO members which may request consultations with the participants if the change seems likely to jeopardize or unduly delay the formation of the customs union or free trade area.

The fundamental characteristic of a customs union or a free trade area under GATT Article XXIV provisions is "substantially all the trade" coverage. This concept has not been clearly defined, however, and the ambiguity has given rise to controversy in the past and difficulties are still encountered over its exact interpretation. Participants in RTAs have tended to interpret the principle as referring to the whole (horizontal) trade coverage and not to specific sectors. This interpretation allows a certain latitude as regards the product sectors covered. For example, many of the customs union and free trade agreements concluded by the EU have excluded the agriculture sector or certain portions of it, but which nevertheless cover a substantial portion of the overall trade between the EU and the parties concerned. These agreements, as far as the EU is concerned, meet the "substantially all trade" feature.

Other countries favour a definition that takes a sector-by-sector approach arguing that for this particular provision to be satisfied, no major sector of economic activity should be excluded from the coverage of the free trade/customs union. Proponents of this interpretation have thus argued that the EU agreements mentioned previously, by excluding the agricultural sector or parts of it, do not conform to the substantially all trade coverage feature. The different interpretations of “substantially all the trade” as to whether it refers to RTA trade in substantially all product sectors or substantial trade in all product sectors combined continues to impede the effective examination of RTAs under the WTO. This ambiguity was not clarified by the Understanding on GATT Article XXIV; it did not offer any clear definition of the concept. The CRTA has thus identified this concept as a systemic issue that it would address and clarify. However, such work should take place without prejudice to ongoing examination of RTAs under existing WTO provisions.

Another important obligation arises from GATT Article XXIV:7(a); it requires participants in customs union and free trade areas or associated interim agreements to promptly notify WTO members of the details (intent and content) of the particular RTA. This examination is an obligation to ensure transparency of the RTA and to ensure the conformity of the RTA with
relevant GATT provisions. The GATT Council decided on 25 October 1972 that notification of an RTA should be made following the signature of its constituent agreement. The practice has been for parties to the RTA to provide the legal text of the agreement to GATT members for their examination, normally by way of a working party established with the relevant terms of reference. Working party reports to the Council which adopts the report. GATT members acting jointly may reach a final decision on the conformity of the agreement with GATT Article XXIV or formulate other recommendations. The decision of the contracting parties is taken by a majority of votes cast; however, the tradition has been to adopt decisions by consensus, this is taken to exist if there is no formal objection to the decision by a member at the meeting when the issue is addressed. The examination process is now overseen under the WTO CRTA.

After the initial notification and examination process, participants in RTAs have to fulfil biennial reporting requirements. These requirements have been reiterated in the Understanding on GATT Article XXIV. Advantages accorded by a WTO member to adjacent countries in order to facilitate border/frontier trade/traffic is permitted under GATT Article XXIV:3.

It should be noted that the Understanding on the Interpretation of Article XXIV of GATT 1994 clarifies the interpretation of various provisions of GATT Article XXIV, but does not change the rules. The Understanding, in particular, requires an assessment of the general incidence of duties and trade regulations applicable before and after the formation of an RTA; determines that the "reasonable length of time" should not exceed 10 years (except in exceptional cases); and allows that the consistency of an RTA with GATT Article XXIV may be submitted to a dispute settlement panel. The latter is particularly significant in view of the creation of a more automatic and binding dispute settlement system under the new WTO Dispute Settlement Understanding.

In terms of the application of GATT Article XXIV, past experience has shown that some of the provisions that are used to judge the compatibility of free trade areas and customs unions within GATT are imprecise and have not been applied successfully. That is demonstrated by the fact that many free trade areas and customs unions have been examined by GATT working parties for consistency with GATT Article XXIV over the years, but such working parties have seldom reached any concrete conclusion. Also, the GATT review process simply became unable to handle the large increase in RTAs that have been notified to it. It was hoped that the introduction of the Understanding on the Interpretation of Article XXIV of GATT 1994 and ongoing efforts to clarify various provisions of GATT Article XXIV under the WTO framework would continually improve on the interpretation of the substantive provisions of GATT Article XXIV, and consequently provide for a more effective control of RTAs. This evolution must be seen in conjunction with the creation of the CRTA, which has had an impact on the procedures under which the WTO examines RTAs and because of its potential as a vehicle for assessing on a systemic basis the overall impact of such arrangements on the multilateral trading system.

3. **Enabling Clause (RTAs among developing countries)**

RTAs constituted by developing countries that affect trade in goods are subjected to the relevant provisions of the Enabling Clause agreed in 1979 in the Tokyo Round of multilateral trade negotiations. The Enabling Clause is formally called the "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries – Decision of 28 November 1979." The adoption of this clause reflected a movement within the
former GATT from a very limited focus on addressing the concerns of developing countries, to an attempt to addressing these concerns specifically. The Enabling Clause has not been affected by the Uruguay Round, and continues to operate in its original form to this day.

Paragraph 1 of the Enabling Clause allows WTO members to provide differential and more favourable treatment to developing countries without according such treatment to other WTO members, and thus deviating from the MFN principle of non-discrimination (GATT Article I). Paragraph 2 of the Enabling Clause identifies the specific situations in which this permission (legal cover) is accorded (see Box 1).

**Box 1. Enabling Clause provisions**

Preferences accorded under the Generalized System of Preferences (GSP) schemes of developed countries. The Enabling Clause thus legalizes the GSP.

Provisions concerning non-tariff measures governed by provisions negotiated multilaterally under GATT including some of the Tokyo Round codes and some of the Uruguay Round provisions on non-tariff measures.

Special treatment of the least developed among the developing countries in the context of any general or specific measures in favour of developing countries.

Trade arrangements among developing countries on a regional or global basis involving the preferential reduction or elimination of tariffs. In respect of trade liberalization affecting non-tariff measures, these should be made in accordance with criteria or conditions, which may be prescribed by the WTO members. No such conditions or criteria have been prescribed so far. However, it has been proposed and opposed by some developing countries, as an issue that could be addressed within the context of the work of the CRTA on systemic issues in respect of "other regulations of commerce" affecting trade.

**Bona fide** RTAs among developing countries must satisfy the following conditions stipulated in the Enabling Clause, paragraph 3, if they are to benefit from its legal permission:

- They shall be designed to facilitate and promote trade of members and not raise barriers or create undue difficulties for the trade of third countries;
- They shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on an MFN basis;
- They shall in the case of such treatment accorded by a developed member to developing member be designed and, if necessary, modified to respond positively to the development, financial and trade needs of developing countries; and
- They should be notified to the CTD when they are created, modified or withdrawn.

These provisions offer more flexibility and are less demanding than the provisions of GATT Article XXIV as further clarified by the relevant Understanding. There is no obligation to conduct an assessment of the ex-ante and ex-post level of protection of the RTA participants against third countries, to verify whether the RTA conforms to the test of not raising barriers against trade of non-participants. Although participants in RTAs would be required to argue and demonstrate that this is the case when they notify the RTA to the WTO. There is no obligation in respect of “substantially all the trade” criteria. No time limitation is specified for interim agreements, and biennial reports are not required of the RTAs. The only obligation is that the developing countries, which concluded an RTA, must notify the CTD when the RTA is created (signed and ratified), modified or withdrawn. The CTD may establish a working party upon the request of any interested member to examine the RTA in the light of the relevant provisions of the Enabling Clause.
The Enabling Clause has been invoked by developing countries that have notified their RTAs to the former GATT and now the WTO. In the period before 1979, RTAs among developing countries were notified to GATT under the terms of GATT Article XXIV, or under the terms of Part IV of GATT. Examples of agreements notified under the Enabling Clause in the period after 1979 includes the ASEAN free trade area, the Andean Pact and the Common Market for Eastern and Southern Africa (COMESA). When GATT was in existence, most RTAs among developing countries had not been notified.

4. **GATT part IV (trade and development)**

Part IV of GATT on Trade and Development was added to the GATT 1947 in 1965. It was not affected by the Uruguay Round results and continues to operate in its original form.

Part IV provides the basis for WTO members to provide special, advantageous treatment for developing country members. These include favourable market access conditions (Article XXXVI:4), especially for processed and manufactured exports (Article XXXVI: 5) in the hope of increasing the trade of developing countries and encouraging the diversification of their export capacity. The special treatment could be provided by way of a standstill, reduction and elimination of customs duties and other charges affecting products of current or potential export interest to developing countries (Article XXXVII). These measures could also be taken jointly by WTO members (Article XXXVIII).

Prior to the Enabling Clause of 1979, developing countries have justified the formation of RTAs among them on the basis of Part IV. Also, some developed countries have invoked Part IV, often in conjunction with GATT Article XXIV, as the legal basis for providing preferential non-reciprocal market access conditions to developing countries. This has been the case of EU in respect of the Lomé Convention, although other GATT/WTO members did not agree with the EU on its interpretation. The impasse in the GATT/WTO in the consideration of the Fourth Lomé Convention led the EU and ACP States to seek a waiver for the Convention, which was accorded up to February 2000 and later extended.

5. **GATT Article XXV and the Understanding (waiver)**

GATT Article XXV: 5 provides that under "exceptional circumstances," members acting jointly can waive an obligation imposed upon another member by GATT. It can therefore (and has been) invoked by members who, in breach of GATT Article I, want to enter into preferential trading arrangements. A waiver is typically requested if the parties to the preferential trading arrangement cannot comply with the terms of GATT Article XXIV (or the Enabling Clause). The decision to waive a GATT obligation of a member however shall be approved by a two-third majority of the votes cast and that such a majority shall comprise more than half of the WTO members (i.e., 74 members as of October 2004).

In the first two decades of GATT, a number of developed countries invoked GATT Article XXV:5 to form preferential trading arrangements. In 1948 France requested and obtained a waiver for a proposed customs union with Italy, which was not at that time a member of GATT. The founding members of the European Coal and Steel Community obtained a waiver in 1952 for their free trade agreement on coal and steel. The limited product coverage of the agreement meant that the parties could not invoke GATT Article XXIV, which required substantial trade coverage. Likewise the USA had to obtain a waiver in 1965 for its agreement with Canada on free trade in automobiles. Thus, GATT Article XXV has provided the basis
for authorizing the maintenance of a number of preferential trade agreements, especially sectoral trade agreements in contravention of GATT Article I.

However, the majority of the waivers that have been granted since the formation of GATT have involved preferences granted by developed countries to developing countries on a non-reciprocal basis in support of the latter's economic development. Most of these agreements drew their inspiration from Part IV of GATT. Examples include Australian preferences to products from Papua New Guinea (1953); Canada's preferences to imports from the Caribbean Basin (1968); USA preferences granted to Caribbean countries under the Caribbean Basin Economic Recovery Act (1985); and the preferences granted by USA under the Andean Trade Preference Act in 1992. One of more controversial waiver granted by GATT pertained to the Fourth Lomé Convention between the EU and the ACP States.

Recourse to the use of waivers has been limited by the Understanding in Respect of Waivers of Obligations under the GATT 1994 (Uruguay Round result). Apart from the obligation to justify the need for a waiver (Understanding paragraph 1), the Understanding provides (in paragraph 2) that all waivers existing as at the time the WTO Agreement entered into force (1 January 1995) shall lapse on the waiver's expiry date or not later than two years after the creation of the WTO (i.e., 1 January 1998), which ever comes first, unless extended in accordance with Article IX of the WTO Agreement.

Under the terms of the WTO Agreement Article IX:3 and 4, members who want to obtain waivers have to go through a complicated process before being authorized to deviate from their obligations under GATT. The waiver could be granted by the WTO Ministerial Conference in "exceptional circumstances," provided that the decision is taken by three fourths of WTO members (about 111 members at present count of 148 WTO members). However some flexibility is provided in terms of decision-making:

- Article IX:3(a) provides for the possibility that, upon request, the Ministerial Conference's decision on the waiver could be taken by consensus. In this case the Ministerial Conference shall establish a time period not exceeding 90 days to consider the request. Failing the reaching of consensus cannot be reached during that period, the decision would be taken by three fourths of WTO members.
- Article IX:3(b) provides for a waiver request concerning the multilateral trade agreements relating to trade in goods, trade in services and trade-related aspects of intellectual property rights, to be submitted initially to its relevant supervisory body, namely the Council for Trade in Goods, Council for Trade in Services or the Council for TRIPS, for consideration during a time period not exceeding 90 days. At the end of that period the relevant Council shall submit a report to the Ministerial Conference.

If a member (or group of them) should succeed in obtaining a waiver, it would have to abide by the stringent conditions that are likely to be set by the Ministerial Conference. Article IX:4 provides that the granting of the waiver shall clearly explain the exceptional circumstances justifying the decision, the terms and conditions governing the application of the waiver and the date of its expiry. If the waiver is extended over several years, it would be reviewed annually until its expiry. In each annual review the Ministerial Conference shall examine whether the exceptional circumstances continue to prevail and the relevant terms and conditions have been met, and on that basis extend, modify or terminate the waiver. This
provision introduces an element of uncertainty over the sustainability of a waiver with adverse implications for economic operators wishing to take advantage of it.

The provisions of the Understanding on the waiver and the WTO Agreement Article IX indicate that unless a WTO member (or a group of them) requesting a waiver could mobilize widespread support from other WTO members to support their request, they will not be able to easily obtain the waiver. This gives the impression that further use of waivers by WTO members as a basis for preferential trading arrangements that are not consistent with the provisions of GATT Article XXIV or the Enabling Clause is likely to diminish. Nonetheless, it can be possible as evidenced by the securing of the waiver by the EU and ACP States for the Cotonou Partnership Agreement from the 4th WTO Ministerial Conference in 2001.

C. GATS Article V (RTAs and trade in services)

GATS Article V allows an economic integration agreement liberalizing trade in services among parties provided the agreement:

- Has substantial sector coverage (in terms of number of sectors, volume of trade affected and modes of supply with no a priori exclusion of any modes); and
- Provides for the absence or elimination of substantially all discrimination through elimination of existing discriminating measures and/or prohibition of new or more discriminatory measures. Agreements liberalizing trade in services involving developing countries will be accorded flexibility regarding the above conditions. Such flexibility has not been further clarified; however, it would appear to imply a lower standard than what is expect from developed countries.

RTAs must be designed to facilitate trade of members and should not raise the overall level of barriers to trade in services within the respective sectors or sub-sectors compared to the level applicable prior to the entry into force of the agreement. RTAs must be promptly notified to the Council for Trade in Services on their creation and following any modifications. The RTAs liberalizing trade in services are permitted, under GATS Article V bis, to provide for full labour market integration on condition that: (a) the citizens of parties to the agreement are exempted from requirements for residency and work permits; and (b) the agreement is notified. A notification under this provision has yet to be submitted.

D. WTO Committee on Regional Trade Agreements

The GATT record in examining the various RTAs was not at all satisfactory. Of the 60 agreements notified under GATT Article XXIV, roughly one-half remained to be examined by a working party in the early 1990s. It had become difficult to find chairmen for such working parties and to organize their work. Moreover, almost all of those working party reports that were finished were inconclusive with no agreements reached by members on the consistency or not of the RTAs examined. It was also GATT practice to require periodic reports on the operation of RTAs. However, by the 1980s such reports were typically not made and the system of examining RTAs was hardly functional by the 1990s. It was falling desperately behind in producing working party reports and was not reviewing existing agreements at all on a systematic basis.

To address such problems, the CRTA was created on 6 February 1996 by the WTO General Council to centralize the examination and reporting of RTAs and assess their systemic
IV: Notification to the WTO of an RTA

implications on the multilateral trading system (see Box 2). At the time of its creation, the CRTA replaced around 25 separate GATT working parties established to examine various RTAs. Its work focused on the examination of RTAs and it has started to look into the reporting obligation affecting RTAs and consideration of systemic issues.

1. The examination of RTAs

As of October 2004, a total of 110 agreements were under examination by the CRTA, 84 of these agreements were in the area of trade in goods and 26 in trade in services. Thirty-eight RTAs are undergoing factual examination, while for 32 RTAs, the CRTA had not yet started the factual examination. For the remaining 40 RTAs the factual examination has concluded that no progress was made on the completion of the corresponding examination reports. These RTAs were referred to the CRTA by the Council for Trade in Goods and the Council for Trade in Services. The CTD has not referred any RTA notified to it to the CRTA. One exception is the MERCOSUR agreement, which was examined under the GATT Article XXIV and the Enabling Clause. The other exception will be the examination of SADC free trade agreement under GATT Article XXIV. The examinations carried out so far indicate a major change from past practice. The examinations are critical and parties under examination are expected to show concrete and substantial prove of the conformity of their trading arrangements with relevant WTO provisions.

Box 2. Terms of Reference of the Committee on Regional Trade Agreements (CRTA)

- Carry out the examination of agreements in accordance with the procedures and terms of reference adopted by the Council for Trade in Goods, the Council for Trade in Services or the CTD, as the case may be, and thereafter present its report to the relevant body for appropriate action.
- Consider how the required reporting on the operations of such agreements should be carried out and make appropriate recommendations to the relevant body.
- Develop, as appropriate, procedures to facilitate and improve the examination process.
- Consider the systemic implications of such agreements and regional initiatives for the multilateral trading system and the relationship between them, and to make appropriate recommendations to the General Council.
- Carry out any additional functions assigned to it by the General Council.

The examination normally takes place in two phases. The first phase is an in-depth factual examination of the RTA in question with the relevant information provided by parties to the RTA in accordance with the Standard Format for Information on Regional Trade Agreements for RTAs affecting trade in goods and a similar one the Standard Format for Information on Regional Trade Agreements for RTAs affecting trade in services. The Standard Format would serve as a guide for RTA parties to furnish the basic information upon which the examination would be effected, in addition to the old GATT practice of questions and answers during the CRTA meetings and in written format. Though the use of the Standard Format is voluntary and non-binding, the practice so far in the CRTA has been to oblige RTA members to use it by refusing to examine RTAs for which the Standard Format is not available (thus postponing the examination). The Standard Format is an innovation of the CRTA in keeping with its mandate on establishing procedures to facilitate efficient and effective examination of RTAs. This first phase of examination is considered as completed when general agreement is reached within the CRTA that all relevant factual information has been supplied and reviewed.

The second phase comprises the drafting of a conclusion on the WTO conformity of the RTA in informal (confidential) setting. The conclusions can be influenced by the calculation of the general incidence of duties and other regulations of commerce applicable before and after the formation of the RTA. The calculation is conducted by the WTO Secretariat on the basis of
information (trade statistics and measures) provided by the parties to the RTA. The exercise is conducted with extreme caution as the results could be controversial (if the findings determine an higher incidence). However, there are some definition problems regarding "other regulations of commerce" for example; deficiency in intra-group trade data; and the precise calculation modality remain to be elaborated and agreed upon.

The factual examination and negotiated conclusions are amalgamated into a single report that is presented to the relevant supervisory body. As of October 2004, the CRTA had yet to release a report on the examination of an RTA to the relevant supervisory body.

2. **The reporting of RTAs**

The CRTA has considered in detail the procedures for giving effect to the obligation on regular reporting by parties to RTAs (biennially in the case of GATT Article XXIV RTAs). These related to the nature of biennial reports to be compiled, the factual information to be included, the coverage of RTAs and the objective and method of considering the reports.

The discussion within the CRTA on reporting generated broad agreement that the reporting should not constitute a new/repeated examination of an RTA (as carried out when the RTA was first notified). It should be an updated report on developments in an RTA. It must not overlap with reporting under the Trade Policy Review mechanism. Concern has been expressed by some WTO members that the clear demarcation between the reporting and examination obligations may become blurred, and that the reporting obligation may become unnecessarily burdensome. The EU is particularly concerned, as it will be affected the most as a major customer of the CRTA, given its many free trade and customs union agreements. Some CRTA members intend to evolve a link between the reporting requirement under GATT to those under GATS and the Enabling Clause, but other members have disagreed.

E. **Doha negotiations on regional trade agreements**

Paragraph 29 of the Doha Work Programme called for “negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applying to regional trade agreements” while taking into account “the developmental aspects of regional trade agreements.” In accordance with this mandate, negotiations on rules have been pursued in the Negotiating Group on Rules. So far, progress has been limited. Initial submissions by some WTO Members emphasized the need for WTO disciplines to be more stringent and effective. The ACP States have submitted a proposal for greater flexibility and special and differential treatment in GATT Article XXIV for RTAs involving developed and developing countries. However, the focus of the Negotiating Group has been on procedural aspects to improve the WTO oversight function of RTAs in the CTRA. The WTO rules negotiations form a part of single undertaking under the Doha round.

The Doha negotiations on rules affecting RTAs provide a unique opportunity in the history of GATT/WTO to bring clarity, improvement and development-orientation to these rules. Presently, however, given the slow pace of negotiations on these issues, this challenge may not be fully addressed.
F. Issues for consideration by developing countries

1. Notifying an RTA is a must

Developing country WTO members are obliged to notify their RTAs to the WTO for examination and for a decision to be taken on its consistency with relevant WTO provisions. The purpose of the examination is to ensure compliance of the RTA with the relevant WTO provisions. It is the membership of the WTO which would agree on the conformity of the RTA undergoing examination. De facto, they have only exceptionally agreed on the conformity of a regional trade agreement. In almost all cases, including the EU (European Union), the examinations remained inconclusive, but without any effects on the implementation of the regional trade agreements by the concerned member States.

The practice in the WTO is for a notification to be made subsequent to (and not before) the entry into effect of the trade agreement. In other words, the notification is made after the implementation of the agreement has started. Thus, in most cases, the trade agreement would be notified after the ratification of the agreement by the signatory member States and its entry into operation. At times, for purposes of transparency countries have communicated to the WTO Council for Trade in Goods or Trade in Services, for example, their intention to form an RTA, provided some broad details about the agreement, and then notified it upon its enactment. Developing countries, and many other RTAs, have followed this path.

2. Notification procedures

The notification can be made by one member State (who is also a WTO member) of the RTA on behalf of the entire RTA, or by a group of members (all of whom are WTO members). A copy of the legal treaty must accompany the notification and the free trade area programme with all relevant documents like product liberalization list and the liberalization time schedule. The notification is addressed to the WTO Secretariat (Director General), which circulates the notification without the legal texts to the relevant WTO Council/Committee. The legal texts tend to be bulky and are kept in the Secretariat and made available to interested WTO members upon request.

The relevant WTO body which receives the notification is the CTD for agreements notified under the Enabling Clause, the Council for Trade in Goods for agreements notified under GATT Article XXIV, and the Council for Trade in Services for agreements notified under GATS Article V. With the exception of Enabling Clause agreements, the examination of all other RTAs is now centralized under the CRTA in contrast to the past GATT practice of constituting working parties. What happens in practice is that the WTO body to which an agreement is notified, adopts a standard terms of reference for the examination of the agreement and refers the agreement together with the terms of reference directly to the CRTA for the actual examination. The CTD has not referred any RTA notified under the Enabling Clause to the CRTA apart from the MERCOSUR agreement. However, while the examinations have been extensive in most cases, the CRTA had not yet released a concluding report on any of its examinations to the Council for Trade in Goods (or Council for Trade in Services). The CRTA’s report of an examination and its conclusions are discussed in informal (confidential) settings. Enabling Clause agreements are examined by the CTD. However, the CTD might agree to refer the examination to the CRTA.
Developing country RTAs can thus be examined by the CTD, if notified under the Enabling Clause, or by the CRTA, if notified under GATT 1994 Article XXIV or GATS Article V. Also, even if developing country agreements are notified under the Enabling Clause, their examination could potentially be referred to the CRTA.

3. Notification under the Enabling Clause

Developing countries forming an RTA in goods should notify the agreement under the provisions (paragraphs 1 and 2) of the Enabling Clause. Most developing country agreements have been notified under this clause to the CTD, which may then establish a working party upon the request of any interested member to examine whether the RTA is in conformity with the provisions of the Enabling Clause.

The practice under the former GATT has been for the CTD or its working party to take note of the notification with little or no discussion. However, recent developments in the WTO and the growth of RTAs generally points toward the possible more substantive and lengthy examination of the RTAs, even those notified under the Enabling Clause. Developing countries members of RTAs should be prepared to provide an avalanche of documentation for the examination process and to ensure physical presence in Geneva whenever the examinations occur starting with the initial notification of the RTA. In addition, developing countries would have to complete and submit the Standard Format for Information on Regional Trade Agreements that is now used by the CRTA as the basic document on which to start examination. Furthermore, the GATT practice of questions and answers in oral sessions during the examinations and in writing if issues remain uncertified or pending has been maintained. There is greater likelihood of a lengthy question and answer procedure for RTAs. It can be expected that some WTO members may request information/studies/analyses on the likely trade creation and/or trade diversion effects of the RTA, even though there is no operative obligation regarding such trade effects under the Enabling Clause (nor under GATT Article XXIV and the Understanding). Also, RTA members can be asked to demonstrate that the level of tariff protection against third countries before and after the formation of the RTA has not changed upwards, although there is no legal obligation to this effect. There also will be heavy statistical requirements, which can be difficult to meet in view of the present poor state of foreign trade statistics of many developing countries.

Notwithstanding the above caveat, the provisions of the Enabling Clause offer more flexibility and are less demanding than the provisions of GATT Article XXIV and its Understanding. As noted previously, the only obligation under the Enabling Clause is that the countries’ members of the RTA must notify the CTD when the RTA is created (signed, ratified and in operation), modified or withdrawn.

The absence of a pre-defined timetable for trade liberalization is a major advantage for developing countries, particularly LDCs, which may be facing considerable difficulties in liberalizing trade and adjusting to the new situated of heightened regional competition. They need a long transitional period, accompanied by investment-production measures to improve competitiveness and production capacity. At the same time it is necessary to periodically review the implementation and effects of special provisions in favour of LDCs, and examine how they are observing their own obligations. Developing countries should carefully consider both the needs and obligations of member States that are LDCs. The special treatment should relate both to trade commitments, as well as to effective implementation of joint measures to strengthen industrialization and competitiveness as well as to facilitate adjustment.
IV: Notification to the WTO of an RTA

4. Notification under GATT Article XXIV and the Understanding

Developing countries can opt to notify any RTAs they have concluded among themselves under GATT 1994 Article XXIV and its Understanding. Such agreements are more or less automatically referred to the CRTA for an examination. This Article defines three types of agreements, i.e., a free trade area, a customs union and an interim agreement leading either to a free trade area or customs union as discussed previously.

An interim agreement, as stipulated by GATT Article XXIV:5(c), shall include a plan and schedule for the formation of the free trade area within a reasonable length of time. The Understanding on GATT Article XXIV clarifies that the "reasonable length of time" for the duration of an interim arrangement should exceed 10 years only in exceptional cases and in such cases a full explanation for a longer period should be provided to the WTO Council for Trade in Goods. A time period of 10 years or less will be in conformity with this critical test. However, developing countries, in particular, the LDCs may not be capable of fulfilling the requirements of trade liberalization within 10 years — a longer period may be necessary.

The RTA would also be tested to check whether it satisfies the definition of a free trade area, as defined in GATT Article XXIV:8(b) of a group of two or more customs territories within which the duties and other restrictive regulations of trade are eliminated on "substantially all trade" between the participants in products originating in their territories. There is no clear definition of the term “substantially all trade” and the CRTA is working on making it clearer. In the meanwhile, in most examinations so far, WTO members have tended to ask for qualitative and quantitative proof in terms of no exclusion of any sector of trade (especially agriculture), large coverage of in the range of 90 per cent of all tariff lines traded and the percentage of intra-trade affected. Member States would need to verify that the RTA meets at least one of these conditions so as to be in a position to defend the agreement on this crucial test.

There also is not clear definition of what constitutes “other restrictive regulations of trade” and the CRTA is working on providing more clarity here too. Thus no strict test can be applied. However, the point is to remove non-tariff barriers that impede trade even as tariff barriers are being eliminated. While this is a legal obligation, it is nonetheless in the trade interest of developing countries generally to remove non-tariff barriers to their mutual trade.

In addition countries would have to show evidence that their RTA promotes the trade of participants and does not on the whole raise barriers against trade with non-participants as stipulated in GATT Article XXIV:5(b). This provision essentially prevents that a country raises its MFN level of protection just before the entry into force of an RTA in order to start liberalizing from a higher level and/or to compensate customs revenue losses (this is also contrary to the interests of the member States of the RTA itself, as the first stages of mutual preferences are in fact nullified). Likewise, import quotas should not be made more stringent for third countries in order to compensate for higher import competitions from within the RTA area. If this happens, it would prejudice WTO acceptance of the RTA.

The examination is normally carried out over several CRTA sessions, but can take years if there are important diverging opinions. This is the case of NAFTA, for example. Such a prolonged examination would considerably increase the workload of the integration secretariat and developing country members, particularly when written answers have to be prepared for
the examination; there is also a non-negligible cost element. Defense of the RTA cannot be made solely by Geneva-based delegates from concerned member States. The questions that are asked are often quite technical and require an in-depth and up-to-date knowledge of the agreement. Integration secretariat staff invariably have to participate in the examination alongside the member States; this entails ensure that staff from the region attend CRTA meetings in Geneva until the examination is completed.

Also the Understanding on GATT Article XXIV introduces an examination of the impact of RTAs. It provides that the evaluation under GATT Article XXIV:5(a) of the general incidence of duties and regulations of commerce applicable before and after a formation of customs union shall be based upon an overall assessment of weighted average tariff rates and of customs duties collected. The result of the evaluation would be a major piece of evidence on which the CRTA would base its conclusions. Obviously, for any parties to an agreement being examined, a result that shows no change in the general level of protection is preferred.

With regard to the procedure to be followed when a WTO member forming an RTA proposes to increase a bound rate of duty, the Understanding reaffirms that the procedure set forth in GATT Article XXVIII must be commenced before tariff concessions under the free trade area or customs union enter into force. In negotiations for achieving mutually satisfactory compensatory adjustment as required under GATT Article XXIV:6, it is agreed that due account shall be taken of reduction of duties on the same tariff line made by other constituents of the customs unions upon its formation. Compensation in the form of reduction of duties should be offered by the customs union if such reductions are not sufficient to provide the necessary compensatory adjustment. However, when no agreement can be reached within a reasonable period from the initiation of negotiations, the RTA shall be free to modify or withdraw the concessions; affected members shall then be free to withdraw substantially equivalent concessions. The Understanding imposes no obligations to provide compensatory adjustments to members of a customs union.

The Understanding furthermore allows that the consistency of an RTA with GATT Article XXIV may be submitted to a dispute settlement panel. It is clear that dispute panels may consider GATT Article XXIV issues, if these are placed before it, and that the conclusions of the panels will be adopted.

Following the conclusion of the examination of the RTA, the CRTA would submit a report and recommendations to the Council for Trade in Goods. The report and recommendations is finalized during informal consultations among interested members of the CRTA. The Council may address recommendations to the RTA, i.e. its member States, to adjust provisions of their trade liberalization programme. The Council may also tie its acceptance of the RTA with certain conditions. There also is the consultation process to be observed in case of difficulties of individual WTO members with the RTA. Afterwards, the question of a dispute settlement panel might arise “on all matters”.

After the initial notification and examination process and hopefully positive concluding report, the RTA members would have to fulfil biennial reporting requirements. Thus the member States and the integration secretariat should be prepared every two years to provide a report to the WTO on the operation of the RTA and to engage in the debate over the report in Geneva. This requirement adds to the cost element of bringing the integration secretariat staff to Geneva to participate in the reporting exercise, and reporting on the updated changes.
So examinations under GATT Article XXIV are much more stringent and involve a high risk that there will be no ex ante agreement on the conformity of the RTA with WTO provisions. The standards of GATT Article XXIV and the Understanding are clearly greater and more stringent than those of the Enabling Clause.

G. Conclusion

The standards of GATT Article XXIV contain more stringent requirements that can be difficult to fully conform with by developing countries, in particular the LDCs. There is also the question of the financial costs of participating in WTO examinations and the biennial reporting. The Enabling Clause offers an easier option to meeting WTO consistency test. In any event, it is not evident that notification under the Enabling Clause would lead to an easy examination. In this light, it could be appropriate for developing countries to continue to notify the RTAs formed among themselves under the Enabling Clause. It provides them greater flexibility in forming RTAs, notifying them and operating them. Such flexibility will also be reflected in the instruments for liberalization under the agreements and thus providing developing countries with flexibility in commitments and trade policies.

In the final analysis, the choice of which WTO provision to notify an RTA remains a political one for developing countries members of an RTA to decide. Also, whatever the choice of legal instrument to notify the RTA, it must be not be under-estimated that the examination of the RTA will be difficult and adoption of a report on its consistency with WTO provisions will be matter of political negotiation with other WTO members.

Last, but not least, developing countries must work with skill and tenacity to use the opportunity afforded the by Doha negotiations on RTA rules to get the best of the deals in terms of clarity and improvements to the rules that enhance the development facilitating aspects of RTAs.
Chapter V

RULES OF ORIGIN: THE EMERGING GATEKEEPER OF GLOBAL COMMERCE

Antoni Estevadeordal and Kati Suominen

Introduction

Preferential trading agreements (PTAs) have proliferated spectacularly around the world over the past decade. The wave of PTA formation has carried with it a colourful mosaic of trade disciplines—such as provisions on market access for goods and services, standards, safeguards, government procurement, and investment—to govern economic relations between the PTA partners. Another central market access discipline embedded in virtually all PTAs is rules of origin (RoO). RoO are a powerful trade policy instrument arbitrating the market access of goods and reverberating to firms’ export, outsourcing, and investment decisions around the world. Much like the several other commercial disciplines, they are hardly inconsequential given that more than a third of global commerce takes place within PTAs—and that RoO are still place even after the phasing out of preferential tariffs.

RoO are also a central issue in many ongoing PTA negotiations, such as the 34-country talks to establish the Free Trade Area of the Americas (FTAA), and the European Union-Southern Common Market (Mercosur) negotiations to connect the world’s two largest customs unions. The growing relevance of RoO in the global trading system is gaining attention at the multilateral level. In the context of the Doha Trade Round, the Committee on Regional Trade Agreements (CRTA) of the World Trade Organization (WTO) is for the first time raising preferential RoO to a systemic issue in the global trade negotiation agenda; meanwhile, the WTO Committee on Rules of Origin is making headway in its efforts to finalize the process of multilateral harmonization of non-preferential RoO.

The purpose of this paper is three-fold: (1) to enhance the understanding of the different types of RoO regimes currently employed in PTAs around the world; (2) to discuss the latest empirical evidence of the economic effects of RoO; and (3) to provide recommendations as to which RoO are most conducive to unfettered global trade and investment flows. The first section discusses the purposes of RoO. The second section lays out the different types of product-specific and regime-wide RoO, while the third section presents recent findings on the effects of RoO. Section four explores the broader policy implications of these findings. The fifth section analyses the different RoO regimes around the world. The final section puts forth policy recommendations.

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44 PTAs include free trade agreements, customs unions, common markets, and single markets. Some 250 PTAs had been notified to the World Trade Organization (WTO) by the end of 2002; of these, 130 were notified after January 1995 (WTO, 2003). The number of PTAs is expected to soar to nearly 300 by the end of 2005.

45 When unilateral preferential schemes such as the Generalized System of Preferences (GSP) are accounted for, no less than 60 per cent of world trade is estimated to be conducted on a preferential basis. Importantly, the unilateral preferential programmes carry many of the same disciplines as PTAs.
I. Why Are RoO Needed?

There are two types of rules of origin: non-preferential and preferential RoO. Non-preferential RoO are used to distinguish foreign from domestic products for the purpose of applying several other trade policy instruments, such as anti-dumping and countervailing duties, safeguard measures, origin marking requirements, discriminatory quantitative restrictions or tariff quotas, and/or rules on government procurement.

Preferential RoO are employed in PTAs and in the context of generalized systems of preferences (GSP) to define the conditions under which the importing country will regard a product as originating in an exporting country that receives preferential treatment from the importing country. The economic justification for preferential RoO is to curb trade deflection—to avoid products from non-preference receiving countries from being transshipped through a low-tariff PTA or GSP partner to a high-tariff one. RoO are an inherent feature of free trade agreements (FTAs) where the member states’ external tariffs diverge and/or where the members wish to retain their individual tariff policies vis-à-vis the rest of the world (ROW).46 RoO would be unnecessary in a customs union (CU) with a common external tariff (CET) that covered the whole tariff universe. However, in practice, RoO are widely used in CUs, either as a transitory tool when moving toward the CET, or in those instances when a more permanent means of covering product categories where reaching agreement on a CET is proving to be difficult, for instance due to large tariff differentials between the member countries.

Given that preferential RoO can be an effective means to deter transshipment, they are sometimes used in efforts, which go beyond a desire to avert trade deflection. Often negotiated at up to 8- or 10-digit level of disaggregation, RoO, like the tariff, make a superbly targetable instrument. Moreover, the fact that RoO are generally defined in highly technical terms rather than assigned a numerical value means that they are not nearly as immediately quantifiable and comparable across products as the tariff is. Indeed, RoO are widely considered a trade policy instrument that can work to offset the benefits of tariff liberalization. 47 Most prominently, RoO can be employed to favour intra-PTA industry linkages over those between the PTA and the ROW, and, as such, to indirectly protect PTA-based input producers vis-à-vis their extra-PTA rivals (Krueger 1993; Krishna and Krueger 1995). As such, RoO can be akin to a tariff on the intermediate product levied by the importing country (Falvey and Reed 2000; Lloyd 2001), and used by one PTA member to secure its PTA partners’ input markets for the exports of its own intermediate products (Krueger 1993; Krishna and Krueger 1995). In an econometric study of the determinants of the restrictiveness of the RoO in the North American Free Trade Agreement (NAFTA), Estevadeordal (2000) shows that the same political economy factors that drive tariff protection also drive RoO; Suominen (2004) encounters similar evidence in the European Union’s RoO regime.

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46 The Asia-Pacific Cooperation (APEC) forum is a prominent exception, with its members employing their respective domestic RoO (OECD, 2002). APEC is based on a principle of open regionalism—extending tariff preferences on an MFN basis—which renders the need for preferential RoO obsolete.

47 Analysts’ interest in RoO has surged over the past few years. See Krueger (1993); Krishna and Krueger (1995); Jensen-Moran (1996); Garay and Estevadeordal (1996); Stephenson (1997); Scollay (1997); Ju and Krishna (1998); Appiah (1999); Falvey and Reed (2000); Estevadeordal (2000); Duttagupta (2000); Duttagupta and Panagariya (2001); Lloyd (1997, 2001ab); Rodriguez (2001); Augier and Gasiorek (2002); Brenton and Mancin (2002); Cadot et al. (2002); Flatters (2002); Garay and Cornejo (2002); Hirsch (2002); Krishna (2002); Estevadeordal and Miller (2002); Estevadeordal and Suominen (2003, 2005ab); Suominen (2004); and contributions in Cadot et al. (2004).
What is more, stringent RoO can also be used to meet the political economy goal of extending protection to intra-PTA final goods producers that are not globally the most competitive ones yet intent on exporting to the PTA partner’s market. Should the linkages between the different stages of production in the industry be tight, extra-PTA final goods producers would likely be hard-pressed to locate the appropriate, RoO-prescribed components within the PTA and remain competitive vis-à-vis the intra-PTA producers in the PTA market. And even if extra-PTA firms were to locate in the PTA market via tariff-jumping “RoO-jumping”, those producers with existing intra-PTA supply links would still have a "lead" until the new entrants’ regional sourcing met the RoO (Graham and Wilkie, 1998). This also means that RoO can play a potent role in influencing the location decisions of prospective investors.48

II. Types of RoO

There are two types of rules of origin, non-preferential and preferential RoO. Non-preferential RoO are used to distinguish foreign from domestic products in establishing anti-dumping and countervailing duties, safeguard measures, origin marking requirements, and/or discriminatory quantitative restrictions or tariff quotas, as well as in the context of government procurement. Preferential RoO, meanwhile, define the conditions under which the importing country will regard a product as originating in an exporting country that receives preferential treatment from the importing country. PTAs, in effect, employ RoO to determine whether a good qualifies for preferential treatment when exported from one member state to another.

Both non-preferential and preferential RoO regimes have two dimensions: sectoral, product-specific RoO, and general, regime-wide RoO.

A. Product-specific RoO

The Kyoto Convention recognizes two basic criteria to determine origin: wholly obtained or produced, and substantial transformation.49 The wholly obtained or produced-category applies only to one PTA member, and asks whether the commodities and related products have been entirely grown, harvested, or extracted from the soil in the territory of that member, or has been manufactured from any of these products. The RoO is met through not using any second-country components or materials. Most countries apply this strict and precise definition.

The substantial transformation-criterion is more complex, and involves four main components that can be used on a stand-alone basis or in combination with each other:

1. Change in tariff classification (CTC) between the manufactured good and the inputs from extra-PTA parties used in the productive process. The CTC may require the product to alter its chapter (2 digits under the Harmonized System), heading (4 digits), sub-heading (6 digits) or item (8-10 digits) in the exporting PTA member.
2. Exception attached to a particular CTC (ECTC). ECTC generally prohibits the use of non-originating materials from a certain subheading, heading, or chapter.
3. Value content (VC), which requires the product to acquire a certain minimum local value in the exporting country. The value content can be expressed in three main ways:

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48 Given that RoO hold the potential for increasing local sourcing, governments can use them to encourage investment in sectors that provide high value added and/or jobs (Jensen-Moran 1996; Hirsch 2002).
49 The Revised Kyoto Convention is an international instrument adopted by the World Customs Organization (WCO) to standardize and harmonize customs policies and procedures around the world. The WCO adopted the original Convention in 1974. The revised version was adopted in June 1999.
as the minimum percentage of value that must have been added in the exporting country (domestic or regional value content, RVC); as the difference between the value of the final good and the costs of the imported inputs (import content, MC); or as the value of parts (VP), whereby originating status is granted to products meeting a minimum percentage of originating parts out of the total.

4. Technical requirement (TECH). TECH prescribes or prohibits the use certain input(s) and/or the realization of certain process(es) in the production of the good. It is a particularly prominent feature in RoO governing apparel products.

B. Regime-wide RoO

Besides product-specific RoO, RoO regimes vary by the types of general RoO—including in the degree of *de minimis*, the roll-up principle, and the type of cumulation:

1. *De minimis* allows a specified maximum percentage of non-originating materials to be used without affecting origin. The *de minimis* rule inserts leniency in the CTC and TECH criteria by making it easier for products with non-originating inputs to qualify.
2. The roll-up or absorption principle allows initially non-originating materials that have acquired origin by meeting specific processing requirements to be considered originating when they are used as inputs in a subsequent transformation.
3. Cumulation allows producers of one PTA member to use materials from another PTA member (or other members) without losing the preferential status of the final product. Bilateral cumulation operates between the two PTA partners and allows them to use products that originate in the other PTA partner as if they were their own when seeking to qualify for the PTA-conferred preferential treatment in that partner. Under diagonal cumulation, countries tied by the same set of preferential origin rules can use products that originate in any part of the common RoO zone as if they originated in the exporting country. Full cumulation extends diagonal cumulation. It provides that countries tied by the same RoO regime can use goods produced in any part of the common RoO zone even if these were not originating products: any or all of the processing carried out in the zone is calculated as if it had taken place in the final country of manufacture.

Whereas *de minimis*, roll-up and cumulation allow for leniency in the application of RoO, there are three provisions that may have the opposite effect and effectively increase the stringency of RoO, these are:\(^{50}\)

1. A separate list indicating the operations which are considered insufficient to confer origin, such as preservation during transport and storage, as well as simple operations of cleaning, sorting, painting, packaging, assembling, and marking and labeling.
2. Prohibition on duty drawback — precluding the refunding of tariffs on non-originating inputs that are subsequently included in a final product that is exported to a PTA partner. Many developing countries employ drawback in order to attract investment and to encourage exports; however, drawback in the context of a PTA is viewed as providing a cost advantage to the PTA-based producers who gear their final goods to export over producers selling their final goods in the domestic market.\(^{51}\)

\(^{50}\) To be sure, non-members to a cumulation area may view the cumulation system as introducing another layer of discrimination by virtue of its providing incentives to the member countries to outsource from within the cumulation zone at the expense of extra-zone suppliers.

\(^{51}\) Cadot, de Melo and Olarreaga (2001) show that duty drawback may have a protectionist bias due to reducing the interest of producers to lobby against protection of intermediate products.
duty drawback entails an increase in the cost of non-originating components for PTA-based final goods producers. As such, the end of drawback in the presence of cumulation may encourage intra-PTA producers to shift to suppliers in the cumulation area (WTO, 2002).

3. A complex method of certifying the origin of goods can impose high administrative costs on exporters. The main certification methods are self-certification by exporters, certification by the exporting country government or an industry umbrella group to which the government has delegated the task of issuing the certificate, and a combination of the “private” self-certification and the “public” governmental certification. The more numerous the bureaucratic hurdles and the higher the costs for an exporter to obtain an origin certificate, the lower the incentives to seek PTA-conferring preferential treatment.

III. Effects of RoO: The latest empirical evidence

What, then, can the complex instrument of RoO do? The fact that RoO can be employed for distributive, political economy purposes does not automatically mean they divert resources from their most efficient uses. However, analysts of the potential trade effects of RoO have produced resounding evidence that RoO impose important administrative costs and increase production costs to parties applying them. Both types of costs introduce protectionist biases that undercut the unfettered flow of commerce. We consider each in turn.

A. Administrative costs

The administrative costs of RoO stem from the procedures required for ascertaining compliance with the requirements of the RoO regime. These are essentially book-keeping costs—first and foremost the costs for the exporter of certifying the origin of a good prior to its export to the territory of another PTA member—and the costs to the partner country customs of verifying the origin of goods. The different certification mechanisms impose divergent costs on firms; moreover, while in some countries certification is free of charge, in many the costs are hardly trivial. In Brazil, for instance, the cost of obtaining certification for a single shipment from a certifying agency is estimated to range between 6 and $20; in Chile, the cost is $7. Koskinen (1983) estimates the administrative costs for Finnish exporters under the European Community-European Free Trade Association (EFTA) FTA at 1.4 to 5.7 per cent of the value of export transactions. Holmes and Shephard (1983) find the average export transaction from EFTA to the EC requires 35 documents and 360 copies. Administrative costs are important even in regimes operating on self-certification: in a recent study, Cadot et al. (2002) disentangle NAFTA’s non-RoO and RoO-related administrative costs, finding the latter to approximate two per cent of the value of Mexican exports to the US market. The verification costs of RoO to member governments have yet to receive empirical scrutiny; however, such costs could be expected to rise particularly for countries party to several complex and divergent RoO regimes.

52 In another pioneering study, Herin (1986) puts the cost of obtaining the appropriate documentation to meet the RoO at three to five per cent of the FOB value of the good in the context of EFTA.
53 Quoted in Herin (1986).
B. Production costs

The production costs of RoO arise from the various technical criteria imposed by the RoO regime. They start playing a role in trade flows when they encourage the use of intra-PTA inputs at the expense of extra-PTA ones even if the latter were cheaper—that is, when they increase the costs of intermediate goods for final goods producers from the pre-PTA levels. Should this occur, RoO could be expected: (1) to result in trade diversion in intermediates to the PTA area; and (2) to moderate the potential for a PTA to boost aggregate trade between the members due to raising the costs for final goods producers.

The pioneering empirical evidence supports these hypotheses. Estevadeordal and Suominen (2005b) and Suominen (2004) employ a 155-country gravity model spanning 21 years, and reached four conclusions. First, regimes with restrictive RoO and regimes with high degrees of sectoral selectivity discourage aggregate trade flows both around the world and among PTA partners. Second, restrictive RoO in final goods in the five examined sectors—chemicals, machinery, textiles, TV and radio transmitters, and vehicles—encourage trade in intermediate goods between the PTA partners. This implies that RoO can engender trade diversion in inputs to the PTA area from the rest of the world (ROW). Third, regime-wide RoO that allow for flexibility in the application of the product-specific RoO—such as cumulation, drawback, and self-certification—facilitate aggregate trade flows. As such, various regime-wise RoO provisions can counteract restrictive product-specific RoO’s negative effects on trade, and thus help PTAs to live up to their promise of increased trade flows. Fourth, RoO are complex technical and complex instruments and require learning and adjustment. The ability of exporters to comply with stringent product-specific RoO and to take greater advantage of permissive regime-wide RoO improves over time.

Other, single-regime studies have reached similar results. Cadot et al. (2002), focusing on NAFTA, show that stringent RoO have undermined Mexico’s aggregate exports to the United States.54 Appiah (1999), also examining NAFTA but in a three-country, multi-sector Computable General Equilibrium (CGE) model, finds that RoO distort trade flows, diverting resources from their most efficient uses and undercutting global welfare. Augier, Gasiorek and Lai-Tong (2003) examined two different types of PTAs—one with RoO only and the other where the RoO regime permits diagonal cumulation—and found preliminary evidence that when there was no cumulation between countries, trade was up to 52 per cent lower than expected level of total trade. The impact was particularly notable in trade in intermediate goods.

IV. Policy implications of RoO’s effects

The findings on the effects of RoO have five immediate policy implications. First, RoO can reduce the utilization rates of the PTA- or GSP-provided preferences. Estevadeordal and Miller (2002) documented “missed preferences”—i.e., utilization rates below 100 per cent—between the United States and Canada, which they attributed to the tightening of the pre-FTA RoO under NAFTA launched in 1994. Cadot et al. (2002) linked the 64 per cent utilization rate of NAFTA preferences to stringent RoO. Indeed, already in the context of the NAFTA predecessor, the US-Canada FTA, Canadian producers were reported to have opted to pay the tariff rather than going through the administrative hurdles to meet the RoO (Krueger 1995). In

54 In January 1995, the US found a high compliance rate among the Mexican and Canadian exporters and producers on RoOs, or at 90 and 80 per cent, respectively (Reyna 1995: 37-38). In NAFTA, the United States played a key role in establishing the agreement’s Uniform Regulations and RoO enforcement mechanisms.
recent studies, Brenton (2004) and Inama (2004) show that GSP RoO do play an important role in arbitrating the odds for developing countries to qualify for GSP treatment.

Second, from a legal standpoint, preferential RoO may breach Article XXIV of the General Agreements on Tariffs and Trade (GATT), which in paragraph 8(b) defines a free trade area as “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.” Indeed, the WTO has recently recognized RoO to be part of “other regulations of commerce” (ORCs); ambiguities remain as to the meaning of “substantially all the trade”. Since RoO have implications on the access of extra-PTA parties to the PTA market, they also risk violating paragraph 5 of Article XXIV, which prohibits PTAs from raising barriers toward the rest of the world from pre-PTA levels. The WTO Negotiation Group on Rules is in effect advocating a case-by-case analysis of the potentially restrictive effects of preferential RoO on extra-PTA parties (WTO 2002b).

Third, besides the short-run trade effects, RoO may in the longer run cause investment diversion. This occurs when extra-PTA final goods producers “jump” the RoO by locating plants within a PTA region in order to satisfy the RoO even if the PTA region was not the most optimal location for investment. RoO can also produce investment diversion within the PTA area.

This raises the question: should final goods producers be hard-pressed to locate appropriate components in the PTA area and remain competitive, they may simply choose to locate to the territory of the largest PTA market and the one with the lowest external tariffs—such as the United States in the context of NAFTA—and continue importing third-country inputs required for the final product.

A second point is that producers located in the PTA member with the lowest production costs can be placed at a disadvantage when the RoO are based on RVC, which is easier to meet in PTA members with higher production costs. As such, RoO may encourage investment to a large hub country that may well be an inefficient producer, and perpetuate the hub given the agglomeration effects of foreign direct investment. Rodriguez (2001) shows formally that RoO can lead to distortions in production structures within the PTA area. To be sure, RoO-induced investment can also help counteract RoO’s effects: should extra-PTA input producers locate to the PTA area to take advantage of higher rents, they could crowd the market, increase supply, and thus drive the price of inputs down. Estevadeordal, López-Córdova and Suominen (2004) strive to empirically capture RoO’s investment effects, finding preliminary evidence that flexible RoO may indeed be conducive to FDI.

Fourth, besides restrictiveness of RoO, diversity among the great many RoO regimes populating the global trading system can place an additional brake on trade—and particularly so for small, less developed countries that are spokes to many different RoO systems. For such countries, the full benefits of their PTAs will materialize only when they both: (1) have customs that are well-equipped to verify the different RoO governing all of the RoO regimes;
and (2) tailor their production structures differently for each PTA market—which, however, can be highly problematic for small producers in small countries with narrow domestic outsourcing base.

Fifth, the relevance of RoO per se and their importance as a constraint on global commerce and investment thereby decreases with the lowering of MFN tariff barriers by PTA members. With the production and administrative costs imposed by RoO rising to unsustainably high levels, final goods producers would rather import their inputs from the ROW and sell their output at their home market than produce to the PTA partner’s market at high input costs. However, the higher a PTA member’s MFN tariff, the greater the preferential margin offered to its PTA (or GSP) partners, and thus the greater the willingness of firms in the partner countries to comply with the RoO, including to shift to intra-PTA inputs and furnish the certifying documentation—and for firms in non-PTA countries to engage in RoO-jumping foreign direct investment. Some analysts have suggested that the current overlapping of PTAs and RoO regimes should be accompanied by the principle of open regionalism, and/or replaced by customs unions or a hybrid arrangement between CU and FTA altogether, lest the benefits of preferential trade liberalization be lost.58

V. Rules of origin around the world

This section examines the wide variety of combinations of product-specific and regime-wide RoO used in selected PTAs in Europe, the Americas, the Asia-Pacific region, Africa, and the Middle East, as well as PTAs between these regions and continents. We subsequently discuss the structure of non-preferential RoO. Appendix I provides a detailed comparative mapping of the different RoO regimes.

A. Comparing the structure of RoO regimes in five regions

i. Expansion of the PANEURO system in Europe

In contrast to RoO regimes in Asia and, in particular, the Americas, RoO regimes employed across the EU’s FTAs are highly consistent with one another. This is largely due to the European Commission’s recent drive to harmonize the EU’s existing and future preferential RoO regimes. Harmonization efforts have extended to the EU’s RoO protocols dating back to 1972-1973 with the European Free Trade Association (EFTA) countries, as well as across the EU’s FTAs forged in the early 1990s in the context of the Europe Agreements with Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, and Romania.59 The work culminated in 1997 in the launch of the Pan-European (PANEURO) system, which established identical RoO protocols and product-specific RoO across the EU’s existing FTAs, thereby providing for diagonal cumulation among the participating countries.60 Overall, the PANEURO RoO are highly complex, combining CTC mainly at the heading level with exceptions, VC, and TECH, and varying markedly across products.

Since 1997, the PANEURO model has become incorporated in the EU’s newer FTAs, including the Euro-Mediterranean Association Agreements, the Stabilization and Association Agreements with Croatia and the Former Yugoslav Republic of Macedonia, the EU-Slovenia

58 See Bergsten (1997); Wonnacott (1996).
59 See Driessen and Graafsma (1999) for review.
60 The Commission’s regulation 46 of January 1999 reiterates the harmonized protocols, outlining the so-call single list RoO.
FTA, as well as the extra-regional FTAs with South Africa, Mexico, and Chile. Importantly, the EU’s eastward enlargement on 1 May 2004 terminated the FTAs forged among the ten new member states and also between them and the EU. When these new EU member countries became incorporated in the EU customs union, they began to apply the EU’s CET, with their overall external tariffs dropping from nine to four per cent, and also assumed the rights and obligations of the FTAs the EU had in place with non-member countries.

The RoO of the EU’s generalized system of preferences (GSP) and the 2000 Cotonou Agreement with the African Caribbean, and Pacific (ACP) developing countries are similar to the PANEURO model. EFTA’s recently concluded FTAs with Mexico and Singapore also follow the PANEURO model; however, the EFTA-Singapore RoO provide in many sectors—such as plastics, rubber, textiles, iron and steel products, and some machinery products—an alternative, 50 per cent VC RoO that either does not exist for a given product in the PANEURO model, or is in the PANEURO system set at lower and thus more demanding levels.

ii. The four RoO families in the Americas

There is much more variation across RoO regimes in the Americas. Nevertheless, distinct RoO families can be identified (Garay and Cornejo 2002). At one end of the scale, there are traditional trade agreements such as the Latin American Integration Agreement (LAIA), which, like the older Asian FTAs, use a general rule applicable across the board for all tariff items (change of heading level or, alternatively, RVC of 50 per cent). The LAIA model is the point of reference for RoO of the Andean Community (ANCOM) and Caribbean Community (CARICOM). At the other end of the scale are the so-called new generation PTAs such as NAFTA, which are used as a reference point for the recently signed US-Central America FTA (CAFTA), as well as for the US-Chile, Mexico-Costa Rica, Mexico-Chile, Mexico-Bolivia, Mexico-Nicaragua, Mexico-Northern Triangle (El Salvador, Guatemala, and Honduras), Chile-Canada, and Mexico-Colombia-Venezuela (or G-3) FTAs. The RoO regimes in these agreements may require a change of chapters, headings, subheadings or items, depending on the product in question. In addition, many products combine the change of tariff classification with an exception, regional value content (RVC), or other technical requirements. The NAFTA model, particularly the versions employed in the US-Chile FTA and CAFTA, is also widely viewed as the likeliest blueprint for the RoO of the Free Trade Area of the Americas (FTAA).

Mercosur RoO, as well as RoO in the Mercosur-Bolivia and Mercosur-Chile FTAs, fall between the LAIA-NAFTA ‘extremes’. They are mainly based on change of heading and different combinations of RVC and technical requirements. The Central American Common Market’s (CACM) RoO regime is placed between the two Mercosur and NAFTA models: it mainly uses changes in tariff classification only, but in more precise and diverse ways than Mercosur because of the changes that can take place at the chapter, heading, or subheading

---

61 Overall, however, the harmonized RoO do not represent a dramatic break with those which existed in the period before 1997. For example, the RoO in nearly 75 per cent of the products (in terms of tariff subheadings) in PANEURO and the original EU-Poland RoO protocol published in 1993 are identical. Both the new and the old versions combine CTC with VC and/or TECH. Indeed, EU RoO feature remarkable continuity: the RoO of the European Community-Cyprus FTA formed in 1973 are strikingly similar to those used today. One notable difference between the older and newer protocols is that the latter allow for an optional way of meeting the RoO for about 25 per cent of the products, whereas the former mainly only considers one way of meeting the RoO. The second option, alternative RoO, which is similar to the first option RoO, combine different RoO criteria; however, the most frequently used alternative RoO is a stand-alone import content criterion.
levels, depending on the product in question. In some products, CACM introduces exceptions; a handful of products are also governed by RVC or technical requirements.

Notably, unlike the EU’s extra-European FTAs that follow the PANEURO system, US bilateral FTAs with extra-Hemispheric partners — Jordan and Israel — diverge markedly from the NAFTA model, operating on VC alone. However, the RoO of the US-Singapore FTA are again more complex, resembling the NAFTA RoO. Similarly, the RoO of the recently forged Chile-South Korea FTA also feature a high degree of sectoral selectivity in the same manner as NAFTA, and, indeed, resembles the US-Chile FTA RoO. Nonetheless, the RoO of the Chile-Korea regime are overall less complex than either NAFTA or US-Chile RoO, and also more reliant on the change in heading criterion than NAFTA, which has an important change in chapter-component, and the US-Chile FTA, which features an important change in subheading-component.

iii. Toward sectoral selectivity in Africa, Asia, Middle East?

The relative complexity of RoO in Europe and the Americas stands in contrast to the generality of RoO in many Asian, African, and Middle Eastern PTAs. Some of the main integration schemes in these regions — the ASEAN Free Trade Area (AFTA), Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA), Singapore-Australia Free Trade Agreement (SAFTA), and South Pacific Regional Trade and Economic Cooperation (SPARTECA) in the Asia-Pacific; the Economic Community of West African States (ECOWAS), Common Market for Eastern and Southern Africa (COMESA), and Namibia-Zimbabwe FTA in Africa; and the Gulf Cooperation Council (GCC) in the Middle East — are based on an across-the-board VC rule that, when defined as RVC, ranges from 25 per cent (in the case of the Namibia-Zimbabwe FTA) to 50 per cent for ANZCERTA. Some of the agreements allow, or, indeed, require, RoO to be calculated on the basis of import content. Most of these regimes also specify an alternative RoO based on the CTC criterion; most often the alternative involves a change in heading or, in the case of ECOWAS that has a relatively low RVC requirement of 30 per cent, a change in subheading.

Recent RoO regimes in both Africa and Asia-Pacific have RoO with high degrees of sectoral selectivity. The Southern African Development Community (SADC) RoO is similar to the PANEURO model both in the types of sectoral RoO and in the degree of selectivity. In Asia, the RoO of the Japan-Singapore Economic Partnership Agreement (JSEPA) are also complex, as demonstrated by the more than 200-page RoO protocol. However, much like in the Chile-Korea FTA, nearly half of JSEPA RoO are based on a simple change in heading-criterion, which makes the regime much less complex when compared with the PANEURO and NAFTA models. Furthermore, JSEPA introduces an alternative, usually PANEURO-type, free-standing VC rule for many products and thereby instills generality and flexibility to the agreement.

The intercontinental RoO regimes of the US-Singapore and Chile-Korea FTAs have created an additional layer of complexity with Asia-Pacific RoO; this is because these agreements tend to follow the NAFTA model but are less complex and feature a strong change of heading component. The future Mexico-Singapore, Canada-Singapore, Mexico-Korea, Mexico-Japan, and US-Australia FTAs, among others, will likely compound this trend. Meanwhile, further European overtures to the Asian front will likely bring the PANEURO model to accompany the NAFTA model in the region. The EFTA-Singapore FTA attests to that; however, importantly and much like in JSEPA, the standard PANEURO package in the FTA is accompanied by the flexible, alternative import content RoO. Further intra-regional FTAs in
V: Rules of Origin

the Asia-Pacific—such as between Japan and Korea, Japan and the Philippines, Korea and Singapore, and between ASEAN on the one hand, and China, Japan, and/or Korea, on the other — will allow to determine whether a genuinely Asian RoO model is emerging. Judging by JSEPA, the model may carry notable sectoral selectivity, but will most probably be simpler and more general than either the EU or the NAFTA RoO regime. The future FTA between India and Singapore could bring further novel features to Asian RoO.

B. Non-preferential RoO

Non-preferential RoO are used for purposes distinct from those of preferential rules. Even if a country does not use preferential RoO, it would still apply to some types of non-preferential RoO. Unlike preferential RoO which have thus far escaped multilateral regulation, non-preferential RoO have been undergoing a process of harmonization since 1995 in line with the mandate provided by the Uruguay Round’s Agreement on Rules of Origin (ARO). The harmonization work, launched following growing concerns about the effects divergent national RoO’s on unfettered trade flows, has been carried out under the auspices of the Committee on Rules of Origin (CRO) of the World Trade Organization (WTO) and the Technical Committee on Rules of Origin (TCRO) of the Brussels-based World Customs Organization. The latter has been responsible for the technical part of the work, including discussions on the RoO options for each product.

The harmonization drive was initially scheduled for completion by July 1998. However, the deadline has been extended several times since then. The Technical Committee’s work was concluded in 1999, with about 500 pending issues that could not be solved at the technical level being sent to the CRO in Geneva. As of July 2003, a solution to 94 core policy issues had not been found at the WTO; these affect an estimated fifth of the tariff subheadings of the entire tariff universe. The General Council at the time extended the deadline for completion of the issues to July 2004, and agreed that following resolution of these core policy issues, the CRO would complete its remaining work by the end of 2004. As they are currently structured, non-preferential RoO are similar to the PANEURO and NAFTA models in sectoral specificity, yet are less demanding than either of these two main RoO regimes. However, as several issues are still being contested at the WTO, the final degree of complexity and restrictiveness of the non-preferential RoO remains to be gauged. What is already clear, however, is that the definition of the non-preferential RoO is driven by similar political economy considerations such as the crafting of preferential RoO; indeed, the harmonization work can, in part, be considered endogenous to the RoO regimes that already exist in the numerous PTAs around the world.

VI. Conclusion: policy recommendations

While RoO are not necessarily bad for sound economic decisions, demanding and inflexible RoO can be. Furthermore, the existing differences in the product-specific and regime-wide RoO across the different RoO regimes can even in a simplified bi- or tripolar RoO world make a difference in economic decisions and limit the opportunities for exporters to expand into new markets.

How can the potential frictions created by stringent RoO and cross-regime differences in RoO be reduced? How can entrepreneurs import inputs from the cheapest sources, firms exploit cross-border economies of scale at lowest costs, and multinational companies make sweeping investment decisions based on economic efficiency rather than distortionary policies? What
are the best ways to counter the development of trade- and investment diverting hubs in favour of globally free flow of goods, services, and investment?

Abolishing RoO altogether represents the best and simplest means to counteract the impact of RoO. Another way to relegate RoO to irrelevance is by bringing MFN tariffs to zero globally. However, since these options are hardly politically palatable in the near future, a third possibility is to harmonize preferential RoO at the global level. This, at least, has the merit that required production methods in a given sector would remain similar across export markets. Measures to accompany the harmonization work could involve: (1) the incorporation of the various mechanisms of flexibility to RoO regimes during the transition to a global RoO regime; and (2) the establishment of a multilateral mechanism to monitor the implementation by member states’ of preferential and non-preferential RoO in order to pre-empt politicization of, and/or a lack of transparency in, the application of RoO, particularly in the importing countries customs.

What are the prospects for harmonization of preferential RoO? To be sure, it is not a simple task given the differences in the types of RoO around the world. Even slight differences can be difficult to overcome because of the political resistance by sectors benefiting from the status quo. It is likewise not clear whether a strong global exporter lobby would materialize to voice demands for harmonization. Perhaps most importantly, both the EU and the US are, in principle, reluctant to adopt each other’s RoO. Both parties are concerned about the prospect of their counterpart striving for a RoO regime which would allow it to transship via the parties’ common PTA partners, such as Mexico, to the other party’s market. However, adopting a globally uniform preferential RoO regime is not necessarily all that daunting. There are three reasons for optimism.

First, WTO members have already been able to sit down and compromise on harmonized non-preferential RoO; this not only evinces a reservoir of political will to tackle RoO, but also provides an immediately available blueprint for harmonizing preferential RoO. And not only are non-preferential RoO negotiated and readily available as a model, but they make a good model: overall, they are less restrictive and complex than either the NAFTA- or PANEURO-type RoO.

Second, preferential RoO would likely prove easier to negotiate than non-preferential RoO. Non-preferential RoO involve tracking the production process all the way to the country in which the goods originate, while preferential RoO simply require that the final exporter country is also the country of origin: the goods either originate — or not — in the PTA area, with the “true” and very initial origin being immaterial. As such, non-preferential RoO talks likely engage a greater number of interested parties to contest a given rule than would be the case in preferential RoO.

Third, the WTO’s growing attention on PTAs in general and preferential RoO in particular, should generate constructive proposals as to the types of RoO that are most conducive to the unfettered global flow of commerce. The concomitant growing interest by policy analysts and academia in RoO only adds to our understanding of the operation and effects of the different types of RoO and RoO regimes.

62 See Suominen (2004a) and Estevadeordal and Suominen (2004c) for details.
63 See Suominen (2004a) for details on the prospects of concluding the harmonization of non-preferential RoO.
Harmonization of preferential RoO and efforts to formulate a flexible regime model currently provides the most attainable means to counteract RoO’s potential negative effects on global trade and investment. Doha Trade Round negotiators should decisively tackle RoO as a distortionary trade and investment policy instrument by:

- Providing a forceful push for the completion of the task of harmonizing non-preferential RoO. Completing the harmonization process is all the more compelling in the face of the growth of global commerce and the increased fragmentation of global production, both of which would thrive under a clear and uniform set of rules.
- Launching a process of de jure harmonization of preferential rules of origin. The relatively demanding RoO of the main RoO regimes and the differences between regimes place unnecessary policy hurdles to rational economic decisions, thereby limiting the opportunities for exporters to operate on multiple trade fronts simultaneously, as well as hampering consumers’ access to the best goods at the lowest prices.
- Constructing a multilateral mechanism to monitor and enforce the transparent application of both preferential and non-preferential RoO.

To be sure, preferential RoO matter only as long as there are MFN tariffs. Thus, the ultimate key to counteracting the negative effects of preferential RoO’s lies in the success of multilateral liberalization. If multilateral trade rounds result in a substantial decrease in MFN tariffs and the proliferation of PTAs help to engender competitive liberalization worldwide, there would be no further need for preferential RoO as "gatekeepers" of global commerce.
APPENDIX I

Depicting RoO around the World

A. Product-specific RoO

Figure 1 focuses on the first RoO component, the CTC criterion, in the RoO regimes of 28 PTAs around the world. These are three of EU’s PTAs (PANEURO — where the RoO are basically fully identical to those of the EU-South Africa FTA — and the EU-Mexico and EU-Chile FTAs); EFTA-Mexico FTA where RoO approximate the EU-Mexico RoO model; seven FTAs drawing on the NAFTA RoO model that is gaining prominence in the Western Hemisphere (NAFTA, US-Chile, US-Central America, Group of Three, and Mexico-Costa Rica, Mexico-Bolivia, and Canada-Chile FTAs); CACM-Chile FTA; Mercosur-Chile and Mercosur-Bolivia FTAs; LAIA; seven PTAs in Asia-Pacific (ANZCERTA, SAFTA, SPARTECA, AFTA, Bangkok Agreement, JSEPA, and Chile-Korea FTA); four PTAs in Africa (ECOWAS, COMESA, Namibia-Zimbabwe FTA, and SADC); the Gulf Cooperation Council in the Middle East; and US extra-hemispheric FTAs with Jordan and Israel. The two final sets of bars depict two potential outcomes of the harmonization process of the non-preferential RoO (as set to their “lowest” and “highest” levels of stringency, which will be discussed in the next section).64

Figure 1
Distribution of CTC Criteria by Agreement

The change of heading-criterion dominates EU RoO, whereas RoO modeled along the lines of the NAFTA RoO regime are based on the change of heading and change of chapter criteria at relatively even quantities. The US-Chile FTA and CAFTA stand somewhat apart from the NAFTA format as they only requiring change in the subheading of a substantial number of tariff lines. Meanwhile, the Chile-CACM FTA diverges from the NAFTA model due to its marked change in heading-component, as do the Japan-Singapore and Chile-Korea FTAs. The other Asian PTAs which are considered also stand out as they use an across-the-board VC preferential requirement exclusively. With the exception of the SADC, African RoO regimes are also characterized by a general, across-the-board CTC RoO, as are LAIA and Mercosur’s

64 The figure is based on the first RoO only when two or more possible RoO are provided for a tariff subheading.
FTAs with Chile and Bolivia that employ the change of heading-criteria across the RoO universe. In contrast to the PANEURO and NAFTA models, non-preferential RoO feature also a prominent change of subheading-component.

Another notable difference between the various PTAs is that some, such as ANZCERTA, employ the VC criterion across sectors, completely foregoing the use of the CTC-criterion. The EU does this in about a quarter of its RoO; the bulk (more than 80 per cent) of them are based on the wholly-obtained criterion used particularly in agricultural products, or on the import content-rule that imposes a ceiling of 40-50 per cent to non-originating components of the ex-works price of the final product. The stand-alone import content RoO are used particularly frequently for optics, transportation equipment, and machinery and electrical equipment. Another idiosyncrasy of the EU RoO, but not included in the figure, is the use of the so-called “soft RoO” in more than a quarter of the RoO requiring a change of heading and about a sixth of the RoO requiring a change of chapter. Soft RoO allows the use of inputs from the same heading (or chapter) up to a certain share of the price of the final product even when the RoO requires a change of heading (or change of chapter). The share is generally between five and 20 per cent.

Table 1 presents on the tariff subheadings governed by VC (including combinations of VC with CTC, and VC when employed as an alternative to a CTC criterion) in various RoO regimes, and, in particular, on the level of the VC criterion. The VC level usually stands at between 40-50 per cent, whether defined as MC or RVC. However, in the US-Chile FTA, CAFTA, and Chile-CACM FTA, RVC is generally set at the lower levels of 30-35 per cent; conversely, for some products in the PANEURO and SADC regimes, the permitted value of non-originating inputs of the price of the final product is as low as 15-30 per cent. Table 1 also displays the various bases for calculation of the VC. Differences in the method of calculation can have crucial implications to the exporters’ capacity to meet the RoO. The PE model that is separated here for analytical purposes essentially involves the same product-specific RoO as PANEURO, while diverging somewhat from the PANEURO in the regime-wide RoO. It also applies to a handful of European FTAs, particularly those arranged by the EU and East European countries with Israel (WTO 2002a).

Capturing the full scale of variation in the RoO regimes requires a look at the various combinations of RoO components. Table 2 displays the RoO combinations in selected FTAs around the world. It considers the entire tariff universe in each RoO regime, and shows the percentage shares of all possible RoO types and combinations thereof in each regime. Particularly notable is the high degree of selectivity of PANEURO, NAFTA, and non-preferential RoO.
## Table 1
VC Criteria by Agreement

<table>
<thead>
<tr>
<th>PTA</th>
<th>Value Content Criterion (%)</th>
<th>Basis for Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>MC</td>
<td>RVC</td>
</tr>
<tr>
<td>PANEURO</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>PE</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>EU-South Africa</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>EU-Mexico</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>EU-Chile</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>EFTA-Mexico</td>
<td>50-30</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>NAFTA</td>
<td>50-60</td>
<td>50 net cost; 60 transaction value</td>
</tr>
<tr>
<td>US-Chile</td>
<td>35-45</td>
<td>35 build-up; 45 build-down</td>
</tr>
<tr>
<td>CAFTA</td>
<td>35-45</td>
<td>35 build-up; 45 build-down</td>
</tr>
<tr>
<td>Mexico-Chile</td>
<td>50-60</td>
<td>50 net cost; 60 transaction value</td>
</tr>
<tr>
<td>G-3</td>
<td>50-55&quot;</td>
<td>Transaction value</td>
</tr>
<tr>
<td>Mexico-Costa Rica</td>
<td>41.66-50</td>
<td>41.66 net cost; 50 transaction value</td>
</tr>
<tr>
<td>Mexico-Bolivia</td>
<td>41.66-50</td>
<td>41.66 net cost; 50 transaction value</td>
</tr>
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<td>Mexico-Chile</td>
<td>40-50</td>
<td>40 net cost; 50 transaction value</td>
</tr>
<tr>
<td>CACM-Chile</td>
<td>N/A</td>
<td>Transaction value</td>
</tr>
<tr>
<td>Mercosur</td>
<td>40</td>
<td>Fob export value</td>
</tr>
<tr>
<td>Mercosur-Chile</td>
<td>40</td>
<td>Fob export value</td>
</tr>
<tr>
<td>Mercosur-Bolivia</td>
<td>40</td>
<td>Fob export value</td>
</tr>
<tr>
<td>Andean Community</td>
<td>50-&quot;</td>
<td>Fob export value</td>
</tr>
<tr>
<td>Caricom-Dom. Rep.</td>
<td>N/A</td>
<td>Transaction value</td>
</tr>
<tr>
<td>LAIA</td>
<td>50</td>
<td>Fob export value</td>
</tr>
<tr>
<td>ANZCERTA</td>
<td>50</td>
<td>Factory cost&quot;</td>
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<td>SAFTA</td>
<td>30-50</td>
<td>Factory cost</td>
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<td>Factory cost</td>
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<tr>
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<td>Value of content</td>
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<tr>
<td>Bangkok Agreement</td>
<td>40</td>
<td>Ex-works&quot;</td>
</tr>
<tr>
<td>Japan-Singapore</td>
<td>40</td>
<td>60 Export value</td>
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<td>Chile-Korea</td>
<td>30-45</td>
<td>30 build-up; 45 build-down</td>
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<tr>
<td>COMESA</td>
<td>60</td>
<td>35 60 value of materials; 35 ex-factory cost&quot;</td>
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<td>ECOWAS</td>
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<td>Namibia-Zimbabwe</td>
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<td>Ex-works price</td>
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<td>Gulf Coop. Council</td>
<td>40-&quot;</td>
<td>Ex-works price</td>
</tr>
<tr>
<td>US-Jordan</td>
<td>35</td>
<td>Value of materials/processes&quot;</td>
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<tr>
<td>US-Israel</td>
<td>35</td>
<td>Value of materials/processes</td>
</tr>
<tr>
<td>Mexico-Israel</td>
<td>35-45</td>
<td>35 net cost; 45 transaction value</td>
</tr>
<tr>
<td>Non-preferential RoO</td>
<td>60-40</td>
<td>Ex-works price</td>
</tr>
</tbody>
</table>

Sources: Estevadeordal and Suominen (2005); Suominen (2004).
Ex-works price means the price paid for the product ex works to the manufacturer in the Member States in whose undertaking the last working or processing is carried out, provided the price includes the value of all the materials (the customs value at the time of importation of the non-originating materials used, or the first ascertainable price paid for the materials in the member state concerned) used, minus any internal taxes which are, or may be, repaid when the product obtained is exported.

The transaction method is:
\[
RVC = \left( TV - \frac{VNM}{TV} \right) \times 100,
\]
where
- \( RVC \) is the regional value content, expressed as a percentage;
- \( TV \) is the transaction value of the good adjusted to a FOB basis; and
- \( VNM \) is the value of non-originating materials used by the producer in the production of the good.

The net cost method is
\[
RVC = \left( \frac{NC - VNM}{NC} \right) \times 100,
\]
where
- \( RVC \) is the regional value content, expressed as a percentage;
- \( NC \) is the net cost of the good; and
- \( VNM \) is the value of non-originating materials used by the producer in the production of the good.

The build-down method is
\[
RVC = \left( \frac{AV - VNM}{AV} \right) \times 100,
\]
and the build-up method is:
\[
RVC = \left( \frac{VOM}{AV} \right) \times 100,
\]
where
- \( RVC \) is the regional value content, expressed as a percentage;
- \( AV \) is the adjusted value;
- \( VNM \) is the value of non-originating materials used by the producer in the production of the good; and
- \( VOM \) is the value of originating materials used by the producer in the production of the good.

The initial VC for chs. 28-40 is 40 per cent for the first three years, 45 per cent during the fourth and fifth years, and 50 per cent starting in year six. For chs. 72-85 and 90, VC is 50 per cent for the first five years, and 55 per cent starting year six.

The MERCOSUR RoO is 60 per cent RVC, and, additionally, change in tariff heading (Garay and Cornejo 2002). When it cannot be determined that a change in heading has taken place, the CIF value of the non-originating components cannot exceed 40 per cent of the FOB value of the final good. Special RoO apply to selected sensitive sectors, including chemical, some information technology, and certain metal products.

The requirement is that the CIF value of the non-originating materials does not exceed 40 percent of the FOB export value of the final good.

A 50 percent MC rule applies to Colombia, Peru and Venezuela; products from Bolivia and Ecuador are governed by a 60 per cent MC rule.

The value added test is based on the formula:
\[
\text{Qualifying Expenditure (Q/E)} / \text{Factory Cost (F/C)},
\]
where
- \( Q/E \) = Qualifying expenditure on materials + qualifying labour and overheads (includes inner containers); and
- \( F/C \) = Total expenditure on materials + qualifying labour and overheads (includes inner containers).

The agreement requires the value added ensuing from their production in member states be not less than 40 per cent of their final value “at the termination of the production phase”. In addition, the share owned by the citizens of the member states of the producing plant cannot be less than 51 per cent.

The MC criterion is calculated from CIF and FOB as follows:
\[
NOM = \frac{MCIF}{FOB} \times 100,
\]
where \( NOM \) is the value content of non-originating materials, \( MCIF \) is the CIF value on non-originating materials, and \( FOB \) is the free on board value payable by the buyer to the seller.
xi The origin protocol requires that either the CIF value of non-originating materials does not exceed 60 per cent of the total cost of the materials used in the production of the goods; or that the value added (the difference between the ex-factory cost of the finished product and the CIF value of the materials imported from outside the member states and used in the production) resulting from the process of production accounts for at least 35 per cent of the ex-factory cost (the value of the total inputs required to produce a given product) of the goods.

xii Besides the 40 per cent RVC rule, the share of member states’ citizens of the plant that produced the product must be at least 51 per cent.

xiii The RVC is calculated as the sum of: (i) the cost or value of the materials produced in the exporting Party, plus (ii) the direct costs of processing operations performed in the exporting party. It cannot be less than 35 per cent of the appraised value of the article at the time it is entered into the other party.

The cost or value of materials produced in a party includes: (i) the manufacturer’s actual cost for the materials, (ii) when not included in the manufacturer’s actual cost for the materials, the freight, insurance, packing, and all other costs incurred in transporting the materials to the manufacturer’s plant, (iii) the actual cost of waste or spoilage (material list), less the value of recoverable scrap, and (iv) taxes and/or duties imposed on the materials by a party, provided they are not remitted upon exportation. When a material is provided to the manufacturer without charge, or at less than fair market value, its cost or value shall be determined by computing the sum of: (i) all expenses incurred in the growth, production, or manufacture of the material, including general expenses, (ii) an amount for profit, and (iii) freight, insurance, packing, and all other costs incurred in transporting the material to the manufacturer’s plant.

Direct costs of processing operations mean those costs either directly incurred in, or which can be reasonably allocated to, the growth, production, manufacture, or assembly, of the specific article under consideration. Such costs include, for example, (i) all actual labor costs involved in the growth, production, manufacture, or assembly, of the specific article, including fringe benefits, on-the-job training, and the cost of engineering, supervisory, quality control, and similar personnel, (ii) dies, molds, tooling and depreciation on machinery and equipment which are allocable to the specific article, (iii) research, development, design, engineering, and blueprint costs insofar as they are allocable to the specific article; and (iv) costs of inspecting and testing the specific article.
### Table 2: Distribution of RoO Combinations, Selected PTAs (1st RoO only)

| Requirement | AUS | BRA | CAN | CHN | COL | CRI | CUB | ECU | ESP | FRA | GBR | GER | HON | IND | ITA | JPN | KOR | LUX | MEX | MUS | NLD | NPL | NZL | PSE | PLA | POR | PRY | QAT | RSA | SGP | SVN | SVK | SWA | TUN | UAE | URY | VCT | VNM | WLR | ZMB | BRA | CAN | CHN | COL | CRI | CUB | ECU | ESP | FRA | GBR | GER | HON | IND | ITA | JPN | KOR | LUX | MEX | MUS | NLD | NPL | NZL | PSE | PLA | POR | PRY | QAT | RSA | SGP | SVN | SVK | SWA | TUN | UAE | URY | VCT | VNM | WLR | ZMB |
|-------------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| NC          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| CI          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| CS          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| CH          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| CC          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| ECTC        | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| VC          | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |
| TECH        | 0.00 | 0.01 | 0.02 | 0.03 | 0.04 | 0.05 | 0.06 | 0.07 | 0.08 | 0.09 | 0.10 | 0.11 | 0.12 | 0.13 | 0.14 | 0.15 | 0.16 | 0.17 | 0.18 | 0.19 | 0.20 | 0.21 | 0.22 | 0.23 | 0.24 | 0.25 | 0.26 | 0.27 | 0.28 | 0.29 | 0.30 | 0.31 | 0.32 | 0.33 | 0.34 | 0.35 | 0.36 | 0.37 | 0.38 | 0.39 | 0.40 | 0.41 | 0.42 | 0.43 | 0.44 | 0.45 | 0.46 | 0.47 | 0.48 |

### Notes
- **NC** = No change in tariff classification required
- **CI** = Change in tariff item
- **CS** = Change in tariff subheading
- **CH** = Change in tariff heading
- **CC** = Change in tariff chapter
- **ECTC** = Exception to change in tariff classification
- **VC** = Value content
- **TECH** = Technical requirement

Calculations at six-digit level of the Harmonized System.

### Table 3
Regime-Wide RoO in Selected PTAs

<table>
<thead>
<tr>
<th>PTA</th>
<th>De minimis (percentage)</th>
<th>Roll-Up</th>
<th>Cumulation</th>
<th>Drawback Allowed?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Bilateral</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Diagonal</td>
<td></td>
</tr>
<tr>
<td>PANEURO (50)</td>
<td>10</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>PE (15)</td>
<td>10</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>EU-South Africa</td>
<td>15</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes with ACP (full with SACU)</td>
</tr>
<tr>
<td>EU-Mexico</td>
<td>10</td>
<td>Yes</td>
<td>No</td>
<td>No after 2 years</td>
</tr>
<tr>
<td>EU-Chile</td>
<td>10</td>
<td>Yes</td>
<td>No</td>
<td>No after 4 years</td>
</tr>
<tr>
<td>EFTA-Mexico (not chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No after 3 years</td>
</tr>
<tr>
<td>NAFTA</td>
<td>7 (exceptions in agric. and ind. products; 7% of weight in chs. 50-63)</td>
<td>Yes except automotive</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>US-Chile</td>
<td>10 (excep. in agric. and processed agr. products)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>CAFTA</td>
<td>10 (exceptions in agric. and ind. products; 7% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (in ch 62 w/ Mexico &amp; Canada)</td>
</tr>
<tr>
<td>G3</td>
<td>7 (7% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Mexico-Costa Rica</td>
<td>7 (except in chs. 4-15 and headings 0901, 1701, 2105, 2202)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Mexico-Chile</td>
<td>8 (excep. in agric. and ind. products; 9% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>No</td>
<td>No after 7 years</td>
</tr>
<tr>
<td>Mexico-Bolivia</td>
<td>7 (not chs. 1-27 unless CS; not chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No after 8 years</td>
</tr>
<tr>
<td>Canada-Chile</td>
<td>9 (excep. in agric. and ind. products; 9% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>CACM-Chile</td>
<td>8 (not chs. 1-27 unless CS)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>CACM</td>
<td>10 until 2000; 7 from 2001 on (7% of weight in chs. 50-63)</td>
<td>N/A</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>Not mentioned</td>
<td>Yes except automotive</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Mercosur-Chile</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Mercosur-Bolivia</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes</td>
<td>No after 5 years</td>
</tr>
<tr>
<td>Caricom</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>No</td>
<td>Possibly²¹</td>
</tr>
<tr>
<td>Caricom-DR</td>
<td>7</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>ANZCERTA</td>
<td>2</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (full)</td>
</tr>
<tr>
<td>SAFTA</td>
<td>2</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>SPARTECA</td>
<td>2</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (full)</td>
</tr>
<tr>
<td>AFTA</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>BANGKOK</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes²¹</td>
<td>No</td>
</tr>
<tr>
<td>Japan-Singapore</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
<td>No (OP allowed)</td>
</tr>
<tr>
<td>US-Singapore (excep. in various agric. products; 7% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No (OP and ISI allowed)</td>
<td>Not mentioned</td>
</tr>
<tr>
<td>Chile-Korea</td>
<td>8 (not chs. 1-24 unless CS; 8% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>COMESA</td>
<td>2²²</td>
<td>Yes</td>
<td>Yes</td>
<td>No after 10 years</td>
</tr>
<tr>
<td>ECOWAS</td>
<td>Not mentioned</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>SADC</td>
<td>10 (not chs. 50-63, 87, 98)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Gulf CC</td>
<td>Not mentioned</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>US-Jordan</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>US-Israel</td>
<td>Not mentioned</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Canada-Israel</td>
<td>10 (excep. in agric. and industrial products; 7% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes (w/ any 3rd party with which both have an FTA)²³</td>
</tr>
<tr>
<td>Mexico-Israel</td>
<td>10 (excep. in agric. and industrial products; 7% of weight in chs. 50-63)</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Sources: Estevadeordal and Suominen (2005); Suominen (2004).

²xiv Drawback is not mentioned in Hungary-Israel, Poland-Israel, Slovenia-Croatia, Slovenia-FYROM FTAs. Drawback allowed for the first two years in EU-Palestinian Authority, two and one half years in EFTA-
Palestinian Authority, three years in EFTA-FYROM, one year in Bulgaria-FYROM, three months in Turkey-FYROM, and two years in Israel-Slovenia.

xv The Revised Treaty of Chaguaramas Establishing the Caribbean Community, including the CARICOM Single Market and Economy stipulates that any member state needs to justify the need to apply an export drawback Council for Trade and Economic Development (COTED). COTED is mandated to review the use of drawback by members on an annual basis.

xvi When products from the South Pacific Islands that are exported to New Zealand are cumulated with Australian inputs, a minimum of 25 per cent of “qualifying expenditure” from South Pacific Islands is required.

xvii Requires the expenditure on goods produced and labor performed within the territory of the exporting member state in the manufacture of the goods to not less than 50 per cent of the ex-factory or ex-works cost of the goods in their finished state.

xviii The agreement stipulates that “With respect to drawbacks within one year from the date of entry into force of this Agreement, the Standing Committee shall consider whether drawbacks on goods imported from third countries should be permitted in relation to products used in the manufacture of finished products for which concessions have been exchanged by the Participating States.”

xix Mentioned in the section on trade remedies. One of the criteria for imposing a countervailing duty is that the targeted subsidy is not less than the 2 per cent de minimis.

xx The FTA stipulates that “Where each Party has entered separately into a free trade agreement under Article XXIV of the GATT 1994 with the same non-Party before this Agreement enters into force, a good, which, if imported into the territory of one of the Parties under such free trade agreement with that non-Party, would qualify for tariff preferences under that agreement, shall be considered to be an originating good under this Chapter when imported into the territory of the other Party and used as a material in the production of another good in the territory of that other Party.”
B. Regime-Wide RoO

Besides sectoral RoO, the different RoO regimes can be compared by their regime-wide RoO. Table 3 contrasts the various RoO regimes by their general, regime-wide RoO—*de minimis*, roll-up, cumulation, and drawback.

First, EU RoO regimes feature a higher *de minimis* (at 10 per cent) than NAFTA and many other FTAs in the Americas; the exceptions are the US-Chile FTA and CAFTA, where *de minimis* is the same as in PANEURO. Meanwhile, there is no *de minimis* rule in Mercosur’s FTAs and in various FTAs in Asia and Africa. However, most regimes have exceptions to this regime: for example, the EU’s *de minimis* does not apply to textiles and apparel, except for allowing an 8 per cent *de minimis* of the total weight of textile materials in mixed textiles products. In the EU-South Africa FTA, *de minimis* is set at 15 per cent but excludes fish and crustaceans, tobacco products, as well as certain meat products and alcoholic beverages. NAFTA *de minimis* does not extend to the production of dairy produce; edible products of animal origin; citrus fruit and juice; instant coffee; cocoa products, and some machinery and mechanical appliances, such as air conditioners and refrigerators (Reyna 1995: 115-117). The Chile-Korea FTA places *de minimis* at 8 per cent, but requires the non-originating materials in chapters 1-24 of the Harmonized System to undergo a change in subheading prior to re-exportation. JSEPA does not permit *de minimis* below levels defined in the chapters on product-specific RoO. CAFTA *de minimis* excludes selected dairy products, edible products of animal origin, citrus fruit and juice, instant coffee, cocoa products, and some machinery and mechanical appliances, such as air conditioners and refrigerators.

Second, the roll-up principle is widely used around the world. For example, in NAFTA, a product may acquire originating status if it is produced in a NAFTA country from materials considered as originating (whether such materials are wholly obtained or having satisfied a CTC or RVC criterion) even if no change in tariff classification takes place between the intermediate material and the final product.

Third, the EU’s Pan-European system of cumulation applied since 1997 draws a clear distinction between the EU RoO regimes on the one hand, and most RoO regimes elsewhere in the world, on the other. The foremost diagonal cumulation regime in the world, the pre-enlargement pan-European system incorporated as many as 16 partners and covered no fewer than 50 FTAs. These include FTAs between EU and third parties, such as the members of EFTA, the central and eastern European countries, the Baltic states, Slovenia, and Turkey, and also FTAs forged between EU partner countries such as Slovenia and Estonia. In concrete terms, the Pan-European system enables producers to use components originating in any of the participating countries without losing the preferential status of the final product.

The European Economic Association (EEA) agreement between EU and EFTA permits full cumulation. The EU-South Africa FTA allows both parties to cumulate diagonally with the ACP states. In addition, it incorporates the “single territory” concept, whereby South Africa can calculate working or processing carried out within the Southern Africa Customs Union (SACU) area as if these had been performed in South Africa (but not in the EU). Notably, AFTA and ANZCERTA models provide for full cumulation, while the Canada-Israel FTA

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65 The participants in the PANEURO cumulation system prior to the eastward enlargement were the EU, Bulgaria, Czech Republic, Estonia, Hungary, Iceland, Latvia, Liechtenstein, Lithuania, Norway, Poland, Romania, Slovak Republic, Slovenia, Switzerland, and Turkey. Eight of these countries — Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia — entered the EU in May 2004.
permits cumulation with the two countries’ common FTA partners, such as the United States. Singapore’s FTAs incorporate the outward processing (OP) concept tailored to accommodate Singapore’s unique economic features and its access to low-cost processing in neighboring countries. The US-Singapore FTA also incorporates the integrated sourcing initiative (ISI), which provides further flexibility to outsourcing. OP and ISI will be detailed in Section IV of this chapter. CAFTA stands out in the Americas for providing for diagonal cumulation with Canada and Mexico. However, the clause covers only materials used for producing goods in Chapter 62, and so only up to a limited amount of imports to the US market and only after Canada and Mexico agree on the CAFTA cumulation clause.

Fourth, EU’s FTAs and FTAs in the Americas tend to explicitly preclude drawback. Nonetheless, both have allowed for a phase-out periods during which drawback is permitted. For instance, the EU-Mexico FTA permitted drawback for the first two years, while the EU-Chile FTA allows drawback through 2007, the fourth year of the FTA. NAFTA allowed for drawback for the first seven years; however, drawback in the bilateral trade between Canada and the United States under the agreement was valid for only two years. Importantly, NAFTA does provide leniency in the application of the no-drawback rule by putting in place a refund system, whereby the producer will be refunded the lesser of the amount of duties paid on imported goods and amount paid on the exports of the good (or any other product manufactured from that good) upon its introduction to another NAFTA member. AFTA, ANZCERTA, SPARTECA, the US-Israel FTA, CACM, and Mercosur’s FTAs stand out for not prohibiting drawback. However, in Mercosur per se, there is a no-drawback rule governing Argentine and Brazilian imports of intermediate automotive products when the final product is exported to a Mercosur partner.

The various RoO regimes diverge in their administrative requirements, particularly in the method of certification (Table 4).

The EU RoO regimes require the use of a movement certificate, EUR.1, that is to be issued in two steps — by the exporting country government once application has been made by exporter or the exporter’s competent agency, such as a sectoral umbrella organization. However, the EU regimes provide for an alternative certification method, the invoice declaration, for “approved exporters” who make frequent shipments and are authorized by the customs authorities of the exporting country to make invoice declarations.
### Table 4
Certification Methods in Selected PTAs

<table>
<thead>
<tr>
<th>PTA</th>
<th>Certification method</th>
</tr>
</thead>
<tbody>
<tr>
<td>PANEURO</td>
<td>Two-step private and public; limited self-certification</td>
</tr>
<tr>
<td>PE</td>
<td>Two-step private and public; limited self-certification</td>
</tr>
<tr>
<td>EU-South Africa</td>
<td>Two-step private and public; limited self-certification</td>
</tr>
<tr>
<td>EU-Mexico</td>
<td>Two-step private and public; limited self-certification</td>
</tr>
<tr>
<td>EU-Chile</td>
<td>Two-step private and public; limited self-certification</td>
</tr>
<tr>
<td>NAFTA</td>
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<td>CAFTA</td>
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<td>G3</td>
<td>Two-step private and public</td>
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<td>Mexico-Costa Rica</td>
<td>Self-certification</td>
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<td>Mexico-Bolivia</td>
<td>Self-certification (two-step private and public during first 4 years)</td>
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<td>Canada-Chile</td>
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<td>US-Jordan</td>
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Sources: Estevadeordal and Suominen (2005); Suominen (2004).
Meanwhile, NAFTA and a number of other FTAs in the Americas, as well as the Chile-Korea FTA rely on self-certification, which entails that the exporter’s signing the certificate suffices as an affirmation that the items covered by it qualify as originating. In CAFTA, the importer rather than the exporter claiming preferential tariff treatment is the party ultimately responsible for ensuring that the good is originating. In Mercosur, Andean Community, Caricom, AFTA, ANZCERTA, SAFTA, the Bangkok Agreement, JSEPA, and ECOWAS require certification by a public body or a private umbrella entity approved as a certifying agency by the government. However, unlike in the two-step model, the exporter is not required to take the first cut at filling out the movement certificate, but, rather, to furnish the certifying agency with a legal declaration of the origin of the product.

The self-certification model can be seen as placing a burden of proof on the importing country producers; as such, it arguably minimizes the role of the government in the certifying process, entailing rather low administrative costs to exporters and governments alike. In contrast, the two-step system requires heavier involvement by the exporting country government and increases the steps — and likely also the costs — that an exporter is to bear when seeking certification. To be sure, the invoice declaration system implemented by the EU facilitates exporting among frequent traders.

66 The CAFTA certification of origin can be prepared by the importer, exporter, or the producer of the good; alternatively, importer can claim origin through his/her “knowledge that the good is an originating good”. Verification of origin can be made via written requests or questionnaires to the importer, exporter, or producer, or by visits by importing country authority to the exporting party territory. Similarly, in the US-Chile FTA, importer is to declare the good as originating and can also certify origin; however, verification can be made by the customs of the importing member “in accordance with its customs laws and regulations.” In contrast, in NAFTA, the exporter or producer are parties in charge of certifying origin, and verification of origin is conducted through written requests or visits by one NAFTA member to the premises of an exporter or a producer in the territory of another member.

67 The certificate in NAFTA, G3, and CACM-Chile FTA will be valid for a single shipment or multiple shipments for a period of a year; in ANZCERTA and SAFTA, the certificate will be valid for multiple shipments for two years. In ECOWAS, the certificate is not required for agricultural, livestock products and handmade articles produced without the use of tools directly operated by the manufacturer. In ANZCERTA, SAFTA, and Mercosur-Chile, Mercosur-Bolivia, and CARICOM-DR FTAs, the certificate requires to be accompanied by a legal declaration by the final producer or exporter of compliance with the RoO. In CAN and CARICOM, declaration by the producer is required. In CARICOM, the declaration can be completed by the exporter if it is not possible for the producer to fill it.
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Chapter VI

KEEPING MULTILATERALISM AND DEVELOPMENT IN MIND: PROPOSALS FOR A NEW MODEL OF NORTH-SOUTH AGREEMENTS

Ramon Torrent and Martín Molinuevo

General objectives

In the past decade a trend has emerged to increasingly feature “beyond trade” regulatory disciplines in international trade agreements. “Beyond trade” refers to trade-related disciplines that apply to national internal regulation in all areas of economic activity. When dealing with trade in goods, the term "beyond trade" encompasses measures applicable to internal operations (standards mainly, but also government procurement); outside the area of goods, it covers all other measures relating to services, establishment and post-establishment treatment of foreign firms, movement of capitals and of workers.

It is known that, in recent years, the number of bilateral North-South trade agreements has increased. In recent months, maybe as a reaction to the WTO’s failure in Cancun and the unconfessed failure of the Free Trade Area of the Americas (FTAA) Ministerial Conference in November 2003, negotiations between developed and developing countries have multiplied. A consequence of this is that interest in the multilateral system is waning, and upsetting doubts about the “adequacy” of the system to confront this “new” reality are being cast.

Against this background, we have sought to find a new approach for the ongoing EU-Mercosur bi-regional negotiations. Most of this approach can be applied to other North-South bilateral negotiations and agreements; this is what we will attempt in this paper.

EU-Mercosur, or for that matter, any other bilateral trade agreements, should focus on two main policy objectives:

- **the strengthening the multilateral system**, through the signature of an agreement that guarantees the compatibility of bilateral relations with the broader ambit of the WTO;
- **the introduction of a coherent and development-friendly regulatory framework**, that might serve as a model for future developments in bilateral as well as multilateral level. These values should be reflected throughout the agreement, but most especially in sensitive areas such disciplines on foreign investment and services.

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68 This chapter draws upon the content of a study presented in the 2004 Second Cluster Workshop of the Chaire Mercosur de Sciences-Po (Paris) on the ongoing EU-Mercosur negotiations convened in Rio de Janeiro on 29-30 April 2004 under the auspices of the BNDES. The study entitled “Beyond Trade in EU-Mercosur: Towards a New Model of North-South Agreements”, was published by the Chaire Mercosur and also appears as the first chapter of the book “Implementing an EU-Mercosur Agreement: Non-Trade Issues” edited by Alfredo Valladão.

69 In the Americas, the failure of the FTAA has meant that there are now several ongoing parallel negotiations, which will convert the Northern countries (the USA, but also Canada) the major “hubs” of the continent.
At the same time, these agreements can evolve and be strengthened in order to ensure true economic integration between the parties and to broaden the economic gains accruing from the bilateral relation. To this effect, agreements may provide for a specific instrument, namely:

- the creation of a common institution (the Joint Council) with the ability to develop binding disciplines towards the parties. This institution may prove to be an adequate forum for the creation of common rules on those issues where consensus was unable to be reached during the negotiations, as well as deepening existent disciplines.

Strengthening the multilateral system

Cancun’s failure\(^70\) has, at the very least, had some analytical and political advantages, which are very relevant for our paper.

Firstly, it has buried, probably for the foreseeable future, the strategy of ever widening WTO’s scope (the strategy of the “Singapore issues”). This strategy has often been attributed to developed countries as a whole, but has, in fact, only been strenuously and consistently defended by the European Commission, with, at most, a passive acquiescence by the EU Council. This burial can lead to a clarification of the relation between regionalism and multilateralism, in particular in the area of services and foreign direct investment. Until Cancun, the discussion on FDI in bilateral/regional agreements was overshadowed by the argument of the possible transfer into the WTO of their approach and specific provisions. This has also spilled over into the discussion on the treatment of services; however, this situation has now changed and we will be drawing the consequences of this in the section that will follow on services and investment.

Secondly, it has proved that the multilateral trading system is really in deep trouble and that there is a real risk for the multilateral approach being replaced by a bilateral one. In reality, this phenomenon may lead to the prolongation of the unilateral approach of the “big powers”. The recent US policy in the Americas is the best indication of the risk. This being so, the issue of the compatibility between bilateral/regional agreements and WTO should be addressed squarely and in full transparency, without relying on wishful thinking appeals to the virtues of the “new” or “open” regionalisms or on completely unfruitful attempts to define the GATT’s notion of “substantially all trade”. In our opinion, the only clear and transparent way, both legally and politically, is that of introducing a “WTO conformity clause” in bilateral/regional agreements. We will discuss it below in Section 3.

A WTO “Conformity Clause”

We have already emphasized that one of the strategic objectives of the new agreement is to avoid further weakening the multilateral system. If this is the case, the issue of the relationship between the new agreement and existing WTO agreements must be raised.\(^71\)

Analytically, there are only three possibilities to organize a system of overlapping international trade agreements, in particular Preferential Trade Agreements (PTAs) and WTO agreements.

\(^{70}\) On Cancun’s failure, see Sauvé (2004).

\(^{71}\) The argument developed in this section is taken from Torrent (2004) where it is discussed in a broader context.
The first possibility consists of renouncing any organizing mechanism: ensuring that the agreements can co-exist alongside each other with no clause or provision establishing the relationship between them. This is the model chosen by bilateral or plurilateral agreements concluded by the European Community (alone or accompanied by its individual Member States). The well known “banana war” and its extremely damaging effects (on all sides) is maybe the best demonstration of the risks of this model.

The second possibility consists of inserting a provision in the PTA establishing its primacy over WTO agreements. The best example of this is NAFTA's Article 103,\(^{72}\) which establishes that:

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).\(^{73}\)

This approach has the advantage of clarity and transparency. However, it runs contrary to the spirit and the letter of WTO agreements, proving, incidentally, 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 with WTO rules, or at least some of its provisions.

The legal and political logic of Article 103 of NAFTA is best understood when comparison with Art. 104 of the same agreement. It establishes that:

*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 recognizes explicitly the primacy of sectoral international agreements to which its Members are also parties;\(^{74}\) in trade matters, however, this primacy is reversed.

The third possibility is, of course, to insert a clause recognizing the primacy of the WTO agreements into the PTA. Such a clause would be the counterpart of Art. XVI.4 of the WTO Agreement, which establishes that:

*Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.*\(^{75}\)

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\(^{72}\) Such a provision is no longer included in recent US-led agreements.

\(^{73}\) Art. 802 is a concrete application of this general rule to the case of safeguards.

\(^{74}\) See also Arts. 712 and 713 (sanitary and phytosanitary measures) and Art. 905 (on standards in general).

\(^{75}\) 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 argument that compensations (or acceptance of retaliatory measures) are a valid way of ‘conforming’ with WTO rules (in spite of the fact that, as is well known, the Understanding on Dispute Settlement explicitly states the contrary).
Such a clause would establish that, in the case where (and/or to the extent that) the WTO competent organs would determine that a specific provision of the PTA was not in conformity with WTO rules, this 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 needed to bring that specific provision in conformity with WTO rules.76

Finally, the insertion of such a clause would have a sort of “liberating effect” on the question of whether the outcome of the negotiations fits within the requirements of GATT article XXIV and GATS article V. The discussion, ultimately academic and never conclusive, on the meaning of GATT’s “substantially all trade” (and corresponding wording of GATS’ article V) would indeed be replaced by a legal/procedural mechanism able to react to any WTO finding of non-conformity to these provisions.

Regulatory issues

A comparison of current disciplines

When considering the regulatory framework enacted in investment agreements, a comparative examination of the regulatory content of a set of selected bilateral and regional agreements leads to three general conclusions.77

The first general conclusion stemming from the comparison is that, in spite of all the relevance accorded lately to the issue of “rules beyond trade liberalization”, the regulatory content of bilateral/regional economic agreements remains relatively low. Key provisions limiting domestic regulatory capacities are either non existent or consist mainly of “treatment obligations” (either national or most favoured nation – NT or MFN- treatment). Although the burden of these obligations on national legislation is not to be underestimated (nor its political and economic significance), such obligations do not necessarily alter national policy preferences (in a traditional right-left perspective, for example) since they focus on the application of national policies on a non-discriminatory basis.

The only exception to this conclusion is the agreement establishing a European Economic Area (1992)78, precisely because its main goal was not to create a free trade area,79 but to extend the European single market to those countries.80 To this effect, it creates a mechanism to replicate as EEA law the relevant past and future Community acquis. Therefore, this

76 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, the initiative was fiercely contested by the Commission, which, in the end, was able to persuade the Council to approve an agreement, which did not contain it (see Chapter 9 in Torrent 1998 for further information).
77 The agreements reviewed are Mercosur, EEA, Europe Agreement (EU-Poland), EuroMed (EU-Morocco), EU-Russia, EU-Chile, NAFTA, and CAFTA.
78 The agreement was rejected by Switzerland by referendum. After the entry into the EU of Austria, Finland and Sweden, only Norway, Liechtenstein and Iceland are Parties to the agreement, together with the European Community and its Member States.
79 (A free trade area existed already as a result of the agreements signed between the European Community and the members of the European Free Trade Area – EFTA.
80 The expanded European single market to the EEA did not encompass matters of agriculture and rules on taxation, and it did not foresee the establishment of a Customs Union.
agreement is and will probably remain unique; however, it can always be used as a benchmark for the regulatory content of any other agreement.

The second general conclusion has a historical character. Contrary to what is generally thought, the “Europe agreements” concluded by the European Community and its Member States with countries in Central and Eastern Europe formerly under Soviet Union hegemony, and whose negotiation began at the end of the 1980s, do not constitute a turning point and are quite limited in scope.81 Concerning the regulatory content of trade agreements, the turning point, if any, was constituted by NAFTA and the WTO agreements resulting from the Uruguay Round (1993-1995). Under the influence of NAFTA, US-led economic agreements show a trend to include within their scope more and deeper obligations on regulatory matters than EC-led agreements.82 As a matter of fact, the only EC-led agreement comparable to NAFTA is the recently signed with Chile.

The third conclusion relates to the absence of a single pattern. This is important because it leaves room for imagination and political bargaining when applying the results of our study to new North-South agreements. In the absence of a single pattern, a “new model” can be found by combining, if necessary, features of all the agreements that have been analysed.

**Current approaches on specific regulatory issues**

On the question of the internal regulations applicable to trade in goods, FTAs show a trend to recall or reproduce the disciplines enshrined at the multilateral level (e.g. WTO’s agreements on sanitary and phytosanitary measures [SPS] and on technical barriers to trade [TBT]), emphasizing maybe the aspect of transparency. In this respect, Mercosur follows a distinctive pattern: it does not have any “primary” obligation on the topic but has produced a lot of “secondary” legislation on it. However, much of this “Mercosur legislation” simply recognizes the regulatory status quo (consisting of divergent national rules); however, a lot of it has not entered yet into force because of lack of completion of the “internalization” process.

On services and investment, the architecture of the agreements varies widely according to two criteria: a) the period before or after the launch of WTO’s Uruguay Round; b) the fact that was spearheaded by the US or the EC.

- Agreements conceived before the end of the Uruguay Round (even if, in many cases, they were signed and concluded later on, as those of the European Community and its Member States with other countries in Central and Eastern Europe, the former Soviet Union and the Mediterranean), always make a distinction between international exchanges of services, on one hand, and investment on all sectors, including the services sectors, on the other.
- For agreements conceived after the end of the Uruguay Round, there is a sharp distinction between US-led and EC-led agreements. The US continues to keep the NAFTA, pre-Uruguay Round’s logic. The European Community and its Member States have shifted, on the contrary, to the GATS approach of segregating FDI.

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81 This is why, in order to promote the adoption of the Community acquis in those countries, a new instrument had to be invented in 1998: the “partnerships for accession”, which made financial assistance conditional on that adoption.

82 An element of explanation for this can be the following: even if, in all the agreements examined, Member States accompany the EC as Contracting Parties, they remain very reluctant to include in them provisions remaining under national competence (on investment, for example, or on intellectual property).
investment in the services sectors from general FDI provisions and treating it as a “mode of supply” of services: the third one, “commercial presence”.

In EC-led pre-Uruguay Round agreements, provisions on international exchanges of services are either non-existent or have a very limited scope. The agreement recently signed with Chile, the only one that includes a full-fledged chapter on “trade in services”, simply reproduces GATS disciplines and adopts its positive list approach for liberalization of market access and the obligation of national treatment. By adopting the GATS approach, it covers not only cross-border exchanges of services but also FDI in the services sectors (as “commercial presence” of foreign providers of services), and includes, like GATS, disciplines not only on access but also on internal regulatory treatment. As a consequence, the investment chapters only address the question of FDI in the goods' manufacturing sectors.

On services, US-led agreements keep to the same structure and, to a large extent, the very same provisions of NAFTA. This approach focuses on cross-border exchanges of services, which, in a comparison with GATS, would include its modes 1 and 2 and, to a limited degree, mode 4. Liberalization is addressed through negative listing, and the disciplines concentrate mainly on market access obligations, although there is room to list applicable quantitative restrictions. Disciplines on GATS mode 4 should be understood to address the international supply of a service when it requires the physical movement of natural persons in order to duly provide the service, and applies mostly to highly skilled professionals. Access to the labour market as such and rules on permanent residence are explicitly excluded from the scope of the agreement.

On investment, US-led agreements closely follow the typical structure and content of Bilateral Investment Treaties (BITs), namely:

- broad asset-based definition of investment, covering both FDI and portfolio investment;
- liberalization of access and obligation of national treatment for post-establishment, subject to a list of exceptions (“negative list” approach);
- rules on expropriation and compensation;
- Investor – State dispute settlement.

A very interesting development is taking place in the United States-Central American Free Trade Area (CAFTA) concerning expropriation clauses. Indeed, it includes an annex on the definition of expropriation, which narrows the scope of the notion of “indirect expropriation”, and recognizes that:

“except in rare circumstances, non-discriminatory regulatory actions ... that are designed and applied to protect legitimate public welfare objectives, such as public health, safety and the environment, do not constitute indirect expropriations”.

This broadens the ability of the Parties to regulate domestically without incurring in so-called “regulatory taking of property”.

On the European side, the equivalent of the BIT/NAFTA approach lies in the bilateral agreements on investment that continue to be signed and concluded by individual Member
States (with no list of exceptions), although European BITs concentrate on “treatment” (after access) and do not create obligations on access. As all BITs, they include far-reaching provisions on expropriation and compensation as well as Investor-State dispute settlement clauses. Instead, EC-led agreements focus mainly, particularly with respect to the Europe agreements, on market opening obligations and access rights for European investors, and disregard investment protection disciplines. In the pre-Uruguay Round agreements concluded by the European Community and all its Member States, there is a distinction between movement of capital on the one hand, and the establishment and treatment post-establishment (or “operation”) on the other.

Current EC-led agreements, while keeping their market opening goal, have undergone a shift in approach. Firstly, as already noted, FDI in services has been segregated from the investment chapter and expatriated to the “trade in services” chapter, creating thus divergent disciplines for the same phenomenon depending on the sector to which FDI is addressed. Secondly, by doing so, they have unified access and post-establishment commitments into one single positive list, hence limiting the possibility of attaining more sectoral coverage in one phase or the other of the investment process. On the contrary, they continue to exclude provisions on expropriation or investment protection, something which should come as no surprise as there are no rules in EC law on such areas and each Member State keeps its full competence on the issue.

Some agreements include no provisions on government procurement. Those that do (NAFTA, CAFTA and EU/Chile) share a common approach, very similar to that of the plurilateral WTO agreement on Government Procurement. They impose national treatment to foreign companies for procurement that exceeds a minimum amount to a pre-established list of Government entities and include a precise set of rules to which national tendering procedures must conform.

The agreements under consideration differ sharply on the question of competition policy (in its meaning of anti-trust). Some of them, both US- and EC-led, contain no provisions on the subject (NAFTA, CAFTA or EU-Chile). Others, in particular Europe and EuroMed Agreements, which otherwise fall short of many others in terms of content, include provisions on the topic and, more significantly, confer powers to a joint organ set up by the agreement to develop them. In the case of the Europe agreements, such powers have been widely used, enacting in the framework of the agreement a set of quite detailed rules that tend to replicate those enshrined in the EC Treaty.

Extensive disciplines on intellectual property rights are to be found exclusively in US-led agreements. EU-Chile and EuroMed agreements provide just for the obligation to grant protection to intellectual property in accordance with the highest international standards, but

83 The lack of a list of exceptions, in particular to National Treatment, leads to a systematic violation of the agreements by European countries because there exist a significant number of pieces of legislation (both within European Community and national government legislation) that grant better treatment to firms controlled by nationals than to those controlled, directly or indirectly, by foreigners. Furthermore, the conclusion of these agreements by Member States alone violates the division of competences between the Community and Member States because it covers topics internally regulated by the Community and on which, as a result, they have lost the competence to undertake international obligations. Recent ECJ jurisprudence confirms this interpretation, particularly on the “open skies” agreements: 5 November 2002 judgments, cases 466, 467, 468, 469, 471, 472, 475, 476, 478/98. See Solé (2003) and Torrent (1998), Chapter 3, for more information.
84 The EU-Chile agreement does not even include provisions on transfers of funds, but this was probably a Chilean request.
do not, in themselves, regulate it. NAFTA and CAFTA, instead, impose a national treatment obligation to foreigners concerning intellectual property rights and include a set of standards to be met by internal legislation. NAFTA’s provisions, to a large extent match, later WTO TRIPS disciplines, while CAFTA adds protection on new technologies issues, such as Internet domain names and programme-carrying satellite signals.

On the environment and labour, US-led agreements are the only ones that tend to include some standards — even if they are quite vague and excluded from the regular dispute settlement mechanism — while at the same time recognizing the principle of national regulatory capacity on these areas.85

A “new model” of North-South PTAs

Law making institutions

A mere “rendez-vous clause” does not create a “two-steps agreement”. More often that not, such clauses simply mask the inability to get to a substantial agreement (at least on the specific area subject to the clause). In any case, they are unnecessary because the possibility is always open for a new agreement to modify any existing agreement: this is a matter of political will and does not depend on the existence or not of any “rendez-vous clause”.

A “two-steps agreement” requires: a) to include into the “first-step” enough provisions that act as a “hook” for later developments; and b) to set up the institutions able to guarantee that, in the framework of those “hooks”, such developments will effectively take place through more detailed disciplines; in order to achieve these goals these institutions must be endowed with law-making powers.86

The debate on law-making institutions has been muddied by the misleading use of the terms “intergovernmental” and “supranational”. In order to avoid misunderstandings, it is better to replace that terminology with the more neutral of the “two techniques” that can be used by an international economic treaty (as a matter of fact, by any treaty) in order to enact rules: a) to previously insert rules in the treaty that must be complied with by member states; or b) to institute a mechanism for creating laws within the framework of the agreement.87

The creation of the European Community — a legal entity with its own competencies — certainly provides the best example of the second technique. However, the European integration process still relies just as much on the first one. The treaty itself contains a set of rules imposing far-reaching and serious obligations on member states when they exercise their own competencies; these obligations are underscored by the general overarching obligation of non-discrimination as regards member state nationality in any area covered by the treaty. NAFTA, by contrast, relies exclusively on the first technique (and is, as a result, a completely static “one step” treaty).

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85 On environment and labour, the specific protocols simply envisage the possibility of examining the internal implementation of applicable domestic law, not its conformity to the agreement.
86 Much of the remaining section is adapted from Torrent (2003).
87 Of course, such a mechanism has a limited, predetermined scope; it can never have (as the European Community itself does not have) what in German is called the Kompetenz-Kompetenz; i.e. the capacity to decide to which areas it extends its law-making powers.
It is very important to emphasize that the WTO agreement also includes such a mechanism to create rules. For example, Article IX. 3 allows the Ministerial Conference to modify and adapt the set of rights and obligations accepted by Members by way of waivers; and Article XII sets up a mechanism for accepting new Members (China, for example) through an agreement with the organization itself approved also by the Ministerial Conference. Completely new international law is created in both cases without any need for ratification procedures by WTO Members.

A very interesting feature of recent bilateral agreements negotiated in the Americas by the United States is that, for the first time, law-creating joint institutions have been established. Their powers are quite limited, but the “taboo” is broken: there is absolutely no “constitutional impediment” to the setting up of such institutions (as had already been proven, on the other hand, by WTO membership).

When such institutions are created in bilateral agreements involving already existent regional integration processes, they might have an additional positive effect. Indeed, the establishment of a joint council in the framework of EU-Mercosur negotiations, for instance, would have an extremely important integrating and strengthening effect on Mercosur. Indeed, it would necessarily imply a revision of its institutional foundations and, more significantly, a clarification of all the confusion that has been generated by mixing the question of the production of new international law (or law for the states) with the completely different one of its applicability to individuals.

**Regulatory Disciplines**

**Trade in Goods**

Given the broad scope of regulatory aspects of trade in goods, and the traditional complexity of bilateral negotiations on these issues, the joint institutions set up by the agreements could prove to be the proper channel to address these matters in an incremental manner after the agreement has entered into force. In their regulatory activity, the joint councils should be

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88 Art. XII concerning Accession to the WTO Agreement states that: “1. Any State or separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement, on terms to be agreed between it and the WTO. Such accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto. 2. Decisions on accession shall be taken by the Ministerial Conference. The Ministerial Conference shall approve the agreement on the terms of accession by a two-thirds majority of the Members of the WTO” (emphasis added).

89 It must be underlined that in both cases, and contrary to common belief, the Ministerial Conference may act by a three-quarter and a two-thirds majority, respectively, even if it strives to arrive to a consensus in conformity with Article IX. We do not insist on this because our point relates to the capacity to produce new international law in the absence of any national ratification procedure and not the voting requirements necessary for this.

90 CAFTA Art. 19.1, para. 3, regarding the Free Trade Commission, reads: “3. The Commission may: (a) establish and delegate responsibilities to committees and working groups; (b) modify in fulfillment of the Agreement’s objectives: i) the Schedules attached to Annex 3.3 (Tariff Elimination), by accelerating tariff elimination; ii) the rules of origin established in Annex 4.1 (Specific Rules of Origin); iii) the Common Guidelines referenced in Article 4.21 (Common Guidelines); and iv) Annex 9.1 (Government Procurement). On this, see Esteban Agüero’s ongoing study for the Observatory of Globalization.

91 The sophisticated institutional and procedural provisions included in the 1993 Agreement on the European Economic Area provide an excellent precedent to prove that solutions can always be found to any so-called “constitutional impediment” to the institution of a mechanism of law-production within the framework of an international agreement.

92 This confusion is analysed in detail in Bouzas, Motta Veiga and Torrent (2002); see in particular section 2.4.
guided by the goal of increasing the “effective content” of the bilateral agreement, avoiding the temptation of simply copying or recalling existent multilateral rules in bilateral context. Indeed, these attempts may (temporarily) mislead public opinion, but add nothing to the content of the agreement, while increasing disorder and uncertainty, as they tend to produce a range of parallel provisions that are never alike, even when they are risk being interpreted differently in the various regimes (bilateral/regional or multilateral).

Services

In the regulation of services there is a trend, followed mainly by the European Community, but that is also followed elsewhere, e.g. within Mercosur with the Montevideo Protocol, to reproduce GATS structure and regulation. This approach attempts to focus on a more extended undertaking of liberalization commitments by the parties at the bilateral level. It has the advantages of making easier the comparison between commitments undertaken in the multilateral GATS level and in the bilateral level, and, perhaps, of facilitating the discussion of whether the bilateral agreement fulfils the requirements established by GATS Article V for regional integration agreements.

However, the approach does not seem very promising in terms of integration/effective liberalization and makes much more difficult an adequate treatment of investment and movement of workers.

On the effective liberalization/integration issue, the regulatory content of such an agreement risk not going much further than existing disciplines at the multilateral level. The “net effects” (or the “effective content”) of the agreement would be limited to the regulatory adjustments necessary to guarantee some access and to ensure the application of national treatment obligations in the specific sectors added to the GATS schedules of commitments, but no obligations would be imposed on national policies beyond that. In some cases, one can even see some GATS-minus disciplines on services. Remarkably, not even a transparency obligation concerning regulation of trade in services, as seen in GATS Article III, is imposed in an across the board manner in EU-Chile agreement.

On the effects on the treatment of investment and movement of workers, the disadvantages of the GATS approach in the context of bilateral agreement are also, in our opinion, clear.

The fact of segregating FDI in the services sectors from general provisions on investment in order to treat it as an aspect of trade in services (the third mode of supply: “commercial presence”) may make some sense in an agreement, which unlike WTO agreements, does not directly address the question of investment. It completely loses this sense and becomes an unnecessary source of confusion and technical, legal and negotiating difficulties when this is not the case and the agreement (like the EU-Mercosur agreement) has a specific chapter on investment.

Much of the same argument applies to movement of workers. There is no need to deal with it as GATS mode four on supply of services, an approach that, furthermore, will lead nowhere. Indeed, GATS' general logic, the term “movement of physical persons” does not refer to

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93 The EU-Chile agreement, remarkably, does not even foresee an across-the-board transparency obligation concerning regulation of trade in services, in the same manner as can be found in GATS Article III.
independent workers entering a Member's labour market,\textsuperscript{94} but to workers \textit{already employed} by a foreign supplier of services and used by him to provide services in another country or to independent services suppliers who have to travel and stay a limited period of time abroad in order to duly provide their service.\textsuperscript{95}

When transposed to the bilateral level, the disadvantages of the GATS approach indicate the need for an alternative approach. This has also become politically possible (even desirable) from a broader perspective.

Indeed, until Cancun, both defenders and critics of the Singapore issues coincided (certainly for opposite reasons) in considering investment as a “new issue” for WTO,\textsuperscript{96} concealing the fact that the GATS is mainly an agreement on foreign direct investment (re-baptized as “commercial presence”, GATS third mode of services supply). Once the idea of dealing with investment as a new issue is no longer a topic for discussion, rational thinking and analysis should emphasize the fact that, from an economic, legal and political perspective, GATS issues fall under two completely different, even if interrelated, headings:\textsuperscript{97}

\begin{itemize}
\item[a)] international exchanges of services, duly accounted for traditionally in the services balance of the balance of payments, and
\item[b)] foreign direct investment (mainly for internal provision of services in the host country), whose economic relevance is not measured by the "once-and-for-all" entry of foreign capital (not necessary, in fact), but by its continued contribution to GDP (or, from another perspective, employment).\textsuperscript{98}
\end{itemize}

From this perspective, the GATS appears as an anomaly to be explained (and maybe justified for some) in the context of the Uruguay Round negotiations, but not to be exported outside the WTO.\textsuperscript{99}

If we separate GATS’ four “modes of supply” and treat each of them on its own merits, a new world of possibilities appears. The first two modes (“cross-border supply” and “consumption abroad”) share an essential economic characteristic: demand comes from one country and supply from the other, and give rise to international current transactions. This is not the case for the third (“commercial presence”, i.e. FDI), which refers to investment (more precisely, to establishment) and should be treated like that. And, finally, there is an obvious need to address movement of natural persons (or at least, movement of workers and their families), even if they are not employed by a foreign supplier of services and, as a consequence, do not fall

\textsuperscript{94}This concern was reflected on GATS Annex on Movement of Natural Persons, where it is expressly recognized that services liberalization does not involve labour-market opening obligations, nor it affects national abilities to regulate the entry and stay of persons in their territories. Such a provision is also enshrined in EU-Chile agreement.

\textsuperscript{95}Or to movement abroad of service buyers if we refer to the second mode of supply (consumption abroad).

\textsuperscript{96}Some had to conceal that they had already “won” (maybe too much) and some that (maybe inadvertently) they had already “lost” in bringing this new issue under WTO’s umbrella.

\textsuperscript{97}For more on this topic, see Molinuevo (2004).

\textsuperscript{98}An international movement of capital is not needed for a foreign company to become established in a different country. It can rely on financing directly obtained in the host country, or be the result of a merger operation through an exchange of shares, for example. This possibility proves that “establishment of foreign firms” is, legally, economically and politically, a completely different problem from that of capital movement.

\textsuperscript{99}Europeans, in particular, should recall (and be reminded of) the fact that in the Treaty of Rome instituting the European Community, exchanges of services have always fallen under one chapter and investment (in its three related aspects of movements of capital, right of establishment and treatment post-establishment) in other different chapters.
under the scope of GATS. There are individual characteristics in each case that deserve a special normative treatment.

For cross-border supply of services and consumption abroad, general obligations of access liberalization and national treatment could be envisaged, subject to a “negative list” approach, which would mainly identify quantitative restrictions and, as a consequence, bring regulatory restrictions to a more transparent environment. There could also be specific provisions applicable when these exchanges of services require movement of persons across borders. Such an approach is followed in US-led agreements.

Additionally, since trade in services might constitute a sensitive area in North-South agreements, where full consensus may not be easily reached in the course of negotiations, joint councils could play a key role in the resolving the issue if they are given powers to address progressive liberalization. Such abilities would grant the common institutions the space it needs to improve the parties’ integration in services, especially by: a) introducing or eliminating some exceptions; b) authorizing safeguard measures; c) delaying or accelerating the timetable for the application of the provisions according to the parties’ needs and political will.

Foreign Investment

Disciplines on foreign investment, as the instable Mercosur-EU and the failed FTAA negotiations are proving, are becoming a key element of bilateral agreements. The first issue to be solved in such regulation is that of the definition of “investment” in terms of the agreement and the distinction between foreign direct investment (FDI) and portfolio investment. While the possible contribution to development of FDI is widely recognized, mainly by its capacity to increase productive capacity and to introduce technical progress, portfolio investment may have dangerous effects in medium-sized, developing economies. Bilateral North-South agreements should therefore focus exclusively on FDI, leaving to national governments the ability to regulate movements of capital related to portfolio investment according to their economic needs and preferences.100

The second issue touches on the sectoral coverage of FDI. As discussed in an earlier section, the apparent "ease" of applying the GATS approach to FDI in the services sectors (as a mode of “trade in services”) may contribute to the “feasibility” of the agreement but at the risk of a complete loss of effective content. 101 Therefore, we consider that provisions of bilateral agreements on FDI/establishment of foreign firms should apply to all sectors.

The third issue is that of the approach to be followed in the two relevant “phases” of FDI: a) access (or “first establishment”); 102 and b) treatment post-establishment. Both the GATS and the US-led model apply the same approach to both phases, a “bottom-up” or “positive list”

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100 A very pedagogical way of emphasizing this fact (and the differentiation with the US-led approach) would be that of calling the chapter “Establishment of foreign firms” rather than “Investment”.
101 Sauvé and Pena's (2004) paper, while recommending the GATS approach on grounds of feasibility for the EU-Mercosur bi-regional agreements, also recognizes the lack of legal and economic motivation for differentiating between investment in the services and the manufacturing sectors.
102 We prefer these two expressions to “pre-establishment”, also widely used. Strictly speaking, “pre-establishment” means either nothing (because “before establishment” there is no FDI), or everything (because everything can be considered to happen before establishment).
approach in the case of GATS\textsuperscript{103} and a “top-down” or “negative list” approach in the case of NAFTA and other US-led agreements. In our opinion there is no clear underlying logic for this.\textsuperscript{104}

Concerning access or first establishment, development, social, or security national policies may provide national governments with legitimate grounds to restrict foreign ownership or participation in enterprises in certain economic sectors. Such an approach would greatly benefit of the existence of the institutional arrangements that we propose, which allow for a very flexible mechanism of enlarging (and in some justified cases narrowing down) the list of sectors to which the liberalization provisions apply.

To the contrary, it is arguable that, for already-established firms\textsuperscript{105}, national firms under foreign membership should only very exceptionally be discriminated against. Therefore, for treatment post-establishment, a horizontal obligation of national treatment subject to a “negative list” of exceptions should be acceptable. If needed, the institutional arrangements we propose could also apply to the introduction of some justifiable transitory exceptions.

In our opinion, this diversified approach would provide an effective, transparent and “development-friendly” environment to foreign investment liberalization.

The fourth issue is that of disciplines on post-establishment regime that go further than the (comparative) standard of national treatment. Here, different aspects must be distinguished and discussed separately.

- The first is that of performance requirements and investment incentives. These two issues, because they are conceptually different and apply to different phases of the investment process, have up to now been regulated independently. In practice, however, these two issues come closely linked. Investment incentives seek to attract foreign investment into particular sectors of the national economy by lowering general obligations imposed to private firms enshrined in national and sub-national regulation. On the other hand, performance requirements impose additional obligations to foreign companies in order to foster national economic goals related, in particular, to balance of payments policy.\textsuperscript{106} One could say that they are the two complementary “bargaining tools” of the two agents (foreign firm/national government) involved. Strict prohibitions of performance requirements, as adopted in a number of free trade agreements as well as in the WTO TRIMs agreement, with no mandatory disciplines on investment incentives, simply increase the latter’s “race-to-the-bottom” effect, as they reduce governmental bargaining ability with foreign investors. On the other hand, a comprehensive approach embracing both questions would enhance the “development-friendly” aspect of the agreement.

\textsuperscript{103} To be precise, it is important to remember that the GATS uses also the “negative list” approach once a sector has been introduced in the “positive list” of sectors for which liberalization commitments are undertaken. However, as the “negative list” only applies after the sector has been included in the positive list, and the positive list embraces at the same time commitments on market access and on national treatment post-establishment, we still can argue, for our needs, that the GATS approach is that of the “positive list”.

\textsuperscript{104} Sauvé and Pena (2004) also point this out.

\textsuperscript{105} Either in the sectors “bound” in the positive lists of access liberalization or in any other sector in which the establishment of a foreign firm has taken place because of any “autonomous” measure or regulation (“autonomous” in the sense of “going further” than “bound commitments”).

\textsuperscript{106} This issue is most adequately discussed in Lavagna (1999).
Of course, any discussion on disciplines on these two interrelated aspects, given their political sensitivity and complexity, should be kept out of the major negotiation, and left to a more profound and detailed analysis by the joint councils. However, in this specific case, the mere introduction of a provision recalling the interdependence of the two aspects and assigning to the joint councils the task of dealing with them in the future would have an important signaling effect from the political point of view in spite of its initial legal emptiness.

- Some specific regulatory topics could be addressed in the body of the agreement, mainly those related to payments and transfer provisions. However, they could also be skipped because, very often, such provisions simply match obligations already assumed under the IMF agreement.

- Disciplines on expropriation have proven extremely dangerous in the context of bilateral/regional agreements. North-South agreements should therefore avoid introducing such disciplines or, learning from NAFTA’s difficult experience with indirect expropriation provision, focus solely on direct expropriation.

- Finally, it would also help to define a “new model” the inclusion in the agreement of the topic of corporative conduct. It would be enough to leave it to further development by the joint council. This would create a “hook” able to link civil society to the operation of the agreement.

The fifth issue is that of dispute settlement: The general provisions of the agreement would apply and, of course, there would be no mention of a private investor/state mechanism.

In the overall context of global architecture, the new approach that we have outlined constitutes a true “new model” for all countries as it stands somewhat in the middle of the US-led agreements on one side and WTO and EC-led agreements on the other.

**Other Regulatory Issues**

**Movement of workers** cannot be excluded from bilateral agreements seeking to seriously enhance economic relations between North and South countries. Of course, the whole set of issues related to the international movements of persons cannot be tackled, but, at least, bilateral/regional should include obligations concerning the (national) treatment of legally employed foreign workers. Specific provision on residence permits for spouses and children could also be envisaged as well as on access for them to the local labour market. Provisions of this kind, already included in Europe Agreements have proved no risk to developed countries’ employment market, at the time they have helped consolidating friendly economic relations with the Eastern partners.

In line with current trends in free trade agreements, rules on **government procurement** are to be included in the agreement; however, such disciplines should take into account the need of developing countries to encourage growing local industries in public tenders, by admitting a fixed rate of preference for local companies based on a negative list approach. The joint institution should have a regulatory role on this issue, and be able to modify thresholds of coverage of the standard national treatment obligation, and to reduce the preferential rate for local tenders when applicable. In all cases, however, general rules should apply to all levels of government, including sub-federal and local entities.
In the area of *intellectual property* regulation, the agreements are to confirm existent multilateral obligations undertaken by the parties with no major further developments. North-South agreements should, however, pay particular consideration to the needs of developing and least developed countries in their efforts to develop patent-free fundamental goods (mostly medicine) or to access key technology to support development policies.

The feature of provision on *competition* should focus on strengthening the developing countries’ regulatory ability on the issue, leaving room for later common regulatory disciplines. At most, the agreements should feature some very basic common principles that could provide guidance to the joint councils when they develop further disciplines according to common needs.

**Final remarks**

This chapter has attempted to design a “new model” of North-South agreement, on the basis of the specific circumstances of the EU-Mercosur bi-regional relationship, but with a potential to present a general scheme able to apply in many scenarios of North-South agreements, and to come up with alternative solutions that might help to consolidate economic relationships between developed and developing countries, while fostering the strengthening of the multilateral system and the needed space for development policies.

Of course, it is always easier not to innovate and leave negotiations proceed in the usual “race to the bottom”, leaving all leading role to defensive interests. The dangers of such an approach are soon understood: reaching an agreement with so little effective content would, leaving aside rhetorical speeches and collective pictures, do very little to deepen the North-South relationship while giving an additional blow to a multilateral system deserving more care than ever before.
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Chapter VII

SPECIAL AND DIFFERENTIAL TREATMENT UNDER NORTH-SOUTH TRADE AGREEMENTS

Piragibe dos Santos Tarragô

North-South Trade Agreements came into prominence in the 1990s as a result of the negotiations of important free trade agreements involving developing countries, as is the case with NAFTA.

To a large extent these agreements are a consequence of intensified competition between the two Northern partners: the US and the EU, and from the insufficiencies of the multilateral rounds in providing deeper cuts in barriers to trade in developing country markets. Equally important, the North-South agreements would provide a tool to break new ground for new areas of commercial interests of the developed countries, such as intellectual property, services and investments, commitments on which were facing difficulties in the multilateral negotiations (or were not going to the extent desired by the North).

Likewise, it appears that market strategies of transnational corporation (TNCs) (globalization), as well as political considerations played an important role in promoting such agreements.

North-South agreements can provide gains to developing countries if they result in additional (to the multilateral trade agreements) opening of the northern markets to products and services of their special export interest, as well as in substantial inflows of FDI in particular in sectors that may create or improve competitive advantages and generate new production/export capacities in developing countries.

Market access barriers in North-South agreements should normally be addressed by means of an asymmetric removal of the impediments, such as front-load for products of export interest to developing countries and back-load for products of export interest to developed countries. In other words, developed countries are introducing substantial cuts in tariffs in a much shorter time-span than developing countries (in 5 years as opposed to 15-20 years, for example). The issue of entry barriers (such as technical barriers, or obstacles to access distribution channels) is more difficult to address. In general, products exported by developing countries may not pass quality tests applied by regulatory agencies or standard-setting entities in developed countries, or are not able to penetrate distribution channels for their internal marketing.

One possible way of tackling this problem would be to subordinate the liberalizing process to a transition period, after which the agreement could be reviewed to ascertain whether it has provided effective opening for products exported by developing countries, and whether the latter have been able to benefit from it.

At the same time, during the transition period developing countries would receive technical assistance (from the developed country partner(s) concerned or a designated international entity) to raise the standards or technical specifications of their products in order to conform with the requirements of the developed country they entered into agreement with.
The same procedure could be applied insofar as market entry barriers are concerned. The government agency of a developed country could assist in facilitating penetration of the products exported by the developing countries in the distribution channels of its internal market by cooperating with the companies and entities concerned.

From the perspective of developing countries, a North-South agreement should not lead to the outright dismantling of productive capacities as a result of the elimination of the tariff protection. A transition period also should be offered for the sectors to adjust. The agreement should provide for technical and financial assistance for adjustments to be made. During the adjustment period, tariff protection would be phased out at a pace compatible with the gradual competitive improvement of the sector. Such an adjustment could either take the form of government assistance or a business association with a developed country partner who could provide the investment, transfer of technology and marketing channels.

It goes without saying that these suggestions are purely theoretical, as they will need to be tested in real negotiations, where the bargaining power, more often than not, hardly argues in favour of the weakest partner. However, developing countries can put to good use the value of their domestic market and test the degree of interest of developed countries to assure themselves the support of the developing countries for agreements in new areas. See, for instance, the interest of the US with the FTAA (WTO plus in services, intellectual property rights and investment).

WTO rules should be adapted to allow such cooperative mechanisms to operate in the context of North-South agreements. One possibility could be to amend the Enabling Clause so as to include also or Free Trade Agreement that would provide for such flexibilities.

UNCTAD could stimulate discussions on the promotion of enlarging the SDT provisions of WTO agreements and other instruments, in order to provide for more flexibility in the multilateral rules. It could also assist developing countries to devise the best strategies to guide them when negotiating North-South agreements through policy analyses that would eventually result in a better definition of the priorities and potentialities to be explored by a developing country in a North-South agreement, and by facilitating business/entities contacts for developing countries in sectors of their interest.
Chapter VIII

CONSIDERATIONS ON THE INTERFACE BETWEEN THE WTO AND THE FTAA NEGOTIATIONS AND BETWEEN THE FTAA AND RECENT FREE TRADE AGREEMENTS IN THE WESTERN HEMISPHERE

Rosine M. Plank-Brumback

I. Reasons for undertaking North-South agreements

The organizers of this forum have developed a series of pointed questions to be addressed by this panel on the development dimension in North-South agreements, including what would be the gains to be derived under such agreements. For the North, clearly there is competition for access for their providers of goods, services and capital in markets of the South vis-à-vis other providers from the North. The North engages in these negotiations for, and enters into, these North-South agreements with the expectation of achieving greater security and stability for its investors, faster and deeper market access for its providers of goods and services than the slower multilateral route, and other dividends, including support for foreign policy objectives. These agreements also serve to shape coalitions for multilateral disciplines in subject areas of interest and in case of bilateral agreements, for regional disciplines as well. The United States Trade Representative Robert Zoellick has referred to the promotion of competitive liberalization with the “can do” countries.

What are the expected gains from the South for undertaking North-South agreements? Let me quote from Colombia, Ecuador and Peru in their press communiqué of 19 May 2004 following their first round of negotiations with the US, on what they see as the areas of gains for them in their negotiations of a free trade agreement (FTA) with the US. They stated that beyond the trade growth generated by the FTA, it will be the principal tool for generating employment, attracting more investment and bringing more dynamic technological development. The opportunity to negotiate this agreement with their principal trade partner opens the door for a qualitative and quantitative leap in their economic development, promoting fair and equitable integration that will contribute to the reduction of poverty, and help them obtain general welfare gains for their people. Other important considerations are the fight against narco-trafficking and terrorism, regional stability and the consolidation of democratic governance and institutions.

One important objective/incentive for countries of the South is to obtain contractual rights to access to markets of the North as opposed to receiving unilateral preferences that may be unilaterally granted, conditioned and withdrawn — notwithstanding the recent WTO Appellate Body decision setting parameters on the scope that preference-granting countries have to discriminate among preference-receiving beneficiaries. Additionally, the deeper the integration agreement, the more leeway countries of the South have to enforce their

107 Any opinions expressed are personal and do not necessarily reflect the official position of the Organization of American States (OAS), its General Secretariat or its Member countries.
contractual rights, provided the agreement allows for cross-sectoral and cross-agreement retaliation.

This forum is entitled Multilateralism and Regionalism: the New Interface. The dictionary definition of the term interface refers to the place at which independent systems meet and act upon or communicate with each other.

II. Interface between the WTO regime, including the Doha Development Agenda negotiations, and the FTAA negotiations and their possible outcome

The construction of the FTAA began at the first Summit of the Americas of the 34 heads of state and government of the hemisphere in Miami, in December 1994 as part of the broader summit goals of advancing the prosperity, democratic values and institutions, and security of the Hemisphere. The leaders’ overall objective for the FTAA was the freer movement of goods, services and capital within the hemisphere, through the progressive elimination of barriers to trade and investment, in a market that currently comprises over 800 million consumers with a combined national output of over $13 trillion—accounting for a quarter of the world’s GDP and a fifth of the world’s trade.

At the second Summit in Santiago, Chile in April 1998 leaders formally launched the trade negotiations, based on the principles and organizational structure worked out a month earlier at a meeting in San Jose, Costa Rica attended by their Trade Ministers. These agreed principles included: consistency with the WTO; improvement upon WTO rules and disciplines wherever possible and appropriate; consensus in decision-making, transparency; the conduct and outcome of the negotiations to be treated as a single undertaking; coexistence with sub-regional agreements to the extent that the rights and obligations under these agreements are not covered by or go beyond FTAA rights and obligations; attention to the needs of smaller economies; and that countries may negotiate and accept FTAA obligations individually or as members of a sub-regional integration group, negotiating as a unit.

The OAS Secretariat is one of three institutions (the Tripartite Committee) providing technical and analytical support to the FTAA negotiating groups and other bodies, as well as technical assistance to participating countries. The other two institutions are the Inter-American Development Bank (IDB) and the UN Economic Commission for Latin America and the Caribbean (UN/ECLAC).

The FTAA is a great laboratory for ideas and cooperation, a microcosm of diversity and challenges, from the superpower to the small island nation, and if they can coalesce, these agreements can help in the search for multilateral understandings and solutions. It has already produced some dividends and innovations in the conduct of trade negotiations in the areas of:

- Business facilitation — through an early harvest of customs-related business facilitation measures;
- Transparency — through the ongoing and permanent invitation extended to civil society to submit written contributions on the FTAA process to the negotiators and through the periodic release to the public of draft versions of the FTAA Agreement (allowing the world at large to engage in the great spectator sport of counting brackets to gauge progress achieved and remaining distance to cover); and
• Trade capacity-building--through the approval of a Hemispheric Cooperation Program (HCP) at the Quito Ministerial in November 2002, to address the needs of less developed and smaller economies in the region.

The HCP aims to strengthen the capacities of recipient countries to participate in the negotiations, implement their trade commitments, and adjust to integration. Countries negotiating the FTAA Agreement did not want to repeat the difficulties encountered after the Uruguay Round when many signatory or acceding member countries were unable to implement their commitments or were not in a position to take full advantage of trade liberalization opportunities. Countries have developed national and/or sub-regional trade capacity building strategies that define, prioritize and articulate their needs under this “aid for trade” programme. The FTAA Consultative Group on Smaller Economies convened a meeting, hosted by the IDB, to match countries seeking assistance under the HCP and donor organizations to discuss financing and implementation of the HCP in Washington D.C. in October 2003 (at which inter alia the OAS, UNCTAD and the World Bank participated). More focused roundtables are being planned at the sub-regional level to discuss specific project profiles. In response to some of the needs identified by countries in their strategies, the Trade Unit of the OAS General Secretariat has helped organize for the benefit of Andean officials and negotiators over the last two months, for example, seminars and workshops on investor-state dispute settlement, the international regime regulating pharmaceuticals, trade in services, treaty administration, as well as intensive courses on international trade, drawing from experts throughout the region.

In fact one might say that trade capacity-building is doing better than the FTAA negotiations themselves at the moment.

At their third Summit in Quebec City in April 2001 hemispheric leaders instructed their trade “ministers to ensure that negotiations of the FTAA Agreement are concluded no later than January 2005.” Pursuant to these instructions, Ministers met in Miami November 2003 to provide guidance for the final phase of the FTAA. To accommodate differences in the desired level of ambition for the FTAA among countries, Ministers made what some have described as a course correction. They formally recognized that countries may assume different levels of commitments. They would seek to develop a common and balanced set of rights and obligations applicable to all countries. In addition, negotiations should allow for countries that so choose, within the FTAA, to agree to additional obligations and benefits. Ministers declared that they fully expected that this endeavor will result in an appropriate balance of rights and obligations where countries reap the benefits of their respective commitments.

Ministers then instructed the Trade Negotiations Committee (TNC) which meets at the Vice Ministerial level, to develop a common and balanced set of rights and obligations applicable to all countries in each of the following negotiating areas: market access; agriculture; services; investment; government procurement; intellectual property; competition policy; subsidies, antidumping, and countervailing duties; and dispute settlement. They also instructed the TNC to establish procedures for negotiations among interested parties who may choose to develop additional liberalization and disciplines on a plurilateral basis within the FTAA. Some observers claim that this two-tier or two-track approach with an obligatory common component and a voluntary plurilateral component compromises, if not abandons, the notion of a single undertaking. The TNC was unable to agree on the guidance to give the negotiating groups on the content of the common set under this new negotiating framework at its meeting in Puebla February 2003 and (after two postponements) has yet to be reconvened. Contacts
between the US and Brazilian Co-Chairs and with delegations are ongoing to resolve the impasse.

The FTAA negotiations and the negotiations under the WTO Doha Development Agenda are running in parallel of course. Both negotiations have the same official deadline and similar but not the same goals. The objectives for constructing the FTAA as defined by Ministers in San José in 1998 are more ambitious: for example, on market access in goods “to progressively eliminate, tariffs, and non-tariff barriers, as well as other measures with equivalent effects, which restrict trade between participating countries.” One of the questions posed at this session refers to the implications of North-North agreements. Certainly with respect to the FTAA, a North-North or really North-South-East-West agreement in the WTO July 2004 on a framework for negotiating the three pillars of agriculture would provide a boost not only to the Doha negotiations but also assist in resolving the current dilemmas faced in the FTAA. These include how to make operational a commitment to ban export subsidies in the hemisphere and how or whether to link that with an effective mechanism against other subsidizing non-FTAA members; as well as how to ensure that opening the tariff door does not open the door to unfair competition from trade-distorting domestic and other subsidies.

The WTO imposes parameters on any free trade agreement between and among WTO members. It is the declared intent of the FTAA participating countries to be consistent with those parameters. Under GATT Article XXIV and the Uruguay Round Understanding on its interpretation, an interim agreement to form a free trade area must eliminate duties and other restrictive regulations of commerce (with some exceptions) on substantially all trade in goods between parties within 10 years. A comparable requirement for internal liberalization or negative integration exists under GATS Article V for an economic integration agreement in services to have substantial sectoral coverage (in terms of number of sectors, volume of trade affected and modes of supply) and to provide for the absence or elimination of substantially all discrimination in sectors covered. There are divergent views on the meaning and scope of almost all these terms. GATT Article XXIV and GATS Article V also have external requirements to protect the interests of third countries, for example, that duties and other regulations of commerce on goods at the formation of a free trade area not be higher or more restrictive than prior.

FTAA participating countries agreed that their schedules for progressive elimination of tariffs would comprise four phases: immediate, no more than 5 years, no more than 10 years, and longer. It was agreed to allow for some adjustments in the base tariffs, for example, CARICOM was permitted to use bound tariffs for a limited list of goods instead of the (lower) MFN applied tariff, from which to initiate reductions. For services offers, countries were free to follow a positive list or negative list approach. Offers on goods, services, investment and government procurement were submitted contingent on the overall results of the negotiations. Market access negotiations are not yet at the stage of requests for improvement in offers and further yet from improved offers. One cannot prejudge what may be the final outcome of these negotiations and how this will mesh with WTO requirements including whether under the WTO examination process flexibility will be needed to take into account development aspects: for example, the extent to which any country will make use of the fourth basket of longer than 10 years for sensitive products and/or exclude them from any liberalization commitment at all.

The idea of two tracks within one agreement raises some interesting questions, not the least of which is how negotiators will go about drafting appropriate MFN clauses therein. It is not uncommon in free trade agreements of more than two Parties to have provisions specifying
that certain rights and obligations under the agreement apply only as between some of the Parties and not among all of them, however, a two-track agreement among 34 parties would appear without precedent in terms of potential scope and complexity. Will the first tier cover "substantially all" trade in goods? "Substantially all" services sectors? Will the second tier provide “substantially all” plus treatment then? Will the first tier be primarily a free trade area in goods while other features common to a deeper integration agreement be in the second tier? Will the second tier be a self-contained whole? Will Parties be able to subscribe to plurilateral disciplines on some subject areas but not on others? What will the linkages be between the two tracks?: will the second plurilateral tier be one to which all parties should aspire and eventually subscribe to? What if schedules differentiate the pacing of reduction commitments by origin in terms of category of parties? This potential and perhaps transitional discrimination within internal integration may or may not have a development dimension. If the agreement eventually eliminates barriers to trade and investment, should it matter to the rest of the WTO how the parties get there as long as the parties primarily concerned agree to this? This is a systemic issue related to regional trade agreements that the WTO Negotiating Group on Rules may not have thought of and one to add to its checklist.

In the worst case and exceedingly unlikely scenario that the FTAA Agreement that is concluded is not WTO-compliant, with a backlog of around 150 agreements under examination, it is doubtful that FTAA parties would have to fear anytime soon a finding by the Committee on Regional Trade Agreements that the FTAA Agreement once notified, is not likely to result in the formation of a free trade area within a reasonable period. Given the continued practice of consensual decision-making and of the participation by the parties to the agreement being examined in that consensus, the chances of such disapproval by the Committee would seem nil.

What is more problematic as an outcome is WTO litigation with respect to a regional trade agreement. In Turkey-Textiles, the WTO Appellate Body seemed to pronounce itself in favour of panels with the jurisdiction to assess the compatibility of a customs union, and by extension a free trade area, with the requirements of Article XXIV. This was part of a two-prong test it enunciated to determine whether it was necessary, hence allowable to impose a quantitative restriction in order to form a customs union and whether such a customs union existed. Moreover, the Appellate Body has yet to rule on whether as a general principle a member of a regional trade agreement can exclude imports from other members from the application of a safeguard measure or other trade remedy or whether mutual recognition agreements relating to standards, technical regulations or sanitary or phyto-sanitary measures in regional trade agreements are authorized.

III. Interface between the FTAA and certain recent bilateral or subregional agreements in the western hemisphere

As pointed out in the background note prepared by the UNCTAD Secretariat, the Western Hemisphere has been fertile ground for regional trade agreements. Canada, Mexico, Chile, and more recently the US have been keen NAFTA missionaries. While the basic template of this second generation agreement remains the same, each iteration does bring changes. Some have referred to the proliferation of bilateral and sub-regional agreements as a spaghetti bowl, posing problems of administration, especially for customs procedures and rules of origin, as

108 In fact, the background note needs to include also the opening of negotiations between the US and Panama, and the US and Colombia, Ecuador, and Peru, to be joined by Bolivia. Events are moving quickly.
well as raising potential risks to judicial cohesion and judicial economy in the resolution of trade disputes. This makes the creation of a single structure of preferences and rules of origin, harmonization of rules and disciplines, institution-building at the hemispheric level even more compelling in order to disentangle overlapping agreements.

On 5 August 2004, the United States, the Dominican Republic and five Central American countries will formally sign a free trade agreement. The US-DR-CAFTA negotiations provide an interesting case study of the incorporation of trade capacity-building within negotiations of a free trade agreement. A trade capacity-building group comprising donors and countries met concurrently with negotiating groups. This has been institutionalized under the US-DR-CAFTA Agreement with the establishment of a Committee on Trade Capacity Building, composed of representatives of each Party, which will inter alia invite appropriate international donor institutions, private sector entities and non-governmental organizations to assist in the development and implementation of trade capacity building projects pursuant to the developing country Parties’ trade capacity building strategies, and monitor and assess progress in the implementation of these projects. The Committee will report annually on its activities to the Free Trade Commission, comprised of cabinet-level representatives.

The provisions of the recent FTAs may set in place certain future contours of the FTAA Agreement. Parties to these recent FTAs have already accepted disciplines, which they may not have accepted or expressed positions on in the FTAA context. It may be difficult for them to resist adhering to these disciplines in the regional or multilateral context. As illustration, I would refer to provisions, for example, that:

- make obligatory the taking of certain enforcement measures which are discretionary under the WTO TRIPS Agreement;
- open dispute settlement panel hearings to the public; or
- subject to dispute settlement, the failure to effectively enforce one’s domestic labor laws or domestic environmental laws through a sustained or recurring course of action or inaction in a manner affecting trade between the Parties, which may lead to the imposition of a fine on the Party complained against, and if this Party does not pay, eventually to trade sanctions against it.

Concluding remarks

There are indeed benefits to be derived from North-South agreements, particularly as regards contractually-protected access but also challenges for developing countries in terms of preparedness (both at the public and private levels), prioritization, negotiating leverage, and strategic planning in the business/art of trade negotiations. It is challenging for any country to negotiate at three or more levels simultaneously in this multi-layered trading world: bilaterally, regionally and multilaterally, and to assure that the results are consistent and advance one’s economic and development needs. The fewer the parties involved in the negotiation, perhaps the faster the conclusion but also perhaps the less the leverage. The recent spate of free trade agreements in the Western Hemisphere mostly follows the NAFTA template. Deviations are possible but limited, requiring calculation and steadfastness to bring about. No less of a challenge is implementing and administering the negotiating results. The increasing complexity of the landscape of tariffs, origin rules and other trade norms in the hemisphere as a result of bilateral and sub-regional agreements makes more compelling the need for business-friendly consolidation and harmonization at the hemispheric level under an FTAA Agreement. Finally there is the challenge of harnessing the new trading opportunities
presented for development. Initiatives such as the Hemispheric Cooperation Program and the capacity-building activities pursued alongside the US-DR-CAFTA and US-Andean countries negotiations offer a step in the right direction.
Chapter IX

LATIN AMERICAN SOUTH-SOUTH INTEGRATION AND COOPERATION: FROM A REGIONAL PUBLIC GOODS PERSPECTIVE

Mikio Kuwayama

Introduction

South-South trade of Latin America and the Caribbean (LAC) countries, composed both by intraregional and inter-regional trade with other developing regions, expanded at a rate similar to that of North-South trade between 1990-2000, thereby constituting a very significant trade component for the countries of the region. After the downturn experienced between 1998-2002, a strong recovery of intraregional trade observed in 2003, and the first half of 2004 and a big surge of inter-regional trade with other developing regions registered in the same period seem to be confirming once again the great potential that South-South trade holds for LAC.

The main trait of LAC trade performance in the 1990s, especially up to 1997, was an impressive expansion in trade both within and among the four customs unions (Andean Community, MERCOSUR, CACM and CARICOM). However, until the year 2002, the economic problems plaguing most of the members of subregional integration arrangements forced the countries to suspend or postpone some of the commitments that had been undertaken to strengthen free trade among the partners and form customs unions in the respective sub-regions. In this sense, the four customs unions within and among themselves still have a long way to go in order to reach a more enhanced stage of “deep integration”. To advance towards this goal, LAC countries should keep perfecting the integration process by deepening trade-related commitments and strengthening the provision of regional public goods (RPG). With respect to the latter, as Devlin, Estevadeordal and Krivonos (2003) argue, a formal regional integration agreement such as a free trade area or a customs union should be considered as a type of RPG.

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109 The author is Officer-in-Charge of the International Trade and Integration Division of the Economic Commission for Latin America and the Caribbean (ECLAC). The views expressed herein are those of the author and do not necessarily reflect the views of the United Nations. Special thanks go to Mr. José Durán for statistical assistance.

110 Preliminary data for the first half of 2004 show that the growth rate of merchandise exports of the region has doubled compared to the same period in 2003 and both intra- and extra-regional trade have seen strong increases. Therefore, the region seems to be experiencing a strong export boom during the biennium 2003-2004, in the aftermath of a two-year long stagnation (2001-2002). This robust performance has been influenced by the following three factors: i) demand expansion in almost all export markets, including not only the countries of the North (Canada, USA, EU and Japan principally), but also developing countries, especially China, India, Africa and Middle East; ii) increases in commodity prices; and iii) recovery of intra-regional trade, which forms part of the South-South trade circuits.

111 Devlin and Estevadeordal (2002) define RPG as “transnational public goods whose non-rivalry and non-exclusive properties extend beyond national borders, but are contained in a well-defined set of states or a geographic region.” As examples, they cite: cleaning up a lake; a transnational park; preserving a rain forest; airport hub-spoke networks; transportation infrastructure; transnational diseases; agricultural and other research; and policy standards (financial; labor, etc.).
Subregional integration schemes are, by definition, integration arrangements with a broader scope than regional trade agreements (RTAs) or free trade agreements (FTAs), regardless of whether these agreements are bilateral or plurilateral. The integration agreements, which are often non-reciprocal in terms of preference provisions, have a clear nexus between “trade” and “cooperation” built explicitly into their original framework. The EU-bilateral Association Agreements systematically integrate several initiatives through political dialogue, cooperation and reciprocal trade under a single umbrella agreement. The recent FTA signed between Japan and Singapore, as well as those FTAs currently being negotiated with other countries of the South, also incorporate elements of cooperation in their official framework (Aoki 2004). These orientations on North-South trade are in strong contrast to that of more mercantilist, “business-like”, reciprocal FTAs such as NAFTA, the new bilateral trade agreements in the region existing or being signed with the United States, and the Latin American Free Trade Association (LAFTA) of the 1960s (Devlin and Estevadeordal 2002). From this perspective, in order to re-activate the regional integration process, it is vital for LAC to revisit the issue of the nexus between trade and cooperation in trade agreements from the perspective of RPG as a vehicle for further regional integration.

South-South trade

A. Overall picture

Trade among developing countries (South-South trade) increased rapidly in recent years, at an annual average rate of 8.0 per cent between 1990 and 2002, raising its share in world trade from 9.4 to 12.5 per cent — in nominal terms, from $318 billion in 1990 to more than $800 billion in 2002 (Table 1). Accordingly, the growth rate of South-South trade was 2.2 times greater than that for North-North trade during the same period. As a result, during 2000-2002, South-South trade (SST) came to represent 37 per cent of total global trade of developing countries. It is important to note that about two-thirds of South-South trade has Developing Asia (DA) either as origin or destination ($466 billion), followed in importance by Middle East ($103 billion), LAC ($84 billion) and the Central and Eastern European countries (CEE) ($79 billion). During the period, the growth rate of SST for CEE was negative while the other regions, especially DA, reported a high rate.

Among the various South-South intraregional trade flows, intra-DA trade (excluding Japan) was by far the most important, with an intra-regional trade share of 34.6 per cent, followed by the intra-CEE trade of 22.6 per cent, much higher than the level registered for LAC of 16.6 per cent. In general terms, these coefficients point to the increasing importance of intra-regional trade, with a possible exception of Africa and Middle East, which maintain stronger trade links with Developing Asia than with the proper region (Table 2).
Table 1

Size of South-South trade: Average of 2000-2002
(Billion US dollars and per cent)

<table>
<thead>
<tr>
<th>2000-2002</th>
<th>LAC</th>
<th>CEE</th>
<th>Africa</th>
<th>ME</th>
<th>DA</th>
<th>SST</th>
<th>Growth 90-02</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America and the Caribbean (LAC)</td>
<td>58.5</td>
<td>3.0</td>
<td>3.6</td>
<td>3.8</td>
<td>14.8</td>
<td>83.8</td>
<td>7.5</td>
</tr>
<tr>
<td>Central and Eastern Europea (CEE)</td>
<td>4.8</td>
<td>53.3</td>
<td>2.3</td>
<td>4.4</td>
<td>14.4</td>
<td>79.2</td>
<td>-1.2</td>
</tr>
<tr>
<td>Africa</td>
<td>4.7</td>
<td>0.8</td>
<td>11.2</td>
<td>3.3</td>
<td>18.3</td>
<td>38.3</td>
<td>9.4</td>
</tr>
<tr>
<td>Middle East (ME)</td>
<td>3.2</td>
<td>1.9</td>
<td>9.8</td>
<td>15.8</td>
<td>72.0</td>
<td>102.7</td>
<td>7.7</td>
</tr>
<tr>
<td>Developing Asia (DA)</td>
<td>27.5</td>
<td>14.7</td>
<td>18.4</td>
<td>30.9</td>
<td>374.0</td>
<td>465.5</td>
<td>11.9</td>
</tr>
<tr>
<td>South-South Trade (SST)</td>
<td>98.8</td>
<td>73.7</td>
<td>45.3</td>
<td>58.2</td>
<td>493.5</td>
<td>769.5</td>
<td>8.0</td>
</tr>
<tr>
<td>Share of region in total world exports</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>In 1990</td>
<td>1.3</td>
<td>2.9</td>
<td>0.6</td>
<td>0.7</td>
<td>3.9</td>
<td>9.4</td>
<td></td>
</tr>
<tr>
<td>In 2002</td>
<td>1.5</td>
<td>1.2</td>
<td>0.7</td>
<td>1.0</td>
<td>8.0</td>
<td>12.5</td>
<td></td>
</tr>
</tbody>
</table>

Source: ECLAC, International Trade and Integration Division, based on WTO data.

By disaggregating SST by region, one can observe that at the beginning of the present decade, Developing Asia represented 60.5 per cent of total global South-South exports, 49 per cent of which was accounted for by its own intra-regional trade. On the side of imports, the importance of DA was even more marked, with 64 per cent of total South-South imports. In the cases of LAC and CEE, only 1.9 per cent of total South-South trade was accounted for by DA, although the coefficient for other regions (Middle East, Africa and CEE) were even smaller (see Table 3). The upsurge in 2003 of certain SST including intra-DA and the LAC–DA bi-regional flows might have modified the relative importance of each SST circuit flow.

Table 2

South-South Trade: Shares of SST in the trade of regions of the South, 2000-2002
(Per cent)

<table>
<thead>
<tr>
<th>2000-2002</th>
<th>LAC</th>
<th>CEE</th>
<th>Africa</th>
<th>ME</th>
<th>DA</th>
<th>SST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America and the Caribbean (LAC)</td>
<td>16.6</td>
<td>0.9</td>
<td>1.0</td>
<td>1.1</td>
<td>4.2</td>
<td>23.7</td>
</tr>
<tr>
<td>Central and Eastern Europe (CEE)</td>
<td>2.0</td>
<td>22.6</td>
<td>1.0</td>
<td>1.9</td>
<td>6.1</td>
<td>33.5</td>
</tr>
<tr>
<td>Africa</td>
<td>3.4</td>
<td>0.6</td>
<td>7.9</td>
<td>2.3</td>
<td>12.9</td>
<td>27.1</td>
</tr>
<tr>
<td>Middle East (ME)</td>
<td>1.3</td>
<td>0.7</td>
<td>3.9</td>
<td>6.3</td>
<td>28.6</td>
<td>40.7</td>
</tr>
<tr>
<td>Developing Asia (DA)</td>
<td>2.5</td>
<td>1.4</td>
<td>1.7</td>
<td>2.9</td>
<td>34.6</td>
<td>43.1</td>
</tr>
<tr>
<td>South-South Trade (SST)</td>
<td>4.8</td>
<td>3.6</td>
<td>2.2</td>
<td>2.8</td>
<td>23.9</td>
<td>37.3</td>
</tr>
</tbody>
</table>

Source: ECLAC, International Trade and Integration Division, based on data of WTO.
Table 3
South-South Trade: Shares in Total SST, 2000-2002
(In per cent of total SST)

<table>
<thead>
<tr>
<th>2000-2002</th>
<th>LAC</th>
<th>CEE</th>
<th>Africa</th>
<th>ME</th>
<th>DA</th>
<th>SST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latin America and the Caribbean (LAC)</td>
<td>7.6</td>
<td>0.4</td>
<td>0.5</td>
<td>0.5</td>
<td>1.9</td>
<td>10.9</td>
</tr>
<tr>
<td>Central and Eastern Europe (CEE)</td>
<td>0.6</td>
<td>6.9</td>
<td>0.3</td>
<td>0.6</td>
<td>1.9</td>
<td>10.3</td>
</tr>
<tr>
<td>Africa</td>
<td>0.6</td>
<td>0.1</td>
<td>1.5</td>
<td>0.4</td>
<td>2.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Middle East (ME)</td>
<td>0.4</td>
<td>0.2</td>
<td>1.3</td>
<td>2.1</td>
<td>9.4</td>
<td>13.3</td>
</tr>
<tr>
<td>Developing Asia (DA)</td>
<td>3.6</td>
<td>1.9</td>
<td>2.4</td>
<td>4.0</td>
<td>48.6</td>
<td>60.5</td>
</tr>
<tr>
<td>South-South Trade (SST)</td>
<td>12.8</td>
<td>9.6</td>
<td>5.9</td>
<td>7.6</td>
<td>64.1</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: ECLAC, International Trade and Integration Division, based on WTO data.

LAC South-South trade

Despite great heterogeneity among countries, LAC as a region already shows a high dependence on SST. In 2003, close to 74 per cent of the region’s exports were directed to the North (USA, Canada, EU and Japan), the rest being accounted for by the South. This overall regional picture changes dramatically when Mexico is excluded: Mexico accounted for close to 45 per cent of total regional merchandise exports, and more than 93 per cent of Mexican exports were destined to the North markets, with only 6 per cent towards South markets. When Mexico is excluded, in the same year, close to 49 per cent of total regional exports found their markets in the South (see Table 4). The importance of the South as an export market has increased over the years, when compared, for example, to 1990 when the South's share was a little over 35 per cent. Generally, MERCOSUR and Andean Community countries depend less on the northern markets, whereas Central American countries show a greater dependence on northern markets, especially the United States (see Table 5).

Therefore, if we exclude Mexico, almost half of region’s exports are South-South exports. The South-South trade was split almost evenly between intra- and inter-regional trade, the former representing more than 27 per cent while the latter, 21 per cent of region’s total trade. These figures confirm that South-South trade is already significant for the region as a whole, and that this trade holds a high potential for future growth.
Table 4

LAC (including Mexico): Export structure by major destinations, 1980-2003
(In per cent of total exports)

<table>
<thead>
<tr>
<th>Regions / World</th>
<th>LAC (including Mexico)</th>
<th>LAC (excluding Mexico)</th>
</tr>
</thead>
<tbody>
<tr>
<td>LAC – North</td>
<td></td>
<td></td>
</tr>
<tr>
<td>North America</td>
<td>36.2</td>
<td>40.9</td>
</tr>
<tr>
<td>European Union</td>
<td>22.9</td>
<td>24.0</td>
</tr>
<tr>
<td>Japan</td>
<td>4.2</td>
<td>5.9</td>
</tr>
<tr>
<td>LAC – South</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intraregional</td>
<td>22.0</td>
<td>14.6</td>
</tr>
<tr>
<td>inter-regional</td>
<td>14.7</td>
<td>14.5</td>
</tr>
<tr>
<td>World</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Source: ECLAC, International Trade and Integration Division, based on WTO data.

As pointed out earlier, the relative importance of the North for LAC (including Mexico) as an export destination in the present decade has been in a range of 70 per cent with a share of 74.1 per cent in 2003, 56.8 per cent of which was accounted for by North America, and 11.1 per cent by EU and 6.2 per cent by Japan (Table 4). The United States' share has been on a discernible rise while the EU's has been steadily declining. If we exclude Mexico — and despite rebounds in recent years — the relative importance of Japan as an export destination for the region is insignificant. The impacts of FTAs that LAC countries have signed, or are in process of signing, with countries of the North are yet to be substantiated, but it is likely that they divert LAC South-South trade, this is especially the case for the more developed countries in the region, at least in the short-run, for a number of manufactures (Nogués 2004).112

Admittedly, the degree of intraregional trade share is not the best measure to gauge the success of regional integration efforts. It depends on a variety of variables, ranging from market size, existing production and trade complementarities to trade infrastructure that exist in the region. As argued in this paper, the relatively low degree of intra-regional LAC relates to the existing significant trade barriers to regional trade, including residual duties, quantitative restrictions, other non-tariff measures such as rules of origin, and other market entry barriers like technical, sanitary and environmental standards, as well as the lack of infrastructure networks, trade facilitation and macroeconomic policy coordination measures. The provision of some of these RPGs is crucial for LAC to reach a more complex stage of regional integration, which will facilitate not only intra- but also inter-regional SST for LAC.

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112 Examining four RTAs involving LAC: (i) a South American Free Trade Area encompassing MERCOSUR, Chile, and the Andean Community countries; ii) an FTA between the Andean Community and the United States; iii) an FTA between the EU and MERCOSUR; and iv) the FTAA. Monteagudo and Watanuki (2003) argue that although North-South agreements are in general better options than South-South agreements, the latter are — from the perspective of productive specialization in value-added goods — the latter are preferable to North-South agreements for the more advanced developing countries of the region.
Table 5
(In per cent of total in each year)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MERCOSUR</td>
<td>59.5</td>
<td>51.8</td>
<td>100.0</td>
<td>40.5</td>
<td>48.2</td>
<td>100.0</td>
<td>45.2</td>
<td>54.8</td>
<td>100.0</td>
</tr>
<tr>
<td>Argentina</td>
<td>48.2</td>
<td>51.8</td>
<td>100.0</td>
<td>31.0</td>
<td>69.0</td>
<td>100.0</td>
<td>32.6</td>
<td>67.4</td>
<td>100.0</td>
</tr>
<tr>
<td>Brazil</td>
<td>65.7</td>
<td>34.3</td>
<td>100.0</td>
<td>53.2</td>
<td>46.8</td>
<td>100.0</td>
<td>52.4</td>
<td>47.6</td>
<td>100.0</td>
</tr>
<tr>
<td>Paraguay</td>
<td>37.3</td>
<td>62.7</td>
<td>100.0</td>
<td>17.6</td>
<td>82.4</td>
<td>100.0</td>
<td>11.2</td>
<td>88.8</td>
<td>100.0</td>
</tr>
<tr>
<td>Uruguay</td>
<td>36.7</td>
<td>63.3</td>
<td>100.0</td>
<td>27.3</td>
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</table>

Source: ECLAC, International Trade and Integration Division, based on official data of countries.

*a* Include region's exports to the United States, Canada, European Union and Japan.

*b* In addition to intraregional exports, include exports to Developing Asia, Africa and Middle East.

Intra-regional integration schemes

The hallmark of the region’s trade performance in the 1990s, especially up to 1997, was an impressive expansion both in trade within each of the four customs unions (Andean Community, MERCOSUR, CACM and CARICOM) and in imports from the rest of the world. During this period, government authorities frequently resorted to regional integration to signal their continued commitment to liberalization, even when economic conditions for further unilateral opening were difficult, or when reciprocal multilateral initiatives were in a transition phase, as was the case since the end of the Uruguay Round.

Nonetheless, as can be seen from Figure 1-A and Table 6, despite a rebound in 2003, intraregional trade in LAC has experienced significant setbacks in recent years, and still

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113 LAC countries have a long history of regional integration. First in the 1950s, there was much discussion of a Latin American Common Market. After a decade of negotiations, the Latin American Free Trade Association (LAFTA) was launched in 1960. The Central American Common Market was created in the same year, followed by the Andean Group in 1969. By the second half of the 1970s, all of these initiatives were in great difficulties and most of them became policy instruments of reduced relevance for the countries when the debt crisis of the early 1980s induced a deep recession in Latin America and a severe contraction of intraregional trade. These integration regimes were characterized by: i) a state-led import substitution industrialization development model; ii) an inward-looking orientation; iii) a high level of selectivity with the application of multiple positive lists; and iv) skepticism regarding private markets and great concern about the presence of, and dependence on, foreign firms (IDB 2002). The approach was to eliminate internal barriers while maintaining high external protection and expanding industrial planning.
remained at a relatively low level when compared with the levels of a decade ago; the level of intraregional trade (Mexico included), which accounted for 14.4 per cent of total regional trade in 2003, was still low compared to the peak of 21.1 per cent registered in 1997 or the 16.4 per cent level of 1980. Furthermore, these trade flows tend to follow a pro-cyclical trend whereby intra-group trade expanded and contracted in line with third-party trade.

This unsatisfactory performance, in large part, reflects the economic instability experienced by the majority of countries in the region as well as the limited progress made in strengthening ties, fulfilling objectives and improving compliance with the rules adopted. Other hurdles on this front have been the incompleteness of, and weakness in, the design of the original agreements themselves and difficulties in securing a consensus to remedy these constraints, economic and partisan-politics crises, and asymmetries in the benefits and costs accruing to the partner countries (IDB, 2003). In sum, although the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border issues, there is much to be done to reach a higher stage of “deep integration.”

The contraction pattern of MERCOSUR is even more severe; the degree of intra-MERCOSUR trade was less than 12 per cent in 2003, this stands in contrast with the 25 per cent level registered in 1998 (Figure 2-A). Trade integration of the Andean Community member countries is even lower; at the peak of 1998, the degree of intra-group trade reached almost 13 per cent and continued to decline to 9 per cent in 2003 (Figure 2-B). The CACM and CARICOM show a relatively brighter situation because the share of all manufactures exported within each sub-region is larger than the share exported to industrialized countries with a sustained growth in terms of volume, but a standstill from the viewpoint of the degree of intra-group trade in recent years (Figures 2-C and 2-D). A common problem among the four groups is the uneven shares of participation of member countries in each group, which point to the issues of asymmetry and special and differential treatment (SDT) for less favoured member countries. In sum, no integration agreement of the region seems to come close to reaching the long-run impact of the EU (Figure 2-B), and the sub-regional agreements, which sparked intra-regional trade for some time, has important challenges ahead in order to foster trade and growth of each member country. Interestingly, ASEAN figures much more favourably than MERCOSUR, though the two regions are similar in terms of trade volume (Table 6).

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114 In 2002, of the 20 major export products within CACM, 17 were manufactures, representing 36% of total intra-CACM exports (ECLAC, 2003c, Table 29). In the case of CARICOM, the top 15 intra-CARICOM exports in 1998 were manufactures representing 72 per cent of total exports. It is notable that primary agricultural products do not feature among the list in the case of CARICOM (see CARICOM, 2000, pp. 58-60). The relatively sophisticated manufactures that are important in both sub regions include chemical and pharmaceutical products, mineral fuels, lubricants and related materials, soaps, pigments, paints, building cement; iron and steel, paper and paper board, water and organic surface active agents, non alcoholic beverages and miscellaneous and edible products and preparations.
The trade structure of each subregional integration scheme also suffers from a heavy trade concentration by member countries. In the case of MERCOSUR, for example, in 2003, Brazil represented more than 45 per cent of total intra-MERCOSUR trade, while this market accounted for only 8 per cent of Brazil’s total exports. In the same year, Argentina accounted for 44 per cent of total MERCOSUR exports, while MERCOSUR partner countries absorbed only 19 per cent of total Argentinean exports. The remaining 10 per cent of intra-MERCOSUR trade was accounted for by Paraguay and Uruguay, whose dependence on this sub-regional markets was much higher, with 36 and 30 per cent, respectively.

A comparable phenomenon occurred in intra-Andean Community trade. In 2003, Colombia (38 per cent), Venezuela (22 per cent) and Ecuador (21 per cent) together represented more than 80 per cent of total intra-subregional trade, the rest being accounted for by Bolivia (8 per cent) and Peru (11 per cent). However, the highest subregional dependence was observed in Bolivia, which exported 27 per cent of its total exports to this integration scheme. A similar case can be made for CACM as well: while the share of intra-CACM trade for Costa Rica, the largest exporter in this sub-regional group, was substantially lower (13 per cent) than that corresponding to the other four countries, over 31 per cent of Nicaraguan exports were absorbed by this group while representing only 8 per cent of intra-CACM trade. In the case of CARICOM, over 76 per cent of intra-subregional trade was accounted for by Trinidad and Tobago, but less than 10 per cent of its exports were directed to its own sub-region. The level of reliance on the subregional market is strongly correlated with the level of GDP per capita of the country in question, pointing to the very important question of asymmetry and the distribution of benefits and costs of regional integration.

It is also disquieting that for the four customs unions, the relative importance of intra-regional trade in the overall trade that takes place at the regional level has been declining over the

<table>
<thead>
<tr>
<th>Regions /Sub-regions</th>
<th>Intraregional Trade ( (A) = \left( \frac{X_{\text{intra}}}{XTot} \right) \times 100 )</th>
<th>Export Share in World Exports ( (B) = \left( \frac{XTot}{X_{\text{world}}} \right) \times 100 )</th>
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<td>EU (15)</td>
<td>55.6</td>
<td>59.9</td>
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</table>

Source: ECLAC, International Trade and Integration Division, based on official data of the respective secretariats of the integration schemes and the IMF’s Direction of Trade Statistics, May 2003.

* Co-efficient corresponds to the year 2002.
years. Trade among LAC countries may be divided into two categories: i) trade between members of sub-regional groupings (intra-group trade); and ii) trade between countries that are parties to the economic complementarity agreements of the Latin American Integration Association (LAIA) or free trade agreements (inter-group trade). Whereas inter-group trade accounted for less than half the exports absorbed by the region in 1998, the proportion rose to 57 per cent in 2000 and 63 per cent in 2003 (ECLAC 2004b). In short, within the declining intra-LAC trade, the combined shares of intra-group trade of the four customs unions have been declining.

B. Impediments to intraregional trade

In light of the above, much remains to be done if LAC is to more fully exploit the potential benefits of regional integration. The countries in the region should continue to work on the continuing constraints facing its regional integration process, namely: i) the persistence of non-tariff barriers; ii) perforations of common external tariffs (CET) and failure to complete customs unions; iii) inadequate regional infrastructure; iv) weakness in the national and regional institutional apparatus; v) limited coordination of macroeconomic and sector policies, as well as tax systems that do no work for integrated markets and fail to stimulate external trade and investment; and vi) few mechanisms to promote a socioeconomic development that would compensate for asymmetries in the distribution of the benefits of integration (IDB 2003). The modernization and simplification of customs procedures, the strengthening of sub-regional dispute settlement mechanisms, and the building of institutional and human capacities in matters related to certification/verification of technical barriers and sanitary and phyto-sanitary measures would also be important elements of such RPG (ECLAC 2002).

115 In the case that the FTAA ends up being a shallow, much less ambitious agreement, subregional agreements should play a larger role in raising the economic and social welfare of the countries in the region. This is especially so when the goal of LAC integration schemes to establish customs unions and common markets are fully met. Moreover, within the context of a complete customs union project, once agreement has been reached on the implementation of the CET, individual members of the union should not enter into bilateral deals with third parties. Regardless of the success and scope of the FTAA, subregions with common market tariffs should continue to reduce external tariffs, which can benefit all members, but especially smaller ones that are more prone to being affected by unwanted trade diversion (IDB, 2002, p.16).
Multilateralism and Regionalism: The New Interface

Figure 1
Evolution of LAC vs. EU Intra-Regional Trade: 1960-2003
A. Latin American and Caribbean

Figure 2
B. European Union (15)

Source: ECLAC Database to the LAC countries, and IMF and WTO for the EU countries.
Left axis: millions of current dollars; right axis: percentages
A. MERCOSUR

B. Andean Community

C. CACM

D. CARICOM

Source: ECLAC, Division of International Trade and Integration, on the basis of official data

* In the case of CACM, intraregional exports excludes maquila whereas total exports include it.
The new MERCOSUR and Andean Community agenda (e.g., the 2006 Objectives and the Quirama Declaration of 2003, the CACM Action Plan, and CARICOM's Single Market Initiative, respectively) take into account the majority of the above-mentioned RPG matters and aim to remove the existing obstacles to sub-regional trade and investment flows. Though the four customs unions have been progressively deepened since the 1990s with the inclusion of non-border measures, they still have a long way to go in order to reach a next stage of “deep integration”, which, in part, involves the provision of RPG (see Boxes 1, 2 and 3).

<table>
<thead>
<tr>
<th>Box 1</th>
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<tr>
<td><strong>Summary of the MERCOSUR proposal “Target 2006”</strong></td>
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</table>

### Political, social and cultural programme
- Increasing participation of civil society
- MERCOSUR Parliament, which could be elected by direct voting by 2006
- Boosting cultural cooperation
- Setting up a social institute
- Enhancing “MERCOSUR Ciudadano” (civil society)

### Customs Union Programme
- Dealing with development asymmetries
- Common external tariff (perforations eliminated by 2006)
- Special common regimes (negotiated until 2006)
- Free trade zones
- Common external negotiations
- Common commercial defence, including safeguards for extra-zone trade (regimes negotiated until 2004 and adopted in 2006)
- Definition of instruments for the gradual elimination of anti-dumping measures and countervailing measures for intra-group trade (negotiated until 2004, entry into force in 2006)
- Policy on common defence of competition (entry into force in 2006)
- Productive integration with promotion of competitiveness forums; definition of financing instruments; training programmes; and mutual recognition of conformity assessment systems
- Discipline on incentives (negotiated until 2004, entry into force in 2006)
- Macroeconomic coordination
- Reinforcement of institutions

### Bases for a Common Market
- Liberalization of services
- Regional capital market
- Promoting regional investment
- Bases for a common currency
- Government procurement (agreement scheduled for conclusion in 2003)
- Circulation of labour force and promotion of workers’ rights

### Programme on new integration
- Education for MERCOSUR
- Cooperation programmes in science and technology
- Advanced productive integration
- Physical integration

**Source:** MERCOSUR Administrative Secretariat, MERCOSUR/XXIV CMC/DI N° 01/03.
### Box 2
#### Summary of Quirama Declaration
(Andean Community)

The aim of this general programme is to enhance the process of embarking on a second generation of policies and to establish the following lines of strategic action and guidelines:

**Political dimension**
- Construction of a governance agenda
- Preparation of a set of guidelines on the Andean common security policy
- Launch of the Andean pan for the prevention, combating and eradication of small, light weapons
- Adoption of a programme to disseminate and implement the Andean charter for the promotion and protection of human rights
- Implementation of the operational plan for the control of illegal drugs and related offences
- Preparation of guidelines for an Andean plan to fight corruption
- Adoption of an Andean plan to fight corruption
- Laying down the guidelines for a subregional food security policy and action plans against poverty and marginalization
- Holding the first Andean Community-MERCOSUR and Chile political dialogue and cooperation meeting; Conclusion of the free trade agreement by the end of 2003; Continuation of negotiations for a political dialogue and cooperation agreement with the European Union and continuing negotiations with other countries and groups of countries.

**Social and cultural dimension**
- Formulation of the integrated social development plan
- Establishment of regulations for the decisions on labour migrations, social security and safety and health at work. The adoption of the necessary legal provisions for mutual recognition of professional licenses, degrees and accreditations
- Ensuring social participation in the integration process and defence of consumer and indigenous rights
- Preparation of policy guidelines to improve the quality, cover and relevance of education
- Promoting the creation of an Andean commission on investment in health.

**Economic dimension**
- Fostering a process of reflection on the Free Trade Area of the Americas (FTAA) and the Andean Community’s international positioning
- Analysis of the causes and proposal of solutions for non-compliance with Andean Community regulatory provisions
- Assessment of the integration process for each country
- Formulation of a common agricultural policy
- Formulation of programmes for the liberalization of subregional trade in services and implementation of actions for linking customs.

**Border integration and development**
- Establishment of a comprehensive plan for border integration and development
- Support for implementation of South American Regional Infrastructure Integration Initiative (IIRSA)
- Promotion of border integration zones.

**Sustainable development**
- Design and execution of programmes on the environment, energy development and disaster prevention and assistance
- Design an Andean Plan to follow up on the World Summit on Sustainable Development (WSSD) held in Johannesburg and WSSD's Plan of Implementation.

**Institutions**
- Supporting and strengthening the Andean integration system
- Preparing proposals for extrajudicial conflict settlement
- Acceleration of the direct election of an Andean Parliament.

*Source: Andean Community, Quirama Declaration [online], General Secretariat, 28 June 2003 (http://www.comunidadandina.org/ingles/document/Quirama.htm).*
Box 3
Summary of Central American Common Market Action Plan and CARICOM Single Market initiative

Central American Common Market Action Plan, 2002 (ADVANCES)
The action plan on Central American economic integration was adopted on 24 March 2002. The plan seeks to achieve deeper integration in the following dimensions:

Political, Institutional and Law dimensions
- Work in a comprehensive agenda to achieve the goals of the Action Plan
- CET tariff harmonization (tariff changes by consensus)
- Adoption of Treaty on Investment and Trade in Services (actually in force)
- The Central American Uniform Customs Code (CAUCA) has been approved
- Approve Dispute Settlement Mechanism
- Integration of the Executive Committee of the Central American Integration System (SIECA)

Economic dimension
- Macroeconomic convergence, specially in the achievement of:
  a) reciprocal financing supervision;
  b) harmonization of Central American public debt markets to eliminate barriers to capital flows

Border integration and development
- Support for implementation of the Puebla-Panama Plan to improve infrastructure of the region to achieve and promote regional development and integration of Central American countries with Mexico in energy, infrastructure, telecommunication, and trade facilitation.

Sustainable development
- Support for implementation of the Puebla-Panama Plan to strengthen the Meso-American initiative for sustainable development, human development and the prevention and mitigation of natural disasters.

CARICOM Single Market Initiative (ADVANCES)
The region has pursued and intensified its efforts to consolidate the Caribbean integration and has established the CARICOM Single Market and Economy (CSME).

Political, Institutional and Law dimensions
- CARICOM authorities decided to establish a work unit within the CARICOM Secretariat
- Joint action to maintain a single voice in international and hemispheric bodies (Regional Negotiating Machinery)
- Harmonization of customs legislation, regulations and forms
- Establishment of the Caribbean Court of Justice
- Establishment of the CARICOM Regional Organisation for Standards and Quality
- Approval of measures to avoid double taxation

Economic dimension
- Macroeconomic convergence, specially in the achievement of:
  a) External reserves requirement (three month’s import coverage of 80% of foreign currency bank deposits in central banks for a 12-month period);
  b) Exchange rate requirement (stable against dollar with 1.5% band for 36-month period); and
  c) External debt-servicing ratio (no more than 15%).

Impediments to Interregional South-South Trade

Two interrelated problems provide possible explanations for the level and moderate growth of trade flows for LAC’s inter-regional South trade: country composition and product composition. Trade flows between LAC and Developing Asia (DA) and Central and European countries (CEE), for example, are concentrated in a few countries (Kuwayama, Mattos and Contador 2000, and Maldonado and Durán 2004), although import and export markets for both regions have become more diversified, and this process is expected to continue in the future. Regarding product composition, trade flows are remarkably different according to the direction of trade: imports from DA and CEE are composed of manufactured goods, whereas LAIA exports are mainly primary commodities. The nature of those flows is almost purely inter-industrial. This problem has been compounded by geographical distance, in general, and the lack of direct transport and irregularity of services offered across the Pacific, in particular, which have rendered trade exchanges between the two regions difficult, negatively affecting the competitiveness of export products.

Given the divergent pattern of international specialization between LAC, DA and CEE, LAC’s future trade expansion to these two regions will most likely involve mainly traditional product areas, rather than those of an intra-industry nature, which theoretically possess high value-added and technology contents. However, as has been demonstrated in several LAC countries (Kuwayama and Durán 2003), it is quite possible to increase value-added and technology and knowledge contents in traditional export products by incorporating high quality services and other production methods such as information technologies.

On the other hand, a better intra-industry articulation between regions in the South is especially promising in cases where countries are less asymmetric in terms of development levels and industrial capabilities, and promoted by a de facto productive and financial integration by way of investment or joint ventures. This process is expected to provide another means for LAC countries to integrate themselves more effectively, especially in DA. It should also promote investment and the incorporation of technology and management skills, which will be facilitated by involving countries that have rapidly closed the "technology gap" with the developed world.

Moreover, given the present low level of economic interchange, discussions of trade accords or agreements should incorporate, from the outset, economic cooperation schemes for deeper interregional interaction. Cooperation could incorporate instruments such as trade and investment promotion schemes, training programmes for managers, scientific and technical cooperation and energy cooperation. "Business facilitation" should be encouraged, and special emphasis needs to be given to customs rules and procedures and technical standards and related testing and certification. Programmes on small- and medium-sized enterprises (SMEs) should also be encouraged, including human resources development, access to information and technology and sharing of technology, financing and joint-ventures. 116 It is also important to

116 APEC has traditionally been in 13 areas of economic and technical cooperation and these could be major component of these efforts, the areas are: human resources development; industrial science and technology; small- and medium-sized enterprises; economic infrastructure; energy; transportation; telecommunications and information; tourism; trade and investment data; trade promotion; marine resource conservation; fisheries, and agricultural technology. Environmental protection does not appear in this list, but is mentioned in the context of some of the other areas.
resolve problems related to cargo systems and passenger transportation, identify areas of bottlenecks and formulate proposals to improve transportation and promote cooperation agreements. With respect to the enhancement of interregional trade for LAC, the provision of several RPG is also essential.

**Proliferation of PTAs and South-South trade**

**A. Introductory remarks**

Among the various routes towards trade liberalization (i.e., unilateral, subregional, multilateral and hemispheric) that have been applied in the region, bilateral and plurilateral FTAs have predominated over customs unions since the mid-1990s. Moreover, LAC governments have been working actively to establish a network of arrangements with countries both within and outside the region, while proceeding with the negotiations on the creation of Free Trade Area of the Americas (FTAA). Mexico and Chile have concluded FTAs with a number of countries and regions that are not geographically contiguous, such as the European Union, as well as with the European Free Trade Association (EFTA). Chile has signed an FTA with the United States, and other FTAs have been implemented with Canada, the European Union, EFTA and several other parties. Central American countries have negotiated an FTA with the United States. MERCOSUR is building up an inter-regional association with the European Union, and there are initiatives to cover India and China, among others.

Using the PTAs in existence as of 31 of March 2004, including those PTAs that have been signed but not yet ratified, ECLAC estimates suggest that approximately 61 per cent of LAC exports in the first quarter of 2004 were covered by PTAs (i.e., bilaterals as well as plurilaterals) in one way or another, and that the increase in this coefficient has been especially sharp since the mid-1990s and continuing on into the present decade. It is important to point out that during this period, the most marked progress has been seen in the conclusion of FTAs with countries outside the LAC region proper (Figure 3), especially with the North countries such as the United States, Canada, the EU and EFTA countries. In the course of this process, Chile and Mexico have become true “semi-hubs” for FTAs in the hemisphere. Of the 61 per cent of LAC exports mentioned above, 49.5 per cent corresponds to extra-regional markets, in contrast to a small portion (11.6 per cent) for intraregional markets. In the former category, the North-South type predominates.

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117 This includes the Central America Free Trade Agreement (CAFTA), which has already been signed, and the FTA between the Republic of Korea and Chile, which has already entered into force.
Figure 3
LATIN AMERICA (18 COUNTRIES): EXPORT FLOWS, BY PREFERENTIAL TRADE AGREEMENT, 2004
(Per cent of total trade)

SOURCE: ECLAC, DIVISION OF INTERNATIONAL TRADE AND INTEGRATION, ON THE BASIS OF TRADE INFORMATION FROM THE UNITED NATIONS COMTRADE DATABASE.

* For the 2004 estimate, the two-year average of exports for each country was used to determine the trade structure, and the PTAs in existence as of 31 March (including those for which negotiations have been concluded) were taken into account.
B. “Deep” integration in North-South and South-South agreements

Perhaps the most dramatic change in the LAC integration process has been the shift from an intraregional focus (South-South) to a growing interest in interregional agreements (North-South). This change has meant that LAC is now trying to link up with North countries via reciprocal FTAs, in contrast to the traditional non-reciprocal approach that these countries were more accustomed to. This increased tendency to pursue bilateral trade agreements (BTAs) parallel to the FTAA negotiations, especially the recent interest by the United States in initiating and/or concluding bilateral FTAs with Chile, Central America, the Andean Community and others, poses potential risks for a comprehensive and balanced WTO agreement and FTAA. In addition, there has been a proliferation of South-South FTAs in the region, led principally by Chile and Mexico as regional hubs. The progress of hub-and-spoke regionalism in the Western Hemisphere has been rapid despite the recognition that preferences obtained by BTAs would be gradually perforated and diluted by other PTAs over time. These strategies could stifle the formation of a balanced FTAA and could have a negative effect on economic and social welfare.\textsuperscript{118}

It is important to note that, with regard to aspects of these BTAs as they relate to the North, that they tend to establish and consolidate the access already enjoyed by LAC countries through the Generalized System of Preferences (GSP). Secondly, those FTAs include provisions on investment, competition policy, government procurement and trade facilitation that are of special interest to the North with “WTO-plus” disciplines for which there are no multilateral rules currently in place. Thirdly, issues that affect Latin American signatories, such as internal support measures in agriculture or anti-dumping legislation, are remitted to the multilateral negotiating forum.

Therefore, LAC countries pursue North-South FTAs to secure more stable and greater market access, to attract foreign direct investment and to “lock-in” and add credibility to the often “WTO-plus” trade-related disciplines contained in FTAs. However, trade liberalization commitments contained in these FTAs with the North tend to reinforce comparative advantages of the countries of the South either in primary commodity sectors (e.g., South American countries), or in unskilled labour-intensive manufacturing sectors (e.g., Mexico and Central American and several Caribbean countries). At the same time, these FTAs are likely to divert intra-LAC trade in several important manufacturing sectors. Likewise, South-South FTAs with other developing countries outside the region (e.g., Chile-Korea FTA) would also reinforce comparative advantages of LAC countries in traditional sectors, while they increase complementarities in inter-industrial rather than intra-industrial trade relations.

Another important characteristic of North-South FTAs involving the United States is that these FTAs generally do not include a “cooperation” component, and are therefore not mercantilist or business–oriented in their initial intent, though this orientation might change in the near future (Devlin and Estevadelordal 2002). From the perspective of exclusion of cooperation aspects from their commitments, NAFTA, the new BTAs and the LAFTA of the 1960s can still be considered “shallow”, despite their broad coverage of disciplines and comprehensive nature of commitments.

\textsuperscript{118} The Santiago Declaration repeats the Declaration of the IV Ministerial Meeting on Trade in San José, Costa Rica stipulating that the FTAA can co-exist with bilateral and subregional agreements to the extent that the rights and obligations under these agreements are not covered by, or go beyond, the rights and obligations of the FTAA (building blocks approach); and that the FTAA should be constructed based on commitments that are balanced, equitable and advantageous for each of the members.
In contrast, the old LAC subregional integration schemes contemplate cooperation schemes in their initial commitments. Meanwhile, Western Europe is a good example of where deepening trade interdependence through trade has evolved into comprehensive mix of trade and cooperation. NAFTA partners seem to be moving from a pure trade orientation to a mix of trade and cooperation. APEC is rather unique with its strong emphasis on cooperation and voluntary commitments on trade liberalization. ASEAN may be a unique case where the focus shifted from cooperation to a combination of trade and cooperation. The Western Hemispheric Summit process, which involves a free trade negotiation coupled with a confederation of somewhat autonomous non-trade cooperation initiatives involving more than twenty areas, might be considered as another type. On the other hand, Japan is beginning to apply the already established pattern of the Agreement between Singapore and Japan for a New Age Economic Partnership, which has a strong focus on economic cooperation, to other FTA negotiations with the countries of the South (Aoki 2004), including Mexico. From the perspective of LAC South-South trade, several cooperation schemes are contemplated within the framework of an India-MERCOSUR Agreement. An inter-regional South-South FTA, the Chile-Korea FTA, contemplates in its official text a series of initiatives on bi-national cooperation in areas such as, amongst others, phyto-sanitary and sanitary measures, conformance and standards, information technology.

It should be stressed that in addition to the mercantilist approach, most of the FTAs signed in the 1990s and during the present decade that include developing countries in the Americas, follow the NAFTA model in terms of thematic coverage, with a possible exception for competition policy. South-South FTAs existing in the region are no exception to this rule. These second-generation FTAs are more comprehensive in scope, not only because they are “broad” in terms of the number of sectors negotiated and incorporated, but also because of the “depth” of the commitments they bring to bear in those sectors that are “WTO-plus” disciplines. This is especially true for services, investment and intellectual property (Blanco and Zabludovsky 2003). These FTAs are, of course, not identical to NAFTA, and take into consideration the specific interests of the relevant trading partner(s), thereby establishing a realistic agenda for the parties involved. However, not only do all these FTAs share the philosophy and format of NAFTA but that some texts in certain disciplines are almost identical to those of NAFTA (Blanco and Zabludovsky 2003). These FTAs also introduce new approaches to older issues such as rules of origin, contingent measures for imports and dispute settlement.

In sum, BTAs, especially those with North-South dimension, improve market access, consolidate and expand trade preferences, establish mutual rights and obligations (dispute settlement mechanisms), lock-in liberalization efforts, and may favour institutional modernization. Nevertheless, multiple BTAs do have some costs: intraregional trade diversion,

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119 As outlined in the Hemispheric Cooperation Programme, endorsed by trade ministers attending the meeting held in Quito, Ecuador on 1 November 2002, the technical cooperation available will be fundamental to ensure that the FTAA brings benefits to its members. This should not be limited to providing technical assistance, but should also include strengthening productive capacity and stimulating competitiveness, innovation and technological transfers.

120 In the case of the Japan-Mexico FTA, the Mexican government sources state that this agreement will have a strong emphasis on economic cooperation especially in the area of enhancement of Mexican SMEs.

121 For instance, India and Brazil signed five agreements that include bilateral cooperation in the peaceful use of outer space, tourism, culture and other areas.

122 In the case of services, for example, the scope of BTAs tend to be similar to that of NAFTA, and a fundamentally compatible relationship thus exists between this agreement and those signed by the countries in the region (Kuwayama 2003).
administrative costs ("spaghetti bowl"), reduced bargaining power for smaller countries, some countries agreeing to certain demands in areas that go beyond commonly accepted trade issues, etc. They also reduce the incentives to push the regional envelope and the willingness of the developed world to push multilateral negotiations. Besides, it should be kept in mind that FTAs (and FTAA) are an opportunity, and not a "panacea" — much in the same way that the structural reforms of the 1990s were not a "panacea" either.

In the same context, ECLAC (2004a) has argued that to ensure their development, countries generally must hold onto some flexibility to stimulate productive development, boost competitiveness and manage the capital account as a tool in macroeconomic regulation. Moreover, to ensure the eventual convergence of the level of development of participating countries, new initiatives are vital, among them the creation of cohesion or integration funds\textsuperscript{123} and increasing international labour mobility (Assael 2004, Bustillo and Ocampo 2003). The countries of the region should maintain a certain degree of flexibility within the subregional, WTO and FTAA disciplines in order to adopt active policies for productive development and thus increase their systemic competitiveness.

Deep integration agenda and South-South agreements

A. South-South agreements as solutions for supply-side constraints

It is often pointed out that the product composition of intra-regional trade differs substantially from that of inter-regional trade with the rest of the world, and that intra-regional trade is mainly composed of manufactured goods with higher value added, in contrast to trade with the rest of the world.

This is precisely the case for LAC: almost 60 per cent of intra-regional trade consists of manufactures, 20 per cent of food products, 2 per cent of agricultural raw materials, 5 per cent of ores and metals, and 14 per cent of fuels. In contrast, the production composition of LAC exports to the US market is skewed toward manufactures (74 per cent) when Mexico is included, while the share of manufactures for the EU market is quite small (29 per cent) and even smaller for Japan (17 per cent). LAC exports to EU (15) and Japan consist mainly of foods, and ores and metals. Interestingly, the share of manufactures with DA is substantially higher (33 per cent), highlighting once again the importance of South-South trade as a potential source of technological learning for LAC countries (see Figure 4).

\textsuperscript{123} With respect to the FTAA on this issue, in the Third Summit of the Americas, (April 2001, Canada) various leaders called for the creation of a fund for social cohesion or integration that would allow a greater support to the hemispheric agreement. In that meeting, the President of Mexico referred to a cohesion fund, while various Caribbean prime ministers highlighted the importance of integration funds. The Government of Ecuador, which was in charge of coordinating negotiations until November 2002, later proposed the creation of a fund to promote competitiveness (Assael 2004). Venezuela has put forward a number of proposals regarding the issue of structural convergence funds (see: FTAA.TNC/w/242, Feb.16, 2004 in the FTAA website).
The product composition of LAC exports by destination (intra-regional markets vs. North markets) and by technology intensity has experienced a substantial change over the years. Between the period 1990-1992 and 2000-2002, the share of manufactures in LAC-North trade increased from 56 to 74 per cent, due mainly to the impressive expansion of Mexican exports to the US market. This maquiladora-type trade for Mexico and several Central American and Caribbean countries with the United States translates into a relatively high ratio of 20.5 per cent registered for high technological intensity (HTI) products (see Table 7.A). It is noteworthy that the share of manufactures in intraregional trade increased to 75 per cent for the 2000-2002 period from an already high level of 71 per cent of the earlier period.

The breakdown of intra-regional trade in manufactures in 2000-2002 was as follows: natural resource-based manufactures (NRBM) products (29 per cent) and intermediate technological intensity (ITI) category products (14 per cent) were dominant, while the share of HTI remained at a low level (7 per cent), but was rising. The picture gets more clear-cut when Mexico is excluded (Table 7.B): the share of manufactures in LAC-North trade was around 50 per cent, and NRBM products accounted for another 25 per cent. In contrast, intra-regional trade showed a high manufactures share, composed primarily of NRBM (27 per cent) and ITI products (28 per cent). Meanwhile, the difference in HTI products between North-South and South-South trade almost disappeared due to the exclusion of Mexico.

Looking at the export structure of each sub-region by technology intensity, in South America, the trend towards diversification of the products that make up the export basket was particularly strong in the 1980s, but then stabilized in the early 1990s. The sub-region continues to be heavily dependent on commodities (see Figure 5.d). Although the share of ITI- and HTI manufactures has increased, it still falls far short of the increases observed in Central America and Mexico. This positive trend is largely due to the expansion of trade in consumer durables and manufactures in MERCOSUR and the Andean Community.
Central America and Mexico have made much more progress in reducing their dependence on commodities. As shown in Figure 5.b, they have completely changed their export pattern, moving from a basket in which commodities accounted for approximately 56 per cent to one in which manufactures, including technology-intensive products, account for 87 per cent. A similar, albeit much more limited, process has been observed in the Caribbean countries (see Figure 5.c). But a more detailed look at LAC intraregional trade by subregional groupings suggests that the importance of manufactures, and of ITI products in particular, applies to each of the four integration schemes (MERCOSUR, Andean Community, CACM, and CARICOM) (see Table 8).
In 2000, for example, ITI and HTI products accounted for more than 34 and 7 per cent, respectively, of total intra-MERCOSUR trade. Similarly, CACM showed remarkably high ratios of intra-zone trade in each of the three technological intensity categories (i.e., low, intermediate and high). An interesting case is Chile, which showed relatively high ratios for manufactures goods including ITI products for its intraregional trade; this stands in strong contrast with this country’s export basket to the North, in which primary commodities occupy a preponderant place. The above observations seem to support the thesis that at least for LAC, regional integration has been, and can be, a device that fosters a diversification of exports towards non-traditional exports, diversified products and even products of more value-added and intensity in knowledge. In fact, the learning curve associated with experience in regional markets can serve as a platform for new international markets (Devlin and Ffrench-Davis 1998). This idea has been a major force of the concept “Open Regionalism” which ECLAC has been advocating since the mid-1990s (ECLAC 1994).
Table 8
LAC Intraregional trade exports by technological Intensity, 2000

<table>
<thead>
<tr>
<th></th>
<th>LACs</th>
<th>MERCOSUR</th>
<th>Andean Community</th>
<th>CACM</th>
<th>CARICOM</th>
<th>Mexico</th>
<th>Chile</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A.- Primary Products</strong></td>
<td>25.0</td>
<td>26.5</td>
<td>37.2</td>
<td>12.3</td>
<td>21.0</td>
<td>7.4</td>
<td>24.8</td>
</tr>
<tr>
<td><strong>B.- Manufactures</strong></td>
<td>75.0</td>
<td>73.5</td>
<td>62.8</td>
<td>87.7</td>
<td>79.0</td>
<td>92.6</td>
<td>75.2</td>
</tr>
<tr>
<td>Manufactures based on NR</td>
<td>26.4</td>
<td>19.8</td>
<td>32.4</td>
<td>30.5</td>
<td>52.1</td>
<td>16.5</td>
<td>46.8</td>
</tr>
<tr>
<td>Low technology</td>
<td>13.3</td>
<td>12.3</td>
<td>12.1</td>
<td>23.4</td>
<td>12.5</td>
<td>14.7</td>
<td>9.7</td>
</tr>
<tr>
<td>Intermediate technology</td>
<td>26.9</td>
<td>34.2</td>
<td>15.0</td>
<td>23.0</td>
<td>12.6</td>
<td>36.1</td>
<td>16.0</td>
</tr>
<tr>
<td>High technology</td>
<td>8.3</td>
<td>7.3</td>
<td>3.3</td>
<td>10.7</td>
<td>1.8</td>
<td>25.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Total (A+B)</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

*Source:* ECLAC International Trade and Integration Division, based on Comtrade data.

North-South FTAs tend to reinforce comparative advantages of the South, as in the case of South America, whose major exports are based on NRBM goods, or Mexico, Central American and some Caribbean countries whose comparative advantage is based mostly on price differentials, especially low-wage labour. Though Mexico and some Central American and Caribbean countries have increased their exports in fast-growing high-tech sectors, the maquila manufacturing contributes little value added to the economy; imported inputs represent between 70 and 80 per cent of the gross value of maquila activities (Kuwayama and Duran 2003). While it is true that free trade zones make contribution in terms of job creation and the generation of foreign exchange, these zones should play a more dynamic role in the development process.

As pointed out earlier, in many LAC countries, natural resources can be an important source to increase value-added and knowledge content in exports, emphasizing natural resource endowments such as landscape, climate and biodiversity as an element of international competitiveness. To foster this process further, it is desirable to: i) create networks and clusters in natural resources areas; ii) encourage the emergence and incorporation of technology intensive services to support the production process and tourism; iii) promote SMEs and their involvement in export activities; and iv) encourage the use of information and communication technologies as a tool for export promotion. In sum, the role of natural resources has to be re-addressed and re-examined as a potential promoter of technology transfer from a viewpoint of advantages of FTAs, North-South and South-South alike.

B. **South-South RTAs/FTAs as Support for “Systemic Competitiveness” of LAC as a Region**

Regional integration should tackle several dimensions of “deep integration” in a context of “open regionalism” by way of enhancing the provision of regional public goods (RPG). This involves reducing tariff dispersions and non-tariff barriers, and addressing “behind-the-border” measures, while harmonizing regulatory regimes, improving infrastructure (e.g., transport, communications, cooperation in energy via regional interconnection, and ports), and strengthening dispute settlement mechanisms. Harmonization of rules among the member countries on areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phyto-sanitary norms, customs procedures, and factor mobility should enhance the systemic competitiveness of each country and the region as a whole. In addition, this approach to integration requires the adoption of agreements that will contribute to macroeconomic stability and productive development in each country. In sum,
government provision of many of these public goods is a key determinant of the enhancement of regional competitiveness.

In the area of trade in services which already represents close to 20 per cent of total exports of the region and which is particularly important for the Caribbean countries because of tourism and financial services, it is desirable to explicitly incorporate services exports into the trade promotion strategy of each country, which will result in establishment and/or harmonization of rules related to trade in services at the regional level. It is also important to adopt measures to expand services exports involving: i) mutual recognition of academic degrees, records and technical standards; ii) agreements on double taxation and double social security contributions; iii) protection and promotion of investments; and iv) facilitation of the temporary movements of individuals, especially business people and their representatives, through initiatives such as the issuance of a regional business visa. (Prieto 2003).

a) Macroeconomic coordination in sub-regional integration schemes

Financial instability and market inefficiency are an important “global public bad” for developing countries and efforts at the regional level to construct regional instructions and mechanisms for macroeconomic coordination can be perceptibly considered as a RPG.

Since the early 1990s, the idea of complementing the trade-related aspects of regional integration processes through the coordination of macroeconomic policy has been gaining force. The renewed interest in this area has been promoted by: i) the recognition that the incorporation of macroeconomic variables into trade integration schemes has come to be a key factor in deepening and ensuring the continuity of sub-regional agreements; and ii) the acknowledgment that growth impulses are increasingly being transmitted through financial variables rather than being confined to commercial conditions as in the past.

In the LAC region, macroeconomic policy coordination efforts have intensified in all integration schemes, but have stopped short of original expectations. Nonetheless, the European solution clarified three important empirical points with respect to a number of diverging theoretical positions; i) macroeconomic convergence is feasible even among countries with significant asymmetries in development levels and vulnerability to external disturbances; ii) macroeconomic stability is essential in order to deepen trade integration, and conversely, dynamic trade is a prerequisite for macroeconomic convergence; and iii) individual solutions, especially competitive devaluations, are suboptimal from both the domestic and regional points of views. The European experience has shown that it is not necessary to wait for the achievement of theoretically-optimal conditions before coordinating policies. As the European case seems to suggest, the prerequisites for successful cooperation in this area include a minimum level of intraregional trade and mobility in labour and capital, and price flexibility in goods, services and factors of production, and the political will to carry out such cooperation over time.

b) Competition regulation

Until recently, most LAC countries operated without a formal competition policy. If a government perceived uncompetitive behaviour, it often intervened directly. However, the latest wave of deregulation, privatization and liberalization has changed the situation. It is increasingly recognized that domestically, without appropriate national competition policies, privatization can reduce social welfare, especially in public services, while from an
international perspective the boom in cross-border mergers poses a potential threat to competition in the region. Likewise, along with the potential benefits of inward foreign direct investment come potential risks; in the absence of an appropriate and effective domestic competition policy, foreign firms can crowd out domestic investment, stifle domestic competition, and reduce domestic productivity growth. Stronger trade flows propelled by the integration process and potential conflicts are challenging trade policies and demanding more attention on the issue of contestability of markets. With this question uppermost in their minds, many Latin American countries in the 1990s created or reinforced their competition institutions and began coordinating and sharing information, and even began to include an element of competition in the subregional integration agreements (e.g., MERCOSUR, Andean Community, CARICOM), or with dispositions on competition in those agreements (NAFTA) and bilateral agreements. But some countries lack such regulations, while others are still at an incipient stage of their implementation. There is a wide scope for regional cooperation in this area (Silva, 2004).

c) Social Cohesion and Structural Funds

Despite their importance, social dimensions have not been adequately dealt with in Latin American regional integration schemes. The implementation of the social agenda is usually slow or postponed, while the concern for distributive effects has only been sporadically taken up. Regional and subregional agreement mechanisms only provide small financial resources aimed at improving the cohesion among social groups and supporting regions. Therefore, one of the major challenges in Latin American regional integration has been the adoption of effective, sustainable economic development policies and social integration policies for all social sectors that have suffered cumulative marginalization in the past 20 years.

In effect, integration processes have been significantly influenced by the fact that: i) disparities among the States and regions pose a risk for the integration process itself; ii) markets cannot, by themselves, promote economic integration when the states and regions are responsible for such disparities; iii) growth, competitiveness and employment are the principal instruments to achieve social cohesion; iv) there is a strong need to integrate economic and social policies in order to guarantee the citizenry an universal social protection system; v) the reduction of disparities by way of better access to training, education, employment (of women, the youth, and the unemployed for an extended duration), as well as of closing income and wealth gaps is an important base for social cohesion; and vi) a strong political will to provide support to States and less developed regions is necessary in order to achieve the conditions of convergence.

d) Inclusion of Border-region Migration Issues in the Regional Agenda

Though rather insufficiently, regional schemes (e.g. MERCOSUR, Andean Community, CACM, CARICOM) have already made some progress toward extending their fields of operation beyond the area of trade and are beginning to advance on issues related to their social agenda, which must include a specific recognition of the importance of migration. In this sense, the subregional integration agreements offer opportunities, as they represent especially suitable spaces for dealing with migration as a vital component of partnerships between members whose asymmetries are smaller than in the case of developed countries. Matters of mutual interests for countries, such as cross-border transit, mobility of the workforce, social security, return of migrants and the mutual recognition of diplomas and courses of study can be more effectively addressed in subregional or bilateral agreements.
There are important precedents in various integration components, the examination and renovation of which is pending: this is the case of the Andean Instrument of Migratory Labour, in the framework of the Simón Rodríguez Convention, which promises to provide the basis for an equalitarian treatment of working migrants.

e) Trade Facilitation

The LAC region as a whole has a clear and urgent need for additional measures to facilitate trade and business activity. Most importantly, special emphasis should be placed on standards and regulations relating to the modernization of customs systems. However, reforming the customs of countries at a low level of development requires complex and significant institutional changes in the public sector, and then are generally systemic in nature and very costly. As a result, coordinated and efficient international technical and financial cooperation is required in order to enable these countries to create the necessary capacities to achieve an appropriate degree of modernization. This is also relevant at the interregional and subregional, as well as bilateral and national levels, but is particularly important for the facilitation of international transactions by small and medium-sized enterprises (Izam 2003).

f) Sanitary and phyto-sanitary measures and technical barriers to trade

In order to ensure that negotiations on enforcing sanitary and phyto-sanitary measures and technical regulations achieve their goal and make it possible for the region to reap the benefits of integration, it is essential for countries to have suitable domestic institutional structures in place to administer the agreements and enforce the commitments that have been made. Most Latin American countries need to strengthen and modernize their institutional structures, to enable them to maintain a suitable and flexible system for the timely diffusion of national, regional and international data, thereby making it possible to fully exploit economic advantages. The countries of the region could therefore be well advised to make progress in harmonizing sanitary and technical rules and regulations, first in the regional domain and then internationally. The establishment of equivalence between measures adopted by the signatories of regional or subregional agreements is advantageous, partly because it reduces the potential for product discrimination among them and streamlines the import process (Larach 2003). As this is likely to benefit national consumers in addition to regional or subregional importers, such measures should be viewed as public policies that are highly beneficial for production, consumption and trade.124

g) Physical infrastructure and sustainable development

In LAC, there are many issues and major challenges in the field of infrastructure and sustainable development that have motivated regional cooperation. Transport and tourism are representative examples. The issue of transport has gained importance in the debate on instruments to promote trade and investment in a world of low tariffs and progressive elimination or harmonization of non-tariff barriers, since lower transport costs directly encourage exports and imports and are equivalent in effect to a tariff reduction. At the same

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124 For example, Andean Community countries have agreed to implement the Andean System of Standardization, Accreditation, Testing, Certification, Technical Regulations and Metrology (Decision 376). An earlier resolution (Decision 238) defined the equivalence of national sanitary and phyto-sanitary regulations between member countries. This type of agreement, in which the Andean countries signed a pact on trans-border movements of genetically modified organisms, is an example of the harmonization of national regulations on biotechnological safety. MERCOSUR has a commitment to harmonize sanitary and phyto-sanitary measures, and maintains a technical standardization committee whose mission is to deepen regional cooperation on this issue.
time, market failures and imperfections that raise transport costs tend to concentrate industrial and economic activity in areas that are already endowed with suitable human and physical infrastructure (Venables and Gasiorek, 1998). Some major initiatives include the South American Regional Infrastructure Integration Initiative (IIRSA) and the Puebla-Panama Plan (PPP). The Association of Eastern Caribbean States has also set up a programme entitled “Unifying the Caribbean by Air and Sea”, which aims to harness public and private efforts among member countries and stimulate regional cooperation mechanisms. Caribbean countries will also cooperate in implementing air transport training programmes.

In terms of sustainable development, the LAC region has a characteristic that distinguishes it from all others: the wealth and importance of its natural resources and the global risks inherent in the rapid process of environmental degradation (ECLAC, 2002a). In recent years, several major regional proposals have emerged in this domain. The eight signatory countries of the Puebla-Panama Plan adopted the Meso-American Sustainable Development Initiative as a strategic and crosscutting framework to ensure that all relevant projects, programmes and measures contain appropriate environmental management practices and promote conservation and sustainable management of natural resources. Another important example is the Regional Biodiversity Strategy for the Tropical Andean Countries —a wide-ranging initiative for this sub-region that represents one of the world’s richest zones in terms of natural resources, containing about 25 per cent of the biological diversity of the entire planet. The strategy is one of the first attempts by the sub-region to develop a comprehensive platform of community action, promoting cooperation between member countries and projecting them with a new and unique identity to the international community. It is also one of the first community strategies adopted on this issue by a group of signatory countries of the Convention on Biological Diversity, and makes a specific contribution towards fulfilling its objectives (Andean Community 2003)

Conclusion

South-South trade already constitutes an important segment of LAC trade, especially when Mexico is excluded from the picture; almost half of region’s exports are of a South-South nature. The region's South-South trade is split almost evenly between intra- and inter-regional trade, the former representing more than 27 per cent while the latter, 21 per cent of region’s total trade. It should be noted, however, that the present level of intra-regional trade is still low when compared to the peak of 21.1 per cent registered in 1997, despite its rebound in 2003 and continued recovery into 2004. While this trade holds a high potential for future growth, there are a series of problems to be addressed in order for regional integration to continue on the paths of recovery and “deep” integration.

By their nature, regional trade agreements (RTAs) divert trade by creating preferential treatment for member countries vis-à-vis non-members. However, regional integration can foster economies of scale: in the presence of economies of scale, what would otherwise be a costly trade diversion could be transformed into a cost-reducing and welfare-enhancing trade creation. At the same time, regional integration can be a device that fosters a diversification of exports towards output that is more connected to the overall competitiveness of the economies concerned, creating dynamic comparative advantages. It serves to “lock-in” improved access to regional markets, thereby fostering economies of scale. It can enhance non-traditional exports, differentiated products and products of more value added and intensity in knowledge.
The concurrent existence of an FTAA and subregional and bilateral FTAs with countries in and outside the region will surely increase the complexity and reduce the transparency of the multilateral trading system. Ensuring that rules across subregional agreements and between these agreements and the WTO are more compatible might lessen the negative effects that arise from the myriad of FTAs with their own distinct "depths" and scope. However, in some cases, coordination among the FTAs facilitates the convergence and compatibility process with regional and multilateral agreements. It may be possible to pursue a multi-track strategy of multilateral, regional and bilateral aspects that might lead to free and fair trade quicker than relying on just one track.

RTAs should tackle several dimensions of “deep integration” in a context of “open regionalism” by intensifying efforts on the provision of RPG: i) addressing “behind-the-border” measures, while harmonizing regulatory regimes in areas such as services, investment, intellectual property rights, rules of origin, anti-dumping, safeguards, sanitary and phytosanitary norms, customs procedures, and factor mobility; ii) advancing the efforts on the coordination of macroeconomic policy; and iii) improving various kinds of infrastructure and providing crucial public goods. These efforts will enhance systemic competitiveness of each country and the region as a whole.

These initiatives, which would result in the reduction of production and transaction costs inside the region and the avoidance of unnecessary competition among the countries, will likely facilitate inter-regional South-South trade as well. Given LAC’s relatively low level of economic interaction with other developing regions, there is a need to institutionalize the mechanism of consultation and implement joint actions. In this perspective, future RTAs/FTAs between LAC countries and other developing regions should incorporate from the outset economic and technical cooperation as an integral part of the trade and investment liberalization effort. Some possible areas are: i) human resource development; ii) science and technology; iii) promotion of SMEs; iv) information technology (IT) and E-commerce; v) tourism; vi) food security; vii) transport infrastructure; and viii) environmental protection.

As for other regions of the South, Developing Asia is still an under-exploited export market for LAC. But as the experiences of some LAC countries in the 1990s and recent years demonstrate, there seems to be a good potential for expanding natural resource-based exports from the region. However, LAC’s trade with Developing Asia exhibits the same limitations that the region has in international trade in general: its exports are mostly primary and semi-manufactured goods. LAC needs to find ways to increase the degree of processing of these natural resource-based export products and seek new outlets in Asia for more value-added differentiated products. The present product composition is extremely sensitive to economic cycles of importing countries and does not help to stabilize export earnings, as evidenced in drastic drops in export earnings in the Asian markets during the financial crisis. What is important in these product areas, however, is to find strategic alliances to augment value-added across the production chain and to increase market access.
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Chapter X

ADDRESSING MARKET ACCESS AND ENTRY BARRIERS THROUGH REGIONAL INTEGRATION TO MAXIMIZING DEVELOPMENT GAINS: THE CARICOM EXPERIENCE

Fay Housty

Background

On 4 July 4 2004, the Caribbean Community (CARICOM) celebrated its 31st anniversary as a Community and the 36th year since its Member States took the first step towards integration through the creation of a Free Trade Area (CARIFTA) in 1968. This makes CARICOM the longest surviving integration movement among developing countries and is only surpassed by the European Union in longevity. Today it has 15 full Member States125 and five Associate Members.126 More than half its members are microstates and are among the smallest in the world. In recognition of this reality, the CARICOM arrangement makes a distinction between its More Developed Member States127 and its Lesser Developed Member States128 and provides for special measures to assist the latter category.

At the beginning of the integration process all CARICOM Member States shared a common language, similar economic and social structures, a common legal system and a common colonial heritage that provided the building blocks for the regional integration process. With the entry of Suriname in 1996 and Haiti in 2002, today CARICOM is a more linguistically, legally and culturally diverse Community.

Notwithstanding the numbers of CARICOM Member States, they are challenged to overcome critical constrains relating to:

- An undiversified range of economic resources;
- Openness with a heavy reliance on external trade, foreign investment, technology, and overseas development assistance;
- A narrow export base, mainly sugar, rice, bauxite, petroleum products, tourism and financial services and in some economies such as Trinidad and Tobago, a growing light manufacturing sector;
- High dependency on trade taxes;
- High dependency on preferential trading arrangements in the US, European and Canadian markets;
- Limited administrative and managerial resources;
- Costly provision of socio-economic infrastructure and services;

125 Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, St Kitts-Nevis, St Lucia, St Vincent and the Grenadines, Suriname, Trinidad and Tobago.
126 Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Turks and Caicos Islands.
127 Bahamas, Barbados, Guyana, Jamaica, Suriname and Trinidad and Tobago.
128 Antigua and Barbados, Belize, Dominica, Grenada, Haiti, Montserrat, St Kitts and Nevis, St Lucia and St Vincent and the Grenadines.
- High per unit transport costs; and
- Extreme vulnerability to natural disasters;

CARICOM Member States recognized that as individual entities they faced serious constraints in stimulating economic growth at a level and pace that would meet the expectations of their populations for a better standard of living. Regional integration was therefore conceived from the outset as an essential element in the economic development strategies of CARICOM Member States. It was perceived that the pooling of resources, markets and bargaining positions could lead to higher levels of economic and social benefits than the individual efforts of Member States. Today the creation of the CARICOM Single Market and Economy (CSME) seeks to make this a greater reality.

In 1989, five years before the WTO was established, CARICOM Heads of Government, conscious of the changing global environment and the need for CARICOM countries to become more competitive in a rapidly liberalized global economy, took a decision to create the CARICOM Single Market and Economy (CSME). While earlier integration efforts were designed in the import substitution mode, the CSME today seeks to remove remaining intraregional barriers and promote the free movement of goods and services, capital and labour. It also provides for the freedom of CARICOM nations to establish enterprises anywhere in the community thereby expanding the production frontier and providing the scope for CARICOM regional entrepreneurs to become more competitive and to integrate more effectively into the global economy.

The CSME also seeks to put in place a number of other measures as the Region seeks to deepen the integration process these include:

- The revision of the Treaty establishing CARICOM and making the single market and economy an integral part of the Community Arrangements.
- More comprehensive harmonization of laws affecting commerce and regulation of economic activities within the market area, including customs laws, intellectual property, competition, government procurement, corporate taxation and commercial legislation in such areas as dumping and subsidization. As all but one CARICOM Member States are WTO Members, these laws have to be WTO compliant. These elements are still in the embryonic stage of development intraregionally and Member States are developing their national capacities to implement these arrangements.
- Reform of the Community's institutions, including its administrative systems and procedures, and the establishment and joint management of common services with particular reference to customs services and data and information services.
- More intensive coordination of macro-economic policy and planning, external trade and economic relations.
- Completion of the application of the Common External Tariff (CET).

In order to effectively implement the Single Market and Economy, new arrangements have been put in place, new institutions have been created including the establishment of a Regional Standards Body in 2003 and the establishment of the Caribbean Court of Justice, which is to serve in its original jurisdiction, as the court for settling disputes arising from the CARICOM Treaty.

One of the major elements in the CSME is the implementation of a process for the removal of restrictions and barriers to the trade in Services. This process is being undertaking in phases.
and at least four Member States have undertaken to complete the process by the end of the current year. The services sector share of Gross Domestic Product (GDP) for CARICOM countries averages approximately 73 per cent, ranging from Antigua and Barbuda with 88 per cent to Guyana at 28 per cent. It is however, difficult at this time to differentiate and compare Member States' trade with the rest of the world and trade with other CARICOM countries.

Implementation of the elements required to establish a fully functioning CSME has proceeded at a slower pace than originally scheduled but there has been steady progress. The process of creating an internal Free Trade Area for trade in goods is essentially complete. The Community has jettisoned the use of quantitative restrictions (QRs) as a protective policy device. Ten Member States have fully implemented the Common External Tariff.

Assistance is being provided to Member States in the drafting of legislation, an area that was identified as major bottleneck in the past. At the political level the realization that the deadline set for the establishment of the FTAA and the onset of negotiations with the European Union has spurred some Member States to accelerate their implementation procedures.

**Assessment of trade**

CARICOM has had a rather checkered trade pattern over the years. The process of the liberalization of trade in goods among member States of the Caribbean Community began with the creation of the Free Trade Area (CARIFTA). CARIFTA encouraged the flow of intraregional trade through the removal of virtually all tariffs on intraregional goods and the use of very rudimentary rules of origin. The major sector that benefited from this process was the light manufacturing sector but the industries produced products with very little value added. Given the structure of the Caribbean economies, the liberalization of goods in the intra-regional market resulted in only modest gains. Despite a doubling of the ratio of Intra-regional trade to total trade between the pre and post free trade era, intraregional trade only accounted to 10 per cent of total trade. The decision was therefore taken five years later to deepen the integration process through the formation of the Caribbean Community (CARICOM).

CARICOM was formed in 1973 with economic integration through the establishment of a Common Market regime, being one of the three pillars of the Community. The Common Market arrangements also proved to be of limited benefit. New rules of origin were introduced with required a higher level of processing in order to qualify for entry into the Common market. Many Member States failed to implement the agreed CET in keeping with the agreed timetable, especially among the Community LDCs claiming severe revenue dislocation. Some critics have described the CARICOM Common Market as the most uncommon market.

During the 1980s at least two of the larger economies experienced severe balance of payments problems and imposed quantitative restrictions on imports. Intraregional products were not exempted from such measures and as consequence the flow of intraregional goods declined to less than half of its 1981 level. The impact of this development was felt in many factories across the region as some firms downsized and many jobs were threatened by this development.

It was therefore recognized that the region’s producers had to begin to seek international markets rather than depend on the protection of regional marketplace. These firms had to become internationally competitive and focus on penetrating extra-regional markets. Member States as part of their structural adjustment agreements with the IMF also agreed to improve
their public sector management, to reform their fiscal systems and to remove their subsidies to agriculture and industry.

During the 1990s the intraregional flow of goods improved and by the beginning of the new decade accounted for about 20 per cent of total exports.

Some the lessons that can be learnt from this experience are:

- The removal of tariff and non tariff barriers is a necessary, but not a sufficient condition for the expansion of intraregional trade.
- It is important to have appropriate rules of origin to stimulate investment and production.
- Companies needed to be competitive in order to provide a quality product at international standards in order to compete with extra-regional goods despite the protection offered by the CET.
- In times of crisis in the intraregional economies, firms have to be flexible and that marginal and less efficient firms may go out of business.
- In the case of CARICOM market size matters. The small-undiversified intra-regional market of six million people prior to the entry of Haiti and now 14 million, is not large enough to stimulate the economies of scale and the demand for products to significantly raise the level of trade in the Region. It is for this reason that the region has begun to look for new markets and to put in place the CSME to provide the economic and administrative platform to equip regional economies to effectively take advantage of the additional extra-regional market access.

While gains from intraregional trade have been modest, economic integration has benefited Member States though the provision of other joint actions such as a collective approach to the improvement in standards, a joint programme to improve private sector competitiveness through the Caribbean Export Agency and a collective voice in international negotiations. CARICOM economic cooperation arrangements also include programmes that address the sectoral and supply side of the equation in areas such as agriculture, tourism, transport and industry.

A major challenge facing the Caribbean Community is the need to find effective ways of making its collective voice heard on the hemispheric and global stage. In seeking to advance its causes beyond its boundaries, the effective coordination and management of its foreign policies and external economic relations is critical. Central to this process is the ability to draw on the best skills that each individual member state has to offer, in order to harness the collective diplomatic and negotiating strengths. As a result of our collective and strategic lobbying efforts, CARICOM member states were able to play key roles in the negotiation of the Conventions between the African Caribbean and Pacific (ACP) countries and the European Union.

Today CARICOM is faced with a rapidly changing global environment in which the preferential access to the markets of Europe, the United States and Canada is rapidly being eroded or will be dismantled by 2008. In order to be able to operate more effectively in this new environment, CARICOM is simultaneously negotiating to deepen its integration process and, at the same time, is negotiating bilateral trade arrangement with its neighbours – Dominican Republic, Cuba and Costa Rica. It is now examining the elements for the enhancement of its trade arrangements with Canada and considering an offer by MERCOSUR
to negotiate a trade agreement. Concurrently, the Region is actively participating in the negotiations for the creation of a Free Trade Area of the Americas (FTAA), a new Partnership Agreement with the European Union and negotiating in the WTO for the implementation of the Doha Development Agenda.

In order to strengthen the CARICOM position for these complex and varied negotiations, CARICOM Heads of Government agreed to establish a Caribbean Regional Negotiating Machinery (CRNM) in 1997. The CRNM was established to design strategies for the major negotiations facing the Region and to prepare, through a coordinated approach, a trade negotiating strategy for the Region. This process includes conducting studies to guide the Region’s positions on trade issues, recommending technical and political negotiators and coordinating the various negotiating processes to ensure consistency.

The CRNM operates under the political direction and supervision of a CARICOM Prime Ministerial Sub-Committee on External Negotiations. It also provides technical and other support to three spokespersons appointed in 2002 by Heads of Government, to spearhead the various negotiations at the Ministerial level, in each of the major negotiating theatres.

In addition to CARICOM Member States, Cuba and the Dominican Republic are members of the CRNM.

The CRNM has spearheaded CARICOM’s efforts in the negotiations among “unequal partners”, as well as to ensure that the special circumstances facing the smaller economies are addressed; this is in line with CARICOM treaty arrangements, which provides for special measures for the CARICOM LDCs.

In the CARICOM negotiations with Colombia, Dominican Republic, Cuba and more recently Costa Rica, CARICOM has been able to negotiate for the CARICOM LDCs to retain the tariffs against the goods of these third countries, while benefiting from market access with these countries.

CARICOM has successfully negotiated in the FTAA for a Consultative Group on Smaller Economies to be established. It has also successfully negotiated to have language inserted in the Ministerial declarations which gives due recognition to the issues affecting smaller economies. However, negotiating groups have yet to provide any follow up to this commitment. CARICOM also supported MERCOSUR efforts to modify and re-examine the scope and ambitions of the FTAA. In the WTO, CARICOM along with other smaller economies, successfully obtained agreement to have a work programme developed in the WTO. However, WTO Member States did not agree to establish a new category of countries.

CARICOM initially entered into the FTAA negotiations in a very defensive mode as the threat of the erosion of its market shares in the traditional preferential markets loomed large. However it was recognized that the FTAA, if appropriately designed, had the scope to provide access to new markets especially for the region's emerging services sector, and could contribute to creating the enabling arrangements to attract additional new investments especially from within the Hemisphere. CARICOM has invested a considerable amount of time, finance and negotiating talent on the FTAA process and would like to see the negotiations resume as quickly as possible. CARICOM is not wedded to the 2005 deadline for the negotiations, but would like to see an outcome that has a balanced ambition and that builds
appropriate flexibility to accommodate smaller economies in a way which will promote their development.

Some of the key provisions related to the needs of smaller economies the region would like to see included in the FTAA include: differentiated obligations; phased implementation of obligations; best endeavour commitments in some areas; exemptions for sensitive products; technical assistance and training; and adjustment facilitation through the creation of a Regional Integration Fund. The FTAA must also be compatible with, and respect the, integrity of the integration process.

In assessing the CARICOM experience in the FTAA there are a few lessons that can be learnt:

- The need for coherence between the intraregional and the external negotiating processes — The CARICOM treaty requires deeper integration among its members than that granted to third countries. In the FTAA the internal and external negotiation processes were not always in sync. This was particularly evident in the disciplines which were being negotiated in government procurement, competition policy and intellectual property where the hemispheric process was requiring obligations in areas in which the Region had not yet gained the competence.
- Similarly in the case of services, the hemispheric process helped to galvanize implementation of the intraregional regime.
- Some of the smaller CARICOM countries are still unsure a FTAA would be in their interest and would result in economic growth rather than further impoverishment of the population.
- The ten years of negotiation of the FTAA has proved to be a useful training ground for a cadre of regional trade specialist and has helped to build the Regional and national capabilities to formulate trade policies and to negotiate new trade issues. The negotiations have also helped the Region to identify its trade capacity needs and to identify the gaps in meeting these needs.

The Caribbean will not be seeking a traditional Free Trade Agreement in the negotiations with Europe. The Economic Partnership Agreement is expected to be a net contributor to growth and development in the region. The first phase of these negotiations is expected to focus on strengthening integration in the Caribbean Region.

CARICOM is still very supportive of the WTO despite the negative impact on the economies of the Eastern Caribbean especially Dominica following the decision on the EU bananas regime and the current threat to the Caribbean sugar industry. It considers that the WTO and the multilateral system still has the potential to develop fair and predictable rules for the promotion of international trade. CARICOM, with the support of the Commonwealth Secretariat, has been working with Pacific Forum and the Indian Ocean Secretariats on the small states/smaller economies issue. It has also been working along with the other countries in the G-90 to ensure that a mutually acceptable framework can be developed to restart the WTO process in July 2004.

CARICOM is very appreciative of the work done by UNCTAD on small states. One output of this effort is in the publication “Turning losses into gains – SIDS and the Multilateral trade Liberalization in Agriculture” which has been made available at his meeting. Too often in the past, issues of interest/concern to smaller economies have been trivialized in the work carried out in other multilateral agencies. In focusing on the empirical data and experience in the
agriculture sector, this UNCTAD study has indicated that Caribbean concerns are well founded but has gone further proposing alternatives in the negotiating positions. The region will continue to support UNCTAD and its work programme.
Chapter XI

REGIONAL COOPERATION AGREEMENT AND COMPETITION POLICY—THE CASE OF ANDEAN COMMUNITY

Richard Moss Ferreira

The Andean Community is the result of two historic and economic processes. The first is related to the need for a collective response to address and resolve the problem of underdevelopment in the region; the second is due to the successful experience of European integration. These movements formed the basis for the establishment of the Andean Community.

From an institutional point of view, Article 48 of the Cartagena Agreement defines the Andean Community as a subregional organization with its own distinct legal identity composed of five member States (Bolivia, Colombia, Ecuador, Peru and Venezuela) and regional bodies and institutions represented in the so-called “Andean System of Integration” (SAI). These five Andean countries have a combined population of 120 million, cover a surface of 4,710,000 km², and have a total GDP of approximately US$ 300 billion.

Within the framework of the Andean System of Integration, regional bodies and institutions work in a coordinated manner with a view to deepening Andean subregional integration, promoting its external reach, as well as consolidating and strengthening actions related to the integration process.

As part of the SAI, the General Secretariat is the executive body of the Andean Community. It has the statutory capacity to initiate the legislative process, as it is authorized to formulate proposals for decision by the two Andean Community decision-making bodies, namely the Andean Council of Ministers of External Relations and the Commission of the Andean Community. Its functions also include promoting the interests of the subregion; giving technical support, whenever appropriate, to other bodies and institutions of the Andean Integration System so as to ensure the application of this Agreement and compliance with the provisions contained in Andean communitarian law, as well as resolving matters submitted to its jurisdiction in accordance with Andean law.

The principal objectives of the Andean Community as established in the Cartagena Agreement are that it should:

- Promote the equitable and harmonious development of its member countries under the principle of equity;
- Accelerate growth through integration, and economic and social cooperation;
- Facilitate the participation of member countries in the regional integration process with a view to the progressive formation of the Latin American Common Market; and
- Ensure the progressive improvement of the living standards of its population.
There have been several different stages in the evolution of the policies and focus of the Andean Community throughout its 35-year history, and these stages can be defined in the following manner:

- **1960-1970** – This period was characterized by regional developments based on the creation of a larger market to encourage industrial development through import substitution and protection of local industries.
- **1980s** – This period was marked by debt crisis, adjustment policy and stagnation of intra-Community trade;
- **1990s** – This period saw the opening of markets for international trade under the concept of “open regionalism”.

During this process, progress has been achieved in the following areas: intra-Community free trade has been accompanied by substantial and continuous improvements in the quality of trade (greater value-added that generates sources for employment); an export basis that allows learning and further outreach in third markets; significant progress towards a common market (free movement of persons, labour migration – Decisions 503 and 545 respectively); the constitution of Andean legislation and dispute settlement bodies; extension of cooperation into new areas (APEC, security, human rights fight against drugs); and, collective negotiations with third countries (GSP, ATPDEA, MERCOSUR).

Nonetheless, important challenges still remain both with respect to the internal agenda (e.g. overcoming poverty, exclusion and inequality, strengthening of democratic governance) and to the external agenda (e.g. compatibility with multilateral, hemispheric and regional relations with a view to negotiating free trade agreements with major trading partners). Both must be addressed to respond to the development needs of the region in the context of globalization.

Against this background, strategic programmes are being implemented to create regional synergies and to promote Andean subregional development through deeper integration. These programmes seek to achieve convergence towards free trade and deepening of the Andean Common Market; development of competitiveness in the subregion; the implementation of the Andean social agenda, and cooperation in new strategic themes such as, energy, biodiversity and sustainable development, and information society and the connectivity.

Various legal instruments form the foundation of a community legal order. These include:

- The Cartagena Agreement, its protocols and additional instruments;
- The Treaty of the Andean Community Justice Tribunal, its protocols and additional instruments;
- Decisions of the Andean Council of Ministers of External Relations and the Commission of the Andean Community;
- Resolutions of the General Secretariat of the Andean Community; and,
- Conventions adopted by the member countries within the framework of the Andean integration process.

The most distinctive feature of this judicial order relates to its supranational nature as expressed by the doctrine called "direct applicability" and "pre-eminence". The first manifestation of the concept of supranationality, direct applicability, implies that "the Decisions taken oblige member countries as of the date when they are approved by the Commission" and "the Decisions of the Commission will be directly applicable in the member
countries from the date of their publication in the Official Gazette of the Agreement, unless the same Decisions indicate a later date ... ".

Accordingly, Andean norms are directly applicable to and obligatory for the Member countries in all their instances and to the institutions of the Andean Community. This means that the Andean norms apply to all the authorities of the Member States without distinction in all its territory and without limitation as regards state, regional or municipal order, and that the community citizen acquires obligations and rights that can be enforced by the national Courts as well as by the national authorities.

The second distinctive characteristic of Andean Community law, namely the concept of pre-eminence, establishes that community law takes precedence over national law regardless the level of the latter. Accordingly, when a conflict arises between national laws and community laws, pre-eminence requires that the latter prevail.

**Competition law in the Andean Community**

In Andean law, disciplines related to competition policy are currently being developed. At the national level, Colombia, Peru and Venezuela now have national legislation regarding competition policy. Bolivia and Ecuador are in the process of developing their respective norms.

At the community level, under the provisions of Articles 93 and 94 of the Cartagena Agreement, the Andean Community adopted Decision 285 with the objective of preventing or correcting distortions in competition caused by restrictive anticompetitive practices. The Decision applies to the following matters:

- Practices originating in a member country with effect on another member;
- Practices originating in more than one member country with effect on other members; and,
- Practices originated outside the subregion with effect on two or more member countries.

Furthermore, the Decision applies also to agreements, concerted practices or parallel actions among competitors, and the abuse of dominant position. The Andean Community is intending to update Decision 285 in the near future and this will further promote competition in the Andean Community.

It would be significant if national competition authorities could assist the General Secretariat in the first phase of its investigation by providing evidence for the determination of anticompetitive practices.

**Agreements on international technical cooperation**

In order to strengthen national and Andean competition law, the General Secretariat of the Andean Community has signed several agreements on international technical cooperation. Two of the most significant operative agreements of this sort are: the Andean Community – European Union Technical Cooperation Agreement “Harmonization of Competition Regulations in the Andean Region (Project Competencia)”; and the “Special Objective Grant Agreement between the General Secretariat of the Andean Community and the United States..."
for Participation of the Andean Community in the Free Trade Area of the Americas” (USAID Grant Agreement), of which competition policy is an integral part.

In the first of these technical cooperation projects, the General Secretariat, on behalf of Andean Community member countries, and the European Commission on behalf of the European Community, signed an Agreement on Financing for the Development of "Project Competencia". Launched in November 2002, the project has a budget of 2 million euros from the European Commission; countries benefiting from these three-year projects have contributed 1.5 million euros.

Five member countries are benefiting from the scheme: Bolivia, Colombia, Ecuador, Peru and Venezuela, as well as the Community institutions, including the General Secretariat, the Andean Community Justice Tribunal, and institutions responsible for the application and control of competition legislation at the community level. The project has the following objectives:

- To improve subregional and national competition laws;
- To strengthen Andean institutions responsible for the application and control of competition laws; and
- To promote a culture of competition.

To achieve these objectives, various activities are being implemented with the participation of European and Andean experts. These include subregional and national seminars; legal consultancies and sectorial studies; training of civil servants and judges responsible for the application and control of competition law; internships; providing equipment; improving the web pages of the beneficiaries; promoting competition forums and virtual networks; establishing libraries; and preparing publications.

The second programme is the “Andean Community – United States Agreement on Technical Cooperation / Competencia” which is being executed through USAID's Regional Office. The US Government began providing technical assistance to the project in July 2003, and the project is expected to end in February 2005. It is a part of the capacity-building assistance provided regionally to Andean Community member countries within the framework of the “Special Objective Grant Agreement between the General Secretariat of the Andean Community and the United States for Participation of the Andean Community in the Free Trade Area of the Americas”.

The objective of this programme is to support Andean Community member countries to develop harmonized competition policies criteria through workshops on advanced investigation techniques for different anticompetitive practices. These events are targeted at civil servants working in regional competition authorities or government institutions responsible for national competition law and General Secretariat employees.

As Bolivia and Ecuador still do not have any competition legislation on their statute books, the programme foresees special technical assistance to these countries to support them in the elaboration and dissemination of draft legislations on competition policy.

The General Secretary of the Andean Community and the Secretary-General of the UNCTAD signed a Joint Declaration in October 1999 to deepen the cooperation between these two institutions. On the question of competition, they agreed to formulate a specific programme to
strengthen competition policies in the Andean Region. As a result of this cooperation agreement, Andean Community member countries will be provided with modern and efficient instruments to respond to the demands placed on them as a result of the integration process and globalization.
Chapter XII

COMPETITION COOPERATION IN REGIONAL INTEGRATION AGREEMENTS,
A SACU EXAMPLE

James H. Mathis

1. Regional Integration and Competition Policy

Although not a new phenomenon, the use of competition policy instruments in regional integration agreements has become common practice, and some greater diversity of approach is also becoming evident. The traditional argument for reinforcing trade liberalization with anti-trust rules has a monumental status as revealed by the structure of the original EEC Rome Treaty. This required the termination of national anti-dumping measures (within the competition policy chapter) at a time when the common competition policy became institutionally effective. With the EC competition policy in place, the early cases of the European Court of Justice ruled on its scope to deal first with vertical segmentation as these exclusive arrangements were “affecting trade” between the member states. Without intending to be exhaustive, the early academic case for regional competition policy action can be summarized as follows:

- Where private restraints operate to segment the market, firms may dump goods across borders but avoid the risk of undercutting re-importation (arbitrage). Regional competition rules can act as a substitute for trade measures that States would otherwise see as necessary to employ (elimination of internal trade measures).
- As government barriers (tariffs and quotas) are reduced according to a plan and schedule, private barriers that segment national markets are either uncovered, or newly constructed as private firms respond to free trade (market segmentation, vertical restraints).
- An open regional market may allow firms to more easily draw horizontal arrangements that negatively affect competition over the entire market, or to allocate portions of the market between firms (area distortions, cartels).

As regional trade agreements (RTAs) have broadened in scope to include services and investment movements, the older arguments are supplemented by some additional considerations, including the following:

- Single markets (common markets) for labour, services and investment require territory legal structures for doing business in and across the market. “Area-wide” commerce requires sufficiency in common rules, or closely harmonized national rules, to provide legal certainty. The internal quality of the market overall determines the capacity for facilitating movements both within the market and inward bound (merger control, investment measures, State aids).

129 The chapter expands upon a presentation made by the author at the sixth session of the Intergovernmental Group of Experts on Competition Law and Policy, UNCTAD, Geneva, 8 November 2004. Portions of this paper are also drawn from a study prepared by the author for SACU at the request of Lesotho, and was partly sponsored by UNCTAD.
The region has the capacity to represent itself externally to the extent it develops sufficient internal institutional power binding together a cohesive internal market. A regional grouping can have a larger voice in establishing cooperative linkages with other regional groupings and primary markets to facilitate investigation and enforcement (external and international cartels, external dominant positions, efficiency reducing mergers and acquisitions.)

The newer emphasis on regional agreements broadens the application of competition policy regardless of whether effected at the regional level or by national cooperation instruments. While external pressures demand market access for the elimination of barriers to services and investment, the need for functional competition law and policy increases to ensure a resulting (overall) competitive internal market. A mere plea for the benefits of import competition is no more sufficient to secure rivalry at the regional level than it is at the domestic level.

1.1 Relation of policies to treaty objectives

A particular trade arrangement may address in an ad hoc manner one or more of the considerations noted above. A characterization of a particular agreement’s treatment of competition law arrangements as related to the quality and scope of economic movement can normally be disclosed by its preamble objectives in connection with its free movement provisions, the provisions regarding competition law and policy, and its institutional structure.

The relationship between competition policy provisions and free movement objectives is clearly of importance. Hypothetically, it is possible to conceive of an arrangement whereby a strong emphasis on free trade commits member States to make actionable all public and private interferences with cross-border movement, regardless of whether or not these impediments would violate a member’s domestic competition law (regional legal enforcement). At the other extreme, it is not difficult to imagine an arrangement that calls for domestic competition law enforcement according only to domestic considerations, thus without any references or linkages to those acts, which actually “affect” or “distort” trade between members or within the regional area.

In the first case, free trade objectives may effectively expand competition law to encompass external commercial policy as a strongest point of reinforcement for free movement. In the second case, obligations to assume competition law and policy are taken up more generally as a convergence exercise, but have just incidentally been included in a treaty that also commits members to a measure of free trade from tariffs and quantitative restrictions.

A middle course approach also emerges which relies upon domestic law and policy, but it is designed to ensure or promote domestic action for those anti-competitive practices that do affect trade between members. This arrangement only acts as an affirmation of what domestic competition law can do anyway, but focuses a zone of enforcement upon those aspects that have cross-border implications. In this context, questions of common principles applied by domestic jurisdiction authorities, essentially coordination and cooperation, emerge to determine whether such structures can actually reinforce the integration objectives. The question of what instruments to apply rests on a balance between necessity and sufficiency that is played on two levels, internal within the market, and external as to the rest of the world.
1.2 **Elements for regional capacity**

While a more detailed checklist could be prepared, some elements that indicate the nature of regional capacity to cope with competition law and policy can be noted. A first listing is *de jure*, the components residing on face of the treaty. A second listing provided is more functional and deals with the positions of the parties themselves, and the circumstances of their particular markets as they interact within the context of regional integration.

1.2.1 **Treaty (institutional) factors**

If competition law and policy cooperation is connected to a regional trade agreement, then the treaty itself forms the legal context for the scope of the suggested cooperation, and raises the parameters for what can be accomplished in the design of more specific cooperation instruments.

**Legal form - Customs Union / FTA**

A customs union requires a functioning external tariff. There is some additional pressure to alleviate internal trade measures in a customs union as well as a necessity to establish an operating common external commercial policy.\(^{130}\) Both have implications for appropriate competition law cooperation and some loss of domestic sovereignty over competition policy may be intrinsic to the integration exercise even when no common institutional approach is provided.

For either free-trade areas or customs unions, competition law cooperation should be a facilitating factor in achieving the quality of the formation dictated by the treaty. Even in a free-trade area, the problem of trade measures between members remains. Thus, what level of cooperation can eliminate or reduce the use of trade measures, and is the treaty structure sufficient to permit instruments to deliver this component?

**Other movements and/or area-wide treatment**

If the treaty encompasses other movements (labor, capital, services, investment), then competition cooperation should reflect these treaty objectives as well. This not only informs cooperation, but may also suggest the scope of domestic competition law to be enacted and applied.

The notion of area-wide treatment for the movement of goods or other factors may also suggest that state-sponsored distortions in the form of subsidies and other industrial policies are also to be considered. This further implies that some additional authority at a regional level may also be appropriate — at least in order to facilitate common definitions and assist in coordinating member responses.

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\(^{130}\) The relationship between competition law and the form of integration has been noted by others. “The idea is that as the market becomes more competitive, firms will try to enter into strategic agreements to keep their profit level at a sufficiently high level. …In particular, in the case of deep forms of regional integration such as customs unions and common markets, the need for a common competition policy approach is stronger.” S. Bilal and M. Olarreaga, *Regionalism, Competition Policy and Abuse of Dominant Position*, European Institute of Public Administration (EIPA), Maastricht, 1998, pg. 5.
Effective provisions, rights of states / persons

What right of access do member states have to enforce treaty provisions, including cooperation provisions? Are private parties given any rights of access to petition authorities or present dispute settlement claims? Are there significant variations as between the members’ own laws regarding rights of access and enforcement that could undermine cooperation? While these aspects may be raised within a cooperation instrument, a treaty’s dispute settlement provisions may also apply to aspects of cooperation.

Provision for regional executive authority

Assuming that a treaty is not providing for a common competition policy at the regional level, a primary question in the consideration of cooperation instruments is the role of a regional executive authority, and whether this authority may function with some supranational voting elements. If this is the case, evolution is possible in the treatment of area-wide practices, and possibly, State practices that distort the market (State aids).

Dispute mechanism – application to states / persons

In cases where the treaty provides for dispute settlement, what might be the legal effects of rulings on competition policy provisions? Assuming that they are binding on the actual parties to the dispute, might they also generate important definitions regarding the powers of the institutions or member States? Related to this, is it possible that the treaty is according a form of individual rights so that, when invoked, national courts are obliged to apply treaty law?

1.2.2 Functional aspects and practices

The character of individual members form an additional context to provide an overview for what might be accomplished by instruments to promote competition cooperation. Again, the listing is only indicative:

Size of group

A larger group of States suggests approaches for a convergence of laws among them, with some mechanism to assist in facilitating such a convergence over time. A larger group may also imply that a peer review mechanism is either possible or advised.

Relative development levels

A North-South agreement would indicate that the balance of reciprocity sought in the application of cooperation instruments has to be tailored to reflect the differences not only in the behaviour of markets, but also for practices to be treated and the institutional capacity of the members to respond. While “one size fits all” might be forced as a template upon a particular trade agreement, the parties may be so varied that the cooperation instruments applied should be tailored.

Market size

Is it realistic to assume that the burden of domestic enforcement on “incoming” practices could reasonably be addressed by an authority in respect of a small national
market, especially in cases where the primary regional partner is a significant regional or a global economic power holding the greater concentration of regional firms?

National capacity / existing law or authority

If cooperation is based upon communicating authorities, what are the implications when some members do not have the necessary law and/or capacity? Does this mean that there can be no cooperation? Or does it mean that different types of instruments can be considered that rely upon different agencies? Is it possible to consider that non-competition agencies dealing with trade, unfair business practices, or consumer protection, might also play some role in cooperation?

1.2.3 Trade practices in territories

While a functional aspect as well, the question of both internal and external practices is significant enough to warrant further discussion. In regional agreements where there are no common rules for the whole market, there is a strong tendency in treaty practice thus far to hold fast to the traditional territorial dimension of national members. This places an emphasis on promoting anti-trust remedies for import barriers.

A problem with this approach is that free trade encompasses the notion of eliminating restrictions on exports as well as imports. To the extent that export barriers are treated at all, the tendency of the instruments developed thus far has been to rely upon instruments that promote better market access issues (imports), or even less developed, purely voluntary, communications between authorities that have to then apply their own effects doctrines. Where there is a great disparity in functional factors, it is reasonable to question whether such instruments can give effect to eliminating the private restraints generated across national borders. As between developed and developing territories joined together in a regional agreement, the balance struck between importation and exportation is revealing as to the balance of concessions established overall.

A classification of competition law matters that relate to trade can be found in Jenny (1999).131

Type 1: "anti-competitive cross border" (exports). This includes export cartels, mergers, cross border abuse, international cartels. The effects felt in one market are directed by actors from another market.

Type 2: import restrictions (market access or exclusionary) – including import cartels, vertical restraints, exclusionary standards, domestic abuse. The practices within one market exclude entrants from trading into the market.132

Domestic competition laws deal with practices based in the domestic territory. They can reach foreign actors to the extent that their practices have domestic territorial effects. This means that regional members acting as individual authorities are better able to respond to Type 2 measures, since the actors and the practices are all engaged within the domestic territory.

Cooperation may facilitate capacity and communication for dealing with Type 2 measures, but essentially, all that is actually necessary is for each member to have a functional law that treats

132 F. Jenny, ibid.
Type 2 practices affecting trade, and to then ensure that this law applies on the basis of national treatment (non discrimination) as to complaints raised by foreign firms.

As for Type 1 measures the situation is more difficult. In the absence of a superior regional law, these practices must be handled by the authority in the territories where the anti-competitive effects are being experienced. However, for investigation and redress, the authority requires sufficient resources to reach foreign actors. There are inherent limitations as to what one authority can accomplish to nationals in another territory, even for developed authorities with high capacity.

An issue for cooperation emerges: what are the possible instruments for assisting in treating Type 1 practices? As a variation on this theme, where instruments are being provided to facilitate Type 2 enforcement, then what other regional arrangements can be raised to strike a better balance between Type 1 and 2 practices where Type 1 aspects are evident? This especially needs to be considered within a RTA where “free trade” means dealing with both exports and import restrictions, and between developed and developing territories.

2. Cooperation RTA mechanisms

A number of instruments are briefly noted and discussed in this section. An attempt has been made to establish an ascending ranking in respect of the degree of domestic sovereignty surrendered to render the approach effective, as well as to the capacity of such instruments to assist or extend enforcement “beyond territory” to deal with Type 1 anti-competitive practices restraining trade in exports.

2.1 Voluntary cooperation

The term "voluntary cooperation" applies to the entire range of actions by which one or more jurisdictions may assist, coordinate or communicate with each other. In this general sense, the principal modalities include:

- informal cooperation relating to analytical issues, practices, policies and procedures, as well as obtaining feedback on proposed laws and regulations, or on potential amendments to existing laws or regulations;
- case-specific cooperation; and
- cooperation typically considered to fall under the broad umbrella of capacity building and technical assistance.133

2.2 Traditional (negative) comity

“Out of territory” investigations were often met with resistance by the subject territory, and actions were taken to block investigation or enforcement in order to discourage exercise over nationals of the subject state. A traditional comity expression is essentially a “good neighbour” declaration and encourages jurisdictions to conduct their investigations in a manner that respects the interests of other jurisdictions. This can be fulfilled by notifying another country when its enforcement actions may affect their important interests, and to conduct its actions without harming those interests.

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2.3 Convergence

Convergence approaches either require or encourage members to have laws, and then to provide for some principles by which the laws may be governed. Two sub-categories are noted

2.3.1 Soft convergence

Several agreements seek to install general principles that are to be provided for in national competition laws, and then emphasize the types of practices that are likely to affect cross-border trade. In addition, these laws are noted to be subject to procedural and substantive guarantees that, over time, would assist in promoting a certain convergence between the parties in a trade-liberalizing supportive role of competition law and enforcement.

An example of this pattern is a Canadian proposal for the “Free Trade Agreement of the Americas”. One summation provides that:

"…there should be an obligation on each country in the FTAA region to adopt or maintain a competition law that promotes economic efficiency and consumer welfare. Such laws should prohibit, at a minimum, certain key anti-competitive behaviours that are most likely to adversely affect cross-border trade or trade within the FTAA region; namely, cartels, abuse of market power, and anti-competitive mergers and acquisitions."  

In addition, each member should have a competition authority:

"…that is independent and authorized to take appropriate enforcement action and to advocate pro-competitive solutions in the design, development and implementation of government policy and legislation."

From this point forward, the emphasis is on the behaviour of the laws and authorities in respect of transparency, due process, and national treatment. Upon this convergence platform, it is suggested that parties can (bilaterally) go forward to initiate more formalized cooperation including positive comity agreements.

The soft convergence approach is clearly supportive of competition culture and also respects the positions in a large and diversified group. To the extent that national authorities become more operational, it also provides for better capacity to address the Type 2 problems. Incidentally, higher functioning authorities may be more able to respond to Type 1 issues as well, but soft convergence does not address on point any form for state responsibility that would treat export restrictions as they affect other regional member states.

2.3.2 “Top-down” convergence

Where the focus remains on national laws and national authorities, but the regional institutional level is operating in some type of an assist capacity, this form of convergence

may be more viewed as “top-down”. The Mercosur common market appears to reflect some of these elements where there is some common definition for the area as a whole being sought to be established and some attention being drawn to anti-competitive practices with a “Mercosur dimension”. Based upon this, it is conceivable that external representation for the area can evolve, as well as the possibility of treating public anti-competitive practices that members will otherwise not resolve.

The potential for blending some regional institutional capacity together with member state authority has to be considered a prime area for experimentation to resolve those aspects that cannot be reasonably addressed by the single authorities. While this may include elements of supra-nationality, this may not necessarily be the case. Approaches can consider inter-authority committees dedicated to addressing cross-border and area-wide problems. Higher institutional levels may be more appropriate for state sponsored distortions and for external representation of the area as a whole. At the same time, these measures can be evolutionary and incremental as the regional structures derive experience.

While this category of top-down convergence seems more appropriate with respect to plans for a customs union or common market, some aspects might also be suitable for free-trade areas. What is perhaps more important from the outset is that a treaty plan does not unreasonably foreclose the potential for creating some area wide capacity even while emphasizing national authority cooperation.

2.4 Positive comity

The OECD provides an international instrument for a more proactive form of cooperation in the form of positive comity. Operating on the basis of an authority's request for assistance or action directed to another authority, the requested party may then:

(1) give a full and sympathetic consideration to another country's request that it open or expand a law enforcement proceeding in order to remedy conduct in its territory that is substantially and adversely affecting another country's interests, and

(2) take whatever remedial action it deems appropriate on a voluntary basis and in considering its legitimate interests.\(^\text{135}\)

Positive comity provisions are often categorized as formal or informal, binding or voluntary, but attempts to categorize them may also confuse the definitional components more than assisting in clarification. Much of what occurs in practice is informal in nature and based upon relationships, regardless of whether or not a formal instrument is in place. The notion of binding cooperation is also in part a misnomer since no state will take action if it is deemed against its interests to do so.

For the regional aspect, what is more important than the classifications is the instrument’s reliance upon requests, and the point that the action is then only taken in respect of the laws of requested countries. This limits the instrument to Type 2 practices. While this certainly promotes the market access component of regional integration, there is a poor match resolved where positive comity provides so little potential for addressing Type 1 problems. As between a developed and developing country installing a positive comity provisions in an RTA, one can conclude that the developed party may get the better balance of the deal if this party has

the greater interest in market access. Finally, while seemingly highly appropriate for issues raised by mergers and acquisitions, the more restrictive environment for timelines to vet notifications appears to work against positive comity approaches.

2.5 Notification

A possible instrument for balancing positive comity is that of notification, whereby an authority informs another of possible violations of the latter’s laws caused by nationals of the former. Since any action taken is still the responsibility of the territory where the effects are being experienced, notification still respects the traditional jurisdiction concept. What is added, however, is the element that, while authorities are going about their domestic business, they are also keeping an eye on activities that may fall under the violations of the partner regimes. The text below is from the US – Australia Agreement:

"(T)he Parties intend to assist one another and to cooperate on a reciprocal basis in providing or obtaining antitrust evidence that may assist in determining whether a person has violated, or is about to violate, their respective antitrust laws, or in facilitating the administration or enforcement of such antitrust laws."

The intent to provide such information certainly raises issues of confidentiality, and the US version of the instrument is heavily circumscribed with guarantees regarding business information. At the same time, however, the instrument also has some far-ranging features including the possibility of a domestic court securing additional evidence and testimony that could be used by the foreign authority.

Another example appears in the Canada – Costa Rica provisions. While commencing with a traditional (negative) comity notification clause, what is defined as “affecting the interests of the other” is broadened to include both:

- Anti-competitive activities, other than mergers or acquisitions, carried out in whole or in part in the territory of the other Party and that may be significant for that Party; and
- involv(ing) remedies that expressly require or prohibit conduct in the territory of the other Party or are otherwise directed at conduct in that territory…

The appropriateness of this type of good neighbour policy is indicated where the parties have already committed themselves to a free trade agreement seeking to eliminate restrictions on imports and exports. As such, this agency cooperation provides some assurances that, in respect of private practices, there may be some meaningful capacity for governments to also deal with them respectively. Although enforcement remains territory-based as to effects, the importance of self-discovery and request is diminished as each authority commences to look out for the other. In this sense there is some additional capacity that is passed to the acting authority to pursue the Type 1 practices since the information given to this authority is likely to include acts by foreign parties upon the market of the receiving authority.

136 There are two caveats: the instrument may be used for export restrictions where there are evident internal effects; and the instrument could be used to address vertical restrictions against dumped goods being re-exported to the home market.


By removing the necessity of taking own domestic action as a condition to notification, one can see the emergence of this more enlightened view that authorities should just be given the freedom to notify each other of violations occurring in the other’s territory, as a matter of course and certainly as a supportive instrument for free trade.

2.6 Delegation

An additional category deals with cases where one authority agrees to take account of the other territory in its market analyses. An example is found in the merger control field for the European Community’s regulation of concentrations. The European Commission receives notification of mergers according to established thresholds for those having a community dimension. In addition, a member State may also request the Commission to review a proposed merger or concentration in light of the national market.\(^{139}\)

While this example refers to a regional authority, this may not be a prerequisite. Where a regional grouping has one large state with a merger notification requirement, it is conceivable that reviews can be made in respect of the other regional members, or also by delegation, for the area as a whole.

2.7 Actions “out of territory”, or power over nationals abroad

These final two concepts address jurisdictional issues by either extending domestic jurisdiction to actors resident elsewhere, or extending jurisdiction for domestic actors for their practices committed abroad. While these approaches are understood to not respect the limits of traditional domestic competition law and policy jurisdictional power, such powers can be accorded by state obligation (state responsibility) in the context of a regional trade agreement. The result is that either an extension of competition law jurisdiction is created, or power may be invested in trade agencies dealing with external relations law.

A regional trade agreement example incorporating elements of actions out of territory is found in the ANZCERTA agreement between Australia and New Zealand, a free-trade area but with provisions also for investment, services and regulatory harmonization. According to Hoekman, the goal of eliminating anti-dumping between the members required the active enforcement of similar competition laws, but in addition that:

An agreement that the jurisdiction of competition agencies extend to matters affecting trade between New Zealand and Australia. In this connection it was agreed that nationals of one state could be made the subject of an enquiry by the competition authorities of the other state and be required to respond to requests for information.

Australian (New Zealand) antitrust legislation was amended to extend its scope to the behavior of Australian and/or New Zealand firms with market power on either one of the national markets or the combined Australia/New Zealand market.

Courts were empowered to sit in the other country; orders may be served in the other country; and judgments of Courts or authorities of one country are enforceable in the other country.\(^{140}\)

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\(^{139}\) Art. 22 of the original European Merger Control Regulation, the so-called Dutch clause.

These techniques clearly require some significant relinquishment of domestic state power over domestic nationals. In this case, it is well known that the purpose relates to the significant difference in economic levels between the two markets involved, and to the presence of significant dominance in one of the partner markets.

The flip side of the ANCZERTA approach is for a state to exercise jurisdiction over its nationals as they commit infractions abroad. There are no regional trade agreement examples of this “nationality” jurisdiction in the competition law context, although examples from areas of enforcement are known. For the United States, these include tax law jurisdiction where citizens are subject to US income taxes regardless of whether they live or earn in the United States. A more pertinent example is in the area of bribery and corruption, where according to the authorizing OECD Convention, US nationals violate US law for their illegal acts committed abroad.

A possible legal basis for this form of jurisdiction in the regional competition policy arena could be a treaty prohibition on export cartels, or other private export private restraints affecting a partner’s trade in imports. This could allow for a state-to-state action that was resolved in an order of termination directed by one state over its domestic actors.141

3. The Southern African Customs Union (SACU) example

With the above inventory in hand, this section considers competition policy instruments for the Southern African Customs Union (SACU); it first outlines treaty components to set an interpretation for the competition provision, and then briefly notes the functional aspects for the SACU members before concluding with recommendations for instruments.

3.1 Treaty aspects

The SACU Agreement has two provisions that establish reference to anti-competitive private practices. Article 40 requires members to have competition policies and to then engage in cooperation for the enforcement of laws. Article 41 is directed to unfair trade practices and requires the SACU Council to develop policies to address these practices. The context for the meaning and scope of these provisions is provided by the balance of the treaty including its preamble, objectives, established institutions and movement provisions.

3.1.1 Preamble

The governing treaty is the Southern African Customs Union Agreement142 as signed by the Heads of State (or representatives of Member States) on 21 October 2002. The Preamble recognizes that the predecessor agreement of 1969 no longer caters to the needs of the customs union, and indicates that the implementation of the 1969 agreement (was) “hampered by a lack of common policies and common institutions”. The Preamble’s primary legal objective is the

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141 Little attention was paid to the actual legal effect of establishing an international prohibition against hard core cartels in WTO Working Group discussions. The EC has no external authority to penalize cartels for any effect they may have in non-EC markets, but anecdotal evidence suggests that an “international” prohibition might raise some external basis for the Community to adjust penalties and termination orders on behalf of other WTO Members.

142 Between the Governments of the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa, and the Kingdom of Swaziland.
recognition of a “Common Customs Area” and the call for the application of the same customs tariff and trade regulations to third country goods upon importation to this area.

3.1.2 Stated objectives

The stated objectives of the agreement provided in Article 2 provide additional detail on the legal objectives of the agreement as they relate to the subject matter of Articles 40 and 41. More directly,143

a) The facilitation of cross-border movement of goods between the Member State;
b) The creation of institutions ensuring equitable trade benefits to the Member States;
c) The promotion of conditions of fair competition in the Common Customs Area;
d) The increasing investment opportunities in the Common Customs Area;
e) The enhancement of economic development, diversification, industrialization and competitiveness of Member States;
f) The integration of Member States into the global economy by enhanced trade and investment; and

g) The development of common policies and strategies.

The objectives refer at different point to the Common Customs area and the circumstances of Member States. Cross-border trade of goods is to be facilitated between the member states and SACU institutions are to be established to ensure equitable trading benefits to Member States. Likewise, Member States are to be the beneficiaries of enhanced economic development, diversification, industrialization and competitiveness, and it is an objective to integrate the Member States into the global economy.

The Common Customs Area (CCA) (and not the Member States) is the point of reference, both with regard to the promotion of conditions of fair competition to be established in the CCA, and to the objective of enhancing inward investment.

3.1.3 Free movement provisions

The more precise legal entity that is created by the SACU Agreement is that of a customs union. Article 3 indicates that there shall be established the “Southern African Customs Union”. This customs union shall have the status of an international organization with legal personality (Article 4). The supporting substantive legal provisions are found in Part Five, “Trade Liberalization”. Article 18, titled “Free Movement of Domestic Products” states that goods grown, produced or manufactured in the Common Customs Area, shall be imported to the area of another Member State, “free of customs duties and quantitative restrictions, except as provided elsewhere in this Agreement.”

For goods originating outside the CCA being imported to one Member State from another, except as otherwise provided in the Agreement, a Member State shall not impose any duties on these goods (Article 19).

The external dimension of the customs union is established by Article 31, Trade Relations with Third Parties. Members may maintain existing agreements with third countries, but shall

143 Agreement objectives inform the meaning of particular provisions of a treaty, where a term should be determined in accordance with the “ordinary meaning” to be given “in its context” and in light of the “object and purpose” of the treaty. VCLT, Article 31.
also establish a common negotiating mechanism and shall not enter new agreements or amend existing ones with third states without the consent of the other SACU Members.

### 3.1.4 SACU institutions

The legislative function in SACU is provided by the Council of Ministers, consisting of at least one Minister from each country; this Council is responsible for the overall policy direction and functioning of SACU institutions. This includes the formulation of policy mandates, procedures and guidelines, as well as overseeing “the implementation of the policies of the SACU (SACU Article 8, paragraphs 1,2 and 6).

The Customs Union Commission, composed of officials from the Member States, has an executive function in the SACU. It is responsible for ensuring the implementation of the Council's decisions and for the implementation of the agreement. (Article 9, paras. 1-3). Where, as in the case of Article 41 (Unfair Trade Practices), the Council shall act upon the advice of the Commission, it may be said that the Commission also has a certain role of initiative in implementing the mandate provided by the Article for common policies.

An additional support mechanism is provided by Article 12 of the Treaty, which establishes the several Technical Liaison Committees. These committees have been created to assist the Commission in the designated areas of agriculture, customs, trade and industry, and transport. By the same Article, the Council has the authority to determine the terms of reference of these committees and to alter their terms. For competition and unfair trade practices, the subject area of trade and industry may be broad enough to encompass these aspects if the Council so decides. If not, the Council also has the power to create new technical liaison committees and other institutions, and to determine and alter their terms of reference as well (Article 8, paragraph 9).

### 3.1.5 Summation for the objectives of the SACU agreement

Taken together, these provisions establish a clear but narrow scope for SACU as the agreement is dedicated to the formation of a customs union for trade in goods. The agreement does not establish provisions for the movement of services or service providers, as in the formation of an economic integration agreement according to GATS Article V. It does not contain provisions for either the free movement of persons or the free movement of capital between Members. Although the objectives refer to enhancing inward investment in the Common Customs Area, as free movement provisions are not provided for investment or services, a common area in this sense is not provided as an objective. Likewise, the CCA itself is not being granted the power to represent the member states in external agreements relating to services, labour movements, or investment.

In light of these articles and objectives in respect of customs union formation, the meaning and scope of common policies provided for in the agreement should be interpreted in this more limited context as well, suggesting that such policies as they may be undertaken should not (or need not) be drawn to exceed the scope of the objectives as to free trade in goods.
3.1.6 SACU’s common policies

The Agreement provides a separate part dedicated to the four following “Common Policies”:

- Industrial Development (Article 38);
- Agriculture Policy (Article 39);
- Competition Policy (Article 40);
- Unfair Trade Practices (Article 41).

The provisions for Articles 40 and 41 also provide for:

1. Member States agree that there shall be competition policies in each Member State (Article 40 Competition Policy)
2. Member States shall co-operate with each other with respect to the enforcement of competition laws and regulations (Article 40 Competition Policy)
3. The Council shall, on the advice of the Commission, develop policies and instruments to address unfair trade practices between Member States. These policies and measures shall be annexed to this Agreement (Article 41 Unfair Trade Practices).

There are textual variations unique to each of the Articles and each therefore presents its own approach to dealing with a recognized common policy area. The concept itself of “Common Policies” should be viewed broadly enough to accommodate the differences between the Articles and the different types of actions suggested by each.

The different Articles do not uniformly refer either to the same institutions or provide for member state responsibility in the same manner. Each Article is titled by the term “Policy”, but only one of them uses the term “common policies”. It should not be presumed that because the title of the Part refers to common policies, that common SACU rules or a superior SACU law is being directed to be formed in respect of each policy. The contrary is rather the case, and each Article should be taken up for interpretation in respect to the meaning of its own terms.

The Articles relating to Industrial Development and Unfair Trade Practices emerge as the strongest substantive and institutional provisions in the common policies title. The Industrial Development provision (Article 38) specifically refers to the creation of common policies. The Article on Unfair Trade Practices (Article 41) also refers to policies, but not to common policies. However here, “(T)he Council shall, on the advice of the Commission, develop policies and instruments to address unfair trade practices between member States…”

The Competition Policy Article (Article 40) also refers to “policies,” but does not suggest that they should be “common” policies, as provided for in both Articles 38, and also without the designated role of the institutions as found in Article 41. Here the objective of realizing policies is applicable to Member States by their own agreement, agreeing to each have a competition policy. This is not a reference to common policies but to national policies. While these may be subject to convergence of some type by the process of cooperation between members, they are not designated at the outset by the Treaty to have the character of single legal acts established at the SACU level nor by SACU institutions.

This interpretation suggests that while Articles 40 and 41 are “common policies” according to the title of Part Eight, there are different avenues being pursued in order to achieve this
commonality. The first avenue is the establishment of “area” rules and policies for investment and unfair trade practices; the second path is active cooperation between national rules and policies for agriculture and competition.

If this interpretation is correct, then the Article 40 provision must be read in this more restrictive context as not requiring the establishment of an independent customs union area competition law or policy, that the member states are responsible for establishing domestic competition policies, and that the member states shall then further co-operate in respect the enforcement of their separate laws and regulations.

3.2 Functional aspects in the SACU area

A workshop session for SACU members provided an opportunity for participants to describe practices of concern in the region. Attention was mostly directed to the problems of small members, in contrast with the largest member, as to the difficulties of domestic firms attempting to compete in their own markets against the larger South African (SA) firms. Concerns were also expressed about high market concentrations of individual firms; local firms finding it difficult to access supply chains in their own territorial markets; refusal to deal (to supply or purchase); dumping (below normal prices); and investment flows possibly affected by restrictive business practices. An analogy was made that while the SACU meant that all parties were present in the theatre, all the best seats in the cinema were already occupied by firms from the largest country.

This raised the issue of liberalization between unequal partners, and noting that South African enterprise maintained significant shares (dominant) in a number of production sectors. An additional example was suggested for offering terms of finance for purchasers by foreign firms that could not possibly be matched by the domestic firms. For another Member State, the effects of mergers were noted as important. The example given was for the banking sector where two SA firms operate in the market (no domestic player). While the South African competition authority blocked that particular merger, if they had not there would have been only a single player left in that particular Member State's market. Another reference referred to the problem of exclusive rights, whereby a dominant firm would choose a single distributor in the member state.

All the members indicated that their national laws, if they them, suffered from implementation problems with respect to capacity, the lack of provisions to attend to the practices, and the issue of competing resources.

From the perspective of the larger SACU member, the problems of other members were indicative of its own problems, whereby its domestic market was somewhat characterized by dominant firms. Most of the major complaints pertained to monopolies, together with the problems faced by new entrants. While this Member State has a functioning authority, firms’ anti-competitive activities can outpace authority resources. Although cartel actions had not been pre-eminent, more activities related to cartels were also emerging.

At the same time, however, when a practice did not affect competition within its own market, the solution was not to be found in its domestic competition law, but rather by members all having and implementing their own laws, and then operating them on the doctrine of effects in
relation to their own territories. As well, a number of practices did not fall under the scope of an individual member’s competition law, including predatory dumping.144

3.3 Practices as applied to the Treaty

SACU has a large country (South Africa) together with the smaller members, namely Botswana, Lesotho, Namibia and Swaziland (BLNS). Most of the examples raised related to dominance and the cross-border effects of dominant practices on other markets, either as to domestic competitors and/or consumers, or as to the quality of competition itself.

Any particular practice may be best treated as an unfair trade practice according to Article 41, while another practice may fall within the terms of Article 40. It is also quite possible that a particular practice may fall under the provisions of both Articles where, for example, an unfair trade practice as between competitors is also injurious to competition. Each separate set of facts would have to be analyzed in order to determine which Article of the SACU treaty is related.

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<td>No territory jurisdiction, but re-importation barriers (vert. restraints)</td>
<td>Law applies, but no anti-competitive effects shown.</td>
<td>Minimum mark up laws, prohibition on sales below cost</td>
</tr>
<tr>
<td>Export country: dumping (non - predation)</td>
<td>Anti-dumping duties, except for customs union prohibition on duties</td>
<td>No territory jurisdiction, but re-importation barriers (vert. restraints)</td>
<td>Law applies, but no anti-competitive effects shown.</td>
<td>Minimum mark up laws, prohibition on sales below cost</td>
</tr>
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</table>

144 It could be presumed that this practice would not fall under the law because its effects are targeted to another jurisdiction.
Any attempt at a categorization of practices as relating to the different SACU provisions must also take account of the relationship between trade laws, competition laws, and unfair trade practice laws themselves (see Table 1). These relationships are viewed in the context of a customs union plan where there is an intent to eliminate tariff duties, and to also disarm member contingent trade laws as a favoured remedial device. At the same time, the inherent territorial limitations of competition laws must be noted in order to appreciate what competition law can and cannot do in supporting a free movement exercise. Where abuse of dominance is a factor in the integration, it also becomes somewhat clearer that cooperation approaches focusing upon market access strategies do not address in full measure the practices flowing from dominant positions.

The treaty objectives for the free trade in goods and the establishment of a customs union are clear, and the treaty likewise has an explicit competition law and policy cooperation provision based upon a member state obligation to have competition policies in place. However, the linkage between competition cooperation and the treaty objectives overall are not explicitly stated, nor are the practices which are subject of national competition law. One can infer a relationship whereby these laws should be functional for those matters affecting trade between the members and which fall as actionable between the national laws. As the SACU is a customs union it is also possible to envision some stronger relationship to trade in order to address practices that affect trade even while not in violation of a national competition law, although members have certainly not explicitly agreed to establish such a relationship in the treaty. The preamble, objectives and free movement provisions more implicitly indicate a common customs area treatment for the movement of goods, and this does suggest some basis for broader cooperation for practices distorting trade within the area or over a substantial portion of it.

Overall, the limitation of the treaty as to movement of goods can be seen as a parameter both in the national laws required and in the forms of cooperation that are undertaken by the members. This may appear illogical in respect of the close relationship between goods, services and investment, but to the extent that the treaty is dictating the cooperation on competition policy, this is itself a limitation dictated by the treaty.

SACU members are highly divergent in respect of country and market size and the international operations of their firms. The customs union is characterized by a single “major” player, and then by intermediate and smaller markets. Also in respect of development levels, while all have significant informal and developing country market aspects, the larger territory also presents important developed country elements, including a fully functional competition law and policy institutional apparatus.

### 3.4 Cooperation instruments for SACU

No systematic study of restrictive business practices in SACU has been undertaken for this discussion. Anecdotal material submitted indicates, not surprisingly, that SACU members deal with issues of dominance and also place some emphasis on treating unfair trading practices, as indicated by the stronger institutional design of Article 41 of the treaty.

These factors suggest some outlines as to the instruments to consider for application. First, as the treaty requires Member States to have laws and cooperate on enforcement, a convergence approach, while not mandated, certainly follows this dictate. A protocol among members
outlining the practices to be treated by national laws and the procedural elements to contain within the laws would be reasonable.

To the extent that SACU is attempting to complete an internal area for movement of goods, some “top-down” convergence can also be imagined both for internal practices affecting SACU overall, but as well for the purpose of developing a common external voice on competition law and policy matters. This latter aspect would be supportive of the degree of external harmonization being realized for the common tariff and commercial policy. An avenue for commencing coordination at the SACU level might be accommodated by a technical liaison committee as the Council has the power to create or define the scope of treaty designated committees.

A positive comity instrument is not necessarily indicated, at least not at the outset. The instrument as commonly employed is based on reciprocity and not all SACU members are dealing with authorities that can either form or respond to requests. Given the stronger position of the larger member’s firm across the SACU market, the implementation of the instrument without some balance to address Type 1 measures might also be viewed as a one-sided form of cooperation. While it is conceivable that a non-reciprocal positive comity could be undertaken by the larger member, it is also possible that very few of the practices affecting the smaller members would actually fall within the terms of violation of the larger member’s competition law. One possible application, however, is the re-importation of dumped goods. To the extent that this has been highlighted by members as an unfair trade practice, positive comity request procedures might assist in addressing actionable vertical restraints that underpin the likelihood of giving effect to a successful price dumping strategy.

Further study might be advised to explore the viability of a notification instrument for SACU. Since the largest member has ongoing investigations in respect of its own firms in its own market, these actions could be communicated to the other members by cooperation based upon notification. While this is a resource intensive gesture for even a well-developed authority, it is also one that can stimulate, and strike the bargain for, the development of the laws and authorities of the other members as well. There is a significant gain for all SACU members where functioning authorities are capable of prosecuting in respect of their own markets based upon a strong signal to firms that information obtained in one is available to the others. It is certainly a concept that is well commensurate with the notion of customs union development.

A delegation instrument could also play a role in respect to the operations of the larger authority for both notified mergers and acquisitions. It may also serve as a bridge for the customs union in respect of external practices subject to investigation and treatment by the larger authority until an external representation could evolve via SACU institutions.

Out of territory approaches to cooperation would appear to require functioning authorities in the members, and this advanced approach would not be able to be considered in the absence of BNLS capacity.

On the other hand, nationality jurisdiction to permit South African authorities to terminate practices of domestic actors as they are committed in other member states is possible. This would be a significant gesture for one national authority to make in respect of its trade partners, and one might imagine that a sort of reciprocity would be required, perhaps in the form of fully functioning authorities activated in the other member states that could respond meaningfully to positive comity requests made by the larger authority.
4. Conclusion

Trade and competition are complementary for the positive effects on consumer welfare. But as also well-recognized, national trade objectives and domestic competition laws are not pieces of the integration puzzle that join so easily together. The degree to which trade objectives can or should dominate the exercise of domestic policy is a matter subject to balance and negotiation in the formation of a regional trade agreement. Since these domestic policies receive more emphasis in the absence of common regional competition rules, the relationship established between the mandate of national authorities and the regional trade objectives should be a conscious one. While this discussion has highlighted a few of the instruments available to assist in meeting regional objectives, innovation is occurring and one can expect to see additional policy instruments emerge over time.

Two areas noted here that deserve some greater study generally are "top-down" convergence and notification. Both hold interesting possibilities for regional trade agreements, and specifically, for agreements containing developed and developing members.
Background on COMESA

The Common Market for Eastern and Southern Africa (COMESA) is a regional integration grouping of 19 African states which have agreed to promote regional integration through trade development and to develop their natural and human resources for the mutual benefit of all their peoples.

The Member States of COMESA are Angola, Burundi, Comoros, DR Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

COMESA was established in 1994 as a successor to the Preferential Trade Area for Eastern and Southern Africa (PTA), which had been in existence since 1981 within the framework of the Organization of African Unity’s Lagos Plan of Action and Final Act of Lagos.

The COMESA Treaty, which sets the agenda for COMESA, covers a large number of sectors and activities. However, the fulfillment of the complete COMESA mandate is regarded as a long-term objective and, for COMESA to become more effective as an institution, it has defined its priorities within its mandate, over the medium term, as the "Promotion of Regional Integration through Trade and Investment". The role of the COMESA Secretariat is to take the lead in assisting its member States to make the necessary adjustments for them to become part of the global economy within the framework of WTO and other international agreements. This is to be done by promoting “outward-orientated” regional integration. The aims and objectives of COMESA as defined in the Treaty and its Protocols is, therefore, to facilitate the removal of...
the structural and institutional weaknesses of member States to enable them to attain collective and sustained development.

**Intraregional Trade – Lessons Learned**

Eleven COMESA member States (Burundi, Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Sudan, Zambia and Zimbabwe) deepened their trade relations when they began to trade on duty-free and quota-free terms as from 31st October 2000 (except for Burundi and Rwanda, which joined the FTA in January 2004). They have, however, maintained their national external tariffs for goods originating from outside COMESA. Trade between the FTA and non-FTA COMESA countries is being conducted on preferential terms determined by the level of tariff reduction given by the non-FTA country.

With the advent of the COMESA Free Trade Area, there has been a significant increase in intra-COMESA trade and it is calculated that this is growing at an annual rate of about 20 per cent, as Figure 2 shows.

The COMESA FTA has highlighted the need for a number of instruments, or factors, to be in place to ensure that free trade becomes a useful stepping stone to deeper regional integration and promotes economic growth, such as:

- simple but development-orientated Rules of Origin;
- a rules-based trading system;
- a level playing field, including the region moving towards a common external tariff and a customs union;
- an effective and efficient regional regulatory environment, which includes fair competition, harmonized standards, NTB observatory;
- open investment policies and national treatment; and
- the existence of a high level of advocacy and “champions”.

The COMESA programme of activities addresses a number of these issues. The COMESA Rules of Origin are relatively simple and seek to promote and enhance industrial development, employment and general economic activity in COMESA while recognizing that the region is not able to manufacture all its needs and that it requires production inputs that are not readily available within the region.

With its Court of Justice, COMESA can be said to be a rules-based institution and is moving towards a level playing field through the gradual movement towards a customs union, supported by programmes on the free movement of persons, labour, services, right of establishment and residence; regional competition policy; a regional programme on public
procurement; the implementation of various instruments to facilitate regional trade (including an NTB observatory, transport facilitation, programme on telecommunications, etc); and the introduction of a COMESA Common Investment Area.

An area requiring more attention, in the COMESA context, is a more comprehensive advocacy programme, and the profiling of the benefits free trade is bringing, and has brought, to the region. In this regard, there needs to be greater publicity given to the significant increase which has taken place in intra-COMESA trade in manufactured products, including cooking oil; chocolate and chocolate powder; wheat flour and flour products; tyres; milk and fruit juice cartons; buses and pick-up trucks; refined copper; and steel and steel products. There has also been a significant increase in the level of small-scale cross-border trade, which is often either under-recorded or not recorded.

The region’s business community is also fast developing alliances and close business ties. Mauritian textile and sugar producers are finding Madagascar to be a lower cost production centre so they are investing in Madagascar to take advantage of both the COMESA market and the US market under AGOA, as well as the EU market under the Cotonou Agreement and the Everything-but-Arms initiative. Other linkages include Egyptian investments in the region, alliances between Zambian freight forwarders and sugar importers of Kenya; Malawian and Zambian insurers and exporters and importers in Kenya and Egypt. The potential for investment and trade is much larger than is currently being exploited, partly due limited funds available for investment.

The FTA has also improved the understanding of trade policy and operational issues such as the implementation of trade remedies and safeguards in a very practical way. As the result of the opening up of national economies and the leveling of the playing field through the elimination of customs duties, competition has become more intense on the COMESA market and weaker producers are facing the possibility of going out of business. To address this eventuality, COMESA has trade remedy and safeguard provisions in its Treaty, which have been invoked and successfully applied following the launch of the FTA.

Economic operators and trade officials have learned more about dumping, subsidies, general safeguards and the application of reciprocal preferential rules of origin in a “hands-on” manner. The FTA experience has also enhanced trade negotiations among member States not only for the regional trade regime, but for multilateral trade arrangements as well.

**Market Access, Entry Barriers, WTO and Regionalism**

African Union Trade Ministers held a meeting in Kigali, Rwanda, on 26-27 May 2004, to discuss, among other things, their respective positions on the WTO trade talks. They came up with the “Kigali Consensus” and the “Kigali Declaration” which outlines in essence, what African Ministers would like to see WTO achieve a fairer global trading system. They are not, per se, fighting against the implementation of a multilateral trading system, and they are not afraid to take part in the process of negotiation. The collapse of the Doha Development Agenda talks has ensured that the status quo in the WTO remains intact and this has not benefited African countries. The problem for Africa is not the multilateral trading system proposed in WTO; the problem for Africa is that this multilateral trading system is not implemented, and the worst culprits, in terms of non-implementation, are the richest countries in the world.
What Africa Ministers decided in Kigali was, unsurprisingly, not very different to what they asked for in Doha and what they asked for in Cancun. The African Ministers’ main demands could be seen to be in agriculture, as agriculture is the mainstay of the economy of Africa. In agriculture, broadly speaking, African Ministers want to see the removal of all forms of agricultural subsidies and the granting, or maintenance, of preferential access into the markets of the rich countries, with a concomitant removal of barriers to entry into these markets, whether these be tariff or non-tariff barriers.

Subsidies on agriculture make African producers uncompetitive in two ways. Export subsidies are where governments subsidize agricultural exports, meaning that these subsidized commodities can be sold to the rest of the world at a cheaper price than un-subsidized goods from the rest of the world can be produced. This means that African producers become uncompetitive, despite possibly having more efficient production systems, and so cannot export their agricultural produce to the rest of the world and cannot supply to domestic or regional markets because of unfair competition from subsidized cheap exports from the developed world. African governments cannot themselves subsidize production because they cannot afford to do so. In addition, if African governments pay subsidies they are in contravention of IMF and World Bank supported structural adjustment programmes, the conditions of which are far more stringent than those agreed under the WTO.

The other form of subsidy is that of domestic support whereby a government pays, through various methods, more to its domestic producers of a particular crop than the world market price. Currently, the most iniquitous example of this, as far as Africa is concerned, is domestic support on cotton. The US government subsidizes US cotton producers, which has resulted in the US increasing its cotton production (the only country to do so over the last few years), despite falling world prices, thereby increasing supply and further reducing the world market price of cotton which puts the more efficient African producers out of business.

Therefore, although African farmers may be efficient producers of agricultural commodities, they are not able to produce, owing to a combination of externally and internally generated price distortions. Africa has great potential, but potential does not automatically equate to market access and removal of entry barriers.

It may, therefore, seem that if the richest countries implemented what has been agreed in the WTO, this would solve the problems of the poorest nations and the world would be a more equitable place. But, the paradox is that, if the developed world were to stop paying agricultural subsidies immediately, many African countries would find themselves worse off than they are at the moment. This is because the system of subsidized agriculture has been in existence for so long that a number of African countries are now heavily dependent on the system. These countries have either now not got the infrastructure to produce the food they require for themselves, and rely on cheap subsidized imported food, or have production systems which rely on subsidies, paid mainly by the EU. The EU, under a series of Conventions, have paid, on a quota basis, subsidies on commodities such as beef and veal, sugar, bananas and rum, to producers in her ex-colonies (the African-Caribbean-Pacific group of countries). Although these subsidies have assisted some economies, mainly those of the small island states, to develop, the immediate removal of these subsidies would result in economic collapse of some economies.

To summarize the Kigali Consensus, as it relates to agriculture, African Ministers are effectively asking for a removal of subsidies, but a phased removal, and the introduction of
measures which will allow African countries to make the necessary economic adjustments to production systems. However, if one were to assume that, in July, at the next General Council meeting, the rest of the world agreed to all the demands contained in the Kigali Consensus, this would still not solve the problems of the poorest countries in Africa.

In the process of elevating the WTO to an organization that goes beyond the boundaries of just trade issues, mainly because it has an enforcement mechanism that other international bodies do not have, the expectations of what the WTO can achieve have been built up to levels which are very difficult, if not impossible, to achieve. There also seems to be a belief that a fairer multilateral trading system is an end in itself rather than being just one part of the process of attaining a higher quality of life for all world citizens. The WTO addresses what can be termed demand-side constraints in the world economy, and aims at creating a conducive environment for production to take place, meaning that a system with a transparent and rules-based regulatory environment, an equitable taxation system, a good supply of productive labour, among other things, is put in place.

However, by concentrating on WTO and the demand side of the equation, the importance of the supply side in African economies seems to have got lost. The supply side involves ensuring that there is an infrastructure to support competitive production in place. It is not enough to create a world where there is a freer movement of goods, labour, capital and people if there are large parts of the world where production is not taking place. An economist may argue that once the demand side is taken care of, and economic distortions are removed, each country will have a competitive advantage in something and will be able to supply this to the rest of the world. The killer assumption here is the “all things being equal” assumption. In the real world all things are never equal. Let us take, for example, the production of sugar cane. Many African countries are amongst the world’s most efficient producers of sugar. One could assume that when a trading system with fewer market distortions is finally in place, Africa would be able to compete favourably in the production of sugar for the world market. But, this may not be so. Brazil is also a major, highly efficient, grower of sugar cane and uses its cane to produce both sugar and ethanol. Brazil has the capacity to supply the whole world with sugar and can, if it so desires, adjust supply by shifting how much of its cane is used to produce sugar and how much goes to the production of ethanol. Brazil could, in theory, shift entirely out of ethanol production and saturate the entire world market with sugar, drive other major world producers out of business, and thus create a monopolistic, or at least a significantly dominant position, in sugar, which she could then manipulate to her advantage.

Another example may be in coffee. Germany grows no coffee but, partly as a result of various tariff and non-tariff barriers, which would be removed in a fairer multilateral trading system, it is the world’s largest exporter of instant coffee. So, one may assume that once the EU removes tariff and non-tariff barriers on coffee, production of instant coffee may shift closer to the source of the raw material. But this is unlikely to happen unless attention is paid to the supply side in the countries that actually grow the coffee.

The supply side is where Africa’s dilemma lies. The capacity building, or infrastructural, component of the New Economic Partnership for Africa’s Development (NEPAD) programme is the latest attempt to address the problems of Africa’s supply-side constraints but, for various reasons, the infrastructure component of NEPAD will have difficulty in living up to its expectations and will, in the minds of many, further confirm Africa’s “lost cause” status. NEPAD is, in many ways, a conventional investment programme and seeks funding for projects or programmes with a positive economic rate of return, which will attract private
investment, and, with this public-private partnership approach, aims to remove supply side constraints. However, there are a number of countries in Africa that, owing to a combination of their physical sizes, relatively small populations and low Gross National Product, could be regarded as not being currently economically viable as economic entities. If these countries are to be a part of the multilateral trading system they must have an infrastructure, which allows imports and exports by road and/or rail. However, in these countries it is often the case that, neither the national budget nor the income that can be generated from the use of the infrastructure itself, is enough to ensure even its maintenance, let alone its capital replacement. So, by any economic measurement, this infrastructure is economically unviable and, in the immediate future, the rate of return is probably negative. But, at the same time, this infrastructure is essential if a country is to provide an environment conducive to investors and essential if trade is to take place.

If Africa is to be brought into the world trading system as much attention must be given to the supply side as has been given to the demand side. However, if this is to be done, there needs to be a major paradigm shift in approach. It is not enough to address only infrastructural investments with a positive economic rate of return in the short term. What is required for Africa is a targeted injection of capital combined with a public-private partnership. A way forward could be for a country to work with a major international company to identify an area of competitive advantage and for the government to work with the targeted international company to agree on what would be required, in terms of infrastructural development and changes in the regulatory environment, for the company to make a major investment in the country which would have an effect on GDP and on employment levels. Once this is done, the role of government would be to address the regulatory environment. The role of the international community would be to finance the infrastructural investment necessary to attract the targeted investment. This could be, for example, an upgrade in a rail or road link to the sea, or an upgrade to a port to make it more efficient and so lower costs on a regional basis. These infrastructural upgrades would need to be done whether or not they have a positive economic rate of return over the immediate future.

If this targeted approach to addressing supply-side constraints was taken on a regional basis, a number of multipliers would come into effect and other investors would be attracted. In this way Africa could be brought into a viable and sustainable multilateral trading environment, which would be for the benefit of all. This, in turn would strengthen the multilateral trading system and address the market access and entry barriers currently faced by African countries.
Annex 1

PROGRAMME OF THE MEETING

BACKGROUND

The proliferation, expansion and deepening of regional trade agreements (RTAs) is one of the most significant international policy developments to have occurred in recent years in the area of trade. Developing countries have been actively involved in this process through intensifying and increasing the scope of integration amongst themselves, as well as with developed-country partners. South-South trade and cooperation has shown new dynamism, including within regional integration groupings, increasingly on an inter-regional basis. The Global System of Trade Preferences (GSTP) is being reinvigorated as an instrument for strengthened South-South cooperation. This drive towards regionalism and South-South cooperation has, in part, been motivated by the slow progress made in ongoing multilateral trade negotiations. It can have significant implications for multilateral trade negotiations and the multilateral trading system in general. Against this background, countries face major challenges in reaping maximum development gains from both multilateralism and regionalism, and in ensuring balance and coherence between the two processes. They need to strengthen the mutual supportiveness of the two processes in fostering a development-orientation of the international trading system.

PURPOSE

The forum aims to draw practical policy insights regarding ways and means to maximize development gains for developing countries through both regionalism and multilateralism by exploring the emerging interface between the two processes and examining their developmental implications. Discussions will be based on research findings and lessons learned from practical regional experiences.

EXPECTED OUTCOME

The forum is expected to shed light on policy debates and options surrounding regional trade agreements and their relationship with the multilateral trading system, especially in the context of the post-Cancún phase of the Doha Work Programme. The meeting was expected to produce a set of policy recommendations on ways that developing countries can best utilize both processes coherently to maximize development gains.

PROGRAMME

9:00 Am Opening Session

Mr. Carlos Fortin, Deputy Secretary-General of UNCTAD

Mr. Mario Mugnaini Jr., Executive Secretary, Foreign Trade Chamber, Brazil (Camara de Comercio Exterior, CAMEX)

9:30 AM SESSION 1: DYNAMISM IN THE INTERFACE OF MULTILATERAL TRADING SYSTEM AND REGIONAL TRADE AGREEMENTS - A POST-CANCÚN PERSPECTIVE

Since the Fifth WTO Ministerial Conference in September 2003, Cancún, Mexico, there appears to be a major shift towards RTAs by both developed and developing countries. A long-standing discussion on the interrelationship between RTAs and the MTS has evolved around the question of whether RTAs
are reinforcing or weakening the MTS (i.e. “building” vs. “stumbling” blocks). While gains are expected from preferential market opening, a major issue involved in current RTA negotiations pertains to the important constraints being imposed by disciplines and commitments made under RTAs on the “policy space” available to developing countries, be it border protection or behind-the-border regulatory policies. Such constraints limit policy options available for the economic, social and human development needed to attain Millennium Development Goals, particularly poverty reduction targets. The impact of RTAs for non-member developing countries has tended to be felt in the form of trade diversion as a result of the erosion of preferences under unilateral preferential schemes such as the Generalized System of Preferences (GSP). An accelerated pace of preferential trade liberalization together with the ever enlarging scope of RTAs have transformed RTAs into negotiating forums virtually substituting the WTO, in particular in the area of new issues. Such “WTO-plus” agreements create an incentive for “forum shopping” and may represent a systemic risk to the viability of MTS.

Following are some of the questions to be addressed during the session:

- What are the opportunities and challenges in the interface between MTS and RTAs?
- How can the two approaches to trade liberalization be made mutually reinforcing?
- Is the MTS still relevant to trade liberalization in a manner supportive of development in view of the shift towards RTAs?
- Should developing countries focus on RTAs?
- Does the increased prominence of RTAs mean the dilution of the WTO?
- What are the implications of the proliferation of RTAs for the prospects of multilateral trade negotiations under the DWP?
- How should developing countries best approach both regional and multilateral trade negotiations so as to maximize development gains, in particular in the areas of agriculture, non-agricultural market access as well as services and regulatory “deep integration” agenda?
- What is the role of UNCTAD in the interface of multilateral and regional trade negotiations?

Moderator: **Mrs. Lakshmi Puri**, Director, Division on International Trade in Goods and Services, and Commodities (DITC), UNCTAD

Panelists:

**Professor Ramón Torrent** (Director, Observatory of Globalisation, University of Barcelona)
**Ambassador Nathan Irumba**, Ambassador of Uganda in Geneva
**Mr. Martin Khor**, Director, Third World Network

11:00 AM **COFFEE BREAK**

11:15 AM **SESSION 2: RESOLVING UNDERLYING ASYMMETRIES: THE DEVELOPMENT DIMENSION IN NORTH-SOUTH AGREEMENTS**

The emergence of North-South agreements has changed the economic relationship between developed and developing countries from the preference-based relations to reciprocity. This is the case with economic partnership agreements being negotiated between ACP countries and the EU, as well as the Free Trade Area of Americas (FTAA) under negotiation in the Western Hemisphere. A variety of bilateral initiatives were activated recently on an inter-regional scale. The underlying asymmetry between the two partners in size, conditions and capacity requires that corresponding asymmetry in obligations and commitments be imbedded in the agreement so as to ensure an equal treatment among “unequal” partners. Such mechanisms would be a prerequisite for mutually beneficial arrangements and outcomes. In practical terms, this translates into exploring commercially meaningful market access for exports of developing countries while at the same time securing special and differential treatment (SDT) under such agreements to address adjustment and social costs, including resource transfer through development assistance. North-North regional integration arrangements, such as the EU enlargement, will also have implications for developing countries.
Some of the questions to be addressed during the session include:

- What are the expected gains for developing countries under North-South Agreements?
- How can market access and entry barriers be best addressed in sectors of export interest to developing countries given the asymmetry in negotiating leverage?
- What kind of SDT and development cooperation is necessary to effectively address adjustment and social costs, as well as the trade, financial and development needs of developing countries?
- How can such SDT be designed for developing countries while existing WTO rules may constrain the ability of RTA partners to do so?
- What reform is required of existing WTO rules to cater for North-South agreements, including GATT Article XXIV?
- What are the implications of North-North agreements for developing countries?
- What role can UNCTAD play in the promotion of the development dimension in North-South agreements?

Moderator: Mr. Mario Marconini, Executive Director, Centro de Relaciones Internacionais, Brazil

Panelists: Mr. Piragibe dos Santos Tarragô, Chief, División de Asuntos Económicos Multilaterales, Ministry of External Relations, Brazil  
Mr. Carlos A. Primo Braga, Senior Advisor, The World Bank  
Mr. Antoni Estevadeordal, Principal Trade Economist and Research Coordinator, Inter-American Development Bank  
Ms. Rosine Plank-Brumback, Senior Trade Specialist, Organization of American States

12:45 PM LUNCH

14:30 PM SESSION 3: SOUTH-SOUTH INTEGRATION AND COOPERATION – NEW TRADE GEOGRAPHY

Regional trade agreements among developing countries have long demonstrated their viability and potential for development. Recently, they exhibit a renewed potential through a variety of initiatives, including subregional, regional and inter-regional agreements. The pace of integration and expansion of the scope of traditional subregional and regional South-South agreements have accelerated and now incorporate “deep integration” agendas that include trade in services and investment. On the other hand, developing countries have extended their reach in finding partners for trade cooperation and integration in different regions. GSTP is a prominent example of such inter-regional trade and cooperation. In addition, a variety of bilateral and trilateral initiatives have recently been launched, including the India-Brazil-South Africa (IBSA) Dialogue Forum. Nonetheless, a number of South-South agreements are yet to exploit their full potential of intra-regional trade, and their trade impact appears to be limited in comparison with that of North-South agreements.

Some of the questions to be addressed during the session include:

- What is the extent and potential value of South-South integration and cooperation? Can they be as important as North-South agreements?
- What are the elements impeding the expansion of intraregional trade?
- Is the inter-regional South-South cooperation viable given a variety of constraining factors including geographical distance?
- How can developing countries explore the potential of intra-regional trade (market access, market entry and supply capacities) including through GSTP?
• Can South-South agreements address supply-side constraints through regional cooperation, and if so how?
• How important is the deep integration in South-South agreement in addressing market entry barriers (competition, investment and standards)? How best can such deep integration agendas be approached through South-South agreements?
• What contribution can UNCTAD make in promoting South-South trade, as well as South-South integration and cooperation?

Moderator: Mr. Sarquis J B Sarquis, General Coordinator, Ministry of External Relations, Brazil
Panelists: Mr. Francisco Thompson-Flôres, Deputy Director-General, WTO
H.E. Mr. Jayant Das Gupta, Joint Secretary, Ministry of Commerce, India
Ambassador M. Supperamaniam, Former Ambassador of Malaysia in Geneva
Ambassador Gyan Chandra Acharya, Ambassador of Nepal in Geneva
Mr. Mikio Kuwayama, Officer-in-Charge, Division on International Trade, ECLAC

16:00 PM COFFEE BREAK

16:15 PM SESSION 4: ADDRESSING MARKET ACCESS AND ENTRY BARRIERS THROUGH REGIONAL INTEGRATION TO MAXIMIZE DEVELOPMENT GAINS - REGIONAL EXPERIENCES AND LESSONS LEARNT

The session encourages an exchange of experiences and lessons learnt in respective regional integration groupings, and seeks to identify ways and means to encouraging greater cooperation among the Regional Integration Secretariats so as to maximize the contribution of regional integration as a stepping-stone towards multilateralism, in particular in the context of the ongoing multilateral and inter-regional trade negotiations.

Some of the questions to be addressed during the session include:

• What are the lessons learnt in expanding intraregional trade?
• Which areas of trade integration and cooperation have proved most beneficial to the member economies?
• How has the MTS affected regional integration efforts?
• How best can equal treatment among “unequal” partners be secured?
• What mechanism and provisions have proved to be instrumental in addressing market access and entry barriers?
• How has the deep integration agenda impacted developing country member of RTAs and how have these affected their participation in the MTS?
• Has regional cooperation contributed to building human, institutional and entrepreneurial, as well as infrastructure and supply, capacities of developing countries for the expansion and diversification of intraregional trade?
• How should developing countries approach regional and multilateral trade negotiations?
• What role can UNCTAD play in exchanging regional experiences and lessons learnt, including the identification of best practices, and in exploring the interface between multilateralism and regionalism?
Moderator: Ms. Sandra Rios, Consultant, National Confederation of Industries (CNI), Brazil

Panel: Mr. Richard Moss Ferreira, Director General, General Secretariat of the Andean Community
Ms. Fay Housty, Director, Foreign and Community Relations, CARICOM Secretariat
Mr. Mark Pearson, Advisor, COMESA Secretariat
Mr. Renato Baumann, Chief, ECLAC Office in Brasilia

18:00 PM CLOSING SESSION

Mrs. Lakshmi Puri, Director, Division on International Trade in Goods and Services, and Commodities (DITC)

18:30 PM END OF SESSIONS
The pre-UNCTAD XI “Forum on Multilateralism and Regionalism: The New Interface” was held on 8 June in Rio de Janeiro, Brazil, in cooperation of BNDES (Banco de Desenvolvimento) and FGV-Rio (Fundação Getulio Vargas). The meeting was opened by Mr. Carlos Fortin (Deputy Secretary-General, UNCTAD) and Mr. Mario Mugnaini Jr. (Executive Secretary, the Foreign Trade Chamber, Brazil). The sessions were moderated by Mrs. Lakshmi Puri (Director, Division on International Trade in Goods and Services, and Commodities, UNCTAD), Mr. Mario Marconini (Executive Director, Centro de Relaciones Internacionales), Mr. Sarquis J.B. Sarquis (General Coordinator, Ministry of External Relations, Brazil) and Ms. Sandra Rios (Consultant, National Confederation of Industries, Brazil).

The following topics were discussed: (a) the dynamism in the interface of multilateral trading system and regional trade agreements in the post-Cancún context; (b) the development dimension in North-South regional trade agreements; (c) South-South integration and cooperation; and (d) regional experiences and lessons learned in addressing market access and entry barriers through regional integration. The UNCTAD secretariat’s background note entitled “Multilateralism and Regionalism: The New Interface” served as a basis for discussion.

The following panellists participated in the meeting: Professor Ramón Torrent (Director, Observatory of Globalisation, University of Barcelona), Ambassador Nathan Irumba (Ambassador of Uganda in Geneva), Mr. Martin Khor (Director, Third World Network), Mr. Piragibe dos Santos Tarragô (Chief, División de Asuntos Económicos Multilaterales, Ministry of External Relations, Brazil), Mr. Carlos A. Primo Braga (Senior Advisor, The World Bank), Mr. Antoni Esteveadeordal (Principal Trade Economist and Research Coordinator, Inter-American Development Bank), Ms. Rosine Plank-Brumback (Senior Trade Specialist, Organization of American States), Mr. Thompson-Flores (Deputy Director-General, World Trade Organization), H.E. Mr. Jayant Das Gupta (Joint Secretary, Ministry of Commerce, India), Ambassador M. Supperamaniam (Former Ambassador of Malaysia in Geneva), Ambassador Gyan Chandra Acharya (Ambassador of Nepal in Geneva), Mr. Mikio Kuwayama (Officer-in-Charge, Division on International Trade, ECLAC), Mr. Richard Moss Ferreira (Director General, General Secretariat of the Andean Community), Ms. Fay Housty (Director, Foreign and Community Relations, CARICOM Secretariat), Mr. Mark Pearson (Advisor, COMESA Secretariat) and Mr. Renato Baumann (Chief, ECLAC Office in Brasilia)

**Dynamism in the Interface of the Multilateral Trading System and Regional Trade Agreements – A Post-Cancún Perspective**

A new kind of regionalism is rapidly evolving in all regions of the world, especially in the period following the formation of the WTO. Some 300 RTAs have been notified to the WTO and some 200 are currently in force. These include South-South, North-North and North-South agreements. These will remain an enduring feature, and an integral part, of the international trading system in the foreseeable future.
The emergence of this new regionalism raises many issues. One is its impact on the multilateral trading system (MTS). The issue of regional integration as a "building block" or "stumbling block" for multilateral efforts was discussed. This is linked to the element of incompatibility between RTAs and MTS, as the former are an exception to the latter. There is no clear-cut answer to this issue. It was stated that RTAs could undercut the MTS and be detrimental to developing countries. Hence, developing countries could have much to lose from a bilateral or regional approach. On the other hand, it was stated that depending on the nature and content of RTAs, it could contribute to fostering the MTS and provide important benefits for developing countries. RTAs were also pursued for various strategic reasons, e.g. political considerations or attraction of FDI. It is obvious that this issue remains an open question and deserves further analytical work.

In fact, due to increasing and parallel participation of countries in various RTAs, the issue of the trade-off between integration in different layers and the preservation of policy spaces to define and implement national development policies by developing countries, and how such “forum shopping” by developing countries affect negotiating prospects, becomes an important strategic issue. It is crucial to assure that RTAs are more conducive to strengthening the MTS by minimizing their possible negative effects, while allowing developing countries to maximize their trade gains in the different layers of integration. The issue is to ensure that both MTS and RTAs are “development-plus” in fostering economic, human and social development and poverty alleviation.

Assessing and understanding the interface and coherence between RTAs and MTS also requires examining the impact of interface among RTAs – the spaghetti bowl illustration. For example, the FTAA initiative existing alongside with sub-regional and bilateral trade and integration processes in Latin America and the Caribbean increases the demand on countries negotiating capital and increases the complexities of issues to be addressed. Membership to multiple RTAs places tremendous burden to the administrative capacity of developing countries. Small economies in particular such as those members of the Caribbean Community are particularly affected.

Resolving Underlying Asymmetries: The Development Dimension in North-South Agreements

The emergence of North-South RTAs was recognized by participants as one of the more salient features of the new regionalism bringing new challenges, but also opportunities to participating developing countries. North-South RTAs are likely to be trade creating because of existing complementarities. The motives behind this new trend were discussed. The motivations by the developed countries in engaging into North-South RTAs have to be understood in the context of North-North relations. The issue of "competitive regionalism" was stressed in this regard. Also, regionalism as a means to foster the trade agenda of developed countries beyond what is currently possible in the MTS, particularly regarding the new issues (intellectual property rights, investment, competition, environment, labour) leads to WTO-plus RTAs that can affect and constrain policy flexibility available to developing countries, hence WTO-minus policy space. Such issues could be and are being discussed and taken up within regional integration groupings of developing countries, but could raise difficulties when approached in the North-South context. High tariff protection in developing countries makes reciprocal liberalization attractive from the developed country perspective.
Also, the strategies of TNCs and political considerations are behind the new North-South activism.

Developing countries are increasingly participating in RTAs with developed countries motivated principally by the possibility of turning unilateral trade preferences into contractual rights for better market access and entry conditions. Also expectations of increasing FDI flows and technology are motivating developing countries in negotiating this type of agreements. There are some issues in favour of participation; RTAs serve as a laboratory for liberalization, harmonization of rules and upgrading of regulatory environment, which diminishes market risks and enhances FDI. There are also some possible negative factors as reduced negotiating capacity and administrative complexity, for example rules of origin. It was highlighted that countries have to identify national objectives to pursue in different levels of integration, and approach negotiations, in a coherent and strategic manner.

North-South RTAs could have positive or negative effects on developing countries depending on a number of factors, these include *inter alia*: the architecture and structure of these arrangements; the level of existing protection; and the composition and the design of rules. Improved market entry conditions including simplified rules of origin, mutual recognition of standards and testing results and trade facilitation measures would be particularly beneficial to developing countries. It was widely recognized that there is a need for these agreements to incorporate elements of asymmetry in the form of SDT in commitments and disciplines, including the level of tariff dismantling, transition period or rules on safeguards and trade remedies such as *de minimis* level. Clear understanding of the impact of these agreements and rules being negotiated and sectors covered is essential.

The new phenomenon of North-South RTAs such as the proposed regional economic partnerships agreements (EPAs) between EU and ACP States under the Cotonou Agreement could affect African regional integration, development policies and the MTS. For these agreements to be development friendly, they must incorporate SDT provisions. For this to happen, WTO rules — particularly GATT Article XXIV — should incorporate SDT principles to allow African countries to better manage and take advantage of their participation in RTAs. The ACP Group of States recent proposal in the WTO on SDT in GATT Article XXIV was noted as a positive initiative in this direction.

The issue of trade and cooperation was addressed highlighting the importance of the integration of cooperation in RTAs which could ensure beneficial outcomes in North-South RTAs. Regional trade agreements combined with regional cooperation can bring development gains to developing countries. This has been the case in CAFTA and the extension of the principles of social cohesion and structural funds under the EU agreements. Another example are the regional infrastructure programmes between Brazil and Peru, Brazil and Venezuela, Brazil and Bolivia and within Mercosur. The newly created BIMST-EC agreement also aims to enhance trade combined with regional infrastructure development to enhance connectivity among the members. Other development features can include reduction of tariff peaks by developed countries; provision of adjustment support, technological support and technical assistance; facilitating mobility of workers; and developing trade remedy rules.

South–South Integration and Cooperation – New Trade Geography

South-South trade issues were also addressed. It was noted that South-South trade has been expanding more rapidly than world trade and thus exhibits great potential for further growth.
Of South-South trade, Asia accounts for a largest share, hence the importance of inter-regional trade. South-South trade is particularly beneficial as the products traded are composed of high-value added and technology intensive goods. Such trade is stronger at the regional level and needs to be encouraged at the interregional level, including through the GSTP. It was noted that South-South trade is not an alternative to North-South trade, but rather complements it as the North remains the key market for the South.

In Africa, regionalism is a development strategy aimed at bringing about greater economies of scale and integration within the various regions and the continent so as to act as a spring board for competitive participation in the global trade. For example, COMESA has formed an FTA and are moving towards a customs union.

The wider development strategy of RTA is also captured in ASEAN where members recently agreed to strengthen economic integration by creating an ASEAN economic community by 2020. The community would facilitate the freer flow of goods, services, capital and people. The goal of reaching higher integration is also manifested in the Andean Community and CARICOM.

**Role of UNCTAD**

UNCTAD has an important role to play in assisting developing countries deal with the interface between multilateralism and regionalism, and the interplay among RTAs, under the new trade, development and cooperation paradigm. This can include: (a) facilitating exchange of experiences and best practices among regional integration groupings; (b) identifying issues that require policy attention; (c) promoting networking and information sharing among regional groupings; (d) facilitating consensus building and international co-operation in addressing the development dimension of RTAs and the interface with multilateral trading system; (e) reinvigorating the Global System of Trade Preferences among developing countries (GSTP).

The following areas for further research were identified: (a) flexibility, differential treatment and asymmetry of commitments for developing countries under North-South agreements; (b) interplay among RTAs including rules of origin; (c) supply-side issues; (d) new approaches to ensure beneficial integration of developing countries in North-South agreements; (e) market entry barriers; (f) integrated trade and cooperation approach under RTAs; (g) development impact assessment of North-South and South-South RTAs; (h) customs union vis-à-vis free trade area; (i) coherence between national policies, RTAs and MTS; and (j) modalities to enhance South-South integration and cooperation including GSTP.

**Questions discussed in the Forum**

The following are some of the policy questions discussed in the Forum. These questions would need to be further addressed and analyzed as countries proceed with trade policy reform and liberalization as part of their overall development strategy.

(i) **Dynamism in the interface between regionalism and multilateralism: A post-Cancún perspective**

- What are the opportunities and challenges in the interface between MTS and RTAs?
- How can the two approaches to trade liberalization become mutually reinforcing?
• Should developing countries focus on RTAs?
• Will the increased prominence of RTAs lead to the dilution of WTO rules?
• What are the implications of the proliferation of RTAs for the prospects of multilateral trade negotiations under the DWP?
• How best should developing countries approach both regional and multilateral trade negotiations so as to maximize gains for development, in particular in the areas of agriculture, non-agricultural market access and services, and the regulatory “deep integration” agenda?
• How can UNCTAD contribute to a positive interface of multilateral and regional trade negotiations?

(ii) Resolving underlying asymmetries: Development dimension in North-South agreements
• What are the areas of gains for developing countries under North-South agreements?
• How best can market access and entry barriers be addressed in sectors of export interest to developing countries, given the asymmetry in negotiating leverage?
• What kind of SDT and development cooperation is necessary in addressing adjustment and social costs, as well as trade, financial and development needs of developing countries?
• How can such SDT be designed for developing countries under RTAs while existing WTO rules may constrain the ability of RTA partners to do so?
• What reform of existing WTO rules is required to cater for North-South agreements, including GATT Article XXIV?
• What are the implications of North-North agreements for developing countries?
• What role can UNCTAD play in the promotion of the development dimension in North-South agreements?

(iii) South-South integration and cooperation: New trade geography
• How important are South-South integration and cooperation? Could they become as important as North-South agreements?
• With regard to South-South RTAs, what are the implications of establishing an FTA as compared with a customs union?
• What are the elements impeding the expansion of intraregional trade?
• Is interregional South-South cooperation viable given a variety of constraining factors, including distance?
• How can developing countries explore the potential of intraregional trade (market access, market entry and supply capacities), including through GSTP?
• Can South-South agreements address supply-side constraints through regional cooperation, and if so, how?
• How important is the deep integration in South-South agreements in addressing market entry barriers (competition, investment and standards)? How best can a “deep integration” agenda be approached through South-South agreements?
• What contribution can UNCTAD make in promoting South-South trade, as well as South-South integration and cooperation?
(iv) **Positive coherence between multilateralism and regionalism**

- What are the lessons learned in expanding intraregional trade?
- Which areas of trade integration and cooperation have proved most beneficial to the member economies?
- How has the MTS affected regional integration efforts?
- How best has equal treatment among “unequal” partners been secured?
- What mechanism and provisions have proved to be instrumental in addressing market access and entry barriers?
- How has the deep integration agenda impacted on developing country members of RTAs and their participation in the MTS?
- Has regional cooperation contributed to building human, institutional and entrepreneurial, as well as infrastructure and supply, capacities of developing countries for the expansion and diversification of intraregional trade?
- How should developing countries approach regional and multilateral trade negotiations?
- What is the role of UNCTAD in exchanging regional experiences and lessons learned, including the identification of best practices, and in exploring a positive interface between multilateralism and regionalism?
Annex 3

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