POLICY BRIEF

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Regionalism and the Multilateral Trading System

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Introduction

Regional trade agreements (RTAs) are an integral part of international trade, accounting for almost half of world trade and expected to grow further in the next few years. These agreements operate alongside global multilateral agreements under the World Trade Organization (WTO), and have both positive and negative effects. They can be attractive, for example, because it may be easier for a small group of neighbouring countries with similar concerns and cultures to agree on market opening in a particular area than to reach agreement in a wider forum such as the WTO. They can also offer new approaches to rule-making and so act as stepping stones on the way to a multilateral agreement.

Indeed, the Doha Declaration, the blueprint for new multilateral trade liberalisation negotiations drawn up by WTO ministers in late 2001, recognises that regional trade agreements can play an important role in promoting the liberalisation and expansion of trade and in fostering development. But regional agreements also risk making it harder for countries outside the region to trade with those inside and may discourage further opening up of markets, ultimately limiting growth prospects for all. Moreover, broad-based multilateral negotiations, with more players and more sectors, will offer greater potential for mutual gain than limited bilateral or regional deals.

While the renewed momentum for multilateral trade liberalisation and rule making launched at Doha may help reduce the risks of regionalism being pursued as a preferred course, should the momentum falter many WTO members are ready to place even greater emphasis on regional initiatives. In any case, RTAs will

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continue to be negotiated, as they have been in the past, for a variety of economic, geo-political and security interests. Preferential regional trade agreements already account for 43% of world trade, and this is expected to increase to 55% by 2005 if all the RTAs currently in the pipeline are realised. The recent pursuit of RTAs in Asia, among countries that had previously eschewed preferential arrangements, is further evidence of the spread of regionalism (see Box 1).

Box 1. **The motives for regionalism**

The spread of regionalism, including among countries that have traditionally avoided this approach, is due to a range of factors, including:

- a concern not to be left out of the growing web of preferential deals;
- a belief in the business community that, as product cycles get shorter and multilateral negotiating cycles get longer, quicker results may be obtained regionally;
- the desire to use regional liberalisation as a catalyst for domestic reform;
- a concern on the part of government to use bilateral deals to promote underlying political or strategic objectives;
- or to pursue non-trade concerns, for example, related to core labour standards or protection of the environment.

It is sometimes suggested that developing countries pursue RTAs for market access gains while developed countries seek deeper integration. This is too stark a distinction. Developed countries too have market access goals (including via regulatory issues like trade facilitation), while developing countries have a stake, via institution-building, in deeper integration.

Clearly, the question of how the positive and negative elements of regional agreements play out, and how they relate to WTO agreements, is an issue of central importance for governments and for trade liberalisation talks. A recent OECD study looked at this question, exploring the relationship between the multilateral trading system and RTAs in 10 sectors that are increasingly covered in regional agreements, ranging from services and labour mobility to environment and rules of origin. It concludes that regional trade agreements can complement, but cannot replace, coherent multilateral rules and progressive multilateral liberalisation. This Policy Brief offers a summary of the study and its conclusions. ■

Why do regional agreements matter for the WTO?

The Doha Declaration gives the green light to negotiations aimed at clarifying and improving disciplines and procedures under existing WTO provisions applying to regional trade agreements. And it agrees that the WTO working group on the relationship between trade and investment should take account, as appropriate, of existing bilateral and regional arrangements on investment. The OECD study looks at the implications of regionalism for the multilateral trading system, providing an analytical tool to help WTO members in their ongoing consideration of how best to manage the relationship between the two.

The OECD study covers 10 sectors which are receiving increased attention in regional trade initiatives: services, labour mobility, investment, competition, trade facilitation, government procurement, intellectual property rights, contingency protection (such as anti-dumping action), environment and rules of origin. It focuses particularly on the rule-making dimension of RTAs in these sectors as these are under the spotlight, and as a complement to the more established work on the welfare effects of preferential regional trade agreements.

The span of regional trade agreements considered in the OECD study is deliberately wide. It includes APEC (Asia-Pacific Economic Co-operation), a forum based essentially on peer pressure rather than binding rules; traditional free trade areas, such as NAFTA (North American Free Trade Agreement), customs unions, such as MERCOSUR (Mercado Común del Sur), with a common external tariff; and the EU, an economic and monetary union entailing integration going well beyond trade. Agreements that have not been notified to the WTO and which, in some cases, are still being negotiated were also included. ■

What is the relationship between RTAs and the WTO?

The relationship between RTAs and the multilateral trading system involves three elements, each of which is of crucial importance to international trade relations. One is

the extent to which RTAs go beyond existing multilateral trade rules in the WTO. The second is the extent to which RTAs diverge from, or converge with, the multilateral system. And the third is what effect RTAs have on countries outside the agreement. ■

Going beyond the WTO

Regional trade agreements frequently include provisions that differ from or go beyond those in the WTO and this is true in a wide range of trade rule-making areas from services to government procurement. But this does not mean that such RTA provisions are necessarily "better" than provisions at the multilateral level, or that they are necessarily more conducive to trade and investment liberalisation.

And in some cases, aspects of RTAs which appear to go beyond the WTO are in fact more a case of doing things differently (see Box 2).

Box 2. **Doing things differently**

Some RTAs rule out the use of anti-dumping measures in return for co-operation on competition policy. These can be said to differ from, rather than expand on, WTO provisions. And the detailed preferential rules of origin contained in RTAs are in fact subject to WTO provisions which seek to ensure that the departure from most favoured nation (MFN) status inherent in RTA agreements does not defeat the central purposes of the multilateral trading system. The MFN principle, whereby trade privileges granted to one trading partner are automatically made available on the same basis to all others, is a key pillar of WTO agreements. By the same token, provisions in RTAs covering the mobility of people in general, including permanent migration, are not so much going beyond the General Agreement on Trade in Services (GATS) provisions on temporary movement of service suppliers as dealing with different, and wider, terms of reference.

Nevertheless, RTAs frequently do go beyond the WTO, essentially by containing provisions that are more far-reaching in a wide range of sectors.

In **services**, many RTAs, unlike the GATS, adopt a "top-down" or "negative-list approach", whereby everything is liberalised unless otherwise specified. While such negative-list approaches can in theory generate broadly equivalent outcomes in terms of liberalisation as the "positive-list" GATS approach, where liberalisation only applies to specifically listed items, and negative-listing can be administratively burdensome, a negative-list approach can be more effective and ambitious in producing liberalisation. Negative-listing can avoid backtracking by locking-in the regulatory status quo while also promoting increased transparency and a commitment to an overarching set of obligations.

In **labour mobility**, several RTAs contain provisions that go beyond the provisions of the GATS on temporary movement of service suppliers (GATS Mode 4) by providing for full national treatment and market access for service suppliers or special market access or facilitated access for certain groups.

RTAs containing rules on **investment** usually go beyond provisions found in the WTO in that they contain provisions on the right to establish a presence in other countries covered by the RTA, an obligation that does not exist in any WTO agreement. And many RTAs reach beyond the question of establishment and the free flow of capital by building on the treatment and protection principles of bilateral investment treaties.

Given the embryonic nature of **competition-related disciplines** in the WTO, most RTAs almost by definition go beyond WTO disciplines, whether by containing general obligations to take action against anti-competitive business conduct or by calling for co-ordination of specific competition standards and rules.

RTA provisions dealing with **trade facilitation** increasingly acknowledge that technological developments may make established procedures obsolete. Hence calls at the regional level for the regular updating of applicable rules to match changed circumstances, and for maintaining the efficiency of procedures through the introduction of new technology. Examples of such technology are advanced risk management and systematic cargo-profiling techniques that obviate the need for physical examination of shipments; or the use of computers, electronic data interchange and Internet technology to provide an environment for paperless trading.

In dealing with **government procurement**, some RTAs have gone beyond the WTO Agreement on Government Procurement (GPA) by enlarging the scope of commitments or by allowing for the provision of additional information. Some have widened

the scope by covering more entities; others have reduced the value thresholds of procurement contracts covered.

Most RTAs dealing with **intellectual property rights** have more far-reaching provisions than those found in the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) in the manner in which they address transition periods (shorter than those under the TRIPS Agreement) and enforcement. Moreover, RTAs that mandate adhesion to international accords (such as the Patent Co-operation Treaty) indirectly embody features of those agreements, such as procedural requirements, which are not contained in the TRIPS Agreement.

In the area of **contingency protection** (also referred to as trade remedies – ranging over safeguards, anti-dumping and subsidies) a number of RTAs have gone beyond WTO disciplines by, for example, eliminating in internal trade all subsidies affecting trade flows or by adopting disciplines on subsidies that are stronger than those contained in the WTO.

RTAs containing provisions, or side agreements, on the **environment** go beyond the WTO in a variety of ways: by requiring parties to prepare periodic reports on the state of the environment; by providing that in case of conflict, parties' obligations under certain multilateral environmental agreements shall prevail over those under the RTA; and by admonishing parties against relaxing environmental laws for the purpose of encouraging trade or investment. Some agreements go beyond discouraging relaxation of standards and include language on the enforcement of domestic environmental laws.

Without necessarily having provisions that are more far-reaching than those of the WTO, RTAs may also be seen as going beyond the WTO by engaging a wider range of countries. Government procurement provides a graphic illustration of this point. A number of RTAs have adopted obligations substantially similar to the GPA, but included countries that are not parties to the GPA. Developing countries, together with developed country partners, are increasingly entering into bilateral or regional procurement agreements whether or not they are parties to the GPA, showing that it is possible to bring countries at different levels of economic development together in a liberalising agreement on public procurement.

In other cases, RTAs engage countries that are not yet WTO members. This occurs, for example, in respect of regional disciplines dealing with labour mobility and with intellectual property rights. ■

Convergence or divergence?

Do regional trade agreements create convergence towards a multilateral standard in a particular area, or do they increase the likelihood of a divergence of approaches? At Doha, former WTO Director General, Mike Moore, referred to the risk that an *à la carte* approach in RTAs in areas such as investment and competition would be a recipe for confusion. What emerges from our analysis is a more nuanced picture. Regional trade agreements create both convergence and divergence.

Convergence

RTAs can have a harmonising role in three ways: by drawing on or replicating underlying WTO approaches; by drawing on other existing international agreements; and, in some cases, by helping to forge model approaches for possible subsequent adoption in a WTO setting. RTAs can also complement the goals of the multilateral trading system by fostering co-operation and technical assistance among regional partners.

While RTAs can have more far-reaching provisions than those found in the WTO, they are nevertheless most commonly based upon underlying WTO approaches and principles. RTAs tend to show broad commonality, for example, both among each other and in relation to the GATS, when it comes to the range of disciplines promoting the progressive opening of services markets, albeit with differing burdens of obligation. At the same time, regional agreements that do not provide for full labour or service supplier mobility tend to use GATS-type exceptions, often using GATS language verbatim. In the area of government procurement, RTAs are broadly speaking modelled upon the GPA, in many cases replicating what can be found in the WTO Agreement, although sometimes going beyond it. Similarly, RTAs generally affirm provisions of the TRIPS and TRIMS Agreements, either by explicit reference or implicitly by echoing at least some of their content.

Provisions in RTAs relating to the environment to a large extent reflect the approach taken in the WTO Agreements. Many contain language in their preambles recognising the need for environmental protection and achievement of sustainable development objectives. Many contain general exception clauses similar to those found in Article XX of the GATT, and the trend is to include language (often borrowed from other RTAs) affirming that the measures referred to in Article XX(b)

of the GATT 1994 include environmental measures necessary to protect human, animal or plant life or health. It should be noted that the NAFTA, and other agreements modelled on the NAFTA, are accompanied by an extensive environmental side agreement that is considered integral to the Agreement and provides for a significant number of additional environmental commitments.

To the extent that they draw on international agreements, regional initiatives also serve to foster moves towards wider harmonisation. This is illustrated, for example, in the field of trade facilitation, given the frequent reference in RTAs to the World Customs Organisation's Arusha Declaration on combating corruption in customs systems and to the Kyoto Convention on the simplification and harmonisation of customs procedures.

Regional initiatives in certain areas may also, in themselves, help forge common approaches. While there is, for example, a marked proliferation of investment agreements at the bilateral and regional level, there is an apparent convergence of investment provisions towards what might be described as an implicit international standard. There are two channels for this. The first is through bilateral investment treaties (BITs), which as "side-BITs" are often associated with RTAs and often based upon model BITs. The second channel is through RTAs that closely resemble or build upon the NAFTA's investment provisions. Indeed, just as most BITs are based on model BITs, the NAFTA investment provisions have in many cases become a sort of model RTA investment chapter.

Similarly, with respect to rules of origin, it appears that the same basic mechanisms or criteria are used by all RTAs, although in varying combinations. As RTAs proliferate, a small number of models, initially formulated by major traders such as the United States or the European Union, are replicated in new agreements concluded between them and third countries.

RTAs also foster co-operation and technical assistance among their participants. To this extent they complement the technical assistance and capacity building goals of the Doha Development Agenda. For example, consultation and co-operation mechanisms concerning the application of measures against anti-competitive conduct are provided for in most RTAs; a number of RTAs have provisions for technical co-operation or for improvements in internal harmonisation and levels of intellectual property rights (IPR) protection; and there are many environmental co-operation agreements at the regional level which facilitate the exchange of information and technical co-operation on matters related to the environment.

Consistent with their provision for technical assistance and capacity building, many RTAs – like the WTO itself – allow for considerable flexibility of application of disciplines, according to the level of development of their members. This is evident in their treatment of rules for foreign investment, domestic competition, transparency in government procurement and trade facilitation – dubbed the "Singapore issues" because they first entered the WTO agenda at the 1996 ministerial conference, held in Singapore. One of the attractive features of negotiating investment rules at the sub-multilateral level is the flexibility that countries with historically similar approaches to investment issues can bring to the process of negotiation – allowing them to scale their regional ambitions according to particular development objectives and local circumstances and sensitivities.

Divergence

The proliferation of regional trade agreements is nevertheless also a source of divergence. Convergence at regional level will not always translate into a harmonised approach internationally. In the area of intellectual property rights, for example, while RTAs may increase the degree of harmonisation of approaches to IPR protection within a regional grouping, the content of such provisions may differ between regional trade agreements. Current regional agreements in the Americas, for example, take two distinct approaches to the relationship between competition policy and anti-dumping action. In one case, there is provision for the reciprocal elimination of anti-dumping actions in return for co-operation in competition policy; in the other, a party's right to apply anti-dumping measures is maintained.

A serious practical consequence of divergent approaches among RTAs is an increase in transaction costs for business, faced with having to respect different rules and standards or follow different procedures in different regions. This is particularly evident in the area of rules of origin. It is not uncommon for a single country to have to apply several different sets of rules when determining how to classify the origin of goods being traded, depending on the RTAs to which it belongs. This complicates both the production and sourcing decisions of companies established, or considering establishment, in that country.

The patchwork of regional initiatives may also give rise to systemic frictions because of divergence both among RTAs and with WTO agreements. For

example, the pursuit of strengthened multilateral disciplines on contingency protection is not aided by the plethora of approaches at the regional level to anti-dumping measures, countervailing duties and safeguard measures.

In other areas, regional approaches may lead not so much to systemic friction – because there is no direct tension with WTO rule-making – but rather to systemic overload. One example arises in investment, where the proliferation of agreements has given rise to a considerable increase in the case-load of various dispute-settlement mechanisms. The rapid growth of bilateral investment treaties has led to a significant increase in the number of disputes brought to the International Centre for Settlement of Investment Disputes. Given concerns over strains on the existing WTO dispute settlement mechanisms and the increased use of the various existing dispute settlement mechanisms for investment, this is an area where considerable work is needed in any eventual investment framework at the WTO. ■

Effects on third parties

Like the question of convergence or divergence, examination of the effects of RTAs on non-members needs to be addressed with care. There is ample evidence of provisions in RTAs that seek to protect the interests of third parties. RTAs covering services typically feature a liberal "rule of origin" (or denial of benefits) clause. That is to say, they extend equivalent treatment to all legal persons conducting substantial business operations in a country that is party to the agreement. This means that, in practice, the post-establishment treatment of investment – in many instances the most important mode of supplying services in foreign markets – tends to be non-preferential as concerns third-country investors. Moreover, a number of governments participating in regional agreements, particularly those adopting a negative-list approach to liberalisation, have shown a preparedness to extend regional preferences on an MFN basis under the GATS.

In the area of competition, as with investment, there is provision for RTAs to adopt the principle of non-discrimination – containing commitments that measures taken to proscribe anti-competitive activities should be applied on a non-discriminatory basis.

Measures taken to promote trade facilitation, with a few exceptions, rarely have a preferential effect. It is impracticable to apply streamlined procedures for RTA-originating goods and more burdensome procedures for third-party goods. And even where provisions in RTAs are preferential, to the extent that they encourage the practice of transparency more widely, as in the case of government procurement, they may, eventually, yield more far-reaching benefits.

Notwithstanding these benign third-party elements in regional trade agreements, there is a clear potential for RTAs to have a prejudicial effect on countries outside the regional pact.

For one thing, regional initiatives can affect investment patterns – in part because of investment protection provisions within RTAs, but perhaps more importantly because of perceived growth opportunities in an expanded regional market. Regional agreements can also distort investment patterns via the effects of sector-specific rules of origin by inducing firms to shift production into the country imposing barriers on imports.

If rules of origin are not sufficiently transparent or predictable, or if their discretionary character makes them vulnerable to capture by protectionist interests, they can represent a trade barrier in their own right. This is a particular risk in sensitive sectors, like textiles and clothing, agricultural or automotive products. The stringency of special sectoral rules ensures that third-country inputs have very restricted market access, especially inputs of a higher value or level of processing.

In a number of other areas examined, the potential for prejudicial effects is evident: for example in the use of competition policy in lieu of anti-dumping measures in intra-regional trade, where anti-dumping measures would still apply to third parties; or in the provision for lower or no customs fees, or for simplified or cheaper labelling requirements in favour of preferential partners.

Issues pertaining to the treatment of third parties have also arisen in the context of a separate OECD project on mutual recognition agreements (MRAs) providing, for example, for mutual acceptance of each country's educational qualifications. A number of recognition agreements or arrangements concluded as part of broader RTAs have been notified under GATS as coming under the heading of regional integration (GATS Article V) rather than recognition (GATS Article VII). It has been queried whether these agreements or arrangements would still be subject to Article VII, which includes a requirement that the parties must provide other WTO members with

adequate opportunity to negotiate their accession to such agreements or arrangements or to negotiate comparable ones. No conclusion has so far been reached. ■

Conclusion

Two broad policy lessons can be drawn. They confirm a view expressed by OECD ministers when they met in 2001, that regional trade agreements can complement, but cannot substitute for, coherent multilateral rules and progressive multilateral liberalisation.

The first lesson is that many consequences of RTA activity bolster the case for a strengthened multilateral framework. This applies particularly to the contribution of regionalism to divergence from the rules of the multilateral system, to the effects which the patchwork of regional agreements can have on non-members of those agreements and to the role of regionalism in raising transaction costs for business.

These elements are compounded by the fact that in some particularly sensitive areas, regional initiatives have been no more successful – and in some cases less successful – than activity at the multilateral level. For example, RTAs have generally made little progress in tackling the rule-making interface between domestic regulation and trade in services, and in some instances have narrower provisions than found in the GATS. In the area of contingency protection, the persistence of different combinations of measures among RTAs is evidence of the intractable nature of this issue – highlighted by the fact that some RTAs add new opportunities to use safeguard measures against import surges with disciplines less stringent than those in the WTO.

It needs to be acknowledged, however, that even were multilateral disciplines to be strengthened, RTAs, and the provisions embodied in them, would not disappear. The question then arises as to how regional arrangements might impinge upon, or co-exist with, any multilateral disciplines. This in turn bears upon the question of the implementation of GATT Article XXIV, which covers customs unions and free trade areas and their relationship to the WTO, as well as GATS Article V, which allows members to enter into regional agreements to liberalise trade in services as long as they do not raise the overall level of trade barriers to WTO members who are not party to them. It also affects the functioning of the WTO's Trade Policy Review Body, Committee on Regional Trade Agreements and Dispute Settlement Body.

The second lesson we can draw from experience with regionalism is that while some consequences of RTA activity contribute to the case for strengthening the multilateral framework, there are features of regional approaches that may nevertheless complement such strengthening or even be drawn upon in designing strengthened multilateral rules. Together, these two elements have yielded highly effective synergies between approaches at the regional and the multilateral levels. For example, while the GATS has achieved a higher level of liberalisation in financial services than that found in most RTAs, the development of the GATS Understanding on Commitments in Financial Services took advantage of insights gained in financial market opening at the regional level.

Nevertheless, while RTA experience might be drawn upon for selective multilateral application, particularly where RTAs are tackling issues specifically referred to in the Doha Declaration, care is needed when identifying best practice for two reasons. First, neither the WTO nor the RTAs are standing still. RTAs are expanding and evolving, including in response to other RTAs, and multilateral rules and market access continue to develop and expand. And second, in many cases agreements reached at regional level are made possible by the close affinities among the members. The ability, and motivation, of RTAs to design and implement provisions that go beyond what might be possible, or desired, in the WTO depend on a complex set of factors including the number of members, and the nature of the links between them.

Implicit in much of the above is the fact that all RTAs are driven in large measure by geo-political considerations. Their role in the trading system, though crucial for trade policy, will always be seen by the participating governments in the broader context of the political and strategic objectives that the agreements seek to serve. ■

For further information

For further information about the OECD's work on RTAs, contact Ken Heydon, Tel.: (33-1) 45 24 89 40 (email: *ken.heydon@oecd.org*). ■

For further reading

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