

# MULTILATERALIZING REGIONALISM

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## A historical perspective on regionalism

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This chapter explores the development of regionalism from a historical perspective, with a view to understanding how the world ended up with some 350 regional trade agreements (RTAs) (so far) of varying degrees of coverage, complexity and efficacy. Understanding the history of regionalism may shed light on how to multilateralize it; and an understanding of the factors that led nations to conclude trade agreements outside the multilateral trading system may help to identify some lessons for dealing with the increasing proliferation of RTAs.

Motivations for regionalism can be varied and several. The report of the First Warwick Commission (2007) identifies a number of important reasons why governments may become involved in regionalism. The most important of these reasons can be summarized as seeking enhanced market access; furthering foreign policy objectives; and influencing the domestic policies of trading partners, for example in the field of intellectual property or migration. Other, secondary reasons include the CNN effect, whereby the short-term publicity associated with signing an agreement may be more important than the substance of the agreement; and the 'laboratory motive', whereby it is possible to experiment with different forms of international rule-making or trade liberalization, perhaps prior to undertaking such liberalization or commitments on a multilateral basis. In the story that follows, we bear these motivations in mind. It is beyond the capacity of this piece to examine in detail which motives are most important in which agreements, but we provide evidence that each of these motives governs some agreements.

### 1 What is regionalism?

First, a short digression: what is meant by the term 'regionalism'? We use the term in this volume to indicate certain types of trade agreements. The WTO's working definition of regionalism seems to be any trade agreement that involves two or more countries but fewer than all

members. It is useful to have an understanding of the complex variety of types of agreement that are covered by this understanding of 'regionalism'. There can be several signatories, as in the case of the EC/EU; or just two, such as the bilateral trade agreement between India and Sri Lanka. The agreements may involve countries that are of close geographical proximity, such as MERCOSOR and SADC; or maybe in different parts of the globe, as in, for example, the agreements between the EU and Chile, Switzerland and Morocco, and the US and Jordan.

In addition, there are other trade policies that may be either unilateral, such as the liberalization policies pursued by Singapore and Hong Kong, China; or are narrow in the scope of products covered, such as the Information Technology Agreement (ITA). These agreements fall outside our definition of regionalism because they are not discriminatory, but an awareness of them is useful to complete the picture.

Aggarwal (2001), from which Table 1.1 is adapted, offers a useful classification of varieties of trade governance and policy. The types of agreement we are primarily interested in fall within table cells 8, 9, 10 and 11. The agreements that fall within these cells all cover a wide variety of products and are between two or more countries, but not so many that they can be considered multilateral. The codes of the Tokyo Round, the concept of which some commentators (such as Pauwelyn, 2005), are suggesting should be revived as an alternative to the single undertaking for either the current or subsequent trade rounds, would fall into the multilateral column, as the goal of such codes is universal rather than exclusive membership.

There is a justification for what may appear at first glance to be a rather haphazard and idiosyncratic definition of regionalism: all the agreements that fall within table cells 8–11 either are (or probably should be) notified to the WTO under Article XXIV (for agreements that involve one or more of the developed countries); or under the Enabling Clause (for agreements that are limited to developing countries). In this way the focus of regionalism is defined directly by the scope of WTO rules. To borrow a phrase from Finger (1993), who said that anti-dumping is trade protection that you can get away with under the anti-dumping agreement, regionalism can be understood to be discriminatory trade policy that you can get away with under Article XXIV. By way of contrast, notice that the examples of agreements that fall into cells 2, 3, 4 and 5 include examples of agreements that may be inconsistent with GATT rules.

Table 1.1. *Varieties of trade governance*

Product scope	Number of participants					
	Bilateral		Mimilateral		Multilateral	
	Unilateral	Geographically concentrated	Geographically dispersed	Geographically concentrated	Geographically dispersed	Multilateral
Few products (sectoral)	1 Trade policy of some Asian countries in some products	2 US–Canada Auto pact	3 US–Japan Voluntary Export Restraints (VERs)	4 European Coal and Steel Community	5 Multifibre Arrangement	6 ITA Tokyo codes
Many products	7 Trade policies of Singapore and Hong Kong, China	8 Mexico–Guatemala India–Bhutan	9 US–Jordan Chile–Rep. of Korea	10 EU MERCOSOR ECOWAS CARICOM NAFTA	11 Protocol relating to Trade Negotiations among Developing Countries (PTA) Tripartite Agreement	12 GATT (1947) WTO (1995)

## 2 Discriminatory trade policy and Article XXIV

Article I of the GATT states that trade concessions granted to one member are supposed to be applied immediately and without conditions to all other members. Despite this commitment to Most Favoured Nation (MFN) treatment by all members, since the birth of the GATT over 550 trade agreements granting selected preferences to some partners have been made; some 330 of these are currently in force, of which two-thirds have been notified to the WTO by members. How did the world get into this plethora of regional trade agreements that has been so ineloquently named 'the spaghetti bowl'? This chapter traces the development of regionalism, seeking to highlight the main motivation of key players at various milestones since 1948.<sup>1</sup>

Exceptions to the MFN clause are allowed under Article XXIV of the original GATT,<sup>2</sup> which allows 'the formation of a customs union *or of a free trade area*' (emphasis added) under specific conditions, the essence of which is that closer integration between the parties to an agreement is considered beneficial, so long as 'the purpose is not to raise barriers to the trade of other contracting parties'. Why was Article XXIV allowed into the GATT in the first place, and how was the term 'free trade area' reputedly allowed to creep in at the last minute? It can be reasoned that provision was made for customs unions, partly because there were a number of customs unions that were operative at the time of the drafting of the GATT (including Switzerland–Liechtenstein); and partly because a customs union would have to be allowed because it recreates some important elements of single-nation characteristics (Bhagwati, 1999).

Scholars that have traced the negotiating history of the GATT have identified three stories as to why the words 'or free trade area' were added alongside customs unions as a permissible exception to the MFN clause. One relates to the idea that European regionalism was viewed as a prerequisite for peace on the war-torn continent. This is unlikely, as the main trading ties of key European nations at the time were with countries with whom they had strong historical ties, rather than with each other. Another story relates to a free trade agreement that was supposedly being negotiated between the United States and Canada.

<sup>1</sup> For a description of trade policy prior to 1948, see Irwin (1993).

<sup>2</sup> The other instruments by which exceptions to MFN are permitted are the Enabling Clause and Article V of the General Agreement on Trade in Services.

Other possible explanations are the existing Italy–Vatican PTA; and an agreement between Lebanon and Syria.

## 3 The first wave of regionalism

The first wave of regionalism refers to the period prior to 1986.

### *Early European regionalism*

The formation of the European Economic Community (EEC) in 1958 was a watershed in the history of regionalism. European regionalism was born out of a French desire for security. France first sought to expand her trading prospects with an approach to her wartime ally, Great Britain.<sup>3</sup> In 1955, two ideas were mooted by France: the first was the possibility of a union between France and Britain; the second was the request by France to join the British Commonwealth. These approaches to Britain can be set against the backdrop of the events in Egypt, Algeria and Israel/Jordan: in Egypt, Nasser had nationalized the Suez Canal; in French Algeria there was a separatist rebellion; and tension was growing along the border between Israel and Jordan. After Britain decided to pull out of Suez, the battle against President Nasser was lost, and all talk of union died too. A year later, France teamed up with Germany, building on the European Coal and Steel Community established in 1952, which placed the French and German steel industries under a common authority in order to lessen the likelihood of war between France and Germany, and the EEC was born.<sup>4</sup>

The Treaty of Rome clearly did not comply with the spirit of Article XXIV, in that it excluded an entire sector – agriculture. Despite this obvious flaw, the EC agreement was allowed to pass in the GATT because of the United States' interest in having a strong, peaceful Western Europe in the post-war era. The Cold War was, at this time, heating up. The accommodation of the EC's imperfect union is referred to by some commentators (e.g. Jackson, 1993) as a breakdown of the GATT's legal discipline. A debate on what constituted 'substantially all trade' began, as excluded countries were concerned about what were termed 'systemic issues', meaning that they feared that the proliferation

<sup>3</sup> Details reported at [http://news.bbc.co.uk/2/hi/uk\\_news/6261885.stm](http://news.bbc.co.uk/2/hi/uk_news/6261885.stm).

<sup>4</sup> The original six members of the EEC were Belgium, France, Germany, Italy, Luxembourg and the Netherlands.

of regional trade agreements and the corresponding disregard for the rules could harm the multilateral system.

The establishment of the EC, with its plan to move to a common external tariff in 1968 (ten years after the Treaty of Rome entered into force), led to the almost simultaneous development of another European bloc, the EFTA.<sup>5</sup> Afraid of being left out, a group of non-EC European nations, led by the UK, formed EFTA. This rival bloc was less successful than the EC. Gradually five of the seven original members of EFTA, except Switzerland and Norway, migrated to the EC. This can be explained by the domino theory of regionalism (Baldwin, 1993; Baldwin and Reider, 2007). Prior to this, the UK had hoped that in joining EFTA it would retain sovereignty over trade policy, but would benefit from a larger market. This was not to be, and finally, after careful analysis, the UK concluded that joining the EEC was in its best interests.

#### *Early regionalism among developing countries*

The EC and EFTA are just two of fifty-seven trade agreements that were concluded during the period 1955 to 1974. Important geopolitical events and movements during this period include decolonization, the rise of the Non-Aligned movement, and the promotion of the development paradigm known as import substitution industrialization, which was developed during the interwar period, under the influence of the early work of Raul Prebisch and the Economic Commission for Latin America and the Caribbean (ECLAC).

These developments gave rise to a spate of agreements between developing countries. Some of these were ideologically motivated, and had very little content in the way of trade concessions. For example, the trade concessions embodied in the Tripartite Agreement between Egypt, India and Yugoslavia, whose leaders were the pioneers of the Non-Aligned movement, amounted to a 50 per cent tariff reduction for 193 products.

However, this period saw the foundations laid for what have become the main regional groupings, including ASEAN, which was formed in 1967 with five members. Initially the formation of ASEAN was related primarily to security motives. A trade dimension, in the form of inclusion lists, was added eleven years later.

<sup>5</sup> The original seven EFTA members were Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the UK.

#### *Early Latin American regionalism*

The idea of Latin American integration has deep roots in the region's political and economic culture that date as far back as Latin American independence during the early nineteenth century, but Latin American schemes of economic integration blossomed during the 1960s and 1970s. During those years, Latin American countries actively pursued a policy of industrialization behind high tariffs and most of them engaged in an active developmental approach.

As the easy stage of light manufacturing was accomplished, Latin American leaders championed the idea of economic integration largely as a way to address the bottlenecks related to the limited size of their national markets, particularly as subsequent stages of development involved capital-intensive industries. This led, for example, to the creation of the Central American Common Market, the Caribbean Community, and the Andean Community.<sup>6</sup> It also led to pan-Latin American integration initiatives, notably the LAFTA (Asociación Latinoamericana de Libre Comercio) and later on the ALADI (Asociación Latinoamericana de Integración), which envisioned the establishment of a Latin American free trade area and common market, respectively, through the granting of regional or bilateral economic preferences among members.<sup>7</sup>

#### *Developments in the early 1980s*

European regionalism expanded and deepened. The first expansion of the EC involved the accession of the UK, Ireland and Denmark in 1973,

<sup>6</sup> This does not imply that political considerations are irrelevant, but for reasons of space we limit this discussion to economic factors. Three of the four customs unions in the Americas were created in the 1960s and 1970s: the Central American Common Market (CACM) created in 1961, the Andean Community created in 1969, and the Caribbean Community and Common Market (CARICOM) created in 1973. The fourth one, the Common Market of the South (MERCOSUR), was created in 1991 and entered into force in 1995.

<sup>7</sup> Established in 1960, the ALALC counted eleven members: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela. The Andean Pact, which was established nine years later, was supposedly an early example of a subregional 'building block' towards regional free trade. Born in 1980, the ALADI built on the legacy of the ALALC, but adopted a more flexible approach to achieving free trade among nations as it allowed subregional and bilateral partial scope agreements on top of regional preferences. Today the ALADI serves as an umbrella agreement for many bilateral FTAs and customs unions in the Americas, notably the MERCOSUR.

bringing the total number of countries to nine. The second expansion in 1981 added Greece to the fold.

During the early 1980s Latin American countries were hard hit by the debt crisis, which triggered an early wave of market-oriented reforms. Top priorities on the external agenda included eliminating policy-induced biases of the import substitution industrialization development strategy, and adopting a decisive export-oriented trade strategy, complemented by friendly policies towards foreign investors – all elements that underscored the success of Asian economies. While regionalism was not a policy option for early reformers, it was brought back with important transformations to the regional agenda in the late 1980s.

#### 4 The second wave of regionalism

The 'second wave' of regionalism, as Bhagwati (1999) termed it, began in the mid-1980s. The seeds of the Uruguay Round had been sown in November 1982 at a ministerial meeting of GATT members in Geneva, where ministers intended but were unable to launch a major new negotiation. In 1986, the Round was launched. What had changed in those four years? Two idiosyncratic events that precipitated the launch of the Round and the second wave of regionalism can be noted.

These two events are simultaneous developments in regionalism in Europe and North America. In Europe, the EC was expanding and deepening: the third expansion of the EC to include Spain and Portugal, together with the laying of plans for completing the move to a Single European Market for goods, services, capital and labour. This led to two concerns among the rest of the world: first, that the EC would be less interested in pursuing multilateral negotiations within the GATT; and, second, a fear of 'Fortress Europe' – the idea that the EC would become less open to trade with outsiders. In North America the efforts to recreate a free trade area joining Canada and the United States finally succeeded, and the CUSFTA came into being.

Two elements were different in the second wave compared with the first wave. The most important development was that the United States had clearly changed track, transforming from a staunch multilateralist stance to embracing and beginning to negotiate preferential agreements. The second element was the planned deepening of integration in Western Europe, which is acknowledged to have paved the way for the inclusion of services in the Uruguay Round.

In Latin America, the 'new' regionalism was decisively 'open' regionalism, for it was accompanied, at least initially, by unilateral and multilateral liberalization. Among South American ALADI members, the new regionalism still maintained traces of the old regionalism, notably its efforts to foster non-traditional exports to Latin American markets and its thematic focus on achieving market access for regional goods. Most Latin American and Caribbean (LAC) countries took on RTA negotiations between each other with renewed enthusiasm and deeper liberalizing ambition. Existing regional pacts were revamped and relaunched, while a new regional scheme took place in the Southern Cone, the MERCOSUR.

The shift in US policy towards regionalism and Mexico's initiative to join the US and Canada in the NAFTA – which posed a major challenge to Latin American countries – were key factors that shaped the content and landscape of the new regionalism in the Americas (Ethier, 1998; Salazar Xirinachs, 2002). NAFTA proposed a revolutionary approach to regionalism in the Americas, as it envisaged a North–South RTA between highly asymmetric partners, with limited or no special treatment for the less-developed partner. Prior to NAFTA, Latin American integration had only involved agreements among developing countries, and these had often included special and differential treatment (e.g. the ALADI). Additionally, NAFTA went far beyond market access as it included 'deep' commitments in an entirely new set of trade disciplines, which responded to the Mexican focus on attracting investment (Lawrence, 1996).

Following the announcement of NAFTA negotiations, many Latin American countries expressed interest in negotiating a similar agreement with the United States. As a response, in 1990 the United States launched the 'Enterprise for the Americas Initiative' with the goal of achieving free trade in the western hemisphere by 2000. Four years later negotiations on the Free Trade Area of the Americas (FTAA) started. However, negotiations were marked by slow progress due to intractable obstacles in agriculture, and anti-dumping on the US side, as well as the defensive position of leading South American nations concerning industrial products and the 'new areas of trade' (chiefly investment and intellectual property rights).

As the FTAA negotiations faltered, the United States and many Latin American countries – notably Chile and Central American countries – embraced bilateral negotiations within the Americas. Meanwhile Mexico,

which had been actively negotiating trade agreements in the Americas throughout the 1990s, turned to path-breaking FTA negotiations with transcontinental partners,<sup>8</sup> initially from Europe and later from Asia.

MERCOSUR countries, led by Brazil, consolidated their network of arrangements in South America by negotiating FTAs and subsequently granting associated member status to Andean countries as a first step towards the South American Union of Nations (UNASUR).<sup>9</sup> While the idea of a South American FTA had already been presented by the Brazilian authorities back in 1994, it materialized only in December 2004. The strong reaction against liberal reforms of the 1990s that spread unevenly throughout the Americas led to the dilution of the commercial component of UNASUR and to placing more emphasis on other aspects of the integration agenda, such as physical integration, energy, and social and cultural integration.

### 5 The third wave of regionalism

The third wave of regionalism has occurred since the conclusion of the Uruguay Round. Some of the more recent agreements can be explained as either the deepening or widening of existing agreements, such as the plethora of agreements that have occurred between the EU and new European nations. The new factors here are the sheer number of countries that want to be associated with the success of Europe.

The current situation is one where, for some customs territories, only the least favoured nations pay the MFN tariff; others pay a preferential tariff or none at all. This has led to a climate of competition among nations to establish preferential arrangements with selected trade partners, in order to avoid a situation where paying the MFN tariff is to be one of the least favoured nations. This situation has led to a third wave of regionalism, with several important countries actively pursuing a smorgasbord of new agreements with a variety of potential partners.

#### *Australia-US agreement*

We include this agreement as a special case. Typically it could be expected that the 'CNN motive', if it exists, would prevail only in the

<sup>8</sup> This claim is within the Latin American context. The United States and Canada had already negotiated transcontinental FTAs back in the 1980s and 1990s with Israel.

<sup>9</sup> As illustrated in Table 1.1, Chile and Bolivia had become associated members of MERCOSUR in the early and mid-1990s.

types of countries whose public spaces are adorned with portraits of their unelected leaders, rather than in liberal democracies. This is seemingly not the case, as the motivation for this agreement is widely acknowledged to be not a particularly good one for Australia, but the prime minister at the time is reported to have wanted an agreement, and hence one was signed.

### 6 Other factors explaining the growth in regionalism

That regionalism has grown is indisputable. Whether or not this is a good or bad thing for the multilateral trading system is the subject of many scholarly papers, and the arguments will not be rehearsed here. It is worth drawing attention to two numerical factors that help explain the growth in the number of trade agreements. First, over the period under consideration, the number of independent countries who are state actors and potentially eligible for membership of the GATT/WTO has grown from 70 in 1949 to 195 in 2008. An increase in the number of countries by a factor of less than three leads to an increase in the potential number of bilateral trade agreements by a factor of eight. Figure 1.1 illustrates the concurrence of the increase in the number of GATT/WTO members and new trade agreements. It is worth noting that the 1960s, which is the period corresponding to one of the peaks in regionalism in Figure 1.1, saw thirty-two African nations achieve independence; and that thirty-three countries have been created since 1990. Twenty of these were formed due to the break-up of the former Soviet Union (fifteen new countries in 1991) and the former Yugoslavia (five new countries in 1992). Many of these new nations have engaged in trade agreements with each other and with the EU, and this accounts for the second peak in Figure 1.1 in the 1990s.

Second, international trade has grown both in absolute terms and as a proportion of GDP. If there is more trade, then more trade agreements might be expected, both in number and in depth of coverage.

The third factor is the apparent simultaneity of expanding and deepening regionalism, and the development of the multilateral system. The explosion of regionalism in the second wave described above was not necessarily detrimental to the multilateral system, as had been feared during what turned out to be the closing years of the Uruguay Round. The Uruguay Round was concluded, with its achievement of the Single Undertaking, despite the NAFTA and the European single market.

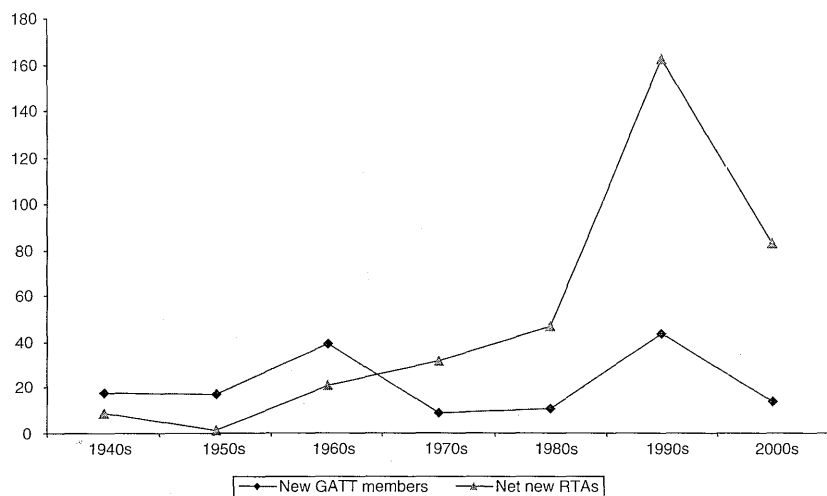


Figure 1.1 New GATT/WTO members and net new RTAs by decade

Source: Author's calculations based on Hufbauer dataset and information from WTO website.

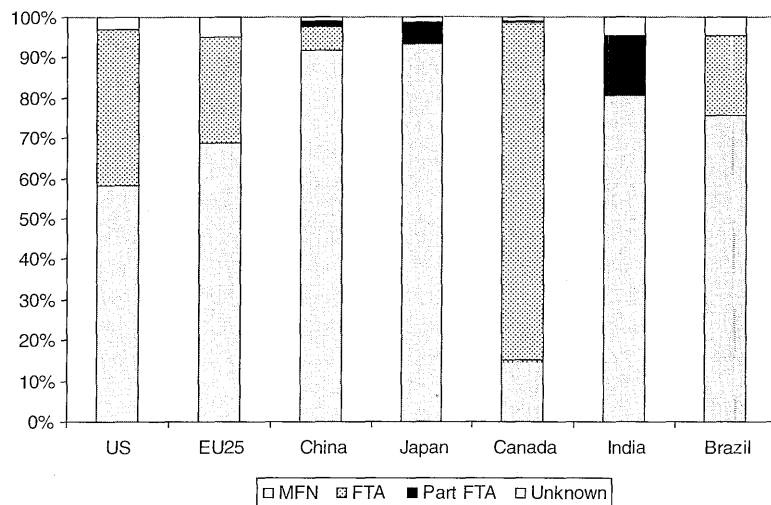


Figure 1.2 MFN and preferential treatment of exports, by exporter (selected countries)

Source: Baldwin and Carpenter (2007).

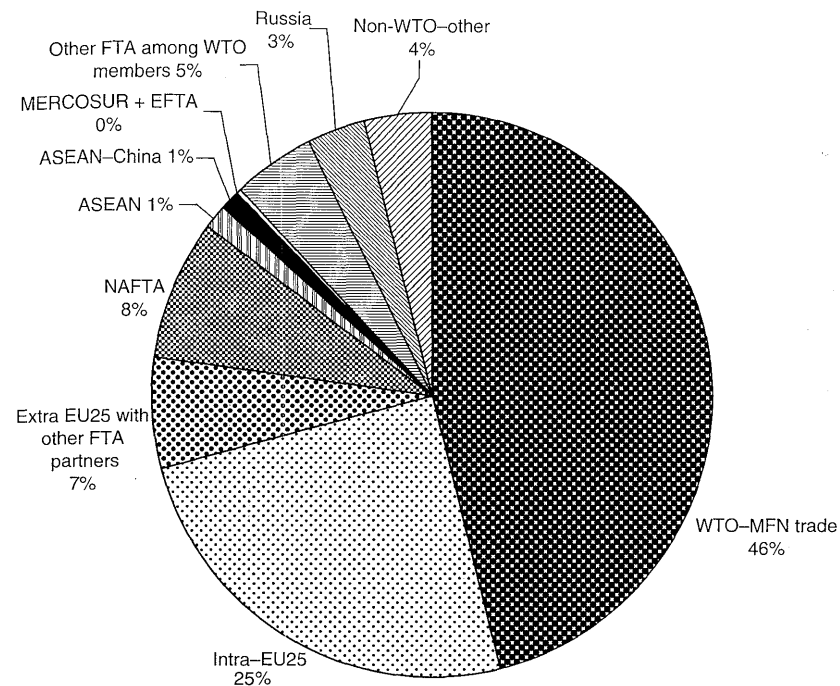


Figure 1.3 World trade by trade governance region

Source: Baldwin and Carpenter, 2007.

Finally, in assessing the importance of regionalism and its potential impact on the multilateral trading system, it is important to note that multilateralism is of primary importance to many of the key players. Figure 1.2 shows the proportion of exports that are subject to MFN rather than preferential tariffs at their destination markets for a selection of countries. For example, almost 60 per cent of US exports are subject to MFN tariffs. The proportion is even higher for exports from the EU to third countries. Only Canada enjoys preferential tariffs for the majority of its exports. Figure 1.3 illustrates that over 45 per cent of world trade is conducted with MFN tariffs. Figure 1.4 illustrates that almost 60 per cent of goods entering the EU do so under zero MFN tariffs; and that 21 per cent of goods, for which the MFN tariffs are greater than zero, are not the subject of any preferences. Together these illustrations demonstrate that multilateralism is still of considerable importance, and that as tariffs are eroded the value of preferences wanes.



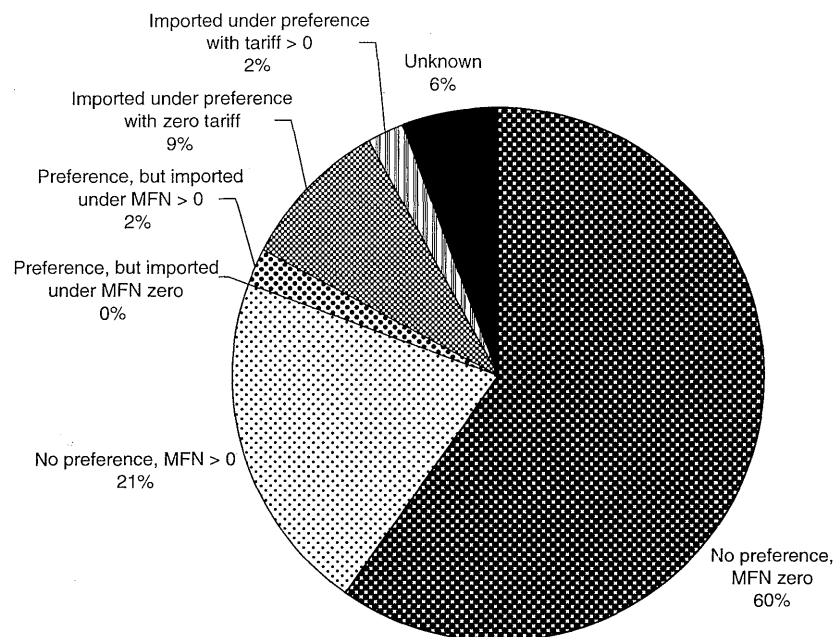


Figure 1.4 Imports to the EU by type of tariff

Source: Baldwin and Carpenter, 2007.

## 7 Lessons from history

Are there any lessons to be learned from the brief historical analysis that has been conducted in this chapter? We have seen that the motivations for regionalism are multilayered and complex. Only if the multilateral system can respond to satisfy these desires could the interest in regionalism be lessened. And, as noted above, regionalism shows no sign of abating; on the contrary, over 150 trade agreements are currently being proposed or negotiated.<sup>10</sup>

If there is something to learn, it is that a growth in regionalism appears to go hand in hand with developments in multilateralism. In

<sup>10</sup> Author's calculation, based on data gathered from national government websites in March 2008. This figure includes agreements being proposed or negotiated by the EU (twenty-nine); India (twenty-two); Republic of Korea (sixteen); China (fifteen); USA (thirteen); Australia (twelve); Japan (eleven); New Zealand (nine); Brazil (five); and other Asian countries (twenty-four).

fact the two elements of trade policy, incompatible as they may appear on the surface, have actually expanded simultaneously. It would seem, just as the spate of new agreements that were negotiated and concluded during the Uruguay Round did not prevent the successful conclusion of that Round, that it is unlikely that the current developments in regionalism will be a sticking point in any conclusion of the Doha Round.

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