

**ARE FTAs A 'STUMBLING BLOCK' OR A 'BUILDING BLOCK' IN THE
MULTILATERAL TRADING SYSTEM?*****TANVI SHARMA**

The slow progress of World Trade Organization (WTO) trade negotiations has led to an increase in regional trading agreements (R.T.As) for the purpose of gaining immediate market access. Economic considerations aside, R.T.As are also driven by geo-political and strategic considerations.¹ Ironically, even though some 40% of global trade takes place among developing countries, there have been no serious efforts to negotiate trade liberalization among the developing countries in a multilateral forum. The only feeble attempt was the General System of Trade Preferences (GSTP), launched under the auspices of the United Nations Conference on Trade and Development (UNCTAD), but the offers made were meagre and symbolic. This could be explained by the tradition, rightly or wrongly, among the developing countries that they should not demand and negotiate market access among themselves in order to preserve a semblance of G77 solidarity. One way out is therefore to choose a special trading partner and negotiating a regional trading agreement (R.T.A.)² either bilaterally or among a group of developing countries. It is therefore no coincidence that there has been a dramatic rise in the number of R.T.As since the Uruguay Round. They are driven as much by perceived economic benefits of regional integration as by strategic and political calculations, if not more.³

1) Regional Trade Agreements

Regional Trade Agreement is an agreement of preferential trade in which a set of trading partners reciprocally reduce trade barriers. The trading partners may or may not be neighboring or even close to each other. RTAs vary significantly along many directions. They come in all size and shape. A glance at the present RTAs reveals that regionalism has varied objectives and can potentially take a myriad of different forms and structures, each with different implications and nuances.⁴

¹. Chak Mun, '*The Comprehensive Economic Cooperation Agreement--The Strategic Imperatives*', Singapore Year Book of International Law, 2006.

². Types of R.T.As include the Economic Union, Common Market, Customs Union, Free Trade Area, and Partial Scope. The most common is the Free Trade Agreement (F.T.A.).

³. Chak Mun "*FTAs: An Economic Reality for Multilateral Trade*" The Financial Express (22 June 2004).

⁴. Das K. Dilip, *Regionalism in Global Trade*, Edward Elgar, 2004 at page 11.

For instance they vary enormously in income levels and the shares of intra-RIA trade. Their structures may vary from loose agreements to facilitate trade. They can follow the principle of open or closed regionalism. An RTA movement can be initiated in a coercive or a benign manner. It can be consensual or hierarchical. It can stop at free trade in goods; emphasize economic integration or political and strategic ties. It can be a consequence of the decentralized operation of market forces, or a product of determined action of the concerned states. Therefore one can infer that RTAs are highly dissimilar and each one is *sui generis*.

The extent of liberalization in trade in goods can vary across RTAs. Many do not even cover all trade in goods. Generally services are not included in RTAs, exclusive economic integration agreements are made for regional or preferential trade in services. The functioning procedures of RTAs also differ considerably. In their operational style, some RTAs are dynamic. They keep moving forward, and work towards eventual deeper integration. Others are consciously stand-alone, static, agreements. Some RTAs are simple in nature and are governed by few regulations. Others are intractably complex and have large framework regulations.

Members of a RTA can and do differ in important economic features. One of the features of economic integration is the level of economic interdependence among the member economies. The difference among member economies regarding dependence in the areas of trade and investment on the members of RTA determines the level of symmetry in the economic relationship of the members. An unmistakable fact about RIA is that they have a political dimension because all countries and regions are political entities in their own right. Therefore, many of their objectives go beyond trade and economic integration and take on political overtones.⁵ The foregoing exposition brings home the fact that a wide diversity in content and form is commonly to be found between RTAs among both developing and developed countries. While tariff elimination is common to all of them, differences commonly exist on agreements related to⁶:

⁵Ibid
⁶Ibid

- Quantitative Restrictions
- Positive or Negative List approach
- Rules of Origin
- External tariffs
- Timetable for liberalization
- Trade in Services
- Movement of labor and capital
- Promotion of Industrialization
- Promotion of trade objectives, &
- Payments arrangements

2) Preferential Trade Agreements

Corresponding to the stage of integration, an RIA could have a spectrum of institutional frameworks or arrangements varying from Preferential Trading Areas (PTAs) or Free Trade Areas (FTAs).

PTAs are the first-tier arrangement. In this arrangement, trading partners grant partial non-discriminatory tariff concessions to each other. They leave their own tariffs, non-tariffs barriers and quantitative restrictions unchanged. ‘Other’ in this case means trade barriers towards the non-members or the rest of the world.⁷

FTAs are created when two or more countries grant preferential treatment in trade to other member countries by eliminating tariffs and other non-tariff barriers to trade on goods within the FTA but maintain their respective trade policies outside the FTA region. Although bilateral FTAs are a longstanding part of international trade history, they have only recently emerged as a dominant vehicle for trade. Before World War II, bilateral trading arrangements were common throughout the world, especially in the context of imperial trading systems. In the aftermath of World War II, however, the West adopted multilateralism as the preferred post-war institutional model for international trade. This policy preference for multilateralism was officially

⁷Id at 15

established by the signing of the GATT in 1947, and it continues under the governance of the WTO. The growth in WTO membership, which today boasts a membership of 150 countries, attests to the historic prevalence of multilateralism, especially when considered in contrast to the original GATT signatories, which numbered only twenty-three states.⁸

➤ **Importance of shift from Multilateralism to Bilateralism/Regionalism**

In recent years, however, the proliferation of bilateral and regional FTAs has threatened to displace, or at least impede, the multilateral trading system.⁹ This shift from multilateral to bilateral and regional trade agreements is important for several reasons:

- First, it represents a significant change in dominant trade policies that may be representative of changing attitudes about globalization and should be examined closely to ensure that overall and long term welfare can be achieved.
- Second, the proliferation of regional and bilateral FTAs may unintentionally allow the undetected advancement of protectionist interests simply due to the number of agreements reached and the complexity of their administration.
- Finally, the specific provisions of the Trade Policy are likely more readily manipulated by special interest groups for protectionist and other purposes in the context of multiple FTAs. This may exacerbate already unequal distribution of trade benefits for less powerful groups.

➤ **Reasons for the shift from Multilateralism to Bilateralism/Regionalism.**

The shift away from multilateralism in favor of bilateral and regional FTAs can be explained by a mix of political and economic factors. Fredrick Abbott, a professor of international law at Florida State University College of Law, suggests that less support for multilateralism now exists among original GATT signatories because their geopolitical interests are no longer most effectively advanced by multilateral trade.¹⁰

After World War II, the GATT nations were united by the common goal of guarding against perceived threats from the ideological and economic enemies of communism and socialism. This

⁸Andrea R. Schmidt, *A New Trade Policy for America: Do Labor and Environmental Provisions In Trade Agreements Serve Social Interests Or Special Interests?*, 19 Ind. Int'l & Comp. L. Rev. 167.

⁹. Sungjoon Cho, *Doha's Development*, 25 Berkeley J. Int'l L. 165, 193 (2007).

¹⁰. Frederick M. Abbott, *A New Dominant Trade Species Emerges: Is Bilateralism a Threat?* 10 J. Int'l Econ. L. 571, 571 (2007).

created a powerful incentive for cooperation among signatory nations to form a Western bloc that could use its consolidated power to prevail both economically and politically over communist and socialist regimes. The "most-favored-nation" (MFN) principle of multilateral trade was key to achieving cooperation because it eliminated contentions among signatory nations over differential trade preferences between them.

In addition to the benefits of creating a united political and economic bloc to counter the communist threat, the most influential GATT signatories likely stood to make significant economic gains from the original multilateral trade structure and the MFN principle. The majority of original signatories were developed countries whose trade agendas were likely to be similar, meaning that signatory nations were unlikely to face highly objectionable demands from other signatories. Further, because the negotiations depended on economic negotiating leverage, those signatories whose trade agendas did not coincide with the agendas of the economic superpowers generally lacked the necessary leverage to prevail. For example, agricultural products were not included in multilateral trade agreements until 1994, largely because the United States and other developed nations, including those that now comprise the European Union (EU), were unwilling to give up substantial protections for their agricultural sectors.¹¹

This omission was perpetuated despite the fact that many developing-country-signatories' economies were heavily dependent on agriculture and would have benefitted considerably from liberalization in that sector. Economic superpowers like the United States and present day EU countries had so much leverage in multilateral trade negotiations that they were able to maintain significant agricultural trade barriers throughout the GATT rounds and even avoided making significant concessions in Uruguay Round's Agreement on Agriculture (URAA) in 1994.

The ability of the economic superpowers to dictate terms in multilateral trade negotiations that overwhelmingly favor developed countries, however, has steadily eroded since the signing of the GATT in 1948 as developing countries have continued to join as member countries.¹² Nearly

¹¹. Carmen G. Gonzalez, *Institutionalizing Inequality: The WTO Agreement on Agriculture, Food Security, and Developing countries*, 27 Colum. J. Envtl. L. 433, 439-40 (2002).

¹². Karen Halverson-Cross, King Cotton, *Developing Countries and the "Peace Clause": The WTO's US Cotton Subsidies Decision*, 9 J. Int'l Econ. L. 149, 190 (2006).

two-thirds of the WTO's current membership—approximately 100 out of 151 total member countries—are developing nations. Of those, thirty-two are defined as "least-developed countries." The priorities of the WTO reflect the shifts in its membership. At the November 2001 commencement of the most recent round of WTO talks in Doha, Qatar (the Doha Round), representatives from 142 WTO member nations proclaimed their commitment to serving the interests of developing countries:

“We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. . . . We shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development.”

Developing countries' leverage has not increased solely because of their increase in numbers, however. They have also achieved unprecedented solidarity throughout the course of the Doha Round, indicating their willingness to compromise amongst themselves in order to pursue common goals that would be unattainable for individual developing nations. Indeed, in September 2003, the Doha Round was brought to a grinding halt when a coalition of over twenty developing nations walked out of the September 2003 Ministerial Meeting in Cancun, Mexico because they were unsatisfied with a compromise reached between the United States and the European Union on agriculture.¹³

The strong showing made by developing countries during the Doha Round demonstrates the potential for changes in the balance of power in the multilateral trade arena. Faced with the potential inability to dictate the terms of multilateral trade agreements, and in the absence of a threat to democracy and capitalism that calls for a unified front, economic superpowers like the United States have little motivation to pursue multilateralism on a large scale.

Another factor in the shift away from multilateralism may be a decline in the multinational business community's faith in the multilateral system's ability to promote its preferred economic agenda. On one hand, businesses may be skeptical about the likelihood that complex negotiations

¹³. Clete D. Johnson, *A Barren Harvest for the Developing World? Presidential "Trade Promotion Authority" and the Unfulfilled Promise of Agriculture Negotiations in the Doha Round*, 32 Ga. J. Int'l & Comp. L. 437, 446-47 (2004).

among 151 member countries can reach satisfactory and timely conclusions on tough and vigorously contested issues.¹⁴ On the other hand, businesses may prefer regional or bilateral agreements because they are better able to advance their specific interests in the context of more narrow treaties. Finally, in the absence of multilateral agreements, countries seek out bilateral/regional FTAs as an alternative for achieving higher growth.

➤ **Debate**¹⁵

Of the two, multilateralism is relatively more difficult to define than regionalism. Multilateralism is a characteristic of the global economy that is shaped and defined by the conduct of individual countries or economies. Whether an economy is multilateral or not is best determined by the degree to which its trading regime is free to vestiges of discrimination and has achieved free trade. As it is an additive process, from the global perspective, multilateralism is a direct function of the degree of multilateralism of individual economies. The sum total of multilateralism of individual economies adds up to global multilateralism. There are periods in which it soars and there are periods in which it sinks, depending upon the rising or falling of multilateralism in individual economies.

A superficial glance at the relationship between multilateralism and regional integration could lead one to believe that they work at cross-purposes. Therefore, the oldest concern in the regional trading blocs and customs union literature is whether regionalism helps or hinders free trade, or whether it underpins multilateralism. Vigorous debate on this issue continued during the 1990s. the current form of the age-old query is whether regionalism is a 'building block' or stepping stone' for advancing towards multilateralism or a 'stumbling block' on the way to multilateralism or a 'milestone' around the neck of progress towards free trade and multilateralism. While some researchers see regionalism as a potential threat to multilateralism, others believe that it contributes to free trade and multilateralism. Consensus on this issue is yet to emerge.

¹⁴. Warren H. Maruyama & Timothy M. Reif, Symposium, Introductory Remarks, *The WTO at 10 and the Road to Hong Kong*, 24 *Ariz. J. Int'l & Comp. L.* 1, 2 (2007).

¹⁵. Das K. Dilip, *Regionalism in Global Trade*, Edward Elgar, 2004 at page 5.

One important reason why a consensus on such an admixture has not emerged is that RIAs differ so much from each other that there is little empirical evidence on their effects, which could be taken for the representative impact of RIAs. Second, there are a number of reasons to believe that RIAs impinge or encroach upon multilateralism. This topic has provoked a good deal of debate among trade economists and concern among policy mandarins – consequently there is a growing body of research addressed to it. Apprehensions regarding proliferation of RIAs undermining the multilateral trade system were frequently raised at the global fora and this concern was partly responsible for the creation of the WTO Committee on Regional Trade Agreement (CRTA) in February, 1996.

Using a monopolistic competitive model, Krugman¹⁶ demonstrated that regional trade and integration could potentially raise the level of common external tariffs (CET), if the trading bloc is non competitive. He also posited that ‘countries that join trading bloc will be more protectionist towards countries outside the blocs that they were before, so that the world as a whole will be hurt more than helped by moves that at first seem to be liberalizing in intent.’ This analysis was narrow in the sense that it focused only on customs unions, at the exclusion of the FTAs. Yet, it sparked a good many responses and reactions.

Several studies concluded that there is an overwhelming possibility of a large volume of trade diversion for the RIA members, leading to significant welfare losses, both individually and globally. Few contended that RIAs constituted a potential threat to the world trading system, because they are in general trade diverting. In addition RIAs created lobbies and interest groups against multilateral trade liberalization in their member countries.

In opposing them, several analysts presented evidence that supported favorable outcomes of RIA creation. Nordstrom (1995) contended that by forming RIAs small economies received a greater incentive to liberalize multilaterally because by doing so they could deal more effectively with large economies as well as trading blocks.¹⁷ Similarly it is argued that as a majority of the recent RIAs have preferred to remain restricted to regional trade agreements, they could choose their

¹⁶ Krugman, P. R., *Geography and Trade*, Cambridge: MIT Press

¹⁷ Nordstrom, H., 1995, *Customs unions, regional trading blocs and welfare*, in R. Baldwin, P. Haaparanta, and J. Kiander (eds.), *Expanding membership of the European Union*, Cambridge University Press, 54-78.

common external tariffs freely. Therefore, regional blocs' monopoly power need not necessarily increase, and forming RIAs has not necessarily resulted in higher tariffs between trade blocs. Therefore, increasing regionalism cannot be taken to necessarily imply an increasing potential threat to multilateralism. Moreover, the global free trade can be sustained if small economies form trading blocs. Their integration can effectively undermine the market power of large trading countries or RIAs.

CONCLUSION

The difficulty in arriving at a consensus on the question of relevance or threats of FTAs in a multilateral regime stems from its multifarious nature and little uniformity. The fact of the moment, however, is that it is a reality of current trade system. Though it suffered a few setbacks under the current Trump regime, it is here to stay and intensify in the near future. If the growth of such regional free trade agreements continues, it might be injurious to the WTO administration of dealing with trade and its affiliated disciplines. There is no doubt that such agreements do provide a viable alternative for developing countries to become a competitive part of trade negotiations. Still, they cannot be termed as the best option for trade liberalization. There are obvious drawbacks which cannot be ignored and have to be accommodated to form an informed view about benefits of FTAs.

A few factors will have to be observed to ascertain their impact on international trade. First off, how much negotiating power does it actually provide to a small country with little international recognition? Second, in a case where one of the parties is visibly stronger, the agreement might get skewed in favor of the same. Moreover, in a situation where the FTAs are a reflection of multilateral rules and regulations, there will be emergence of several trading blocs where they reinforce the system when in consensus but will divulge from the same as it suits them. This would render WTO feeble.

Perhaps the biggest threat would be introduction of uncertainty, arbitrariness and opacity in trading practices among countries leading to unfair practices. Nevertheless, the practice is here to stay with a clear picture unfolding gradually.