



PECC Trade Forum

Implications for the Multilateral Trading System of the New Preferential Trading Arrangements in the Asia Pacific Region

Peter Lloyd

**November 11-12, 2002
Vancouver, Canada**

Pacific Economic Cooperation Council

4 Nassim Road Singapore 258372 Tel: +65 67379822 Fax: +65 67379824 Email: info@pecc.org
www.pecc.org

PECC Seminar on Developing Patterns of Regional Trading Arrangements in the Asia-Pacific Region: Issues and Implications, Vancouver, BC, Canada, 11-12 November 2002

Implications for the Multilateral Trading System of the New Preferential Trading Arrangements in the Asia-Pacific Region

by

P. J. Lloyd

University of Melbourne

Address for Correspondence:
Department of Economics,
Faculty of Economics and commerce,
The University of Melbourne,
Parkville, Victoria 3010,
Australia

Phone: 61 3 83445291

Fax 61 3 83446899

Email: pjlloyd@unimelb.edu.au

1. Introduction

From the early 1990s there has been a growth in the number of regional trading agreements notified to the WTO. This is sometimes known as “New Regionalism”. In an exercise that

mapped the location and growth of these RTAs, WTO (2000) enumerated some 172 regional trade agreements known to the WTO and in force on 31 July 2000. In an update of these estimates, the WTO has calculated that the number of RTAs (free trade areas and customs unions) in force on March 2002 has surged to 197 (WTO, 2002). I shall refer to this latest growth as recent regionalism to distinguish it from the earlier wave.

This paper explores the effects of recent regionalism on the world trading system. Particular attention is paid to developments in the Asia-Pacific area. The Asia-Pacific can be taken as coincidental with the APEC area as all of the actual and proposed RTAs in East Asia (the West Pacific) with links to those in the East Pacific are among countries which are also members of APEC.

East Asia is a latecomer to this trend. In 2000, the only RTA in East Asia was ASEAN. North East Asia stood out as the only area of the world economy in which there were no RTAs: at that time, Hong Kong, Japan, Korea and Mongolia were the only members of the WTO that were not parties to an RTA. The first RTA involving a North East Asian country was the Japan-Singapore Economic Partnership Agreement that comes into force in the summer of 2002. However, in the last two years or so there has been a new wave of RTA proposals in South East Asia and North East Asia. Several are being negotiated and more are being studied. If some or all of these come into force, East Asia will resemble other regions of the world in having multiple RTAs.

2. Features of Recent Regionalism

This section presents a minimal review of trends in recent RTAs in order to highlight features that are relevant to an analysis of the systemic effects of recent regionalism. To get an accurate picture of the growth of RTAs, we need to distinguish several dimensions of this growth; the growth in the number of RTAs and of RTA members, an expansion in the commodity coverage of RTA agreements, an increase in the depth of cuts of regional tariff preferences, and the extension of instrument coverage to non-border instruments of government policy and in some cases cross-border factor trade. All areas of the world have seen an increase in the *numbers of RTAs and of RTA members* since about 1990. This part of the development is well known.

WTO (2002, Figure 1) depicts the number of RTAs notified to the GATT/WTO from 1948 to 2002 and WTO (2002, Map 1) depicts the density of RTAs in different parts of the world.

The growth in the number of countries participating in RTAs understates considerably the growth in regional trading preferences. Individual RTAs have also generally become more liberalising in terms of the *commodity coverage* of the agreements and the *depth of cut* of regional tariff preferences.

With respect to goods commodity coverage, Article XXIV specifies, for both free trade areas and customs unions, only that the agreement cover “substantially all trade”. There is considerable variation in the commodity coverage among agreements. Some free trade areas cover all goods with zero exclusions; for example, the CER Agreement and the Singapore-New Zealand CEP Agreement. A number of agreements exclude goods in certain sectors from the free trade provisions, most commonly agriculture. Thus, EFTA excludes the whole agricultural sector. In NAFTA, the US, Canada and Mexico were unable to reach a common agreement in agriculture. Instead, there are three separate bilateral agreements, each of which excludes some agricultural products; for example Canada and the US continued the provisions of the previous Canada-US Free Trade Agreement where Canada had insisted on exempting dairy products, poultry and eggs. Other agreements exclude particular goods in the agricultural and manufacturing sectors. Most of the agreements concluded in the 1990s and the current decade are broad in terms of commodity coverage, with fewer exclusions than earlier pre-1990 agreements. This is most notable in Latin America. Devlin and Estevadeordal (2001) provide a detailed comparison of the “Old” and “New” Regionalism in the Americas.

In relation to trade in services, agreement to liberalise trade in services may be a part of the initial RTA, as in the Canada-US FTA and NAFTA, or it can be an add on. Prior to the 1990s, only a handful of RTAs included service trade; the EU, the Canada-US Agreement and the CER Agreement between Australia and New Zealand. WTO (2002) reports that of 197 RTAs in force on March 2002, 18 contain commitments in services.

With respect to the depth of cut, the cut on an individual tariff item may be 100 per cent of the MFN tariff or less. The members must first agree on a base rate or level to which the reductions schedules will apply. These base rates usually coincide with the MFN applied rates at the time of the negotiations. Many of the pre-1990 agreements provide preferences that, for the goods covered, were less than 100 per cent of the base rate. Most RTAs now reduce tariff levels and other restrictions on goods trade to zero, after a transition period, for those goods not excluded. The ASEAN Free Trade Area (AFTA), the trade liberalization component of ASEAN, specifies that goods on the Inclusion List have final tariff rates in the range 0-5 per cent. In Latin America, a majority of recent agreements provide for duty-free entry of all products by the end of the transition periods (see Estevadeordal, 2002, Figure 3a).

One way of measuring crudely the significance of this growth in the number of RTAs and commodity coverage is to compute the percentage of world trade that takes place between countries that are members of RTAs. The WTO estimated that in 1999 57 per cent of world goods trade was covered by RTAs in this sense. (This does not include non-reciprocal preference trade such as GSP imports from Developing Countries into Developed Countries.) Of this, the intra-EU trade alone accounted for 25 per cent of total world trade and intra-NAFTA trade for another 11 per cent. Thus, trade between countries that trade on MFN terms is less than one half of world trade. WTO (2002) maps the countries that have different percentages of imports from their RTA partners but does not provide a global average for 2002.

It needs to be stated that not all intra-RTA trade takes place on preferential terms. There are several reasons. Some tariff items with positive MFN tariff rates have no preferential rates because the commodity coverage of the agreement is less than 100 per cent. A large part of the trade of all countries that are members of an RTA has a zero MFN rate. Less importantly, during the phase in which the regional reductions are being made, some of the rates are no less than the MFN rates, and some importers do not claim preferences for which they are eligible because of ignorance or administrative costs. Therefore, the RTA does not favour members for trade in such imports. Unfortunately, the WTO does not calculate the percentage of world trade that takes place on RTA-preferential terms.

RTAs have also become much more comprehensive in terms of the *range of economic instruments or policies* covered. In relation to the instrument coverage, a distinction is commonly made between shallow and deep integration, following Lawrence (1996). “Shallow” integration refers to the elimination of the traditional border measures, tariffs and non-tariff measures for goods trade and other border barriers to trade in services and factors. “Deep” integration refers to policies that are beyond the border. Examples of deep integration are the development of standards relating to industrial products or safety or health or the environment, policies relating to particular sectors, such as industry or transport, and business laws that are amended to remove differentiation between foreign and domestic suppliers.

The range of instruments of economic policy that have been subject to harmonisation differs greatly among these second generation agreements. The EU has progressed the furthest in terms of integration policies and has set most of the precedents for modalities of achieving deep integration. It has eliminated discrimination in the EU as the Treaty of Rome incorporates the general principle of non-discrimination according to nationality. This applies to both persons and enterprises.

A number of areas of regulation have been harmonised in RTAs other than the EU but there is no uniformity among RTAs in the areas chosen. The areas include standards relating to industries, sanitary and phytosanitary standards, industrial policy, the environment and some areas of business law. (Charnowitz, 2002, chapter 7 discusses provisions relating to the environment in RTAs and Lloyd and Vautier, 2001 discuss those relating to competition law.) The CER has the second most extensive coverage of areas of harmonization after the EU. It covers technical standards, food standards and food inspection, conformity assessment, competition law and some other areas of business law, and subsidies and bounties. The RTAs in Latin America that have come into effect in the 1990s have deep integration in selective areas (see Salazar-Xirinachs, 2002).

There are a number of possible modalities to achieve the harmonisation of national policies/regulations, or regulatory cooperation as it is sometimes known. These are discussed in Section 3.5 below.

In addition, a number of recent RTAs contain provisions liberalising trade across borders in capital and/or labour.

3. Systemic effects

Of course, the proliferation of RTAs has increased discrimination in the world trading system. The concern in this section is with other systemic effects.

3.1 Effects on multilateral liberalisation

The effect of regionalism that is usually regarded as the big issue is the effect it may have on the rate of multilateral liberalization. Does the formation of bilateral agreements have a positive or a negative effect on multilateral trade negotiations? This has been called the “building block or stumbling block” debate.

First, one can note that RTAs are generally WTO-consistent. But this is because the requirements of Article XXIV and the Enabling Clause and GATS are very weak and have never been enforced. The meaning of the key phrases in Article XXIV “substantially all trade”, “other restrictive regulations of commerce” and “on the whole...shall not be higher or more restrictive” have never been defined and have been interpreted in many ways.¹ The only effective restraint GATT/WTO rules have imposed on RTAs is that they have prevented trade barriers being raised against third countries but there are a few exceptions (see Panagariya, 1999, p. 499). This has not prevented the discrimination inherent in all RTAs. Moreover, almost all of the deep integration features of recent RTAs are outside the WTO rules.

The effect of regionalism on multilateral negotiations has been examined many times, including detailed examinations by the multilateral organisations; the OECD (1995), the WTO (1995) itself and by the World Bank (2000). (For a recent academic review, see Panagariya, 1999.) The answer commonly given is that it does not slow down multilateral liberalisation. These studies point out many positive interactions from RTAs to the multilateral trade negotiations; for

example, the “dipping the toe in the water” effect of RTAs which has prepared some reluctant countries to be more favourable towards multilateral liberalisation that forces them to lower or bind border barriers. Discussants also point out that regional liberalisation does not preclude the multilateral liberalisation and in fact both have gone on at the same time for long periods.

One should note too that regionalism may have an effect on unilateralism, the lowering of barriers on an MFN basis by countries individually. Unilateralism has been an important part of trade liberalisation in the last two decades. The usual argument for unilateralism is that a country benefits from reducing its own-imposed barriers to trade.

Thus, one needs to consider the relationships between regional (discriminatory) trade liberalization on the one hand and the combined effects of multilateral and unilateral reduction in MFN tariff rates and trade barriers on the other. If member countries lower tariffs and other barriers to imports on an MFN basis at the same time as they lower them preferentially for RTA partners only, the trade discrimination is reduced. Regional liberalisation may have effects on the incentives to lower trade barriers multilaterally (see Bagwell and Staiger, 1998) and on the incentives to lower barriers unilaterally (see Panagariya, 1999, pp. 495-99). It is possible that the effect of regionalism may increase the benefits of unilateral reform because the latter decreases regional trade diversion. On the other hand, preoccupation with regional trade opportunities may diminish unilateral actions. These effects may go either way.

What has happened in reality? The evidence is mixed. The ASEAN countries and the CER countries have engaged in substantial unilateral trade liberalisation during the period of reduction of trade barriers within their RTAs. In APEC this is known as “open regionalism”. Latin America too conforms to this pattern. Estevadeordal (2002, Figure 2) shows that the MFN rates declined almost as rapidly as average preferential rates in Latin America over the period 1985 to 1997. In NAFTA, Mexico and to a lesser extent Canada have lowered MFN rates unilaterally. However, this coincidence of reductions in both preferential and MFN rates over time cannot be construed as regionalism encouraging multilateral or unilateral reductions. The case and effect could go either way. Or, perhaps, most plausibly, it could be that both are due to change induced

by reform-minded governments that pursued both the unilateral and regional routes to trade liberalisation.

On the other hand, the US and EU, two large territories whose intra-area trade is much more than 50 per cent of total world intra-RTA trade (WTO, 2001, Table A4), have not made any significant reductions in trade barriers in the last two decades that are not part of RTAs or part of the Uruguay Round multilateral concessions.

3.2 Hubs and spokes – layers of discrimination

In terms of geographic coverage, new regional developments have fundamentally changed the pattern of RTAs. Up to the early 1990s, RTAs were a set of non-intersecting areas with only a few exceptions but this is no longer true. Many countries are now members of more than one RTA. This pattern is what Bhagwati (1995) picturesquely called the “spaghetti bowl”.

Wonnacott (1996) introduced the terminology of hubs and spokes. Wonnacott described a hub as arising from the decision of an outside country to form a bilateral agreement with only one member of a multi-member pre-existing RTA. The inside country is called the hub. This definition of a hub is too narrow. The general phenomenon is one of *intersections* between RTAs. A hub exists where one country (customs territory) is a member of two distinct RTAs. This is a generalisation of the Wonnacott definition.²

Intersections or hubs arise in several ways. Hubs may arise when one country is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another single country outside the origin RTA, as Wonnacott discussed. In such cases, the spokes may be called *bilateral spokes*. Or they may arise when one country is a member of one (bilateral or plurilateral) RTA and then forms a new bilateral RTA with another RTA; for example the US has an agreement with the CACM countries. These spokes may be called *plurilateral spokes*. Or hubs may arise when one country almost simultaneously negotiates bilaterals with a number of countries: for example, Chile. Or they may arise when one country is a member of more than one plurilateral; for example, Mexico is a member of the NAFTA and of the Group of Three.

Most hubs arise when a country is a member of one (bilateral or plurilateral) RTA and then forms/joins a new RTA with one or more other trading partners. There are hubs now in all regions of the world economy.

Many hubs have multiple spokes. One can measure this effect by counting the number of spokes for each hub, that is, the number of parties with which one hub country has separate free trade agreements. One can separate bilateral spokes from plurilateral spokes (and from membership in plurilateral RTAs). Many hub countries have a policy of developing numerous spokes. The EU has 25 spokes by my count.³ EFTA has a similar strategy. MERCOSUR is engaged in regional trade negotiations with several neighbouring countries. The states of the former Yugoslavia are negotiating bilateral RTAs among themselves within the framework of a Stability Pact. Some individual states have a similar multi-spoke strategy. One might describe countries with a large number of spokes as *super-hubs*. The number of super-hubs is growing rapidly.

In the Asia-Pacific area, Singapore, the US, Canada, Mexico, Chile, Peru, Australia, New Zealand and Russia are now hubs on the basis of RTAs already in force. Table 1 presents a list of hub countries in the Asia-Pacific with their bilateral and plurilateral spokes. Others such as Japan and Thailand may join them soon.

Most of the hubs in the Asia-Pacific area have multiple spokes. Mexico has the largest number as well as being a member of two plurilateral RTAs; it has bilateral spokes with Nicaragua, Costa Rica, Bolivia, Chile and Brazil, it has plurilateral spokes to the EU, EFTA, the CACM and the three Northern Triangle countries. It is negotiating another spoke with Singapore, Peru, Ecuador, Panama and Trinidad and Tobago. Chile has bilateral spokes to Canada, Mexico, Colombia, Venezuela, Peru, Ecuador and Bolivia. The US has two bilateral spokes (the US-Israel and US-Jordan agreements) and is currently negotiating with Singapore and Chile, and it also has a plurilateral spoke to the CACM countries. Canada has spokes to Chile, Costa Rica, Israel and is negotiating with Singapore, and it is negotiating a plurilateral spoke to the CA-4 countries. Singapore has bilateral spokes to Japan and New Zealand, a plurilateral spoke with the EFTA States and it is negotiating with the US, Canada and Mexico. Australia is currently negotiating two bilateral spokes, one with Singapore and one with Thailand. Russia has several spokes as

well as being a member of two plurilateral RTAs. Only New Zealand and Peru have a single spoke at the time of writing, although New Zealand is currently negotiating with Hong Kong.

The natural representation of the relationship between sets of countries with different market access is the Venn diagram. A graph in the form of a Venn diagram for the pattern in the Americas is given by Estevadeordal (2002). Figure 1 shows a Venn diagram of the RTAs in force in the APEC area in 2002, using the same technique as Estevadeordal (2002). The sets labelled with capital letters refer to plurilateral RTAs and the others to bilaterals. This figure does not include RTAs between countries inside the Asia-Pacific and countries outside the area.

Intersections among RTAs create multi-layered preferences. These have complex effects. Consider an RTA with two or more members and now let one of the members form a new bilaterals with one or more outside countries. First, the hub country now has preferential access to the markets of the new bilateral spokes which are not shared by the other member(s) of the original RTA. This effect can create problems if two or more of the members of the original RTA are significant competitors in the markets of the spoke countries. For example, New Zealand has recently protested strongly to Australia about the possible effects of Australia but not New Zealand signing an RTA with the US. Second, looking now at the preferences which the spoke countries have in the markets of the hub countries, the original members may consider that their mutual preferences were not intended to be weakened by a subset of them extending preferences to countries outside the original group. For example, some of the ASEAN countries have protested to Singapore about its strategy of forming bilateral spokes with countries outside the ASEAN region. Looking at the totality of the hub and spoke arrangements, the hub country gains preferential access to the markets of the original regional partners and the spoke countries whereas the original members have preferential access only to the markets in the original member countries, and the spoke countries have preferential market access only to the single countries with which they have a bilateral. The same patterns arise with imports into the hub and spoke countries. These differential terms of market access and imports will have complex effects on the efficiency of trade and consumption in the countries concerned.

3. 3 Do RTAs discriminate against Developing Countries?

There is a further general effect of RTAs that has received little attention but is, in my opinion, important. The spread of RTAs has created unequal access to world markets. Has the spread of RTAs discriminated against Developing Countries?

As a preliminary, we need to appreciate that the world trading system could discriminate against Developing Countries as a group in two distinct ways. First, the level of MFN barriers to the exports of the Developing Countries could, on average, be higher than those to the exports from the Developed Countries.⁴ Second, preference could, on average, favour Developed Countries rather than Developing Countries. (Or, of course, both could hold.) Although the first dimension is the one that has been raised repeatedly in the current WTO negotiations and by the anti-globalisation movement, I shall consider only the second dimension here.

Most of the plurilateral RTAs with a larger number of members involve only developed countries and most bilaterals are between developed countries or between developing countries. In a few cases between a developed and a developing country; examples of the latter are the agreements Mexico has with the EU and EFTA countries as well as membership of NAFTA. When the larger size of the markets in developed countries and especially the US and the EU is taken into account, there is no doubt that the increase in market access resulting from RTAs has gone mostly to developed countries and not to developing countries. Developing countries have not gained much greater access to the major potential markets through membership of RTAs. The one significant exception among the developing countries appears to be Mexico which has secured mostly free access to its major markets in both North America and Europe. (This picture will change substantially if and when the negotiations for the FTAA and the negotiations between the EU and Developing African, Caribbean and Pacific countries are completed.)

Of greatest concern, none of the bilaterals links a Least Developed Country (LDC) to a Developed Country. And very few LDCs are members of RTAs with other Developing Countries. Myanmar, Laos and Cambodia are members of ASEAN that contains Singapore but ASEAN is mainly an RTA among Developing and LDC countries.

One must be careful to interpret these trends. RTAs are voluntary associations among nations. Generally Developing Countries have been slower to form RTAs than Developed Countries, either among themselves or with Developed countries. Furthermore, the RTAs they have formed have been much less comprehensive in terms of commodity coverage, depth of cut and beyond-the-border instrument coverage, though this has changed recently in some areas, notably Latin America. This feature has made them less attractive to Developed Countries as partners.

One must also add in the effects of non-reciprocal preferences which have gone to Developing Countries and, in particular, to LDCs. The EU has allowed free entry to all exports from LDCs except arms (“everything but arms”) and recently at the 2002 APEC Leaders Meeting Australia committed itself to free entry for all imports from LDCs. However, the effects of GSP preferences have been reduced by exclusions of important commodity groups that are important to Developing Countries, especially agricultural and clothing, textile and footwear products, and by restrictive rules of origin. WTO (2001b) reviews the GSP systems in the Quad countries and, for a detailed discussion of the US rules of origin under GSP and related schemes, see Mattoo, Roy and Subramaniam, 2002.

Overall, the gains from trade liberalisation from regional agreements and from RTAs in general have probably gone largely, and perhaps overwhelmingly, to developed countries. Unfortunately, there has not been a comprehensive empirical examination of whether the RTAs discriminate against Developing Countries to my knowledge, presumably because data showing entry into countries of goods under the same tariff item but at different preferential and non-preferential rates is not available for most countries.

This pattern has two effects . One concerns the traditional fear of negative trade diversion effects for countries outside the preferential areas. Scollay and Gilbert (2001) carry out simulations of the effects of various bilateral and many-country RTAs in the Asia-Pacific. They find that all bilaterals have negative effects on the welfare of some outside countries⁵ with the sole exception of the New Zealand-Singapore agreement which has a zero effect on all countries.⁶ Similarly, there is concern that some Developing Countries may have suffered investment diversion.

The second part is that Developing Countries have not shared in the positive benefits of freeing trade regionally. Indeed, this effect may be greater than the effects of unequal progress within the Uruguay Round and prospectively from the current multilateral round that the Developing countries complain about.

Finally, the dynamic effects of recent regionalism may also militate against Developing countries in the future as they may be less attractive partners. I have mentioned the scenario that would see some of them excluded from major bipolar or tripolar centres of trade liberalisation.

3.4 RTAs and the multilateral approach to integration

There are recognisable styles of regional trade agreements. For example, there are differences in commodity coverage and in dispute settlement mechanisms. I shall concentrate on differences in deep integration, including factor movement regulation, as these are relevant to the current multilateral negotiations on the new issues. The EU and the NAFTA are used as the primary examples as they have set the major precedents.

The styles of these two RTAs differ greatly in the extent of deep integration:

EU Style

- deep integration in a very wide variety of areas of government regulation
- total coverage and total elimination of all border barriers to the movement of labour and capital based on the principle of non-discrimination according to nationality

NAFTA Style

- deep integration to a few areas in a few areas only
- some liberalization of trade in capital (both FDI and financial capital) but very limited provisions relating to the movement of natural persons
- side agreements on labour and environmental cooperation

There are also major differences in the modalities used to achieve the harmonisation of national policies/regulations, or regulatory cooperation as it is sometimes known. The most extreme is the adoption of a single uniform standard for the whole area; for example, Australia and New Zealand adopted common food standards in 2000. Weaker variants are the convergence of standards, or “approximation” as it is known in the EC/EU, and the design of minimum standards. However, many economists do not agree that there should be a single or approximate or minimum standard; differences in national circumstances and priorities may dictate differences in national standards. It is also difficult for members to have to agree on the single standard: should this be the standard of one of the members or new agreed standards?

These difficulties led the EC/EU to develop the modality of mutual recognition as an alternative to harmonization. This is the principle that what is legally produced and sold in one country may be sold in another member country. The principle has also been applied to the recognition of labour market qualifications. It has the advantages of simplicity and allowing each nation to have its own national standards. Mutual recognition has been adopted in some other RTAs; for example, ASEAN and CER. (Mutual Recognition Agreements have also been taken place between countries which are not members of an RTA or between an RTA and another country but outside the framework of an RTA, such as the EU-US Mutual Recognition Agreement on Conformity Assessment and the 1998 EU-Australia Mutual Recognition Agreement on Conformity Assessment.)

Another and still weaker alternative is cooperation between the regulatory authorities of the member countries. This is the modality adopted in NAFTA and other subsequent agreements signed by the US and Canada such as the Canada-Chile Agreement, and it is the modality under discussion in the FTAA negotiations. In relation to sanitary and phytosanitary standards, NAFTA Chapter 7 directs members to use “relevant international standards”. Similarly, in relation to product standards, NAFTA Chapter 9 directs members to use “relevant international standards”. In relation to competition law, Chapter 15 is limited to the obligation of each member to maintain and enforce a competition law and to cooperate with each other in the enforcement of these national laws. There are no common rules or even agreed scope of competition law and no supranational authority as in the EU. This North American style of

cooperation arises chiefly from a concern over national sovereignty and a lesser willingness to harmonise or approximate national laws and regulations.

With the proliferation of hub-and spoke arrangements around the EU and NAFTA countries, the precedents set in the EU and NAFTA are gaining much greater geographic coverage.

Experience shows that when a country or group of countries engages in its second or third or subsequent regional agreement, it tends to follow the precedents set in the first. Thus, the EU has followed many of the features of the Treaty of Rome and other EU Treaties in its regional agreements with the former EFTA states (The European Economic Area), the Europe Agreements with Central European countries, the Europe-Mediterranean Agreements and the most recent Europe-MERCOSUR Agreement. In this case, the EU has made it plain that all countries aspiring to full membership of the EU must accept the rules of the EU (the “*acquis communautaire*”). Similarly, all three NAFTA countries have incorporated many of the features of NAFTA in other subsequent agreements to which one or more are party; and the features of a draft FTAA that are emerging are heavily dependent upon NAFTA precedents. Consequently, the EU and NAFTA styles have spread beyond the borders of the original areas.

During the negotiation of NAFTA, the Bush Administration insisted that Mexico sign the so-called side agreements on labour standards and the environment, the North American Agreement on Labor Cooperation and the North American Agreement on Environmental Cooperation, as a condition of entry into NAFTA. The former lays down the objectives of protecting the environment and establishes general commitments to monitor and protect the environment. The latter lays down general commitments, establishes core labour principles (such as the rights to organise, bargain collectively and to strike, non-discrimination, abolition of forced labour and protection for children and young workers) and promotes cooperation among members. These agreements also establish a Commission for Labor Cooperation and a Commission for Environmental Cooperation. Similarly, the 1997 Canada-Chile Agreement and the 2001 Canada-Costa Rica Agreement, following NAFTA, both have two side agreements, an Agreement on Labor Cooperation and an Agreement on Environmental Cooperation. These side agreements are designed to force developing member countries with weaker systems of law to achieve minimum standards in areas that impinge on intra-area trade.

In the current negotiations relating to areas that fall within “deep integration”, the US and the EU positions reflect closely the features they have developed in their own regional agreements and subsequent hub-and-spoke agreements. There is thus a major interaction between the precedents of RTAs and the rules which may be developed in the Doha Round relating to deep integration and the new issues. This parallels the interaction between regional and multilateral liberalisation of market access for goods and services.

In fact, there is a kind of competition between the major super-hubs. The EU and the US are locking those countries with which they have formed recent bilateral or plurilateral spokes into their style in terms of the extent of deep integration features and the choice of modalities.

3.2 Dynamic effects of hubs and spokes

The distortions of trade, consumption, investment and production that result from the multi-layered preference of hub-and-spoke arrangements have presented a negative view of the merging pattern of new regionalism and led some economists to deplore these developments. However, this negative view of hubs-and-spokes arises from a static perspective. When viewed in a longer term perspective, they may play a positive role in the evolution of trade liberalisation.

One bilateral in a hub-and-spoke context may have flow on effects. One bilateral may encourage further bilaterals. When one bilateral happens, there is a greater incentive for other members of an RTA to form bilaterals with the outside country in order to compete equally in the markets of the spoke country. Alternatively, one bilateral creates new incentives for the RTA as a group to take in the spoke country as a new member of an enlarged RTA. All of the existing members then compete in the markets of the spoke country on equal terms and obtain imports from the country on equal terms. In cases where the outside country is itself a member of another RTA, a series of bilaterals could lead to coalescence of the two areas.

In fact, the present pattern of RTAs already exhibits these features. Bilaterals are proliferating. A number of countries have clearly followed a strategy of gaining access to markets all over the world via bilateral RTAs; for example, Mexico, Chile, Singapore and Israel. Several of the cross-regional agreements connect individual countries outside the polar regions to one or more of the three possible poles. Conversely, we noted in Section 3 that some RTAs themselves have deliberately built free trade connections in many different parts of the world. This is particularly true of the EU and the EFTA states but now the US is negotiating bilateral free trade arrangements with countries outside the Americas. Some enlargements incorporate members who previously had bilateral links with one or more of the enlarging RTA.

Lloyd (2002) has considered the possible incentives for dynamic evolution of hub-and-spoke arrangements. At this stage it is not clear where the world trading system is heading. Several long run scenarios are possible. One is bipolar or tripolar world. Another scenario is a world with two or three poles but with a number of countries excluded from this process for economic and/or non-economic reasons. This list might include countries such as Japan, Korea, Australia, and New Zealand. In particular, developing countries are less attractive as members of RTAs with developed countries because of their small markets, demands for unequal transition periods and general reluctance to accept commitments to deep integration. This list could include countries such as India.

In conclusion, recent regionalism is having profound effects on the world trading system. It has increased greatly the discrimination in world trade in goods, most of this in favour of other Developed Countries, and it has introduced new patterns of multi-layered discrimination. It has affecting the pace of multilateral liberalisation of trade in goods and services and the pace of multilateral agreements on beyond the border features such as trade and competition and the environment. In the case of the former there is still debate about whether it has promoted or retarded multilateral trade liberalisation. In the case of the latter, it has increased the desire for multilateral agreements on new issues and greatly affected the modalities under discussion. And, the growth of the number of RTAs and of countries which are parties to one or more RTAs is creating new incentives for further regional trade liberalisation.

FOOTNOTES

- 1 WTO (1995) provides a critical review of these rules.
2. The terminology can be confusing. A country may be both a hub and a spoke, depending on the country point of view. For example, consider the agreement currently being negotiated between Singapore and the US. If this is concluded, Singapore can be regarded as a hub but from the US point of view, it is a spoke. Conversely, the US is a hub but from the Singapore point of view it is a spoke.
3. These are the 13 accession countries plus 12 agreements with Developing Countries in the Mediterranean and Africa already in force or being negotiated. The agreements with the accession countries will lapse if and when they become full members. This number does not include the 77 African, Caribbean and Pacific countries with which the EU hopes to replace non-reciprocal agreements with reciprocal FTAs. See McQueen (2002).
4. One should include the effects of non-tariff barriers in these estimates. One should also include the effects of export subsidies as these could discriminate against some Developing countries, though they might also favour importing Developing Countries.
5. Some may have a negative effect on one partner: for example, the Australia-Singapore agreement is estimated to have a negative effect on aggregate Australian welfare.
6. One cannot expect any trade diversion in the case of agreements with a country that already has zero MFN tariffs or tariff rate equivalents of ntbs.

REFERENCES

- Bagwell, K. and R. W. Staiger (1999), “Will Preferential Agreements Undermine the Multilateral Trading System?”, The Economic Journal, 108, July, 1162-82.
- Bhagwati, J. N. (1995), “US Trade Policy: The Infatuation with Free Trade Areas” in J. Bhagwati and A. O. Krueger (eds.), The Dangerous Drift to Preferential Trade Agreements, American Enterprise institute for Public Policy Research, Washington, D. C.
- Charnowitz, S. (2002), Trade Law and Global Governance, Cameron and May, London.
- Devlin, R. and A. Estevadeordal (2002), “What’s New in the New Regionalism in the Americas?” in V. Bulmer-Thomas (ed.), Regional Integration in Latin America and the Caribbean: The Political Economy of Open Regionalism, ILAS, London.
- Estevadeordal, A. (2002), “Traditional Market Access Issues in RTAs: An Unfinished Agenda in the Americas?”, paper presented to the WTO Seminar on Regionalism and the WTO, Geneva, 26 April 2002. This is available at the WTO website <http://www.wto.org>.
- Lawrence, R. Z. (1996), Regionalism, Multilateralism and Deeper Integration, Brookings Institution, Washington, D. C.
- Lloyd, P. J. (2002), “New Bilateralism in the Asia-Pacific”, The World Economy, September,
- Lloyd, P. J. and K. Vautier (2001), “Regional Approaches to Cross-border Competition Policies”, in S. Lahiri (ed.), Regionalism and Globalization, Routledge, London.
- Mattoo, A., D. Roy and A. Subramaniam (2002), “The Africa Growth and Opportunity Act and Its Rules of Origin: Generosity Undermined?”, World Bank Research Paper.

McQueen, M. (2002), “The EU’s Free-Trade Agreements with Developing Countries: A Case of Wishful thinking?”, The World Economy. September,

Organisation for Economic Cooperation and Development (OECD) (1995), Regional Integration and the Multilateral Trading System: Synergy and Divergence, OECD, Paris

Panagariya, A. (1999), “The Regionalism Debate: An Overview”, The World Economy, 22, 477-511.

Salazar-Xirinachs, J. M. (2002), “Proliferation of Sub-regional Trade Agreements in the Americas: An assessment of Key Analytical and Policy Issues”, Journal of Asian Economics, 13 (No.2), 181-212.

Scollay, R. and J. P. Gilbert (2001), New Regional Trading Arrangements in the Asia Pacific?, Institute for International Economics, Washington, D. C.

Thanadsillapakul, L. (2001), “Open Regionalism and Deeper Integration: The Implementation of ASEAN Investment Area and ASEAN Free Trade Area”.

Wonnacott, R. J. (1996), “Trade and Investment in a Hub-and-spoke System versus a Free Trade Area”, The World Economy, 19 (3), 237-252.

World Trade Organisation (WTO) (1995), Regional Trading Arrangements and the World Trading System, WTO, Geneva.

World Trade Organisation (WTO) (1998), “Mapping of Regional Trade Agreements”. This is available at the WTO website <http://www.wto.org>.

World Trade Organisation (WTO) (2000), “Mapping of Regional Trade Agreements”, WT/REG/W/41. This is available at the WTO website <http://www.wto.org>.

World Trade Organisation (WTO) (2001a), International Trade Statistics 2001, WTO, Geneva.

World Trade Organisation (WTO) (2001b), “The Generalised System of Preferences: A Preliminary Analysis of the GSP Schemes in the Quad”, Committee on Trade and Development, WT/COMTD/W/93, WTO, Geneva.

World Trade Organisation (WTO) (2002), “Regional Trade Integration under Transformation”. paper presented to the WTO Seminar on Regionalism and the WTO, Geneva, 26 April 2002. This is available at the WTO website <http://www.wto.org>.

Table 1: Hub Countries in the Asia-Pacific with their Spokes

<u>Actuals</u>	<u>Under Negotiation</u>
Singapore, in ASEAN with spokes to Japan, New Zealand EFTA States*	USA, Canada, Mexico, Australia
Thailand, in ASEAN with spoke to	Australia
USA, in NAFTA with spokes to Israel, Jordan CACM*	Singapore, Chile
Canada, in NAFTA with spokes to Chile, Costa Rica, Israel	Singapore CA-4*
Mexico, in NAFTA with spokes to Nicaragua, Costa Rica, Bolivia, Chile, Israel EU*, EFTA*, CACM*, Northern Triangle*	
Chile with spokes to Canada, Mexico, Colombia, Venezuela Peru, Ecuador, Bolivia	
Peru, in Andean Community with spoke to Chile	
Australia, in CER with spokes to	Singapore, Thailand
New Zealand in CER with spokes to Singapore	
Russia, in CIS with spokes to Kyrgyz Republic, Georgia	* denotes a plurilateral spoke

Figure 1. RTA's in Force in the APEC Area, 2002

