

# Always look at the bright side of non-delivery: WTO and Preferential Trade Agreements, yesterday and today

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**Abstract:** The disciplining of Preferential Trade Agreements (PTAs) by the WTO has been ‘relaxed’ recently as a result of the new context (the *Transparency Mechanism*) within which notified PTAs are being multilaterally reviewed. This is probably a blessing for a number of reasons, including the success of the multilateral trading system in bringing tariffs down over the years (and the ensuing reduced trade diversion), the fact that modern PTAs deal with many non-trade issues as well (for which no WTO disciplines exist), and the recent empirical literature suggesting overall positive welfare implications for those participating in similar schemes. This paper discusses these and other reasons to support the view that the WTO should rather focus on the multilateral agenda instead of diverting its attention towards disciplining PTAs. In more concrete terms, this paper argues in support of the thesis that the *Transparency Mechanism* should not be simply a *de facto* substitute of the previous regime (where outlawing a PTA could not *a priori* be excluded), but the *de jure* new forum to discuss PTAs within the multilateral trading system, at least for the time being. A first do-no-harm-policy is one of the rationales for the thesis advocated here.

## 1. Clearing PTAs at the WTO level

All PTAs must be notified to the WTO (Art. XXIV GATT).<sup>1</sup> The Committee on Regional Trade Agreements (CRTA), the successor to the Art. XXIV Working Parties, is the organ where all PTAs are routinely notified. The CRTA is composed

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<sup>1</sup> In this paper, I do not deal with PTAs notified under the *Enabling Clause*, or under GATS (although much of the analysis is relevant to those schemes as well).

by delegates of all WTO Members and has always decided by consensus.<sup>2</sup> In principle, the CRTA has wide powers. Art. XXIV.7 GATT relevantly provides that it has the power:

to make such reports and recommendations to contracting parties as they may deem appropriate.

In principle, thus, one cannot exclude the possibility that the CRTA concludes that a notified PTA is GATT-inconsistent. This conclusion is underscored by the explicit wording of Art. XXIV.7(b) GATT dealing with *interim agreements* leading to PTAs:

If ... the CONTRACTING PARTIES find that such agreement is not likely to result in the formation of a customs union or of a free-trade area ... the CONTRACTING PARTIES shall make recommendations to the parties to the agreement. *The parties shall not maintain or put into force, as the case may be, such agreement if they are not prepared to modify it in accordance with these recommendations.* (emphasis added).

These provisions give the impression that the multilateral review was designed as an institution akin to a modern merger authority: PTAs would not be consummated unless cleared through the process established.

## 2. Years later: no delivery

The numbers first: as of November 2010, 462 PTAs in total had been notified to the WTO, 345 of which under Art. XXIV GATT, almost two-thirds of which are now in force. Schott (1989) identifies four cases where PTAs were judged *broadly* consistent with the GATT. Since his study, there has been one case where there has been definitive and unambiguous acceptance, at the CRTA level, that the notified PTA was GATT-consistent: the customs union (CU) between the Czech and the Slovak republics. We are simply in the dark as to the GATT-consistency of the remaining PTAs currently in place. The inescapable conclusion is that the multilateral review has not delivered on its institutional promise to ensure that PTAs will be GATT-consistent.

Those unhappy with the outcome can of course, always litigate. Not much litigation has happened either; only a handful of disputes since the inception of the GATT (1947) have arisen where the consistency of a PTA with the GATT was the main or ancillary component. Mavroidis (2005) identifies a number of good reasons why this has been the case: collective action problems; non-enforcement might leave outsiders better off (because of the reduced trade diversion); strategic

<sup>2</sup> In theory, if a consensus decision cannot be reached, the matter can be referred to the higher organs, which can decide by majority voting. This has neither happened, nor been threatened to happen. There is no study to my knowledge measuring the impact of this threat, which, intuitively speaking, should be low in light of the collective preference, explained *infra*, for not enforcing this provision.

reasons (except for Mongolia, all WTO Members participate in PTAs, and they would have little incentive to undermine their options in this area by streamlining the various obligations embedded in GATT); the institutional design of panels (why trust amateur judges with interpretations of loaded terms, such as *substantially all trade*, that the trading nations have failed to clarify?).<sup>3</sup>

Lack of scrutiny at the multilateral level and absence of litigation led to tolerance of dozens of PTAs of doubtful, at the very least, consistency with the WTO rules.

### 3. No delivery is now *de facto* established

On 14 December 2006, the *General Council* of the WTO adopted a decision concerning the *Transparency Mechanism for Regional Trade Agreements*.<sup>4</sup> The *Transparency Mechanism* was supposed to *complement* the existing arsenal.<sup>5</sup> *De facto*, the *Transparency Mechanism* did not *complement*, but *substituted* the previous arsenal: the multilateral review was narrowed down to a mere exercise in transparency. This, in practice, means that agreements are no longer checked for consistency by the CRTA: once the factual presentation of a notified PTA has been distributed, WTO Members send in questions to which responses must be provided by the parties and circulated three working days before the meeting of the CRTA. There is also a written record of each agreement considered by the CRTA. The WTO Members' questions and the parties' responses as well as a record of the discussion are available on the WTO RTA database (<http://rtais.wto.org/>). There is, however, no longer review of the consistency (from a legal perspective) of the notified PTA with the WTO rules. The exercise is meant to increase transparency and stop short of going any further.

Some might deplore this evolution. Indeed, as the numbers of PTAs increase by the day, one might legitimately ask whether it is indeed reasonable to reduce rather than enhance the penetration of the multilateral review: assuming that litigation numbers will remain constant, and there is no reason to think otherwise, is this

<sup>3</sup> The sheer amount of authorized retaliation and the difficulty in calculating it might also provide those interested in enforcing Art. XXIV GATT before a GATT Panel with a disincentive to do so: the WTO Arbitrator would have to calculate the total amount of trade lost (a fairly straight-forward exercise depending on the assumptions made), and then apportion the amount of trade lost by the complainant and use the outcome of this latter calculation as the basis for authorized retaliation.

<sup>4</sup> See WTO Doc. WT/L/671 of 18 December 2006. The WTO continues to use the term *Regional Trade Agreements* (RTA), against mounting evidence that there is often not much *regional* about new notifications, by-passing thus the quintessence of such schemes, that is their *preferential* character.

<sup>5</sup> Indeed, the preamble and the text of the Decision adopting this mechanism leaves no doubt that this was indeed the case: it points to the increasing number of PTAs; it is meant to *enhance* the existing transparency (judged implicitly insufficient); nowhere does it put directly (stating for example, that a certain proviso of Art. XXIV GATT is hereby deleted or substituted) or even directly into question the existing framework (Art. XXIV GATT) to which it repeatedly refers and leaves the overall impression that this was an additional instrument to the fight against PTAs, see WTO Doc. WT/L/671, of 18 December 2006.

really a good strategy to stay idle against schemes that go against the heart of the multilateral trading system? In what follows, I advance some arguments why, indeed, staying idle is probably wise strategy.

#### 4. Non-delivery is probably a blessing

In what follows, I advance the reasons why in my view, for the time being at least, it makes good sense to follow the current benign attitude towards PTAs.

##### 4.1 *From day one we apply the wrong test*

The GATT test for consistency of PTAs with the multilateral rules aims at ensuring that PTAs will not be *à la carte*: absent the *substantially all trade requirement*, PTAs could be formed on one tariff line only. As Grossman and Helpman (1995) have shown, absent this requirement, countries would have an incentive to offer cuts where trade diversion is likely. This could severely undermine MFN (most favoured nation), the cornerstone of the GATT-edifice. So the GATT framers could not live with a GATT *à la carte*, but could live with GATT-consistent PTAs, which resulted in *trade diversion*, the evil that Viner in his classic analysis (1950) warned us against. The classic Vinerian analysis would request us to calculate the trade created through the establishment of a PTA (since intra-PTA trade would be liberalized)<sup>6</sup> and compare it to the trade diverted (since trade might be deflected from the *worldwide* most efficient source of supply to the *intra-PTA* most efficient source of supply).<sup>7</sup> Indeed, especially in the 1950s and the 1960s when MFN rates were high (and thus, the potential margin of preference large) PTAs that would take the intra-PTA tariff rates to 0% could create substantial trade diversion if the PTA partners were relatively inefficient (un-competitive): the GATT would applaud while Viner's worst fears would have been confirmed. One might legitimately ask the question whether the candle is indeed worth the flame? Should we, in other words, be enforcing an economics-uninformed test and ensure that trade diversion has indeed been created in the name of avoiding PTAs *à la carte*? In other words, yes there is a good reason why this requirement was enacted, but enforcing it rigorously could have led to substantial trade diversion. It is probably a blessing that a *de facto* halfway house approach was adopted, whereby GATT contracting parties (and now WTO Members) could not engage in cherry-picking when deciding where to go preferential but were not required to go the full nine yards either.<sup>8</sup>

And one can further ask the question how realistic is the risk of cherry-picking nowadays anyway? Even if true theoretically, as the cited work of Grossman and

<sup>6</sup> I assume here a GATT-consistent PTA.

<sup>7</sup> See the excellent survey of PTAs by Panagariya (2000).

<sup>8</sup> Lack of 'deep integration' might have led to fewer challenges by non-participants since their trade damage was, as a result, less than what it would have been had the PTA partners gone the full nine yards on tariffs.

Helpman suggests, this is not realistically much of an issue any more: the level of duties in the overwhelming majority of goods is quite low now, and there are fewer (than before) product categories where substantial trade diversion can still take place; moreover, although as noted above litigation has not occurred for good reasons in this context, one could well imagine that challenging the consistency of say a one good-PTA with the GATT would be less of a problem (than say challenging the consistency of a PTA liberalizing 70% of intra-PTA trade), since anyway the common agreement was that ‘substantially’ cannot cover just one good.<sup>9</sup> In other words, there seems to be adequate institutional insurance policy to cover for the risk of cherry-picking when forming a PTA.

#### 4.2 *The Indeterminacy of Art. XXIV GATT*

When we ask for the WTO to enforce Art. XXIV GATT, we also have to ask what exactly do we want the WTO to enforce. Art. XXIV GATT contains two requirements: the external (the obligation not to raise protection towards third parties), and the internal (the so-called substantially all trade requirement). There is not much dispute regarding the former, especially since the Understanding on Art. XXIV GATT was adopted during the Uruguay Round and clarified at what level comparisons should be made. The key stumbling bloc in clarifying the current text is the understanding of the term ‘substantially all trade’. Past practice cannot serve as meaningful guidance since all sorts of interpretations have been advanced, none with quantifiable content. An Australian proposal to clarify this term during the Uruguay Round by introducing a quantifiable benchmark (95% of all trade at the six-digit HS level) met the approval of the proposing state only.<sup>10</sup> One could avoid, of course, many of the problems by following a different road: instead of clarifying the terms, introduce a change in the voting procedures, say consensus minus the PTA members. The inevitable argument would be why confine voting to the CRTA. But, even if somehow this obstacle is addressed, many of those voting might prefer not to risk their political alliance with the PTA members and let political evaluations rather than strict legal scrutiny guide their vote. Although *de facto* we do not observe PTAs *a la carte*, and this could be attributed to the substantially all trade requirement, we do observe asymmetric PTAs, some with deeper, some with shallower integration. What is the metric that we should use for future PTAs, the former or the latter, and why? As things stand, there is no clear response to this question for the legal test is simply indeterminate.

#### 4.3 *Are bygones bygones?*

Moreover, even if a way is found to address PTAs from now on, the question will arise what to do with the existing PTAs. “Bygones are bygones” seems not to be

<sup>9</sup> Except for extreme cases when countries produce only one or overwhelmingly only one good, but then the substantially all trade requirement would have been met anyway.

<sup>10</sup> Mavroidis *et al.* (2010).

an option in light of the sheer number of existing PTAs. Maybe GATT contracting parties, having committed the original sin (by demonstrating benign attitude towards the European integration), refrained from a changing attitude subsequently for fear of being inconsistent. Finger (1993) has defended this line of argument. Conversely, those who judged by using the European integration process as a benchmark (which evolved into the deepest integration process we know as of today) might have felt reluctant to undo serious policy choices with a trade component which might lead to genuine FTAs in the future. Be it as it may, we are now confronted with a situation where a large part of international trade takes place within PTAs of dubious GATT consistency. To say that we care only about the future and forget past sins would amount to creating two classes of PTAs and yet another layer of discrimination in the name of rigorous enforcement of the GATT contract. And it might be politically unacceptable as well since some WTO Members are new kids on the block and might want to profit from relaxed enforcement of Art. XXIV GATT. Indeed, as argued above, it is difficult to prove that they would have entered the WTO in the first place if the price to pay would have been rigorous enforcement of Art. XXIV GATT.

#### 4.4 *What is the counterfactual to PTAs?*

One might legitimately ask: What if countries refused to make the same MFN cuts if they were deprived of the possibility to go preferential? What if they refused to participate in the WTO altogether? This is not meant to put into question the classic Vinerian analysis, indeed, Viner was interested in measuring the *allocational impact* of discriminatory integration;<sup>11</sup> the point here concerns *Realpolitik* and suggests that there is no reason to believe that MFN cuts, or indeed participation in the GATT altogether, would be the appropriate counterfactual to preferences.<sup>12</sup> The pace of trade liberalization might have been different had the possibility to offer perks to preferential partners been seriously undermined through rigorous enforcement of Art. XXIV GATT.

#### 4.5 *Is trade diversion an issue as it was?*

Recent empirical studies provide us with mixed evidence regarding the extent of trade diversion resulting from the formation of PTAs. We lack a comprehensive

11 And of course, as Kowalczyk (1990) has shown employing terms of trade and volume of trade analysis, trade creation and diversion do not necessarily equate with welfare gains and losses. WTO Members might be deriving important political benefits by association with their preferential partners, and this is most likely the case when associating themselves with the two main hubs, the EU and the US. Becoming a preferential partner in trade might open the door to all sorts of political cooperation.

12 There are few papers that discuss this issue. In two recent papers, Saggi and co-authors design models with endogenous cuts in order to ascertain whether MFN cuts are a counterfactual to preferential cuts: Saggi and Yildiz (2010) find that when countries have asymmetric endowments or when governments value producer interests more than tariff revenue and consumer surplus, there exist circumstances where global free trade is a stable equilibrium only if countries are free to pursue bilateral trade agreements. Saggi *et al.* (2010) argue that if the players have asymmetric endowments, Art. XXIV GATT (regionalism) might, on occasion, help further the cause of multilateral liberalization.

calculation of trade diversion for all PTAs (indeed one might wonder if one is feasible), but the on-going tariff liberalization of tariffs at MFN level would strongly argue in favour of the thesis that the problem is not of the magnitude that it used to be.<sup>13</sup>

Scholarship points to the (missing) incentives to agree on MFN tariff cuts following establishment of a PTA; Bhagwati (2002), Krishna (1998), and Limão (2006) all have contributed in making the point that, besides trade diversion generated through the establishment of PTAs, members of PTAs behave as enemies of non-discriminatory trade liberalization, since they are unwilling to cut tariffs on MFN basis for fear of eroding the margin of preference that they have granted to their PTA-partners: they become thus, *stumbling* (as opposed to *building*) blocs opposing MFN trade liberalization, and frustrating the achievement of the basic WTO objective. The fear was probably legitimate at some point, but the question is how relevant is it today? On the one hand, studies such as Karacaovali and Limão (2008), looking at the EU, and Limão (2006), looking at the US, have provided empirical evidence that PTAs have behaved like stumbling blocs: they ask the question whether MFN tariff cuts during the *Uruguay Round* are related to their preferential tariffs. The stumbling bloc thesis would suggest that trading nations would have cut tariffs less in areas where they had preferential tariffs, and indeed this is what these authors find. Other studies however find the opposite: Freund (2010), Estevadeordal *et al.* (2008) examine the Latin experience with PTAs and find that Latin nations cut their MFN rates most in products where they had preferences in place.<sup>14</sup> Baldwin and Seghezza (2010) use tariff data for 23 large trading nations and find that MFN cuts and preferences are complements not substitutes: margins of preferences in the real world tend to zero or close to zero where nations have high MFN tariffs; intuitively, one would associate the stumbling bloc thesis with large preferences in cases of high MFN tariffs, but the authors show that this is not the case in practice. The authors discard, thus, the stumbling bloc thesis, without supporting the building bloc thesis. Acharya *et al.* (2011), in similar vein, find that the impact of plurilateral PTAs on extra-PTA imports and exports is large and positive. Thus, recent empirical evidence lends little or no support to the uni-dimensional conclusion that PTAs are stumbling blocs *per se*.

Of course, trade diversion can result from instruments other than tariffs. It can result from say convergent environmental or public health policies across PTA partners. With respect to domestic instruments in general, nonetheless, there is no need for action: to the extent that a *trade advantage* has been conferred, it must be extended to all WTO Members automatically and unconditionally by virtue

<sup>13</sup> Irwin (1998).

<sup>14</sup> And, of course, a tariff reduction to PTA partners enhances the bargaining power of that same MFN tariff cut in broader negotiations with non-PTA partners worried about market access.

of Art. I GATT (MFN). PTAs, in other words, cannot provide legal shelter for discriminatory domestic instruments since the latter were not meant to protect anyway, and, hence, cannot be regarded as a *restrictive regulation of commerce* in the sense of the term embedded in Art. XXIV GATT.<sup>15</sup>

Trade diversion can also result from say increased use of antidumping (AD) proceedings against non-PTA partners, as the work of Prusa and Teh (2010) shows. Once again though, nothing much can be done about it: at a positive level, the only MFN obligation that WTO Members incur with respect to AD duties is to collect them on non-discriminatory basis.<sup>16</sup> At a normative level, the burden associated with proving that under similar circumstances PTA partners privileged AD proceedings against a sub-set of the WTO Membership (namely, outsiders to their PTA) is quite high: except for conceptual issues, those carrying the burden of proof (that is, the Members asked to pay them) will have to also address issues such as the opportunity cost of conducting another investigation, scarcity of administrative resources etc.

#### 4.6 *Subject matter for which no multilateral disciplines exist*

Horn *et al.* (2010) examine the subject matter of PTAs concluded by two hubs (EU, US) with various spokes between 1992 and 2008, and divide it into WTO+ (say tariff cuts beyond the MFN level), and WTOx (issues that do not come under the mandate of the WTO, say positive integration in fields such as environmental policy, fight against corruption etc.). The WTOx part of the PTAs is quite substantial. This paper thus suggests that the rationale for going preferential should *also* be sought in the WTOx type of obligations. The problem, however, is that we lack a test (other than MFN) to measure the consistency of WTOx provisions with the WTO.

Assume, for example, that the US and Peru agree that the latter increases its level of environmental protection up to the level of the former. As a result, it now faces no barriers in the US market with respect to a number of goods. Irrespective of its participation in a PTA with the US, Peru would have faced no barriers had it unilaterally increased its environmental protection up to the US level. In other

<sup>15</sup> At a more disaggregated level, one might wonder what should be done with, for example, biases in certification in favour of PTA partners. If we do not talk law but specific practices, there is little that can be done other than litigating any time something similar occurs. But, again, this is not a PTA issue since biases in certification can occur for PTA-independent reasons.

<sup>16</sup> Moreover, relevant GATT/WTO practice has failed to clarify whether AD duties qualify as a *restrictive regulation of commerce*. If yes, then they anyway must be eliminated across PTA partners. One should also be mindful of the fact that some PTAs have eliminated AD duties altogether in intra-PTA practice (the European Union and the ANZCERTA (Australia-New Zealand) offer appropriate illustrations to this effect), or have provided some additional disciplining through 'regional' reviews (e.g., NAFTA). More generally, intra-PTA liberalizing efforts can spill over to the multilateral agenda as the work of Fink and Molinuevo relating to trade in services (2008) shows, although one should always be mindful of the arguments to the opposite, see Adlung and Morrison (2010).



words, the US cannot have one environmental policy *vis-à-vis* its PTA partners and another (more onerous) *vis-à-vis* the rest of the WTO Membership. Environmental policies are covered by MFN (Art. I.2 GATT) and are not meant to protect domestic producers (since they fall under the ambit of Art. III GATT, which is meant to ensure equality of conditions of competition within markets): an Art. XXIV GATT-defence cannot thus be raised to justify departures from MFN. Hence, the rise in the level of environmental protection in Peru, even if it takes place because of Peru's participation in the PTA, should not mystify the CRTA. It should not concern it either.

The analysis above assumes that we want to keep the current WTO mandate constant. But doing that might lead to other problems: one might be proclaiming a PTA GATT-inconsistent because it does not meet an agreed definition of the *substantially all trade* requirement, and deny PTA participants of benefits in the form of FDI (foreign direct investment), technical assistance in a number of policies etc. This does not mean that FDI and PTAs are indissolubly linked. Indeed, one could (as countries do) conclude a Bilateral Investment Treaty (BIT) without anchoring it in a PTA. As Horn, Mavroidis, and Sapir (2011) point out, however, there could be substantial advantages when negotiating one instead of two agreements (e.g., fixed costs, better enforcement, linkages between concessions across two issues) and this is why they often happen this way. Disentangling them might be too onerous. At any rate, this is just a side argument suggesting caution before action and nothing more.

The WTO Membership would have to negotiate a new multilateral framework to act as legal metric if it wants to discuss the whole of the subject matter of modern PTAs. The extent of the new metric, as the work of Horn *et al.* (2010) shows, is quite vast. The ensuing negotiating cost would be correspondingly large. And in times when the Membership cannot deliver on a much narrower promise circumscribing the *Doha Round* mandate, it would be cavalier to go for the wider picture. At the present time, in the midst of a round that has been dragging on for almost ten years, it would be a disservice to add such a demanding new subject to the current agenda. Although there is some theoretical work responding positively to the need for an enlarged WTO mandate, the case is far from being clear and certainly far away from the radars of policy makers.

#### 4.7 PTAs can be welfare improving

Subsequent (to Viner) economic theory culminating with the *Kemp–Wan* theorem (showing that trade diversion can be eliminated by reducing external tariffs so as to keep trade with non-members unchanged, keeping, in other words, prices constant) shows that trade diversion is not a necessary evil stemming from the creation of PTAs. The result in the *Kemp–Wan* theorem applies in a set of given circumstances. The *Kemp–Wan* theorem, nonetheless, is not a *passage obligé* in order to support a claim that PTAs can be welfare improving. A trading bloc, as Krugman (1991) observes, will normally have more monopoly power in world trade than

any of its members alone. By entering into a PTA, in other words, trading nations can improve their *terms of trade*.<sup>17</sup>

But there could be other, less immediate reasons for arguing in favour of establishing a PTA. Analysts routinely make the point that NAFTA was beneficial to Mexico not simply because the US lowered its tariff barriers to Mexican goods and services, but also because Mexico benefitted from other dynamic benefits, such as increased investment over the years as a result of rationalization of its policies etc.<sup>18</sup> Baldwin (1993) correctly suggests that it is an onerous exercise to estimate the dynamic effects of preferential agreements; some of them, for example, might be shielded within the realm of private information that is never revealed to the rest of the world (e.g., side payments in the form of support for a permanent or temporary seat with the UN *Security Council*). In this vein, as Baldwin himself notes, the difficulty of calculating similar benefits is no intellectual reason to outright exclude them from any calculation.<sup>19</sup>

Recently, there is some empirical support for this view when authors have calculated some of the perks: Baltagi *et al.* (2008) discuss the relationship between PTAs and FDI (foreign direct investment) and conclude in an empirical paper discussing the Europe Agreements that removal of trade barriers can lead to substantial flows of FDI for those participating.

## 5. Concluding remarks

If the analysis above does not manage to persuade PTA-busters with enough arguments to hold their fire, then maybe they should reflect on what could be done to redress the current, disappointing in their view, equilibrium.<sup>20</sup>

PTA-busters should first ask the question whether going against PTAs is beneficial for current WTO Members? If their behaviour as litigators against PTAs is an indication, then probably this is not the case. But one can always make the point that collective action<sup>21</sup> is the dominant explanation for not litigating PTAs and not other factors such as strategic behaviour. That is, assuming there was no collective action problem here, WTO Members would be willing to constrain PTAs. If true, then WTO Members might be willing to do collectively what they are not prepared to do individually by raising a complaint before a WTO Panel. There is, however, a very heavy opportunity cost associated with the renegotiation

17 Non-members of course, lose and hence the perspective for welfare analysis (rational egoists or cosmopolitan definition) here matters.

18 Caliendo and Parro (2009). On the EU experience, see Sapir (1998).

19 There is a huge literature looking at many positive and negative implications of PTAs and I cannot do justice to it in this brief note, and looking exhaustively into this literature clearly goes beyond its limits.

20 Bhagwati (2008).

21 I understand this term here in its widest possible connotation: WTO Members would neither like to incur the financial cost of the litigation, nor the diplomatic cost of alienating their trading partners through hostile litigation where not a specific trade measure, but a wider development option, is at stake. On this issue, see the analysis in Chapter 7 of Schiff and Winters (2003).

of Art. XXIV GATT: recall our discussion about the indeterminacy of the substantially all trade requirement and the reaction to the only practical proposal to address it. Recall further that even if we come up with better, more precise language, we will be miles away from addressing the subject matter of modern PTAs, the mandate of which extends beyond that of the WTO. In short, it is negotiation of multilateral rules in areas covered by modern PTAs that is required, and this is indeed a top-heavy agenda at this moment.

PTAs are formed for many, often idiosyncratic, reasons. We cited some of the reasons *supra* and there are many more: Winters and Schiff (1998) discuss political benefits stemming from the formation of PTAs. Baldwin (1997), for example, tries to explore the validity of some of the rationales, and, more recently, Whalley (2008) attempts a similar endeavour. Some of the rationales advanced for PTAs are not persuasive: for example, the argument has time and again been advanced (and continues to be so) that countries have gone preferential because they were frustrated with the slow pace of multilateral tariff liberalization. I attach little value to this view: if true, then why did not they go for what Bhagwati has termed *open regionalism*, that is allow others to join their PTA assuming they had agreed on the tariff cuts decided? Other rationales hold more promise: Baldwin (2008), for example, develops a theory aiming to predict who goes preferential depending on the identity of the spoke and the hub that have already gone preferential. But we lack a dominant explanation that can serve as rationale across PTAs.

The historic rationale for PTAs is not of much help either. Arguably, one reason for its inclusion is that the GATT negotiators were presented with a *fait accompli*: two CU participated in the negotiation, the Syro-Lebanese customs union (Syria, Lebanon), and *Benelux* (Belgium, Netherlands, Luxembourg). Institutional arrangements probably had to be made in order to accommodate these contracting parties. Chase (2006), drawing from a series of archival records, explains the extension of the discipline to cover FTAs as well: the author persuasively demonstrates that it was the US negotiators that designed this provision in order to accommodate a trade agreement that they had secretly reached with Canada. The *US–Canada FTA* did not see the light of the day for 40 years. On the other hand, the view held by many that the inclusion of a provision on FTAs was there to accommodate the European integration process must be discarded: in Acheson's (1969) record, Jean Monnet revealed his plans on European integration after the *Havana Conference* had taken place.

We are still struggling with the rationale, but recent research paints a much rosier picture for PTAs than was the case before. One contributing factor is the success of the multilateral trading system: MFN reduction of tariffs results in reduction of trade diversion resulting from PTAs. So we are now facing a problem less acute than before. Moreover, the content of PTAs has changed drastically over the recent years and moved to areas escaping the current WTO mandate. Finally, evidence shows that PTAs can be welfare improving. And while all these changes were happening, the WTO continued to enforce an ill-informed and out-dated

system to constrain PTAs. Against this background, the shift towards a mere exercise in transparency (facilitated by the WTO *Transparency Mechanism*) should be welcomed with relief. For one, it removes the risk of false positives, which can have important institutional (negative) external effects. Moreover, assuming the exercise is taken seriously, it can provide the WTO Membership with important information regarding the rationale (and not only the formation) of PTAs: WTO Members might have more of an incentive to cooperate in question and answer sessions when they do not risk a sanction than otherwise. Although not a perfect surrogate for litigation, transparency might in and of itself affect behaviour by say exposing participants to flimsy schemes at reputation costs etc.

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