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A Matter of Synergy: The Role of Regional Agreements in the Multilateral Trading Order

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The last decade of trade negotiations has considerably enlarged and strengthened the framework of rules governing cross-border business dealings. A combination of regional, subregional, and multilateral negotiations has proved remarkably successful in moving governments toward acceptance of a more open, less discriminatory system for regulating cross-border economic transactions and settling transnational commercial disputes. In effect, governments have succeeded in establishing a multi-tier system of rules, with virtually all economically significant countries applying the universal rules of the World Trade Organization (WTO) and with many countries accepting additional rights and obligations to govern trade and investment with their most important or proximate economic partners through regional agreements.

Despite the progress of the past decade, however, none of these agreements has fully caught up to the degree of international integration that now exists at the corporate level, and many still assume the continuing importance of national frontiers in organizing economic activity. From a corporate perspective, national markets have become a less dominant factor in decision making, while the continued presence of market-segmenting national policies has become a negative determinant in investment decisions. Nevertheless, as long as there are borders (that is, as long as governance continues to be organized on the basis of the state), governments, firms, and individuals alike will need rules to govern transnational as distinct from domestic economic transactions. Governments need to respond collectively to the demands and challenges of a world in which national economies have become more integrated both regionally and globally.

The demands of this deeper integration are likely to lead to further rule making, some at a multilateral or global level; others, either initially or permanently, at a regional level. As such, it will be important to understand the positive and negative interaction between regional and multilateral

approaches. To that end, this chapter considers the conflicting and complementary aspects of rule making at the regional and global levels.

Background

GATT and Regionalism

From its inception, the General Agreement on Tariffs and Trade (GATT) provided, in Article XXIV, rules and procedures setting out the circumstances under which regional or preferential agreements would be acceptable within the multilateral order. These rules, however, were geared to the tariff-centred trade policies of the 1940s and 1950s. Today's more complex range of economic transactions and concomitant policy measures may require different rules and criteria. As noted in a recent Organization for Economic Cooperation and Development (OECD) study, "regional and global integration no longer lend themselves to the type of clear-cut separation embodied in GATT Article XXIV: both are facets of the same effort to accommodate the growing complexities of economic interdependence against the diversity of social preferences."[1] Understanding why requires an appreciation of the difference between traditional and modern regional agreements and their treatment in the GATT.

The first serious wave of postwar regionalism began in Europe in the 1950s, culminating in the establishment of, first, the European Economic Community (EEC) in 1958 and, then, the European Free Trade Association (EFTA) in 1960. Both flowed from a complex series of motives and circumstances. Certainly, commercial policy considerations were central, but political motives – including security, historical sentiments, past conflicts, and Cold War anxieties – played a very large part and have continued to be critical to the success of the European integration movement. Without a strong base in such sentiments, efforts to create a single European customs union in the 1950s would have come to naught. Strong American support for these political sentiments, particularly in the 1950s and 1960s, explains why American political leaders were prepared to tolerate departures from the multilateral ideal. Academic analysts, however, were less kind, identifying a range of characteristics that made regional agreements suspect.

The circumstances that had led to two competing approaches to regional integration in Europe – the French-led EEC and the UK-led EFTA – also resulted in some less than salutary consideration of these agreements at the GATT. The result was stalemate. The United States and Canada, for broad geopolitical reasons, were prepared to tolerate what were widely regarded as politically desirable agreements. Attacks on the two agreements by the rival camps and their supporters, however, led to inconclusive working party reports. These reports then set the unhappy

precedent that such reports need not come to a definitive conclusion as to the conformity of such agreements with the GATT's requirements. Additionally, officials of the participating governments made the pragmatic assessment that while departures from the requirements of Article XXIV might be regrettable from a systemic point of view, to insist on purity (that is, on more discrimination) was to ignore one's trading interests. Finally, members realized that a definitive decision that an agreement conformed with the GATT's requirements would make any future complaints about trade diversion and other negative effects difficult to sustain. Thus, the first serious resort to Article XXIV led to non-decisions by GATT members that were wholly consistent with their interests – political and commercial – but left the unfortunate impression that Article XXIV was a toothless tiger.

Concurrently, a number of regional integration schemes were also pursued in Africa and Latin America that, in retrospect, turned out to have been more dream than reality. They were based on more questionable motivations than those in Europe, aimed at furthering the import substitution strategies then in vogue. The drafters of the Treaty of Montevideo, for example, deliberately set out to discriminate by maintaining high barriers to industrial products (through both tariffs and other measures) but at the same time sought to create larger markets for regional manufacturers by creating free trade zones. These plans were inward-looking import-substitution schemes rather than efforts to facilitate trade and reduce barriers among the members. Given such rather contradictory objectives, it is not surprising that little came of these efforts.

By the time of the Tokyo Round of GATT negotiations (1973-9), this initial wave of regional agreements had largely come to an end, and concern about the negative repercussions of regionalism had largely receded. The EEC, renamed the European Community (EC) in 1967, had emerged as a major player in GATT negotiations, contributing significantly to the liberalization of trade and the making of rules at the multilateral level. Various regional experiments in Africa and Latin America had largely stagnated; many remained on the books, but most had little if any commercial impact. Some never involved any liberalization, while for others it did not take long for exceptions and exemptions to prove the norm. Finally, the success of GATT's Kennedy (1963-7) and Tokyo Rounds had largely negated the complaint that regional agreements were a substitute for multilateral negotiations. The combined impact of the two rounds and the concurrent enlargement of the EC validated the claim that multilateral and regional arrangements could be complementary. The EC experiment had also suggested that as long as there was concurrent regional and multilateral liberalization, any complaints about trade diversion were likely to disappear. Indeed, given the high levels of intra-EC trade already evident in the 1950s and 1960s, the scope for diversion was never as large as critics had feared.

The New Regionalism

By the mid-1980s, however, regionalism had gained a new lease on life, and it is this most recent version that has created current anxieties about the negative impact of regionalism on the maintenance of a multilateral order. The deepening and expansion of European integration, which transformed the EC into the European Union (EU) in 1993, and the resort to regionalism in North America via the North American Free Trade Agreement (NAFTA), have been particularly critical in raising anxieties. Most of the fears and concerns expressed, particularly in Asia and Latin America – and echoed to some extent by academic commentators in Europe and North America – appear to be based on a profound misunderstanding of the policy motivations underlying recent regional integration movements as well as ignorance of the extent to which, despite earlier regional integration agreements, world trade and investment patterns have not become regionalized.[2] The details of these developments can be found elsewhere. For our purposes, they involved a profound change in direction, reflecting a pragmatic assessment by member governments of how best to achieve national political and economic objectives.

Some of these regional agreements were policy driven; that is, propelled by the conviction that good agreements make good neighbours. Such agreements reinforce good diplomatic practices aimed at reducing the inevitable rancour that can flow from cross-border commercial disputes. They can also help to reinforce broader political and security considerations. Policy considerations, for example, are critical to understanding the EU's efforts in expanding its membership to include three former EFTA countries (Austria, Sweden, and Finland) and in extending more liberal trading conditions to the former Soviet bloc countries in Central and Eastern Europe. Similarly, Canada and the United States can boast a long history of negotiating such agreements dating back to the middle of the nineteenth century. They flow from a prudence dictated by the realities of geography and economic interdependence and have proven, for example, the best way for Canada and the United States to manage the tensions that flow from unbridled expressions of American manifest destiny and Canadian anxiety. Experience over the past decade further indicates that trade agreements are more likely to *reflect* than *cause* integration. Integration is driven by geography, technology, and economics, but it can be facilitated or hindered by government policies, including the negotiation of trade agreements. Such agreements are not likely to alter the direction of broad economic changes, but they can influence the pace and the structure of those changes.

The new regionalism can also be seen as part of efforts to define a new, post-Cold War international order. During the first four decades of the

postwar trade and payments system, the leading members had a strong ideological commitment to the success of the "Western" multilateral order. Although there might be quarrels across the Atlantic or Pacific, there was a limit, given shared political and security interests. With the demise of the Soviet threat, both Europe and Asia are less likely to view American hegemony as benignly as in the past and tend to define their interests, including their commercial interests, more narrowly and regionally. Regional agreements provide an outlet for working out such divergent aims, while at the same time providing a basis for moving toward a multilateral order that can meet the interests of each of the world's three major trading areas. The difficulties in bringing the Uruguay Round of GATT negotiations (1986-93) to a successful conclusion illustrated some of the birth pangs of the new, shared responsibility for leadership and the coalition building that are essential to progress in multilateral negotiations in the absence of a hegemon.[3]

This rule making has also reflected the pressures generated by developments in the technology and organization of production. Over the past twenty years or so, the nature of international business has radically changed in response to the opportunities created by the rapid decline in the cost of transportation and communication and the concomitant progress in reducing government-imposed barriers to cross-border transactions. As a result, trade and investment today are taking place within an increasingly integrated global economy rather than among a set of distinct, if linked, national economies. The kinds of rules required to smooth the way for commerce in today's circumstances are substantially different from those prevailing in the immediate postwar era when the basic contours of the international trading system took shape. These demands are particularly cogent for neighbouring economies as the forces of proximity accelerate the process of technologically driven silent integration.

This new level of integration is not just driven by increased trade in goods but even more by increased cross-border mergers and acquisitions, strategic alliances, and other forms of foreign direct investment (FDI). In the 1980s, there was not only a surge in intraregional FDI, but an even larger increase in interregional investment flows as well as an increase in exchanges of the technology, information, and services that often go hand in hand with such investments. This phenomenon further illustrates the synergy between regionalization and globalization. Global, as well as regional, liberalization throughout the 1970s helped to create the conditions that made the surge in intra- and interregional trade and investment possible in the 1980s; technology made it a profitable and even compelling business strategy. The success of this market-led leap in regional and global integration in turn put pressures on governments to address a new

range of issues that stood in the way of further market-led integration; governments responded with regional and global policy initiatives that reflected the range of social and political preferences of their electorates.

Europe has moved furthest along the path of experimenting with the demands of this new agenda. The EU – in its rules and institutions – is a much more integrative agreement than NAFTA. The EU has developed a scheme of regulation that has allowed a group of now fifteen countries to maintain their separate identities, while creating a highly integrated single market. There are no customs procedures, no antidumping provisions, and no market-limiting product standards; there are EU-wide rules about competition, subsidies, and restrictive business practices; and there is a commission, a parliament, and a court to enforce these provisions.

The European experiment has demonstrated the extent to which deep integration is accelerating the transition from international trade agreements that are focused largely on customs issues to agreements that address a range of what have traditionally been considered domestic policy instruments, such as investment and competition policies or product standards and labour market regulations. Deep integration agreements are more likely to involve positive norms (that is, rules about what governments will do) than the negative prescriptions of traditional agreements (that is, rules about what governments will not do). Their emphasis is on detailed rules and procedures rather than on general principles. They are less likely to rely on negotiated solutions to conflict and more likely to mandate the adjudication of disputes based on agreed rules and procedures.

NAFTA did not proceed as far down this deep integration path. Its provisions, for example, still include customs and antidumping procedures, buy-national procurement preferences, and market-limiting product standards; there are no NAFTA-wide rules about competition, subsidies, or restrictive business practices; and there is no independent commission, legislature, or court to enforce its provisions. By design, NAFTA is a GATT-plus regional liberalization agreement rather than an EU-like regional integration agreement. In the original Canada-US Free Trade Agreement (CUSFTA) and then in the NAFTA negotiations, the parties to both agreements did not set out to negotiate a regional integration agreement. They set out to liberalize trade within North America and at the same time address some of the newer issues that would, of necessity, move them closer to an integration agreement. The United States sought to make progress on services, investment, and intellectual property rights, while Canada and Mexico wanted to pursue competition-related issues. Progress was made on these issues, but in a cautious, GATT-like manner.

The success of Europe and North America in addressing the pressures of so-called silent integration through regional agreements created anxieties in Asia and Latin America that these agreements would evolve into

inward-looking trade blocs, shutting them out. As a result, two sets of responses played out simultaneously in both regions: efforts were mounted to develop intra-Latin American and intra-Asian regional or subregional agreements and also to find ways for the countries of these regions to get into one, or even both, putative trade blocs. Thus, Latin America saw the emergence of MERCOSUR (Southern Cone Common Market), efforts to revitalize the Andean Pact, the Central American Common Market (CACM), and the Caribbean Common Market (CARICOM), as well as Mexico's free trade agreements (FTAs) with Chile and other countries. Unlike the Latin American integration schemes of a generation ago, these new efforts aimed at strengthening the capacity of export-oriented industries rather than at complementing import substitution strategies. Similarly, discussions sought to achieve freer trade and investment among the ASEAN (Association of South-East Asian Nations) countries in the form of AFTA (ASEAN Free Trade Area) and among a group of South Asian countries (South Asian Agreement on Regional Cooperation – SAARC). Additionally, various initiatives have tried to find ways to achieve freer trade on a Western Hemisphere (the Free Trade Area of the Americas – FTAA), Asia Pacific (Asia Pacific Economic Cooperation – APEC), and transatlantic basis.

None of the regional experiments, however, involved the rejection of multilateralism. Concurrent to the negotiation of CUSFTA/NAFTA and the expansion and deepening of the EU, the United States, Canada, Mexico, and the EU were deeply engaged in the Uruguay Round of GATT negotiations. Their results may have been influenced by the lessons learned and commitments undertaken in these regional efforts, but there is no evidence that any of the parties sought to reduce or derail multilateral negotiations. All saw a successful, expanded GATT as vital to their interests.

The Multilateral System Catches Up

Thus, concurrent with regional efforts, discussions also continued to upgrade the multilateral system of rules. Its earlier success, first in binding and reducing tariffs and then in negotiating detailed rules aimed at reducing discrimination in the application of various non-tariff measures, had helped to transform international trade from the largely inter-industry trade of the 1930s to rapidly increasing intra-industry trade in the 1960s. When coupled with the technological breakthroughs in the 1970s that were rapidly decreasing the cost of long distance communications and transportation, these developments had by the 1980s spawned much more intense levels of intra-industry trade at a global level.

The GATT rules, originally limited to trade in goods and to customs-related issues, clearly needed to catch up to this new reality by establishing, on a more or less universal basis, binding rules and procedures for a much wider range of economic transactions, such as foreign direct investment,

trade in services, intellectual property protection, and technology transfers, based on the GATT principles of non-discrimination, due process, and transparency. To ensure that these new rules would have the intended impact, they also needed to be backed up by GATT's dispute-settlement procedures, suitably upgraded to reflect the new demands that would be placed on them. That, in effect, was at the heart of the ambitious agenda of the Uruguay Round of GATT negotiations. To be sure, older issues were also on the agenda, such as bringing trade in agricultural products more firmly within the ambit of fixed rules or reintegrating trade in textiles and clothing into the mainstream of GATT's principles of non-discrimination. These issues proved extremely difficult and threatened at times to undo progress on other fronts. Nevertheless, the continued viability of multilateral rule making required substantial progress in expanding the GATT to cover the new issues.

It took a protracted period to convince countries that such an ambitious agenda was both necessary and negotiable and an even longer period to bring it to a successful conclusion. In the end, however, the negotiators put together a package that more than met expectations. They succeeded in reversing the gradual shift away from multilateral agreements toward regional ones and strengthened the primacy of a universal set of rules and institutions. They also established an impressive foundation for continuing the process of applying these principles to a wider range of international economic transactions.

A comparison of the trading rules, institutions, and procedures as they existed in 1960 and as they had evolved by 1995 shows the enormous progress that has been made. In 1960, despite GATT's existence for more than a decade, even the trade regime for trade in goods remained at a very primitive state. Tariffs were high; many were still unbound; the administration of tariff-related measures (such as customs valuation, tariff classification, and remission schemes) varied widely from country to country. These variations allowed for very high rates of effective protection and frustrated growth in international trade – and thus efficiency – in many sectors. Exceptions and exemptions weakened even these rules for politically sensitive sectors such as agriculture and textiles. GATT rules applied only to trade in goods, with a patchwork of bilateral and plurilateral arrangements providing, at best, superficial discipline on other types of cross-border transactions. GATT as an institution enjoyed a very precarious existence, and disputes were more likely to be settled through power-based negotiations than rules-based adjudication. The first wave of regional agreements threatened to erode the progress that had been made in entrenching the principles of non-discrimination and multilateralism. In short, the GATT regime very much reflected the fact that trade represented only a small percentage of economic activity for most of the principal

players. It was a set of rules that regulated a modest flow of trade among a set of linked but still largely independent economies. For those European countries for whom regional trade links were significant, the more extensive rights and obligations of regional agreements governed trade among them.

Today, despite the growth in regional agreements, the WTO regime reflects a new reality. Its very detailed codes ensure an increasing uniformity in the regulation of not only trade in goods (through detailed rules governing such measures as customs valuation, classification, licensing, antidumping procedures, and countervailing duties) but also the much wider range of economic transactions that now take place on a cross-border basis. Rules about government procurement, foreign direct investment, services, product standards, subsidies, and intellectual property protection all seek to provide producers with the ability to organize their production on a multinational basis, ship parts and components with relative ease between plants located in different jurisdictions, and respond to increasingly convergent regulatory requirements. The fact that signatories are required to adopt virtually all the constituent codes of the WTO ensures that it will evolve into a universal code. In short, the WTO regime is becoming a set of universal rules to regulate economic activity within an integrated global economy. At the same time, a new set of regional agreements addresses the need for more intense rules among more highly integrated neighbouring economies.

From this perspective, it can be appreciated that traditional economic analyses of preferential agreements that concentrate on their economic effects through discriminatory tariff-cutting miss what trade negotiations are all about today. They are less about trade liberalization as traditionally conceived and more about security of access and rule making. From the traditional perspective, modelling of NAFTA's or the EU's impact on third-country trade interests, for example, will not prove very productive because tariffs – the most easily modelled instrument of protection – have become marginal for most OECD countries. As a result of the Uruguay Round, an increasing number of industrial products and even sectors will enjoy tariff-free access conditions in the markets of most of the advanced industrial economies. Increasingly, the game has moved to considerations of non-tariff barriers and dispute settlement, and a beginning is being made on regulatory barriers and rule making that facilitate greater policy convergence. Coverage has moved well beyond trade in goods to include transborder transactions involving services, capital, technology, and even people. None of the analytical models for studying the complementarity or contradictions between multilateral and regional approaches has yet captured this much more complex reality.

Additionally, such models fail to factor in that customs unions and free

trade areas have historically been negotiated and implemented among neighbours in order to reinforce and secure economic links established as a result of geographic proximity and historical ties. The number of successful agreements that do not fit this model are few and far between and usually reflect unique political and historical circumstances, such as the 1986 US-Israel Free Trade Agreement. As the OECD concluded: "To date regional and multilateral approaches to trade and investment have interacted in a dynamic way which has been to their mutual benefit. It is no exaggeration to say that … a slowdown or reversal of the process in the existing regional integration arrangements would similarly affect the multilateral process; the reverse may indeed also be true."[4]

The New Context

Experience over the past fifty years, therefore, does not lead to any a priori conclusions about the compatibility, or lack thereof, of regional agreements with a multilateral trading order.[5] The experience of the past suggests that, while there can be very positive synergy between the two approaches, there are also disadvantages flowing from regional agreements' inevitable discrimination against non-participants. Negotiating the next generation of international economic agreements can be facilitated by a more thorough appreciation of the extent to which regional agreements can be building blocks rather than stumbling blocks toward the ideal of a well-functioning, open global trade regime. Key to such an appreciation is a better understanding of the economic, political, and commercial context within which such agreements will be pursued.

A Techno-Economic Paradigm Shift

For the last two decades, the world economy has been going through a period of profound change, undergoing the consequences of what economist Carlotta Perez has called a techno-economic paradigm shift; that is, a transformation in the organization of production flowing from developments in communication, transportation, and information-processing technology.[6] The resulting information-based economy is spawning new products and industries at an unprecedented rate and creating pressures for new approaches to industrial organization, management, and production techniques. Advances in information-processing technologies, coupled with remarkable progress in bringing down barriers to cross-border trade and investment, have also led to a quantum leap in the internationalization of the economy. Production is steadily being reorganized on a global or regional basis and the nature of extranational economic transactions reflects this change. Such transactions now involve a much more complex and sophisticated range of exchanges and are more likely to be among related than unrelated parties. In effect, the world is experiencing

the beginning of a transition from commerce among a set of interlinked national economies to exchanges within a much more integrated global economy.

While the changes are most apparent at the economic level, the long-term implications of this transformation are more fundamental. It also involves global convergence in political and other values. At the same time, a resurgence in local and regional loyalties is pulling in opposite directions. From Quebec to Bosnia, the pursuit of narrowly conceived nationalisms is straining the fabric of established states. Ultimately, what appears to be happening is a gradual reshaping of the institutions of society and of social, economic, and political behaviour patterns that have long characterized life in the modern state. Cherished assumptions about the integrity and governance of the state are being squeezed between the centrifugal economic forces of globalization and the centripetal pull of more local political, cultural, and social values, loyalties, and preferences.

Over the past century and a half, as national economies have become more and more integrated, governments have established a range of regulations and institutional structures to achieve various social, economic, and other goals. Laws ranging from corporate governance through the protection of competition, consumers, the environment, labour markets, and intellectual property rights to the promotion of specific cultural and social values ensure that the operation of the market is subject to political control. Societies have collectively determined the extent to which they are prepared to live with market outcomes and the extent to which such outcomes need to be conditioned by political, social, and other preferences.

Until recently, such national regulatory structures operated on the assumption that most economic activity took place within the confines of the state and that the limited activity that crossed national frontiers could be adequately addressed through border regimes. Even the postwar international trade and payments regime of the GATT and the International Monetary Fund (IMF) was designed to address commerce between relatively autonomous national economies, leaving domestic regulatory regimes largely intact to deal with how societies would govern themselves.

Such a balance between domestic and international regimes no longer represents today's reality. The forces of globalization have made it possible to breach the territorial, social, and cultural integrity of the state on a daily basis. The convergence of popular culture, the globalization of commerce, and the crisis of the welfare state all point to the need to develop a new set of norms for inter-state relations, a set of rules that recognizes that the realms of production, exchange, and consumption have largely escaped from the effective regulation of the territorial state, while the people who make up that state remain largely attached to it. An increasing share of national economic activity is conditioned by extranational transactions

and influences; few goods and services, and little capital and technology, are still produced and consumed wholly within a single national economy. The result is that the national regulatory structures so carefully built up over the past century and a half may now serve as impediments to harmonious economic development rather than as adjuncts or facilitators. They are more likely to lead to conflict than to harmony.

Fundamentally, this is an issue of governance: Who will set the rules and how will they be enforced? Will these issues be resolved at the national or international level? On the basis of unilateral coercion or multilateral cooperation? Through supranational or intergovernmental rules and institutions? For some, international rules can be used to create a level playing field, disciplining governments from capriciously interfering in the efficient operation of the market. For others, the ideal line of defence is to isolate national economies from the rigours of competing in the international economy and thus ensure that national social and other priorities cannot be compromised.

Formulating appropriate answers will not be easy. It will involve analyzing how best to devise a universal regime consonant with the new reality of a global economy but still sensitive to local needs and concerns. Over the years, governments have made steady progress in laying the foundations for such a regime. The postwar trade and payments system of the GATT and the IMF has succeeded in providing both the stability of an enforceable set of common rules and a shared commitment to the progressive liberalization of markets and the expansion of a fixed-rule regime. With the establishment of the WTO, the system reached a new level of commitment as well as new levels of sophistication, detail, and enforceability. Thus the experience of the past suggests that it is possible for national governments to find an increasing array of areas of common cause and shared interest and to address them through jointly agreed rules, procedures, and institutions; that is, to delegate political authority to extranational institutions and provide them with the capacity to enforce that authority.

The next step, however, involving the move from the regulation of commerce among national economies to the regulation of a global economy, may prove to be more than a matter of degree. It may involve a major adjustment in thinking and in governance, and it may require institutions, attitudes, and procedures with which there is as yet little experience. If nothing else, the new rules will need to take full account of the activities of the main vehicle of globalization, the transnational corporation. They will also need to achieve what various analysts now refer to as the international contestability of markets.[7] Revolutionary as this concept may seem to those steeped in postwar concepts of sovereignty and who have experience with a limited number of international regimes, changing

attitudes in both developed and developing countries suggest that there may be growing receptivity to further work along these lines.

New Attitudes

Efforts from the early 1960s through the early 1980s to establish a New International Economic Order (NIEO) at times seemed aimed at establishing a parallel and in many ways antithetical set of rules to that established a generation earlier at Bretton Woods and elsewhere. The postwar trade and payments system was based, at least in principle, on non-discrimination; the NIEO tried to establish a regime based on reverse discrimination. The Bretton Woods system assumed the efficacious operation of the market as the principal mechanism for allocating resources; the NIEO assumed the iniquitous effect of the market. In short, the NIEO sought to graft rules about equality of results to a regime built around the principle of equality of opportunity, whether couched in terms of equity, special and differential treatment, or reverse discrimination.

A debate based on such fundamental differences was bound to be long on rhetoric and short on results. Nevertheless, it enjoyed legitimacy much longer than its results warranted, in part because the perceived threat of a shortage of natural resources, underlined by the oil crisis of 1973, gave the developing countries an influence in the 1970s not commensurate with their real economic power. As a result, the industrialized countries were prepared to contemplate ideas and proposals that were fundamentally at odds with their own political and economic ideologies. The bitterness of the North-South dialogue also reflected the birth pains of a postcolonial order, with a large number of nations determined to show that they were now independent with a will of their own and unprepared to trade one form of colonialism for another.

On the whole, neither the trade nor the payments regime was much infected by the demands of the South. While much ground was yielded in political resolutions, declarations, and action plans, when it came to binding, contractual commitments, the industrialized countries managed to maintain the integrity, if not the vitality, of the original postwar order. By the mid-1980s, both the seriousness of Less Developed Countries' (LDCs) potential control over essential raw materials as well as waning attachment to an interventionist ideology brought the era of the confrontational North-South dialogue to an end and opened the way to more pragmatic and fruitful negotiations on a range of issues fundamental to the effective functioning of a global economy. Developing countries' struggle with the debt crisis of the 1980s exposed them to the costs of ignoring market disciplines, while the end of the Cold War removed one of the geopolitical props that had given their claims political cogency if not economic legitimacy. With the successful conclusion of the Uruguay Round and its

implementation on a nearly universal basis, the last vestiges of the political ground yielded to interventionism and discrimination in the 1970s and 1980s have been regained, while at the same time there has been a significant expansion of the territory covered by the principles of the Bretton Woods system.

Attitudes in the South are not the only ones that have changed. Many OECD members also determined in the 1980s that the long-term competitiveness of their economies required that they become more open to both trade and investment. Finally, in the 1980s, for the first time, the United States began to feel the effects of much deeper involvement in the international economy. For most of the postwar years, trade and inward investment represented relatively minor adjuncts to the largely inwardly focused American economy. By the 1980s, however, imports and exports as well as inbound and outbound investments or alliances became the lifeblood of an increasing number of US-based firms, leading to a new appreciation of the importance of intergovernmental rules. Old attitudes, however, are more difficult to shed in the halls of the hegemon than elsewhere, and much ink will need to be spilled and rhetoric endured before American policy fully catches up to the realities of a much more balanced political and economic global order, one in which American interests may need to accommodate themselves to those of others.

What is emerging, therefore, is a remarkable convergence in attitudes based on a much greater appreciation of the extent of shared experiences and problems. Most governments, developed and developing alike, have now embraced the philosophical assumptions that underpin the Bretton Woods system, in large part because history has demonstrated that it works and it has equally demonstrated that intervention and discrimination do not. The combined impact of common views on the limits of government intervention and shared experience in introducing tax and regulatory reforms and implementing privatization are fuelling a greater readiness to work out common solutions. Most governments now accept that the shortest route to efficiency and sustainable economic growth lies through market-based competition, nationally and internationally. With such convergence and cooperation developing along an ever wider front, the prospect of developing common rules about a wider range of issues is becoming increasingly more likely.

The Emerging Agenda

What to Negotiate

A modern, comprehensive, effective regime governing the operation of a global economy should provide a seamless set of non-discriminatory trade, investment, and related disciplines with which to govern both private

actions and public policies affecting the ability of globally active firms to contest markets anywhere in the world.

The first part of this bargain can be expressed quite simply: governments may not discriminate in their treatment of goods, services, capital, information, and technology, either between foreign and domestic sources or between one foreign and another foreign provider. In effect, this rule would require national or equivalent treatment for the full range of transborder economic transactions. Any exceptions to this fundamental rule would need to be circumscribed by clear criteria and, if possible, subject to sunset provisions. Exceptions may be politically necessary, but they are likely to become a slippery slope of special pleading involving claims of national security, cultural identity, technological sovereignty, and sectoral carve-outs. Much negotiating ingenuity and energy will need to be devoted to finding the fine line between what is politically necessary and what is economically desirable. Additionally, given the fact that national treatment may not involve very good treatment, an effective agreement would need to spell out a number of basic or minimum standards of treatment related, for example, to expropriation, compensation, transfers, performance requirements, and incentives. Finally, this part would need to be integrated with existing disciplines governing trade and investment and thus ensure that rules governing the full range of governmental policies that may distort cross-border economic transactions provide foreign and domestic firms alike with full and equivalent opportunity to contest any market.

A second part would require more work and ingenuity. In effect, it would involve the establishment of a basic code regarding fair competition in the global economy, based on national experiences with antitrust and company law. It would thus address private practices that may constitute impediments to the contestability of markets. Unlike the voluntary codes of conduct enunciated in the 1970s, such a code would be enforceable and would establish norms of corporate behaviour that have proven their worth in domestic practice. This part would thus need to ensure that governments can insist on certain norms of behaviour within their territorial limits, norms that would be respected by firms active in the global economy.

Related to, but not necessarily a part of such an agreement, governments are likely to see benefit in the negotiation of a series of codes setting out minimum standards of behaviour in such areas as labour practices and environmental protection. In effect, such codes would satisfy John Kenneth Galbraith's concept of countervailing power. In his study of the growth of large, national firms in the immediate postwar period, Galbraith argued that as business organizations evolved from largely local to principally national enterprises, regulatory authority governing their behaviour was

gradually assumed by national political authorities.[8] In a similar vein, it would seem logical that because business is increasingly organized at the regional or even global level, national governments are likely to want to organize matters in such a way as to provide an effective regional or global regulatory capacity.

Taken together, these various elements constitute what would seem to be the essence of any international agreement that would govern the international contestability of markets. Such an agreement would ensure that there are clear rules and procedures governing the kinds of actions both governments and private firms can take to impede market-based outcomes. It would recognize the extent to which trade and investment are complementary means to contest markets and thus can no longer be treated as separate issues. As Edward Graham observes, "From an economics perspective, the goals of policies toward competition, direct investment, and trade are at the level of fundamentals all the same. Each of these policy domains should aim jointly to maximize technical efficiency in both the static and dynamic senses and, hence, economic welfare, by promoting an optimal level of competition among suppliers of goods (or services) in some appropriately defined market. Thus, these three policy domains must complement each other and not, as can be the case too often today, stand in each other's way."[9]

At the same time, such an agreement would restore the ability of governments to exercise political control over the operation of the market to achieve important non-economic objectives – albeit collectively rather than individually – a control that has to some extent begun to erode as a result of globalization.

How to Negotiate

Negotiating such an agreement will entail more than an incremental addition to existing trade and investment agreements. A new strategy based on changed circumstances will have to be developed. To what extent, for example, would the existing principles and practices to be found in the WTO and in the various investment instruments support a new direction in negotiating more extensive international economic agreements?

Many earlier negotiations involved two reinforcing bargaining strategies. The first revolved around a set of negative prescriptions. The GATT rules respecting tariffs and quantitative restrictions or the OECD investment codes, for example, both involved self-denying ordinances: governments agreed not to engage in certain policies and practices and thus let the market determine winners and losers. Such prescriptions are susceptible to an exchange of concessions; that is, each government can deny something in return for other governments' denying something of similar

value. On the trade side, governments were able to exchange politically risky increases in import competition for politically rewarding increases in export opportunities within a fixed rule order that guaranteed stability. Less was accomplished on the investment side because concessions could not be swapped as easily.

The second strategy was based on commitment to most favoured nation (MFN) treatment and the organization of negotiations around market power; that is, the largest economies exchange concessions among each other that are then multilateralized for the benefit of all the other participants. Smaller countries, having little to offer in terms of economically significant markets, are marginalized both in the concessions they can offer and in the specific concessions they can seek. Nevertheless, they gain considerably from the concessions traded among the larger economies, and the overall effect of the process is liberalizing. Following the lead of the major powers thus makes both political and economic sense for the smaller powers and ensures commitment to a regime dominated by a few major players.

These two fundamental characteristics of the postwar trade relations system, however, seem less suited to the development of rules about the contestability of markets among a much larger and less heterogeneous group of countries. Such rules will require governments to go beyond self-denying ordinances and enter into positive obligations: that is, conformity to international standards. Bargaining about norms and standards is not as easily organized on the basis of market power. In most cases, the norms are those of the major powers that insist they do not have to make significant adjustments. It is the smaller powers that will have to make the most significant concessions but without the politically helpful counterweight of gaining additional access to the markets of the large powers. While there may be clear benefits to expanding the reach of a fixed-rule international economic order, such benefits are likely to be perceived more readily in economically than in politically persuasive terms.

Complicating matters even further, the number of countries actively participating in the global economy has vastly increased. The WTO now has 134 members involved in its work. Many of these members are small countries with a high stake in a successfully functioning multilateral order but with little to offer to make it work better or to unlock stalemate. Thus, in proceeding to the next stage of global rule making, the basic rules and procedures will need to adapt to a new range of issues, and bargaining strategies will need to be upgraded to reflect the desirability of engaging all participants and concentrating on rule making rather than concession swapping. At a minimum, this new direction will require upgrading existing institutional and decision-making structures.

Considerable attention will also need to be devoted to the development of appropriate enforcement procedures. The stage has not yet been reached in international legislation at which international agreements establish rules that impinge directly on private actors. As international rule making delves deeper and deeper into issues that were traditionally considered to be within the primary jurisdiction of sovereign states, that divide may need to be crossed. For a number of these issues, for example, recourse for failure to live up to the rules set out in the agreement could be found in the domestic courts, with international litigation limited to patterns of consistent misbehaviour or failure to let domestic procedures work. Experience with the provisions of the WTO Trade-Related Intellectual Property Rights (TRIPs) agreement, which stipulates enforcement along these lines, will yield important insight into the viability of this approach. At this stage, however, most issues are likely to remain firmly within the ambit of rule making limited to the rights and obligations of governments. As such, institutional and dispute-settlement provisions will have to be sufficiently bolstered to provide all participants in the system with the confidence that the rules are being applied fairly and uniformly.

Where to Negotiate

Finally, there is the matter of where to negotiate. As governments prepare to address the extensive range of issues that are now beginning to crowd the international economic policy agenda, some attention will have to be paid to appropriate locations for some of this negotiating activity. In an ideal world, the WTO would seem the most logical place to address the full range of issues related to market contestability. It already boasts extensive institutional and enforcement machinery as well as rules governing trade and trade-related issues. WTO members together account for about 90 percent of world trade and probably an even higher level of international investment activity. Nevertheless, there appears to be a certain degree of reluctance to pursue these issues in Geneva, at least in the first instance. Some of this reluctance can be traced to the unwillingness of bureaucrats in national institutions to cede authority to international organizations; some may be due to the strains of interdepartmental rivalries in capitals. Most, however, reflects the sheer unwieldiness of trying to address such a complex agenda among so many players with such a variety of needs and goals. More experience is required among players with similar backgrounds and objectives. Given the state of the art, therefore, there remains scope for plurilateral, regional, and other less-than-universal experimentation. What is important is that at the end of the day, everyone recognizes that a global economy needs universal rules to promote efficiency and achieve sustainable economic development. Regional and other less-than-universal agreements could thus serve as precursors to more widely applied agreements.

The Current Multi-Tier Trading System

The current complex trade relations system suggests that, if not by design, then by accident, governments have created a multi-tier regime involving a multilateral set of rules as well as at least three types of regional agreements, each of them providing rights and obligations that go beyond the universal rules. Each type also comprises a degree of discrimination in favour of its members at the expense of non-members that may undermine the goals and principles of the multilateral regime. The three kinds of regional agreements include:

- the *highly integrationist EU model,* involving a high degree of internal policy harmonization or convergence, rules governing a wide range of policy measures, and the necessary institutions and procedures to enforce them. It also denotes a high degree of discrimination against non-members. Because the elaboration of its rules involves inter-state negotiations, rather than an intra-state political process, its experience provides interesting precedents for possible future inter-state rule making on a wider basis.
- the more traditional *preferential liberalization model,* largely limited to the trade policy of the past (that is, to the elimination of tariffs and other border measures for member states), comprising some discrimination against non-members, and relatively weak procedures and institutions to enforce the preferences. Such agreements are viewed by some as important vehicles for spreading liberalization, mainly to developing countries, for whom this interim step may prove politically important. The discriminatory dimension of this model may also involve disturbing aspects that may undermine achievement of a more open global economy and may, perversely, even be the best way for less competitive economies and sectors to retard liberalization.
- a new *hybrid liberalization model* represented by NAFTA, building on the preferential liberalization model and also partaking of some of the harmonization aspects of the integrationist model but lacking supranational institutions and procedures to enforce its provisions. This hybrid model involves a more limited degree of discrimination, as some of its non-traditional provisions are applied on an MFN basis. Because of the important role of the United States in the global economy and the continuing importance to it of non-NAFTA trade, NAFTA's provisions are more sensitive to the concerns of third parties and to the continued health of the multilateral trading system.

As the following hierarchy of issues suggests, some interesting synergies, both negative and positive, can now be identified as flowing from concurrent multilateral and regional approaches to the issues.

- *Tariffs and related border issues,* the focus of the first postwar regional and multilateral agreements, have been progressively eliminated with only a few residual or hard core issues remaining for the major trading countries. The techniques used to achieve this objective largely involved negative prescriptions. The complexity of modern rules of origin, however, has had the perverse effect of undoing some of the benefits of tariff-based free trade. To some producers, the transaction cost of meeting rules of origin is higher than the cost of the MFN tariff, while for others, carefully deployed rules can offset the threat posed by liberalization. In both cases, the economic benefits of liberalization are being denied. For multilateral and regional approaches to be complementary at this level, rules of origin need to be relatively more liberal than appears to be the trend. Even better, perhaps the time has come to bring the era of the tariff to an end by moving expeditiously toward tariff-free trade on a multilateral basis, obviating the need for discriminatory rules of origin.
- *Non-tariff barriers* to trade in goods have been progressively eliminated or contained within codes of conduct. Although issues remain to be tackled, the intellectual and institutional framework for doing so has been firmly established. The techniques used to achieve this objective involve both negative prescriptions as well as cooperative rule making about how other measures may be deployed. For these issues, there exists a high degree of synergy between multilateral and regional approaches, but regional commitments remain ahead of multilateral ones in such areas as government procurement and trade remedies. As a result, regionalism still involves a significant degree of discrimination that will take some time to overcome in continued multilateral negotiations. Experience gained in various regional agreements, however, has helped and may well continue to stimulate and facilitate the negotiation of multilateral rules and procedures addressing such non-tariff access barriers as public procurement restrictions.
- The new frontier, first tackled seriously in multilateral and regional agreements in the 1980s, entails *regulatory barriers* to international exchanges and covers impediments not only to the international exchange of goods, but also to exchanges of services, capital, and technology and the movement of people. The techniques used to achieve access commitments at this level of international integration often comprise positive prescriptions; that is, rules involving mutual recognition and even harmonization of policy measures. Regional agreements have provided a critically important framework for tackling these issues and are likely to continue to be at the cutting edge of consideration of regulatory barriers. Fortunately, in many instances, particularly when negotiations involve major trading partners, it is often practical to implement regional commitments on an MFN basis, thus reducing the scope for discrimination.

At the same time, because of the complexity involved and the implications for traditional concepts of sovereignty, the issues are controversial, evoke a variety of approaches, exhibit significant conflict between various regional approaches, and indicate that the negotiation of multilateral rules will be difficult and time-consuming. Recent experience suggests that it is unlikely that useful multilateral rules can be devised without the essential experience and confidence first gained through regional agreements.

- The next frontier, already evident in a range of bilateral irritants, involves *structural impediments* to further international exchanges; that is, barriers to doing cross-border business that are embedded in social, political, and cultural institutions that have developed differently in various societies in response to different social preferences. Structural impediments range from approaches to restrictive business practices to the protection of cultural industries. The intellectual and institutional frameworks for tackling such issues are fragile while the need to address them is more urgent as economic exchanges become increasingly global in scope. Some progress has been made in tackling these issues (for example, in the sectoral annexes of both the WTO and NAFTA). EU experience in encouraging policy convergence through mutual recognition rather than harmonization provides a useful guidepost for further efforts along these lines. Regional agreements, given the fact that they usually build on ties of geography, history, and culture, appear best suited to gaining experience in negotiating about such difficult and emotive issues. While the result will inevitably involve conflict and discrimination between various regions of the globe, the alternative is even less attractive: continued bilateral conflicts, sometimes resolved on an ad hoc basis, as the sheer difficulty of the issues frequently ensures prolonged multilateral stalemate.

Characteristics of Successful Regional Agreements

The development of a multi-tier trading system over the past decade has involved a large degree of synergy between regional and multilateral negotiations. It has required not only the negotiation and implementation of a series of regional agreements, but also a willingness on the part of members of those agreements to learn from their experience and apply it at the multilateral level. In effect, this multi-tier system requires well-functioning and mutually supportive agreements at both levels. Based on recent experience, it would seem that successful regional agreements capable of complementing rather than inhibiting multilateral negotiations exhibit a number of common characteristics. These include:

- *Proximity*. Successful agreements often involve geographically contiguous countries or countries within the same broad geographic area.

- *Level of integration*. They often involve countries that exhibit high levels of cross-border trade and investment, including intra-corporate transfers and inter-corporate alliances, before the negotiation of the regional agreement. In effect, the regional agreement is more likely to be the result of rather than the precursor to closer economic relations.
- *Similarity*. Successful agreements are more likely to be found among countries with similar levels of economic development, legal structures, business cultures, political institutions, and cultural values. Mexican participation in NAFTA is more the exception than the rule, and it will be interesting to see whether this experiment will work in the long run. If it does, it will require Mexico to make major adjustments. Similarly, the accession of Greece, Portugal, and Spain to the EC involved major adjustments by these countries, including in their political institutions.
- *Institutional maturity.* Partners in such an agreement are likely to boast political and economic institutions that have developed over time and are capable of adjusting to the demands of a regional agreement. Greece, Portugal, and Spain, for example, could not accede to the EC until they had developed and lived with democratic institutions.
- *Stake*. Partners in such an agreement are likely to have a high or similar stake in the success of the agreement and would face problems in the absence of an agreement.
- *Commitment*. Successful agreements involve a significant commitment by the parties to an open, rules-based relationship.
- *Power relationship*. Disparities of power – political and economic – among parties to the agreement are such that it is possible to provide for full reciprocity and equality of obligations, both de jure and de facto.
- *Economic impacts*. On the whole, successful agreements are more likely to be trade-creating than trade-diverting. While there may be some trade diversion in the early stages, the mature agreement leads to net growth in economic activity and prosperity for the members rather than to the redistribution of trade and investment patterns.
- *Dynamism*. Successful agreements grow and expand as the extent of economic integration among the parties deepens.

Since the inception of the multilateral trade and payments system some fifty years ago, about 145 regional agreements have been notified by members to GATT and now WTO.[10] Not all remain in force. Many of the early agreements faded away within a few years. Some are still on the books but have been more or less moribund for years. Others have been swallowed up in larger agreements (such as some of the European agreements involving countries that are now members of the EU). Thus the number of notified agreements tends to exaggerate the issue. What is significant is that about eighty of these agreements are still in force.

Among existing regional agreements, it is not surprising that the EU is the most extensive and integrative. Time and geography have knitted a relatively cohesive group of countries into a functional whole that shows every sign of continuing to develop along positive lines. In addition, the EU has entered into a series of preferential agreements and arrangements that involve either the continuation of former colonial ties on a non-reciprocal basis (the Lomé convention between the EU and some four score countries in Africa, the Caribbean, and Pacific) or memberships-in-waiting for contiguous states at different stages of economic and political development (for example, Central European and Mediterranean countries). The continued viability of these arrangements depends in part on the evolution of the multilateral trading system and on the early willingness of the EU to welcome new members. At this stage, these preferential arrangements enjoy a rather ambiguous existence under the WTO rules.

The Australia-New Zealand Closer Economic Relations Agreement (CER), the latest in a succession of transtasman agreements, is similarly proving successful, in part because both the commitments and the institutions to make them work were built cautiously and over a considerable period of time. The agreement's long-term viability appears fairly secure, even though its commercial significance is rather limited.

NAFTA, while it exhibits many of the characteristics of successful agreements, also has some built-in weaknesses, such as the dominance of the United States and the disparity between US and Canadian levels of development on the one hand and Mexico's on the other. Its long-term viability cannot thus be assumed. In effect, the parties to NAFTA will need to demonstrate over the next few years what direction they want to take to justify the agreement's continued existence as a deeper set of commitments than is available on a multilateral basis. Without a sustained effort to deepen its obligations, however, the multilateral regime may well catch up and make NAFTA redundant. Current American reluctance to engage in politically sensitive issues such as trade remedies and government procurement, let alone some of the newer issues such as competition and investment, suggests that such an outcome is not inconceivable.

MERCOSUR may, over time, develop sufficiently to become a permanent feature of the economies of Argentina, Brazil, Paraguay, and Uruguay. To date, progress has been encouraging. The agreement entered into force on 1 January 1995 on the basis of an ambitious set of commitments that may, however, prove more than the parties are able to live with on a permanent basis. Given the track record of earlier agreements among Latin American countries, it will take a sustained commitment on the part of MERCOSUR's member states to avoid this fate and build a true common market.

Few other agreements in Latin America, Africa, Asia, or elsewhere have either the track record or the depth of commitment to suggest that they

are likely to remain as significant, continuing departures from the multilateral norm. Most reflect the ebb and flow of political and economic fads in these countries. It is currently fashionable to be in favour of liberalization, and announcements of regional agreements among countries that exhibit very little intraregional trade give the appearance of purposeful movement without creating much of a threat to import-sensitive sectors.

Among current fads are dreams to achieve regional free trade through APEC, the Free Trade Area of the Americas, and the transatlantic dialogue. These efforts should be seen for what they are. They are less matters of reducing tariffs and eliminating non-tariff barriers along the lines of traditional free trade agreements, and more matters of technical cooperation, confidence boosting, institution building, networking, and other trade and investment facilitating and enhancing activities. Their strength lies in their capacity to accelerate, complement, and foster other, more formal, trade liberalization initiatives.

Criteria for Acceptable Regional Agreements

Against this background of the record, longevity, and sustainability of various free trade and other regional preference agreements, it may be possible to construct a set of criteria delineating which agreements should be considered compatible with a well-functioning multilateral trade and investment order and which should not. The basic criteria, of course, are those to be found in GATT Article XXIV, and its analog in the General Agreement on Trade in Services (GATS) Article V. These criteria can be briefly summarized as follows:

- The terms of access in a regional agreement must be significantly more liberal than those prevailing in the WTO agreements, either immediately or at the end of a specified period of phased implementation.
- The agreement must eliminate substantially all barriers and discrimination to trade between the parties.
- The agreement must cover substantially all trade between the parties on the basis of rules of general application rather than on the basis of sector-specific, outcome-oriented commitments.
- The terms of access for non-members must not be worse than before the agreement went into effect.

Based on experience with successful preferential or regional agreements, four additional criteria might usefully be added.

- Preferential agreements should be limited to neighbours or geographically proximate economic partners. There is already a hint to that effect

in GATT Article XXIV, Paragraph 3(a) – the right to accord advantages to adjacent countries in order to facilitate frontier traffic – but this point has never been developed.

- Preferential agreements should be limited to countries that already enjoy a high degree of economic integration based on descriptive criteria delineating what constitutes a significant level of existing trade and investment. Again, there is a hint along these lines in GATS Article V, Paragraph 2 – the relevance of a wider process of economic integration between the countries concerned – but it too needs further development. With high levels of pre-existing trade and investment, it is unlikely that the agreement would result in much trade diversion; low levels of pre-existing integration, on the other hand, suggest that trade diversion could be high.
- Preferential agreements should involve higher levels of obligation along the full range of policy measures that may affect cross-border economic transactions, including not only trade in goods and services, but also exchanges of capital and technology.
- Finally, preferential agreements should be open-ended; others should be free to join if they can meet the criteria, including the requirement of proximity and significant existing integration.

Excluded from this list are the kinds of criteria favoured by economists but that are virtually impossible to demonstrate to a satisfactory degree to a panel charged with the task of examining such an agreement.[11] Some economists, for example, have argued that the parties to a preferential agreement must be prepared to demonstrate that the agreement is trade-creating rather than trade-diverting, a task that would defeat most economists on other than a theoretical basis. In effect, GATT Article XXIV, Paragraph 4, already suggests that members must determine whether the agreement will facilitate trade among the members without raising barriers to the trade of non-members. Informed officials have proven that they can make a shrewd commercial policy judgment along these lines; they would be hard pressed to do anything more.

There is one further rule that may make sense but is difficult to implement. For the new frontiers of rule making, involving, for example, rules about mutual recognition or the adoption of common norms, it would be desirable to apply such rules on an MFN basis. Regional rules that go beyond global rules governing product standards, government procurement procedures, or foreign direct investment, for example, should not so much discriminate as set a higher standard. In many instances, it does not make much sense for a government to maintain two separate sets of regulations. In other instances, there may be concerns about free riders. In

such cases, there is a strong presumption that the issue should be pursued multilaterally as quickly as possible.

At a general level, the EU would meet these criteria, as would CER; MERCOSUR would probably pass muster, although there are some problems, such as low levels of existing trade and investment; many of the earlier Latin American agreements, such as the Andean Pact and CACM, would not. NAFTA would be more problematic, as would the EU network of dependency agreements. NAFTA would not meet the test of covering substantially all trade (agriculture is not fully covered) or of eliminating substantially all barriers (for example, antidumping duties), and some of its rules of origin have the effect of raising barriers to third-country trade (for example, for automotive products and textiles and clothing). Improvements along these lines would be needed to bring NAFTA into full conformity. Mexico's FTAs with Chile and others would probably not meet the criteria nor would Israel's network of FTAs with the EU, the United States, and Canada. Neither the Canada-Chile agreement nor the accession of Chile to NAFTA would meet the criteria; Chile is too remote and its trade and investment with North America is too insignificant. AFTA and a possible free trade agreement among the members of SAARC would have difficulty meeting all of these tests; at the same time, they would probably be approved by a WTO panel because of their potential contribution to helping member countries open their economies and embed liberalizing rules within their domestic economies. Similarly, it is questionable whether FTAA, a free trade area for Asia Pacific, or a transatlantic agreement would qualify, but WTO members accept the value of these initiatives in building confidence, sharing information, and facilitating future trade and investment. None is likely to develop into a true regional integration agreement.

In effect, the WTO provides as much and more than could be accomplished through the vehicle of regional agreements as geographically wide in scope as the Western Hemisphere, around the Pacific or across the Atlantic. With the exception of a few issues, the multilateral regime currently encompasses as much as could be expected at this stage on anything but a geographically proximate regional basis. If there is scope for more liberalization and rule making at such a broad level, the WTO is the appropriate forum to pursue it.

By establishing a tougher set of criteria and applying them, it will be possible to delineate clearly the contours and limits of the multi-tier trading system. Such a system will strengthen the bias in favour of multilateralism and at the same time allow useful and positive experimentation with rule making in new areas at the regional level. It will provide a practical and realistic differentiation between what should properly be the focus for multilateral discussions and what can still only be done at the regional level.

Conclusions

In developing his theory of countervailing power, Galbraith observed that as the locus of control over economic activity grew from local and regional actors to national actors, the power of the national government grew commensurately so that governments could continue to exercise democratic control over the operation of the market. An equivalent step in the evolution of the economy from the national to the global level has yet to take place in the governance of the global economy. The logic of Galbraith's observation, however, suggests that as economic activity globalizes, so should governance of that activity. Ironically, Galbraith is likely to be among the last economists to find this an attractive proposition.

The stage has now been reached where we can properly speak of a multi-tier trading system. The WTO represents a far-reaching and widely applied universal code of conduct conditioning a broad range of transnational transactions as well as creating a more uniform approach to an increasing array of domestic economic regulations and policies. Additionally, a number of regional experiments are simultaneously expanding liberalization and deepening integration, ranging from rules attuned to the deep integration of the EU to the shallow integration of the NAFTA and other newer arrangements. Within this context, it is unlikely that three competing regional trading blocs will develop. Instead, three trading areas may emerge within which trade and investment, and the rules governing such intraregional transactions, may become more intense and integrative than interregional trade and investment. Interregional trade and investment will continue to grow, however, while the rules to govern such transactions will also continue to evolve.

At the same time, there will be continuous efforts to widen the circle of liberalization. To the extent possible, such efforts should be pursued multilaterally, or, if not, at least the results should be made available on an MFN basis. Efforts to effect liberalization on a regional basis – within the Americas, across the Atlantic, or across the Pacific, are unlikely to be as integrative and demanding as the EU or NAFTA and should be pursued as politically attractive ways to build momentum for multilateral tariff-free trade.

These various elements of the multi-tier trading system should be seen as building blocks for an eventual multilateral or universal set of rules. Their differential evolution reflects the exigencies of political reality as well as the degree of existing economic integration. As the OECD notes, "From a purely trade perspective, global free trade without regional preferences might be considered the optimum situation. But in the real world, this would hold only if trade liberalization and integration could be achieved at the multilateral level with the same scope and coverage attainable at the regional level. This is hardly conceivable in the foreseeable

future, be it only because of the extreme diversity of partners."[12] In consequence, and based on recent experience, properly conceived regional and multilateral negotiations can be pursued as complementary rather than conflicting approaches to commonly held goals.

Notes

1 See OECD, *Regional Integration and the Multilateral Trading System* (Paris: OECD, 1995), 22.

2 Virtually all statistical studies indicate the extent to which there has *not* been a significant regionalization of the world economy. While there has been some intensification of trade ties in Europe and to a lesser extent in North America, trade among all regions of the globe has continued to grow. In short, regional agreements appear to have reinforced rather than altered patterns of trade dictated by historical, geographical, and institutional factors. See Kym Anderson and Hege Norheim, "History, Geography and Regional Economic Integration," and T.N. Srnivasan, John Whalley, and Ian Wooton, "Measuring the Effects of Regionalism on Trade and Welfare," in *Regional Integration and the Global Trading System,* eds. Kym Anderson and Richard Blackhurst (New York: Harvester Wheatsheaf, 1993); and OECD, *Regional Integration,* 55-65.

3 For an analysis of the Uruguay Round negotiations, see Fen Hampson with Michael Hart, *Multilateral Negotiations: Lessons from Arms Control, Trade and the Environment* (Baltimore: Johns Hopkins University Press, 1995), chaps. 7 and 8.

4 OECD, *Regional Integration,* 90.

5 Many analysts are disturbed by the contradiction of regional agreements within a multilateral system built around the principle of non-discrimination. For example, Sylvia Ostry in *The Post-Cold War Trading System* (Chicago: University of Chicago Press, 1997), 205, expresses the concern of many that "there is a real danger that regionalism will undermine, not energize, the global rules-based system." Robert Z. Lawrence, "Regionalism and the WTO: Should the Rules Be Changed?" in *The World Trading System: Challenges Ahead,* ed. Jeffrey J. Schott (Washington: Institute for International Economics, 1996), 43, on the other hand, takes a more benign view, concluding that "on balance these agreements are positive developments. They do pose problems for the multilateral system, but these are more subtle than the cataclysmic results some would predict. The devil lies in the details of these agreements, which could undermine multilateral liberalization that has already occurred or make further progress more difficult to achieve." This chapter takes the Lawrence side of the debate. Governments have and will continue to negotiate such agreements; the task of the analyst is to consider whether they are helpful and how best to maintain balance between multilateral ideals and regional realities.

6 See Carlotta Perez and Christopher Freeman, "Structural Crises of Adjustment: Business Cycles and Investment Behaviour," in *Technical Change and Economic Theory,* eds. Luc Soete et al. (London: Pinter, 1988).

7 As noted in an OECD paper: "A market could be defined as internationally contestable when the conditions of competition prevailing in that market allow for unimpaired market access for foreign goods, services, ideas, investments and business people, so that they are able to benefit from opportunities to compete in that market on equal or comparable terms to those enjoyed by local competitors." TD/TC/WP(95)55, 5. For a fuller discussion of concepts related to the contestability of markets, see the chapters by Sylvia Ostry and Patrick Low in OECD, *New Dimensions of Market Access in a Globalising World Economy* (Paris: OECD, 1995).

8 Galbraith first posited his thesis of countervailing power in *American Capitalism: The Concept of Countervailing Power* (Boston: Houghton Mifflin, 1952) and then developed it in considerable detail in the trilogy *The Affluent Society, The New Industrial State,* and *Economics and the Public Purpose* (Boston: Houghton Mifflin, 1958, 1967, and 1973). It is not necessary to accept the full force of Galbraith's view of American capitalism to see the insight offered by his concept of the evolution of countervailing power.

9 Edward M. Graham, "Competition Policy and the New Trade Agenda," in OECD, *New Dimensions of Market Access in a Globalising World Economy,* 105.
10 See WTO, *Guide to GATT Law and Practice* (Geneva: WTO, 1996), Article XXIV.
11 For a critical examination of some of these proposals, see Lawrence, "Regionalism and the WTO: Should the Rules Be Changed?"
12 OECD, *Regional Integration,* 89.