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The World Trading System at the Crossroads

Multilateral Trade Negotiations in the Era of Regionalism

by Peter Nunnenkamp

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CONTENTS

- The multilateral trade negotiations in the Uruguay Round have stagnated for years. At the same time, the world economy has witnessed a strong revival of regional trade arrangements. This juxtaposition suggests that major trading partners are drifting away from the GATT.
- Systemic weaknesses in the GATT framework, particularly the lack of effective sanction mechanisms, and the overly ambitious agenda of the Uruguay Round have rendered it difficult to reach a multilateral trade accord. In the EC, the Internal Market programme has been given priority over the GATT negotiations. And the recent move by the United States towards regionalism also threatens to undermine the basis upon which multilateralism could rest in the future.
- The future of the world trading system depends critically on whether the trading partners realise that regionalism cannot be defeated successfully by forming countervailing protectionist blocs. To prevent a further erosion of the fundamental GATT principle of most-favoured-nation treatment, sweeping decisions are required in three respects:
 - In concluding the Uruguay Round, swiftness is more important than completeness. An immediate agreement should comprise all tentative achievements reached so far.
 - Trade disputes left open for the time being and new challenges such as ecologically motivated trade barriers should be tackled in follow-up negotiations to be started immediately after conclusion of the Uruguay Round.
 - The EC and the United States should commit themselves to open regionalism by relaxing restrictive accession procedures. Moreover, GATT obligations must be extended by a provision stipulating that third countries whose trade is negatively affected by regional integration schemes will be compensated.
- The responsibility to establish the conditions under which regional integration and multilateral trade liberalisation could reinforce each other rests with the world's leading trading partners. Open regionalism in a strong multilateral framework would not only break the vicious circle that is eroding the world trading system, but may even induce a virtuous circle of mutual trade liberalisation between regional groupings.

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I. Introduction

Recent trends in trade policies provide a startling picture. It has become more and more widely accepted that liberalising foreign trade is a powerful means to achieve an efficient allocation of scarce resources and, thereby, foster economic development. Since the start of the Uruguay Round of the GATT in 1986, dozens of developing countries throughout the world have removed trade barriers unilaterally [GATT, a]. However, this move has not prevented the persistent stalemate in international trade negotiations under the auspices of the GATT. The era of multilateralism appears to have come to an end. At the same time, we have witnessed a strong revival of regional trade arrangements. Partly as a response to integration widening and integration deepening in Europe, the United States concluded the North American Free Trade Association (NAFTA) with Canada and Mexico, and have launched the Enterprise for the Americas Initiative. New attempts at institutionalised regional integration gained momentum in the Asian-Pacific region as well, the most prominent example being the Malaysian initiative to form an East Asian Economic Caucus (EAEC).

In all probability, the pendulum will swing further towards bilateralism and regionalism if GATT talks in the Uruguay Round will not be concluded successfully in the near future. The formation of trading blocs would seriously interfere with an efficient division of labour at a worldwide scale, if closer integration among partners were only achieved by erecting higher trade barriers against outsiders. The ensuing welfare losses would be particularly high for those developing countries that are not invited to participate in any of the major integration schemes in Europe and the Western Hemisphere. Latin America may develop closer links with the United States, and Africa may continue to rely on preferential trade arrangements with the EC. It is mainly the world-market-oriented economies in Asia which have to fear most from major trading partners drifting away from GATT principles.

As stated by the Director General of the GATT, Arthur Dunkel, "the keys to a final conclusion (of the Uruguay Round) are held in a very few hands" [quoted in the Financial Times, 28 August 1992]. Regrettably, these hands are not those of the actors with a particularly keen interest in preventing a further erosion of multilateralism, i.e. the Asian countries. The future of the world trading system rather depends on those countries which are the driving forces of regionalism today, i.e. the EC and the United States. Hence, the role of the EC and the United States figures prominently in the subsequent discussion of international trade negotiations.

The remainder of the paper is structured as follows. The next section confronts the ambitious working programme at the start of the Uruguay Round with the modest achievements reached so far. The discussion will show that the major responsibility for the persistent impasse rests with the EC and the United States, i.e. the negotiation parties which initiated the new round of GATT negotiations in the mid-1980s. Section III analyses the reasons for the

This paper is part of a research project on "The Evolution and Perspectives of the Social Market Economy". Financial support by the Bertelsmann Stiftung is gratefully acknowledged. Thanks are due to Erich Gundlach, Ulrich Hiemenz, Rolf J. Langhammer, and Hubertus Müller-Groeling for critical comments and helpful suggestions on an earlier version of this paper.

serious delay in reaching a final agreement. It is argued that the Uruguay agenda was overloaded with too many issues, while major stumbling blocks to further trade liberalisation received insufficient attention in the early phases of the negotiations. This refers to the conflicts with regard to agriculture in the first place. Based on a critical assessment of the behaviour of major actors, the chances for a liberal world trading system are evaluated (Section IV). The focus is on the possible conflict between multilateralism and regionalism. Possible ways to reconcile both concepts are discussed in Section V. Section VI summarises and provides some clues on new challenges which the world trading system is going to face in the future.

II. The Uruguay Round: Persistent Struggles over an (Over-) Ambitious Agenda

Previous GATT negotiations on multilateral trade liberalisation, e.g. the Tokyo Round of 1973–1979, had focused on tariff reductions for manufactured goods plus a limited number of specific issues such as liberalising trade in tropical goods. By these standards, the agenda of the Uruguay Round was much more comprehensive and represented “the most complex and ambitious programme of negotiations ever undertaken by GATT” [GATT, 1986, p. 1]. The subsequent topics figured prominently on the agenda [Hauser, 1991; Langhammer, 1991, pp. 3 f.; Schultz, Weise, 1992]:

- The transparency of non-tariff barriers (NTBs) was to be improved. Open questions and ambiguities inherited from the preceding Tokyo Round were to be clarified.
- Sectors considered to be sensitive, particularly textiles and clothing as well as agriculture, were to be reintegrated into the GATT and subjected to the principles of non-discrimination and obligatory liberalisation.
- Safeguard clauses, emergency provisions, countervailing measures, and anti-dumping procedures were to be defined more rigorously to prevent an abuse of these instruments.
- New areas were to be subjected to GATT rules. This applied to trade in services, trade-related investment measures (TRIMs) such as local-content requirements, and trade-related intellectual property rights (TRIPs) such as patents and copyrights.
- Dispute settlement in the case of an alleged breach of GATT rules was to become more efficient and binding. An improved monitoring of the contracting parties’ trade policies was to be established.

All in all, it was attempted in the Uruguay Round to stop the trend of exceptions to the validity of GATT principles becoming the rule and to extend GATT discipline to new trade issues. In many respects, however, vaulting ambitions were frustrated during the negotiations. Tentative agreements were reached mainly in areas where producer interests in importing countries were not affected significantly. This applied to the further liberalisation of trade in tropical products, for example.¹ Other negotiating groups focused their attention on defini-

¹ However, product coverage was defined in an arbitrary fashion. For example, sugar and bananas were not considered to fall into the category of tropical products.

tions and classification issues. In this way, conflicts between trading partners were camouflaged for some time, e.g. with respect to services. From the beginning, negotiations proved to be protracted in sensitive areas such as agriculture, textiles and clothing, TRIMs, and TRIPs. Similarly, the application of safeguard clauses in the case of a sudden import surge (Art. XIX GATT) and of trade restrictions by developing countries for balance-of-payments purposes (Art. XVIII: B GATT) remained heavily disputed. Not surprisingly, the progress in trade negotiations achieved until the scheduled conclusion of the Uruguay Round by end-1990 was inversely related to the producer interests and adjustment needs in importing countries.

The failure to reach an agreement at the GATT Council of Ministers in Brussels in December 1990 was mainly because the EC refused to liberalise substantially its highly interventionist Common Agricultural Policy (CAP). According to OECD calculations, the absolute amount of transfers granted to agricultural producers was by far the highest in the EC (Table 1).² Furthermore, agricultural protection in the EC was mainly achieved through administered food prices, i.e. extremely distortionary instruments. Consumers contributed nearly 60 per cent to the transfers to agriculture. This share was even higher for Japan and some EFTA countries, but significantly lower for the United States (37 per cent).

Table 1 — Transfers to Agriculture in Selected Industrialised Countries, 1991

	Total	Per capita		
		total	taxpayers' contribution	consumers' contribution ^a
	US\$ billion	US\$		
Australia	1.2	70	41	29
EC	142.0	409	168	241
Finland	5.9	1137	460	677
Japan	63.2	510	16	494
Sweden	3.6	416	100	316
United States	81.0	318	200	118

^aBy paying high administered food prices.

Source: The Economist [1992] on the basis of OECD calculations.

The concessions offered by the EC with regard to agriculture were considered insufficient by the United States and the Cairns Group of 14 agricultural exporters (among them are: Argentina, Australia, Brazil, Canada, Hungary, Indonesia, Malaysia, the Philippines, and Thailand). The proposed reduction of internal support for agricultural producers in the EC and the alleviation of market access for external competitors through a reduction of trade barriers remained significantly behind the respective demands of the EC's trading partners. Furthermore, the EC declined to make any binding commitment to reduce export subsidies. The re-

² In per capita terms, EC transfers to agriculture ranked between Australia, paying hardly any subsidies, and Finland, which represented the most extreme case among the highly protectionist EFTA countries.

jection by the EC, as well as by Japan and South Korea, of a last minute compromise proposal by Sweden, i.e. another country with high protection in agriculture (Table 1), triggered a temporary breakdown of GATT negotiations. All tentative agreements achieved so far in other areas were placed at everybody's disposal again, since the United States and the Cairns Group had made their approval contingent on the resolution of the conflict in agriculture.

Agriculture has remained the pivotal point since the GATT negotiations were resumed in 1991. However, EC-US conflicts prevailed throughout the Uruguay Round in other important respects as well [Langhammer, 1991, pp. 13 ff.]. A long-standing controversy relates to unilateral tariff concessions granted to developing countries outside the GATT negotiations. The EC considers the preferences to be a major instrument of its aid policies. The breach of the principle of non-discrimination has proved to be a two-edged sword for the perceived beneficiaries, however, since preference margins are eroded by restrictive rules-of-origin requirements of the EC. The attempt by the United States to subject unilateral trade preferences to GATT rules (i.e., regarding them as a waiver) was frustrated by the Enabling Clause through which the preferential treatment of developing countries had been incorporated into the GATT framework during the Tokyo Round.

Both the EC and the United States argued that a transition period of at least 10 years would be required to phase out the Multifibre Agreement (MFA) and to reintegrate textile trade into the GATT. Developing and newly industrialising countries pressed for a significantly shorter transition period. Apart from timing, the liberalisation of trade in textiles and clothing was hindered by the EC's inclination to discrimination and selectivity. The Community insisted on MFA quota extension to be based on the existing bilateral agreements. By contrast, the United States proposed to gradually replace country-specific quotas by a global quota and to allow all textile suppliers to compete for an expanding overall import volume. Similarly, the EC remained rather isolated in its request to apply the safeguard clause of Art. XIX GATT selectively against trading partners which are held responsible for an exceptional import surge.

Another unresolved issue inherited from previous GATT negotiations concerned subsidies. Again, the struggle on which subsidies are GATT inconsistent was mainly between the EC and the United States. The United States strived for a general ban on producer subsidies and insisted on imposing countervailing duties in the case of export subsidies. The EC tolerates export subsidies and those internal subsidies which do not adversely affect external trade. As the trade effects of internal subsidies are difficult to evaluate in quantitative terms, any agreement along the lines suggested by the EC would face serious enforcement problems.

Finally, EC-US disputes hindered the liberalisation of trade in services. Here, it is the United States which are reluctant to acknowledge the most-favoured-nation (MFN) principle for important services, notwithstanding that the US government was the driving force to place the liberalisation of trade in services high on the agenda of the Uruguay Round. Exemptions from MFN treatment are sought for air and maritime transport, financial services, and telecommunications [Commonwealth Secretariat, 1992, No. 45, pp. 13 f.]. Access to service markets in the United States is made conditional on reciprocal concessions by the respective trading partner. Controversies with the EC are focused on telecommunications and audio-visual services. The United States feel discriminated against EC suppliers and complain about the dominance of public monopolies in EC service markets.

Similar to major industrialised countries, developing and newly industrialising countries asked for trade liberalisation in those service subsectors where they possess comparative advantages such as in construction services. They also pressed for a free movement of labour. On the other hand, they strongly resist free market access to their highly protected markets for financial services as long as domestic banks and insurance and securities companies cannot withstand fiercer competition from abroad. A similar discrepancy is to be observed as concerns the reaction of developing countries to the attempted extension of the GATT framework to TRIPs and TRIMs. In the case of TRIPs, they forcefully argued in favour of free trade and opposed an extensive interpretation of intellectual property rights, which they consider to be a powerful protectionist means at the disposal of industrialised countries. By contrast, an agreement on TRIMs was resisted by developing countries because they want to maintain the option to interfere with the sourcing and marketing decisions of private investors.³

More generally, developing countries (including the newly industrialising economies (NIEs)) insisted on preferential treatment in almost all negotiation groups during the Uruguay Round by referring to the above mentioned Enabling Clause. They have thus helped the further erosion of the principle of non-discrimination. The majority of developing countries is not prepared to subject themselves to greater discipline with regard to import restrictions for balance-of-payments purposes (Art. XVIII: B GATT). On the other hand, the world-market-oriented economies among them demand greater discipline of the EC and the United States in applying anti-dumping procedures, a request which they share with Japan. The permanent threat of dumping allegations also undermines structural reform programmes of those developing countries which had traditionally been rather inward-looking.⁴ A further disincentive to internal reform efforts is the resistance of industrialised countries to take into account unilateral import liberalisation by developing countries when it comes to the balancing of trade concessions made during the Uruguay Round.

III. Causes for the Persistent Impasse

Little progress has been made in resolving the above mentioned trade conflicts since the failure to reach an agreement in December 1990. Several attempts at a "political breakthrough" foundered on the discord between major actors [Schultz, Weise, 1992, p. 656]. The so-called Dunkel Paper fared alike. In December 1991, the chairman of the Trade Negotiations Committee (TNC) presented a consolidated package of tentative agreements in the form of a draft Final Act.⁵ This move did not prevent 1992 from becoming another lost year as to the conclusion of the Uruguay Round.

³ On TRIMs, see also Balasubramanyam [1991].

⁴ The threat of anti-dumping allegations is present, although trade policy reforms by developing countries aimed at removing the previous disincentives to exports relative to the production for the domestic market, rather than being targeted towards outright export subsidisation.

⁵ For a summary of this 440 pages document, see Commonwealth Secretariat [1992, No. 44].

The difficulties in concluding the Uruguay Round are partly due to the systemic weaknesses of the GATT framework.⁶ The MFN principle has been seriously eroded by granting preferential treatment especially to developing countries, whereby the issue of trade liberalisation was intermingled with distributional concerns. Important sectors such as agriculture and textiles and clothing were exempted from GATT discipline. Contracting parties were ingenious in applying new protectionist measures such as so-called voluntary export restraints, which are not covered by GATT rules. In addition, the private sector was encouraged to manage trade by means of industry-to-industry arrangements. Affected countries find it difficult to provide conclusive evidence on the injury caused by violations of GATT rules, since the counterfactual is typically open to debate. Finally, the enforcement of GATT rules suffers from a serious lack of effective sanction mechanisms.

Institutional shortcomings have characterised the GATT from its very beginning. They are no sufficient explanation for the particularly serious problems in concluding the Uruguay Round. Hence, an additional argument relates to the differences between the Uruguay Round and earlier GATT negotiations. The most striking difference is the lengthy "shopping list" of trade issues on the Uruguay agenda, while previous rounds were more targeted on specific issues of topical interest. The overly ambitious agenda contributed to the maximisation of conflicts among negotiating parties and rendered the balancing of trade concessions extremely difficult. As a consequence, the multilateral trade negotiations have been largely replaced by continuing bilateral struggles over specific issues, among which the EC-US dispute on agriculture is only the most widely publicised one.

In contrast to earlier expectations, the 1992 reform of the CAP did not provide a sufficiently strong impetus for a quick resolution of trade conflicts in agriculture.⁷ In May 1992, a drastic reduction of internal support prices was agreed among EC member countries for the first time in the history of the CAP (minus 30 per cent within three years for grain, minus 15 per cent for beef). However, price-related support arrangements were maintained for other agricultural products, and compensatory transfer payments to prevent income losses of grain and beef producers were not decoupled from production. The reform of the cereals market, though an important step in the right direction, was identical to the acreage-based support scheme of the EC for oilseeds, which a GATT panel had judged twice to be non-conforming with GATT rules upon request of the United States. Accordingly, the new acreage-based transfer payments do not fall into the production-neutral "green box", as defined in the GATT negotiations, but rather into the "yellow box" of subsidies to be eliminated over time.

Conflicts in agriculture continued even after protracted EC-US negotiations had resulted in a compromise on oilseeds in November 1992 [Frankfurter Allgemeine Zeitung, 27 November 1992]. The EC agreed to restrict the oilseed acreage to 5.1 million hectares and to reduce the volume of production dumped on to the world market on a product-by-product basis by 21 per cent within six years. Hopes for a speedy GATT accord, lifted by this compromise, faded again when France objected to the terms of the settlement and threatened to veto it when it comes before the EC Council of Ministers for a vote.

⁶ For an overview on GATT inherent shortcomings, see Hauser [1991].

⁷ For details of the reform, see Koester and von Cramon-Taubadel [1992].

Further delay in concluding the Uruguay Round may lie ahead, even though it might be expected that Japan and South Korea will finally open their rice markets in view of their strong dependence on a liberal world trading system. Notwithstanding repeated warnings to propose as few changes as possible to the draft Final Act of December 1991, there is still the risk that the package will be unravelled. The United States insist on bilateral sanctions if the proposed anti-dumping rules do not ensure "fair trade". Furthermore, the US government has challenged the creation of the proposed Multilateral Trade Organisation, i.e. the umbrella institution that might supersede the GATT. It is feared that such an institution will not restrict its activities to administering contractual obligations within the GATT framework, but may compromise US sovereignty by interfering with US trade policies. Amendments to the draft Final Act sought by the United States may induce other countries to follow suit in picking specific agreements to their liking, rather than signing the package as a whole. As argued before, this tendency is most pronounced with regard to the liberalisation of trade in services, upon which tough bilateral bargaining is likely to continue.

Bilateral struggles over various trade issues might have been contained if the Uruguay agenda had been targeted on some critical developments which threatened to undermine a liberal world trading system. This refers to the mushrooming discrimination among trading partners in the first place, by which the fundamental GATT principle of MFN treatment is increasingly eroded. The EC has been a driving force in this respect. Multilateralism has never taken precedence over regionalism in the EC's external trade policies. Since recently, it has become even more difficult to strengthen multilateralism by reversing the trend towards discriminatory trade practices. Arguably, the move towards regionalism by the United States in the early 1990s has removed another pillar on which multilateralism might rest.

All in all, it appears that those who initiated the Uruguay Round in 1986, i.e. the EC and the United States, block it today, while those who resisted it then, mainly the developing countries, today want it to succeed without further delay [de Pury, 1992; Davenport, 1992]. This suggests that a closer look into the underlying motivations of the major actors in the Uruguay Round may further help to explain the difficulties in achieving a multilateral trade accord. The trade policy stance of the EC and the United States is not only important for explaining the persistent impasse of the Uruguay Round. It will also have a dominant impact on the future shape of the world trading system.

IV. The Critical Actors: The EC and the United States

As concerns the EC, the Uruguay Round has vied for attention with integration deepening and integration widening within Europe.⁸ The opening of GATT negotiations in 1986 coincided with the start of the EC's Internal Market programme. For quite some time, multilateral trade issues have taken second place behind the 1992 project. There is reason to assume that the EC did not have a strategy for the GATT negotiations but reacted defensively to US attacks on the CAP [Pelkmans, Murphy, 1991]. The mandate of the EC Commission was restricted by

⁸ For details, see Gundlach et al. [1993].

diverging interests among member countries, which are the contracting parties to the GATT. An efficient mechanism for internal arbitration is largely lacking.⁹ Consensus building among EC members is time consuming, and more often than once EC proposals merely represented a careful balancing of country-specific benefits and costs rather than true support of a multilateral trading system.

The EC's mandate in GATT negotiations was further restricted by the attempt to protect the privileged trading position of associated countries, particularly the former colonies in the ACP group. In pursuit of its own broad interpretation of Art. XXIV GATT, which provides a waiver for deviations from MFN treatment for regional trade agreements, the EC maintains a multilayer system of trade preferences vis-à-vis third countries on a reciprocal or unilateral basis (Figure 1). Preferences are granted in the context of free trade agreements (e.g. with EFTA countries), through a wide range of association and cooperation agreements (including the Lomé Convention) and by the Community's GSP scheme. Even before the collapse of socialism in Eastern Europe, the bulk of external EC imports originated from countries participating in some form of preferential trade scheme [GATT, 1991, p. 7].

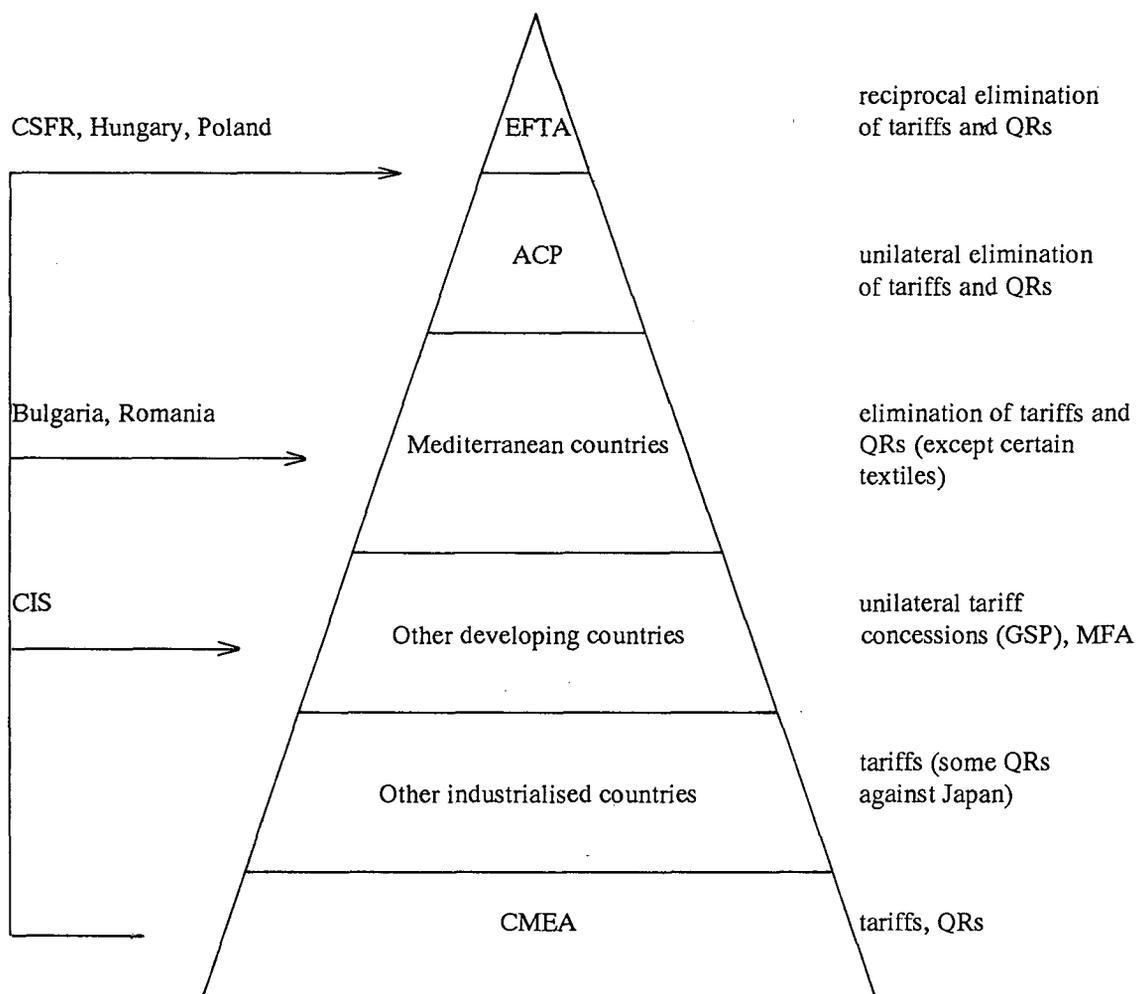
Recently, the discriminatory stance of EC trade policy has gained further momentum. Integration widening has been initiated in several respects:

- An EC–EFTA agreement envisages the formation of a European Economic Space, whereby earlier free trade arrangements will be extended to the free mobility of capital and labour.
- Several EFTA countries applied for full EC membership.
- The so-called Europe Agreements which the EC concluded with the former Czechoslovakia, Hungary and Poland in 1991 promoted these countries from the bottom to close the top of the pyramid of trade preferences (Figure 1). The ultimate objective is full EC membership. Though more limited in scope, trade concessions were offered to other post-socialist countries as well.

While EC trade policies towards European neighbours were liberalised significantly, high barriers against non-European exports are basically unchanged. Initial concerns that, in the course of European integration, the EC would turn more and more inward-looking have been overly pessimistic: "There is little evidence of any recent major intensification of protective measures on the part of the EC" [GATT, 1991, p. 20; see also Pelkmans, 1992]. However, discrimination and selectivity remain typical features of EC trade policy with regard to non-European competitors. First, this is because of the traditionally large differences in protection levels across sectors.¹⁰ Exporters of agricultural products, textiles and clothing, coal and steel, as well as automobiles are hit particularly hard. Second, the preferred protectionist instruments such as "voluntary" export restraints and anti-dumping procedures clearly reflect the EC's bias towards bilateralism, selectivity and discretion. Japan and NIEs in Asia were the principal targets.

⁹ In contrast to all other areas of common EC policy, an annual progress report does not exist with regard to trade policy.

¹⁰ For empirical evidence, see GATT [1991] and Hiemenz et al. [1990].

Figure 1 — The Pyramid of EC Preferences for Trade in Manufactures^a

^aThe following abbreviations are used: ACP: group of African, Caribbean and Pacific countries under the Lomé Convention; CIS: Commonwealth of Independent States, i.e. the former USSR republics; CMEA: the (former) Council of Mutual Economic Assistance; CSFR: the (former) Czechoslovakia; GSP: generalised system of preferences; MFA: Multifibre Agreement; QRs: quantitative trade restrictions.

Source: Gundlach et al. [1993, p. 18].

MFN treatment by the EC is effectively restricted to the United States [Davenport, 1990, p. 183]. It has been estimated that only 25 per cent of the EC's total trade was conducted on a MFN basis, as compared to almost 90 per cent of US trade [Sideri, 1990, p. 29]. Hence, it is hardly surprising that the EC took long to overcome its defensive attitude in the Uruguay Round negotiations. That the EC has recently become a more constructive partner, for example, with respect to the much disputed rules for trade in services, seems to have been contingent on the progress made in completing the Internal Market [see also Gundlach et al., 1993].

Internal liberalisation gave the EC greater negotiation leverage and expertise in areas such as services, public procurement and technical standards. Likewise, the EC had to find an internal consensus in favour of a reform of the CAP before the deadlock of multilateral negotiations on agriculture could be broken. With European integration proceeding, the readiness of the EC to contribute to a settlement of remaining disputes in the Uruguay Round has increased. This seems to indicate that regional integration and a liberal world trading system are not strictly antagonistic but may be reconciled, an issue to which I will return in the subsequent section [see also Bhagwati, 1991b].

The higher political priority which the EC attached to the resolution of multilateral trade conflicts is a necessary but not a sufficient condition to finally conclude the Uruguay Round. This is mainly because multilateralism lost ground in the United States, where it had relatively solid foundations until recently. The tendency to focus on domestic economic concerns, to establish a free trade area in the Western Hemisphere as a countervailing force to European integration, and to tackle trade disputes bilaterally is likely to gain further momentum under the new US administration.

New uncertainties with regard to the outcome of multilateral trade negotiations relate to the prolongation of the fast-track mandate in the first place. At the beginning of March 1993, the authority of the President expires to submit a GATT deal to Congress for approval as a package, precluding Congress from dissecting an accord point by point and demanding amendments. While President Clinton has announced to ask for the prolongation of the fast-track mandate, it is still open whether Congress will agree [Frankfurter Allgemeine Zeitung, 15 February 1993]. Trade unions, a number of industries and environmentalists oppose the prolongation. There is an increasing inclination to unravel the draft Final Act of December 1991 and to renegotiate tentative agreements relating to market access, services, TRIPs, and textiles.

More generally, there is a mounting pressure by interest groups to protect US industries facing adjustment problems and to react more swiftly to alleged dumping of foreign trade partners. First moves in this direction are countervailing duties imposed on steel exports of 19 countries and the threat of retaliation against restrictive public procurement practices of the EC [Frankfurter Allgemeine Zeitung, 5 February 1993]. Further protectionist requests have been filed by the automobile, oil and semi-conductor industries. The attempted revival of the GATT inconsistent "Super 301" legislation fits into this picture. According to Section 301 of US trade law, the administration may impose sanctions unilaterally against countries which impede the access of US companies to their markets [Hauser, 1991, p. 11]. Bilateral trade deficits are considered to be a criterion for unfair market access, which clearly contradicts the multilateral GATT framework. Japan is the major target of Section 301 legislation. In February 1993, a bill was prepared which requires Japan to reduce its trade surplus with the United States by 20 per cent per annum [Frankfurter Allgemeine Zeitung, 5 February 1993]. The experience of the late 1980s shows, however, that the threat of trade sanctions may induce a number of other countries, including Asian NIEs, to grant unilateral concessions in order to escape an identification under Section 301 [Hiemenz, 1991].

All in all, US trade policy appears to aim increasingly at short-term job security. The longer-term vision of revitalising the domestic economy through competitive pressures resulting from an open trading environment seems to be at the retreat. The new US administration runs the danger of invalidating the earlier GATT initiatives launched by the previous admin-

istration because bilateral arrangements raise suspicion among other negotiating parties about the true US intentions [Hiemenz, 1991]. In other words, the United States risk the success of the Uruguay Round which, in turn, is of utmost importance to prevent the fortification of trading blocs. The future of the world trading system depends critically on whether the US administration realises that regionalism cannot be defeated by regionalism [see also Nunnenkamp, 1992]. Furthermore, both the United States and the EC must ensure that regional integration is not at the expense of third parties.

V. Liberal Trade between Integrated Regions: A Proposal

The above discussion provided first clues on the ambiguous relation between regional integration and multilateral trade liberalisation. On the one hand, successful integration at the regional level may eventually help the resolution of trade conflicts with third parties.¹¹ On the other hand, the formation of regional blocs to counteract regionalism elsewhere may further undermine multilateralism. From an economic viewpoint, it would be unreasonable for the world's leading trading nations, including the EC and the United States, to consider regional integration as a substitute for an open multilateral trading system. US trade with its immediate neighbour Canada accounted for about 20 per cent of total US trade in 1990 (Table 2). The share of intra-regional US exports was only slightly above one third if the region is defined as encompassing the whole American continent. Intra-regional trade is much more advanced in the EC. Intra-EC trade increased to about 60 per cent of total EC trade for both exports and imports in 1990. However, EC exports to non-European destinations remained significant (28.8 per cent). The share of non-European trade partners in total EC imports was of a similar size, although it declined more rapidly during the 1980s. Preserving external competition is of utmost importance for encouraging economic adjustment and restructuring as well as constraining monopoly power at the regional level [see also Jacquemin, Sapir, 1991]. Hence, it is not only in the interest of outsiders but also in the longer term self-interest of member countries that regional integration schemes do not result in protectionist trading blocs.

To prevent an outcome of regional integration which would be at the expense of all trading partners, though to different degrees, regional trade arrangements should be designed in a way to dissipate fears of adverse trade effects on non-members, especially in Asia. This basically requires stricter GATT monitoring of regional trade arrangements. Art. XXIV GATT authorises derogations from MFN treatment if free trade areas and customs unions cover "substantially all" the trade among partner countries and do not raise trade barriers against third countries. These vague requirements suffer from serious enforcement problems, however. None of the about 80 preferential trade arrangements that have been notified to the

¹¹ For a similar reasoning, see Pelkmans [1992]. Lawrence [1991] strengthens the case for a positive relation between regionalism in the EC and multilateral trade liberalisation by referring to historical evidence. It is argued, for example, that the formation of the EC was an important impulse for the Kennedy Round of the GATT in 1964–1967.

Table 2 — Regional Structure of EC and US Trade, 1980 and 1990 (per cent)

Trading partners	EC				United States			
	exports		imports		exports		imports	
	1980	1990	1980	1990	1980	1990	1980	1990
<i>Developed economies</i>	76.5	83.1	72.8	83.7	59.5	64.7	51.1	64.7
Europe	67.0	71.2	59.9	70.6	30.0	27.7	18.3	23.3
EC	55.8	60.7	51.6	60.8	26.7	24.8	16.1	20.1
EFTA	11.1	10.3	8.2	9.7	3.3	2.8	2.2	3.2
Canada	0.7	0.9	1.2	0.8	15.7	20.9	17.1	20.0
United States	5.6	7.1	7.8	6.7	—	—	—	—
Japan	1.0	2.1	2.4	4.0	9.5	12.3	13.2	19.1
<i>Developing economies</i>	19.2	13.3	23.2	12.7	38.2	34.0	48.3	34.8
Africa	6.6	3.2	5.9	2.9	2.9	1.6	12.4	2.6
America	3.2	1.9	3.2	2.1	17.6	14.0	14.5	9.1
Middle East	5.3	3.0	10.3	2.0	4.7	2.7	8.4	2.0
Other Asia	3.1	4.4	3.3	5.2	12.6	15.5	12.8	20.8
<i>Eastern Europe and former USSR</i>	3.5	2.2	4.0	3.6	1.8	1.1	0.6	0.5
Memo item:								
Total trade (US\$ bil.)	689.6	1351.0	744.5	1349.0	216.6	374.4	240.3	476.5

Source: UN [1992].

GATT under Art. XXIV has been rejected as inconsistent with GATT obligations [Hufbauer, Schott, 1993].

Any proposal to reconcile regional trade arrangements with multilateralism, so that both concepts could co-exist or even reinforce each other, must rest on openness and external liberalisation as the two principal building blocks.¹² First, integration schemes must be open to new members which are ready to comply with the obligations of the regional trade accord. Second, transparent mechanisms have to be implemented providing for compensation for those non-member countries whose trade is adversely affected.

The first suggestion, i.e. openness, ensures that regional trade liberalisation may spread beyond its primary boundaries. To this end, the accession procedures of integration schemes in both Europe and the Western Hemisphere would have to be modified. While NAFTA membership is principally open to all countries without geographic limitations, any of the three present members can veto new members. In practice, the near-term prospects for the enlargement of NAFTA are limited. The United States are not ready to accept an accession required by highly competitive Asian NIEs, not to speak of Japan [ibid., p. 46].

Likewise, the EC is reluctant to accept new members except some EFTA countries. Requests for full membership by post-socialist countries in Europe, and even more so by countries such as Turkey, have received a lukewarm response. Among the reasons for the limited openness, concerns about mass migration induced by closer integration figure prominently. However, the migrants' drain into the EC will continue even though the sending countries are

¹² For similar suggestions, see Bhagwati [1991b], Lawrence [1991], Pelkmans [1992], and Hufbauer and Schott [1993].

denied the free movement of labour, i.e. one of the so-called four freedoms characterising the Internal Market. At present, migration is to a large extent illegal. Restraining access to the EC may even fuel (illegal) migration. Pronounced income differentials and high unemployment, which tend to be perpetuated by the remaining trade barriers against would-be EC members, provide strong incentives to migrate. Such incentives should rather be diminished. To this end, the EC's integration strategy should be more concerned about extending the achieved intra-EC liberalisation of trade and factor movements to other countries, rather than focusing on integration deepening for a small club of Western European economies.¹³ Eventually, a broader economic club based on liberal principles, including liberal accession rules, is in the interest of both present EC members and would-be members.

External liberalisation by the members of regional integration schemes, i.e. the second building block of our proposal, might be achieved in different ways. Bhagwati [1991b, p. 77] has suggested that any country that joins a free trade area must simultaneously reduce its external tariffs for all GATT members:

“A simple way to do this could be to modify Article XXIV to rule out free trade areas with diverse tariffs by members and to permit only customs unions with common external tariffs. With most tariffs bound, this would ensure that for the most part a substantial downward shift in tariffs would be a consequence ... A surer but more heavy-handed way to ensure this would be to write in the requirement that the lowest tariff of any union member on an item before the union must be part of the common external tariff” [ibid.].

An alternative suggestion, for which the support of major trading nations might be easier to achieve, requires for compensation if regional integration results in trade diversion at the expense of non-members. In this respect, an earlier proposal to enforce the dismantling of trade barriers erected by OECD countries against Third World exports through compensatory, additional aid payments can be referred to.¹⁴ To sanction the breach of agreed liberalisation schedules, contingent compensation payments might be fixed according to the welfare losses of trading partners from retained protectionist measures and distributed among the affected countries under the auspices of an international institution. A similar compensation scheme has been developed and operationalised by Hufbauer and Schott [1993, pp. 38 ff.] with special regard to the trade diversion effects of regional integration schemes. Compensation for those non-member countries whose trade is adversely affected would be determined by the GATT Secretariat according to the following procedure:

First, the shares of intra-regional imports in total imports would be calculated for each member country on an industry-specific basis. The development of these shares would be evaluated at fixed time intervals starting with the implementation of the integration scheme. Assuming that trade diversion at the expense of non-members results in higher shares of intra-regional imports (and correspondingly lower shares of external imports), import categories with lower shares of intra-regional imports would be dismissed from further consideration for compensation.

¹³ For a discussion on integration deepening versus integration widening, see Schmieding [1992].

¹⁴ For details, see Hiemenz [1989, pp. 14 f.] and Nunnenkamp [1991, p. 17].

Second, for the remaining categories the question has to be addressed whether higher shares of intra-regional imports are actually due to trade diversion. Higher shares may also result from trade creation, i.e. higher ratios of imports from all sources to the member country's consumption induced by regional integration. Compensation for non-member countries would be reduced to the extent that the latter import penetration ratios increase over time.¹⁵ Trade diversion would then be given by the dollar value of the rise in intra-regional import shares minus the dollar value of integration-induced trade creation.

Third, the compensation for trade diversion should be "paid" by a reduction of protectionist measures against extra-regional imports of the respective categories. External liberalisation would be required to an extent that produces a rise in extra-regional imports equivalent to the calculated trade diversion effect.

Together with openness towards new members, the proposed compensation scheme for trade diversion at the expense of non-members can prevent regional integration from degenerating into the formation of protectionist trading blocs. If both suggestions were followed and strictly applied, regional integration might even provide a stimulus to liberalising world trade in general. In the best of all circumstances, the recent revival of regionalism may eventually result, though unintentionally, in a new era of multilateralism. Such a development might be further encouraged if the proposed compensation were conditioned on reciprocal commitments. Member countries of a regional integration scheme should be eligible for compensation from another regional grouping only if they had agreed to reciprocal concessions for any trade diversion caused by their own integration scheme.

VI. The Future of the World Trading System: Old Problems and New Challenges

The multilateral trade negotiations in the Uruguay Round of the GATT have stagnated for years. Major results are still pending, and an outright failure of the Round is not completely out of question in early 1993. At the same time, we have witnessed a strong revival of regional trade arrangements, especially in Europe and the Western Hemisphere. The driving forces of regionalism, i.e. the EC and the United States, also bear the main responsibility for the protracted trade conflicts that have delayed the conclusion of the Uruguay Round. This juxtaposition suggests that major trading partners are drifting away from the GATT.

The uncertainty surrounding the international trading system threatens to result in a vicious circle. This uncertainty will lead more countries (especially small trading partners) to apply for membership in regional trade arrangements as a safeguard against a breakdown of the GATT [Paqué, Soltwedel, et al., 1992, pp. 23 ff.]. Expectations that multilateralism has no future can be self-fulfilling insofar as a move towards regionalism weakens the incentives of joining countries to support the GATT system [see also Bhagwati, 1991a, p. 242], an effect which could be observed in the past in the case of developing countries enjoying special pref-

¹⁵ For details of calculation, see Hufbauer and Schott [1993, pp. 40 f.].

erences. Diminishing support for a liberal multilateral trading system would, in turn, increase the risk that regional integration schemes degenerate into protectionist trading blocs. To prevent such an outcome, which runs against the longer term interest of all trading nations, it is of utmost importance that (i) the Uruguay Round is concluded as soon as possible, (ii) follow-up negotiations are focused on major questions left open for the time being as well as on some newly emerging trade issues, and (iii) adverse trade effects of regional trade arrangements are scrutinised more effectively.

The conclusion of the Uruguay Round would reduce the prevailing uncertainty and, thereby, the relative attractiveness of regionalism. In this respect, swiftness appears to be more important than completeness. It has been shown that the overly ambitious agenda of the Uruguay Round has delayed its conclusion from the beginning. Hence, an immediate agreement should comprise all achievements reached so far. While such an undertaking is relatively modest, it requires that major trading partners, particularly the United States, relax their provisos according to which tentative agreements will become effective only after remaining disputes have been settled. The required delinking of various trade issues may be encouraged by a commitment of trading partners to start another round of GATT negotiations immediately after the conclusion of the Uruguay Round, and to focus future negotiations on major unresolved problems plus a limited set of new challenges that have emerged recently.

The agenda of the next GATT Round should include the following items:

First, the further liberalisation of trade in agriculture must figure prominently. Most importantly, discrimination among agricultural exporters by the EC must be forestalled. This is because the EC may be tempted to shift part of the adjustment burden to non-European exporters of agricultural products once the Community cannot resist a speedy opening of its agricultural markets for Eastern European exports in order to stem the inflow of surplus labour from neighbouring countries [Paqué, Soltwedel, et al., 1992, pp. 27 f.].

Second, the erosion of the MFN principle should be halted by reducing the number and coverage of special trade preferences offered within and outside the GATT framework. Developing countries should not resist this trend reversal as special preferences have typically proven to be a mixed blessing. Especially the growing number of developing countries which have liberalised their trade policies recently have a strong interest in securing the multilateral trading system which threatens to be undermined by ever increasing discrimination.

Third, the issue of trade-related investment measures (TRIMs) will gain in relevance given the inclination of many countries to extend trade restrictions to foreign investment designed to circumvent traditional barriers to trade (e.g. the so-called screwdriver plants). Negotiations on TRIMs should address two aspects: (i) the liberalisation of performance requirements restricting the activities of foreign investors, such as minimum requirements in terms of export shares and local content, and (ii) stricter rules on the applicability of anti-dumping procedures to foreign investments, e.g. in the case of non-compliance with local-content requirements.

Fourth, the liberalisation of TRIMs might be easier to achieve once restrictive business practices of multinational corporations, which presently escape GATT monitoring and surveillance, are tackled by international competition rules. Principally, such rules would be superior to discretionary anti-dumping actions. Multilateral negotiations would have to ensure, however, that competition rules can be enforced without becoming a surrogate for protectionist industrial policies.

Fifth, future GATT negotiations have to tackle the recent tendency of industrialised countries to establish stricter ecological standards which could be used as a new protectionist device, particularly against suppliers from Eastern Europe and developing countries.¹⁶ The same countries might be affected by outright import bans on goods the production of which is said to cause serious environmental degradation. To prevent environmental protection from degenerating into trade protectionism, compensation schemes for ecologically motivated trade restrictions should be considered. For example, compensatory trade concessions for manufactured exports of developing countries should be obligatory if developed countries restrict natural resource exploitation through trade barriers.

Finally, the EC and the United States, as the critical actors regarding the future shape of the world trading system, should launch an initiative to enable the GATT to monitor and survey regional trade arrangements more strictly. Art. XXIV GATT must be extended in two respects: (i) by a commitment towards open regionalism so that preferential trade arrangements could be rejected as GATT inconsistent because of restrictive accession clauses, and (ii) by a provision to compensate non-member countries whose trade is negatively affected by regional integration. If these two requirements were met, regionalism and multilateralism could indeed reinforce each other. Any progress in regional liberalisation, i.e. a regional "GATT-Plus" accord, would then spread beyond its primary beneficiaries. Regional integration designed in this way would not only break the vicious circle towards an erosion of the multilateral trading system, but may even induce a virtuous circle of mutual trade liberalisation between regional groupings.

¹⁶ On the relations between trade and the environment, see GATT [b].

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