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# **WORKING PAPER**

## **Regional Trade Agreements and WTO**

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## Contents

|   |    |
|---|----|
| Abstract.....                                   | 1  |
| Introduction.....                               | 2  |
| Regional Trade Agreement.....                   | 2  |
| Characteristic of Regional Trade Agreement..... | 3  |
| The Impact of Regional Trade Agreement .....    | 5  |
| Undermining WTO's Progress .....                | 8  |
| Conclusion .....                                | 10 |
| Bibliography.....                               | 11 |

## **Regional Trade Agreements Versus World Trade Organization**

### **Abstract**

Menghangatnya diskusi mengenai China-ASEAN Free Trade Area (CAFTA) pada tahun 2010 menandai semakin semakin pentingnya keberadaan lembaga kerjasama ekonomi regional (RTA). Kerjasama ekonomi dalam lingkup regional tentu memunculkan pertanyaan apakah bentuk kerjasama tersebut tidak menyalahi prinsip umum perdagangan bebas yang secara multilateral dipromosikan oleh organisasi perdagangan dunia (WTO). Tulisan pendek ini mengajukan argumen bahwa keberadaan RTA justru dapat memberi alternatif terhadap kebuntuan dialog yang membayangi agenda pembangunan putaran Doha (Doha Development Agenda).

## **1. Introduction**

In recent years, regional trade agreement has increased rapidly. There are more countries gave their commitment to decrease trade barrier among geographic region or even across region through applying preferential tariff. In one hand, this progress raises a new hope that world economy will be more integrated and ready to carry out a more open economy. In the other hand, this trend gave a sign that multilateral forum did not automatically lead world concern to one negotiation system.

Differences on determining international trade strategy whether submit to regional type of Economic group or directly to WTO highly depend on rational gain for a country. There are arguments that keep support for continuing multilateral negotiation to energize world economic growth, while several others tend to choose trading within their neighboring country or region.

Nonetheless, the increasing of RTAs has correlation to the stalemate Doha Round without any consensus. The increasing number of RTAs since 1990s is comparable to similar situation when the RTAs in 1980s up blooming since the gloomy prospect of GATT after ministerial meeting in 1982 did not come into conclusion. RTAs provide an alternative route to ensuring greater market access. Enlargement of economic consensus based on the regional agreement can be a support for resuming multilateral dialog.

It is necessary to get an understanding the relationship between RTA and WTO, whether RTA support or undermine WTO agreements. Through discussing about the nature and characteristics of regional economic bloc, we will try to explore economic impacts of regional agreements to global trading system.

## **2. Regional Trade Agreements And WTO**

In general, RTA and WTO should not be regarded as competitor for each other in establishing the global trading system. Article XXIV ensure RTA's compliance to WTO since members country is permitted to establish customs unions and free trade area.

“this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area or the

adoption of an interim agreement necessary for the formation of a customs union or of a free trade area”(WTO 1947)

Interpretation of Article XXIV that reaffirmed in GATT 1994 reaffirm the presence of RTA to be part of WTO’s subject and even more, GATT in 1994 acknowledged significant growth of RTA since the establishment of GATT in 1947.

“*Recognizing* that customs unions and free trade areas have greatly increased in number and importance since the establishment of GATT 1947 and today cover a significant proportion of world trade”(WTO 1994)

In the other hand, RTAs have demonstrated their willingness to conform to WTO agreement. RTA gives notification for any settlement has made to Committee on Regional Trade Agreements (CRTA) at WTO. CRTA will make recommendations on the propose schedule based on the thorough analysis. CRTA will determine whether the formation of free trade area or customs union is legal or against world trade principles. WTO members are necessary to inform their RTA to ensure that there are no increasing barriers to any country that not participate. (Hoekman & Schiff 2002, p. 548)

### **3. Characteristics Of The Regional Trade Agreements**

The increase of RTAs occurred by the nature when there is a demand to expand economic activities in a country to supply domestic market. The cheap and simple approach is finding the resources from a close region. Beside economic factor, social or political interest may also stimulate the interest to join or form a new agreement by inviting neighboring countries.

According to Sager, there are four factors that drive for a formation of RTAs. First, geographic proximity. Close distances stimulate several countries to think about doing more economic exchange. Barrier perceptions within a region to commit for a trade agreement will become much lower when trade activities could be attained at cheap cost of transportation and communication. Second, political circumstances. Countries that share the same interest will have higher chance to tying their economic together. Similarities in social, cultural has enabled Malaysia, Thailand and Myanmar join with Indonesia and Philippine to form ASEAN/ ASEAN Free Trade Area instead with India or Bangladesh that also their neighboring countries. Third, experiment before

joining a more complex relationship in WTO. Several countries may need to have a benchmark of their economic capacity before joining a much larger group in WTO. Countries need more preparation before making a decision. This is become a preparation steps for countries across region to practice negotiation process and building mutual trust in small scope. Fourth, large number of GATT members along with complex issues has made the negotiation to reduce tariffs and trade barrier more difficult and uncertain. This situation encouraged some countries set their preferential tariff (Sager 1997, pp. 240-3).

Ethier share the same analysis to Sager. He asserts that RTA's presence signifying member willingness to practice open trading system. First, the new regionalism is constituted by one or more small countries connected to large countries. Economically, Mexico and Canada are small countries relative to United States. Indonesia, Malaysia and Thailand are big countries in AFTA that have small countries like Brunei, Cambodia and Vietnam.

Second, unilateral reforms had been initiated by some small countries before joining RTA. Many central European countries launched their economic reform before joining and accepted to be European Union (EU) member. Mexico and Canada were unilaterally doing their economic adjustment before joining NAFTA.

Third, there is no radical change in tariff policies after a formation or joining RTA. Major domestic adjustment in member country had been done before joining to a RTA. Vietnam, Cambodia and Laos did not start to reform their economic just because of their intention to join AFTA.(Ethier 1998, pp. 1150-2)

There are other findings beside those three, but the remainder almost the same with four Sager's factor. They share the same idea about the improvement of RTA in recent years that made the identity of RTA different to the previous.

Unlike Ethier, Fernandez argues that the new feature of RTA are deepening and widening process. The deepening process refers to extension of trade restrictions applied. Traditional restrictions that used to cover the tariff and quota on manufactures and agriculture, now have been extended to new area which is called as soft area, health and environmental. New RTA also made an agreement on Intellectual property sectors, services, investment and capital mobility agreements. The European economic integration to European Union (EU) has demonstrated at how the deepening



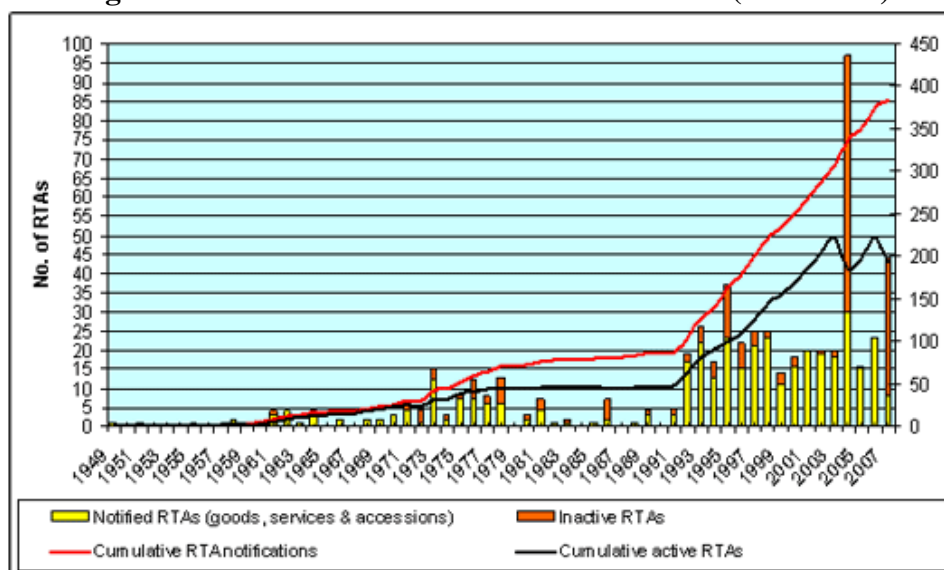
process may happen to RTA. The widening process refers to the enlargement of RTA members. AFTA which established originally by 5 country, now has more than ten members (Fernandez 1997, pp. 1-2).

#### 4. The Impacts Of Regional Trade Agreements

The impacts of regional trade agreement could be analysed from one side to another. First at how RTAs advancement has influences, whether positive or not, to WTO. The second, to determine the impact of policy changes in WTO to the increasing RTA. Almost all WTO reports the perspective of determining the impact coming from one direction, at how the influences of increasing number RTAs (WTO 2003, 2004, 2005, 2006). Less studies try to measured from the way around (Mansfield & Reinhardt 2003).

According to WTO, regional trade agreements (RTAs) have increased in over the past decade. Almost 380 RTAs had been notified to the GATT/WTO until 2007, 300 of them were notified under Article 24 of the GATT 1947 or GATT 1994; 22 under the Enabling Clause; and 58 under Article 5 of the GATS (Fig. 1). The sharp increase has happened since 1990s and by 2010, almost 400RTAs are expected to be realized.

**Figure 1: All RTAs notified to the GATT/WTO (1948-2007)**



Source:(WTO 2006)

Ironically, although there are more RTAs in recent years, but according to WTO, the increasing number of RTA does not give much improvement to WTO agreements. In WTO report 2003, there are three arguments that are sceptic at RTA's contribution in global trading. First, empirical data that tried to calculate intra regional trade shares and goods exchange does not show significant increase in trade exchange among members. If there is no significant number of trade created after RTA established, so the effectiveness of this mechanism could be in question. Second, most of trading activities among RTA's member not conducted in preferential tariff. Some portion of trade activities was not done in preferential tariff because base tariff for MFN duties already set to zero. The remainder item that apply tariff might had been excluded from agreement coverage. Third, sensitive tariff that used to be excluded in multilateral negotiation are almost likely become the sensitive item in regional agreement as well. Limited (WTO 2003, p. 54)

Nevertheless, there are optimistic arguments that belief in beneficial aspect of RTA in WTO interest. For developing countries that are not ready to compete in open market system, implementation of preferential tariff at RTA may help them to ease unsafe perception of joining multilateral agreements. Domestic adjustment and market reforms could be implementing at sustainable step before integrating to world economy.

In the other hands, RTA could also become a problem for developing countries whenever they are in a weaker position to negotiate with dominancy of developed countries. While, according to WTO report 2003, the number of agreement between developed and developing countries during 2000-2002 had increased rapidly, higher than other type of partners like developing-developing or developed – developed. RTA could mislead negotiation at multilateral trading system to become less transparent. This situation could decrease attention to WTO as multilateral system. (Crawford & Fiorentino 2005, p. 1)

Indonesian experiences as APEC and AFTA member confirmed the positive contribution of RTA in the multilateral agreement. Unlike mechanism on WTO negotiation, both APEC and AFTA agreement conducted at more informal. Confidence building measures through leadership meeting and peer pressure has effectively encouraged Indonesia and other member of APEC and AFTA to undertake unilateral liberalisation effort. (Feridhanusetyawan & Pangestu 2003, pp. 54-9)

Annual individual action plan from every APEC member is the important instrument for making liberalization schedule. As unilaterally designed proposal, time schedule has success to discipline APEC members. Unilateral action demonstrates willingness and willingness to do liberalization.

AFTA is stronger than APEC that highly depends on voluntary mechanism. AFTA adopted preferential tariff for regional liberalization, which called as Common Effective Preferential Tariff (CEPT). This preferential tariff is a binding commitment. Though more formal than APEC, AFTA does not have clear sanctions and settlement.

Although APEC and AFTA heavily criticized for its voluntary and non-binding mechanism, there is immeasurable benefit through informal style of meeting and interaction among leaders.

WTO agreement is more comprehensive than AFTA or APEC. Both AFTA and APEC focus only at tariff reduction. Under WTO, the area covered are elimination of domestic distortions, settlement for dumping allegations, avoid discriminatory actions and reduction of non-tariff barriers,. Further, WTO also set liberalization agenda in agricultural sectors.

Analysis from the perspectives of how WTO's progresses have influenced the RTA gave us the understanding that WTO has triggered the formation of RTAs. The main reason of that idea is countries want to increase their bargaining position through their membership in a RTA. (Mansfield & Reinhardt 2003, p. 830).

Mansfield & Reinhardt support their argument through analyzed empirical data from several phenomena. First, an increasing number of WTO members. This raises the issue about collective action and heterogeneity problems. The more members means a difficulty in monitoring others' trade practices. Unless joining the groups, they will be easily cheated by their counterparts. Heterogeneity implied a more preferences and practices must be considered during negotiation. Mansfield cited Financial News which mention "a round with China in is going to be much more difficult than a round without China". Difficulties in achieving global consensus stimulate countries to try RTA's way.

Second, there were dispute in GATT/WTO, dispute concern policies, such as dumping, subsidies may lead one countries tries to bypass the process through another forum in RTA. Mansfield claims that Argentina's motives to join Mercosur were to

have preferential access to Brazil. Third, unsatisfactory result from negotiation at WTO, since the enforcement systems are weak, many countries tries to tie their relations as bilateral or regional agreement.

Success achievement of WTO to expand the memberships of parties has become a double edged sword for the organization. In one side giving an opportunity to settle many issues among countries in multilateral dialogue, but in the other side, many WTO members attracted to form or join RTA.(Mansfield & Reinhardt 2003, p. 858)

### 5. Undermining WTO's Progress ?

In 1947, there is no as much pressure from RTA to be acknowledged as the main player in global trading system. Table 1 excerpted from WTO report 2003 could be used to indicate the presence of RTA in the early period. Counting the period of 1958 until 1969, there are only 4 RTAs entry into force. It means, there are a few influence from RTA to GATT decision makers.

**Table 1: Notified RTAs in goods by the date of entry into force and type of partners**

|             | Developed-Developed | Developed-Developing | Developed-Transition | Developing-Developing | Developing-Transition | Transition-Transition | Total |
|-------------|---------------------|----------------------|----------------------|-----------------------|-----------------------|-----------------------|-------|
| 1958 - 1964 | 2                   | 0                    | 0                    | 1                     | 0                     | 0                     | 3     |
| 1965 - 1969 | 0                   | 0                    | 0                    | 0                     | 1                     | 0                     | 1     |
| 1970 - 1974 | 5                   | 3                    | 0                    | 2                     | 0                     | 0                     | 10    |
| 1975 - 1979 | 0                   | 5                    | 0                    | 1                     | 0                     | 0                     | 6     |
| 1980 - 1984 | 2                   | 1                    | 0                    | 1                     | 0                     | 0                     | 4     |
| 1985 - 1989 | 1                   | 1                    | 0                    | 2                     | 0                     | 0                     | 4     |
| 1990 - 1994 | 3                   | 3                    | 12                   | 5                     | 0                     | 6                     | 29    |
| 1995        | 3                   | 7                    | 10                   | 4                     | 12                    | 28                    | 64    |

|                   |    |    |    |    |    |    |     |
|-------------------|----|----|----|----|----|----|-----|
| -<br>1999         |    |    |    |    |    |    |     |
| 2000<br>-<br>2002 | 0  | 11 | 4  | 5  | 4  | 6  | 30  |
| Total             | 16 | 31 | 26 | 21 | 17 | 40 | 151 |

Source: (WTO 2003, p. 47)

After almost 60 years from GATT treaty signed on 1947 and more than 10 years of existence of the WTO that exception has becoming a rule of international trade. There is an intention to shape RTA as the instrumental measures to foster multilateralism.

If RTA could convince WTO and their counterpart about their mission to support open market economy, then no more question about the function of WTO. The problem now at how to optimize RTA's function to be in line with WTO interest as multilateral forum. To optimize the function of RTA as the building blocks for WTO, Soesastro gave emphasize to three issues. RTA should genuinely inclusive and open to whole range of liberalization purpose. Tailor made of an agreement based on particular interest from member countries will delay the conformity of RTA to multilateral agreement. RTA should strive to extend liberalization benefit through improvement preferential tariff well above MFN basis. (Soesastro 2003, p. 18)

However, WTO is still dilemmatic on dealing with RTA. Since RTAs has proven to be a lifeboat instrument to safe GATT from further stagnancy during tough negotiation on Uruguay Round, it is worth for WTO to acknowledged and more flexible to deal with RTAs, rather than questioning the function of RTA. Current discussion on WTO Forum between Jagdish Bhagwati and Gary Hufbauer which titled "Are RTAs stepping stones or obstacles to the trading system?" held 12 September 2007 demonstrate that WTO has not yet finished to define the position on dealing with RTAs (WTO 2007). That was such a question that should have been ended in 1947.

## **6. Conclusion**

We can conclude that the increasing of RTAs becomes a good sign for the need for open market system, an agenda that should not solely monopolize by WTO. RTA has been proven to be a lifeboat mechanism to maintain liberalization pace running on.

Recurrent question whether RTA support or undermine progress in the WTO is not coming from one side problem, RTA's mistakes. Problem in WTO, such as inability of WTO to define the satisfactory relationship since 1947 has made WTO always in dilemmatic position to pose RTA issue. Internal factors in WTO such as large amount of members and various preferences within the members become problematic to be settled without any delay. Nonetheless, the increasing of RTAs has correlation to the stalemate Doha Round without any consensus.

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Menghangatnya diskusi mengenai China-ASEAN Free Trade Area (CAFTA) pada tahun 2010 menandai semakin semakin pentingnya keberadaan lembaga kerjasama ekonomi regional (RTA). Kerjasama ekonomi dalam lingkup regional tentu memunculkan pertanyaan apakah bentuk kerjasama tersebut tidak menyalahi prinsip umum perdagangan bebas yang secara multilateral dipromosikan oleh organisasi perdagangan dunia (WTO). Tulisan pendek ini mengajukan argumen bahwa keberadaan RTA justru dapat memberi alternatif terhadap kebuntuan dialog yang membayangi agenda pembangunan putaran Doha (Doha Development Agenda).

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