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Axel Borrmann and Georg Koopmann*

Regionalisation and Regionalism in World Trade

The growing importance of regional integration, particularly in the Triad of Western Europe, North America and the Asia-Pacific region, is not always regarded as positive, but is also criticized because of the dangers involved for free world trade. What effects on world trade are to be expected? Can the new world trade order limit the possible risks?

Opinions as to the effects of the ever-growing number of regional integration projects continue to differ: their supporters see them as a meaningful complement to the attempts to achieve multilateral liberalisation and as a pragmatic in-between stage on the way toward the global removal of all barriers to trade. The latter can only be achieved in the long run via strenuous international negotiations. Regional integration, they claim, represents a stimulant to the multilateral process. The critics, on the other hand, see formal integration as a turning away from the principle of multilateral liberalisation with negative consequences for global welfare. Regional preferences in trade, services and capital transactions necessarily imply discrimination against third parties. They represent an institutionalised beggar-my-neighbour policy, strengthen the tendency toward regional concentration and lead in the final analysis to the disintegration of the world economy into protectionist economic blocs.¹

Increasing Regionalisation

It cannot be ignored that there is a certain concentration of economic activities on a few regions, nor that regionalisation is increasing.² Western Europe is presently the dominant region, with 32% of global economic production (1991), followed by North America with 30% and the Asia-Pacific region with 23%.³ Regionalisation is even more marked in world trade. Western Europe's share of the trade in goods is 48% (1992)⁴ and its share of trade in services is over 50%.⁵ The rise of Japan and the resulting opening of the first and second generations of newly industrialising countries to

world markets has meant that Asia-Pacific has replaced North America (16%) as the second-largest trading region and today conducts 23% of world exports of goods (1992: 11%). The Triad – consisting of Western Europe, North America and Asia-Pacific – is responsible for 87% of world trade (1992).

The concentration on these three large regions has increased continuously since the end of the second world war. The driving forces behind this development are Europe and the dynamic countries of the Asia-Pacific region. The economic growth of the latter will probably continue in the coming years to be considerably higher than that of the established industrial countries of Western Europe and North America, which will lead to a further shift

¹ This article is based on a study by the Hamburg Institute for Economic Research (HWWA) for the German Federal Ministry of Economics. Cf. Axel Borrmann, Bernhard Fischer, Rolf Jungnickel, Georg Koopmann and Hans-Eckart Scharrer: *Regionalismustendenzen im Welthandel*, Hamburg 1994 (forthcoming).

² In the following regionalisation is defined according to Lorenz as an empirically observable process of the regional concentration of economic activities. Regions are defined according to geographical criteria. The concept of regionalisation leaves open which influencing factors are responsible for geographical concentration. Regionalism is formal regional integration by means of preferential or free trade agreements or the formation of customs or economic unions. Regionalism thus implies that regional concentration is politically desired and therefore actively pursued, whereby it remains unanswered whether, or to what extent, this tends – due to bloc-building effects – to be to the disadvantage of third countries, or whether – if it has an open form – it is to the advantage of all. The delimitation of regions in this context takes place according to membership in regional unions. Cf. Detlef Lorenz: *Regionalisation versus Regionalism – Problems of Change in the World Economy*, in: *INTERECONOMICS*, Vol. 26 (1991), No. 1, pp. 3-10.

³ World Bank: *World Development Indicators 1993*, Washington 1993.

⁴ UNCTAD: *Handbook of International Trade and Development Statistics 1992*, New York 1993.

⁵ Gatt: *International Trade Statistics 1993*, Geneva 1993, p. 5.

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in the regional structure of world trade. It has been forecast⁶ that Asia-Pacific's share of world trade in goods will increase to over 25% by the year 2000. North America's position in the world market will probably continue to decline slightly, while Western Europe will retain its present standing. The importance of developing countries in Latin America, Africa and western and southern Asia for world trade will probably continue to decline. The trend of recent decades will thus continue, in which these countries' – which include oil-producing countries – share of the world market fell from 24% (1960) to 15% (1990).

The regionalisation of world trade is increasing as a result of the growing intensity of trade interdependency within the Triad. Trade within the individual major regions and the exchange of goods between them account today for three-quarters of world trade. The intraregional trade in goods in Western Europe, North America and Asia-Pacific alone makes up about 50% of total world trade (cf. Figure 1). Western Europe now conducts 70% of its trade within its own borders. Despite its already high level intra-European trade in goods expanded further in the eighties. In the Asia-Pacific region, too, intraregional trade is growing and already covers almost half of the region's total foreign trade. The trade relationships between Japan and the four Asian NICs, in particular, strengthen regionalisation. Only in North America has regionalisation shown no increase so far. Interregional trade between the USA and Canada has stuck at around 30% of their foreign trade for a number of decades.

Extraregional Involvement

Despite the great and growing importance of their intraregional trade the members of the Triad remain closely interlinked with one another. The share of their exports to the respective other members of the Triad has – with fluctuations – remained relatively stable. At 48% and 44% of their total exports (1991) respectively, the interlinking of North America and Asia-Pacific with other parts of the Triad are particularly striking. Western Europe's links with the other members of the Triad, in contrast, have become weaker as a result of the dynamic of intra-European trade between 1960 and 1980, although it today – at 15% – again lies at a clearly higher level than in that period. The increase in intraregional and interregional trade within the Triad has resulted in a parallel loss of importance for trade with and within the rest of the world.

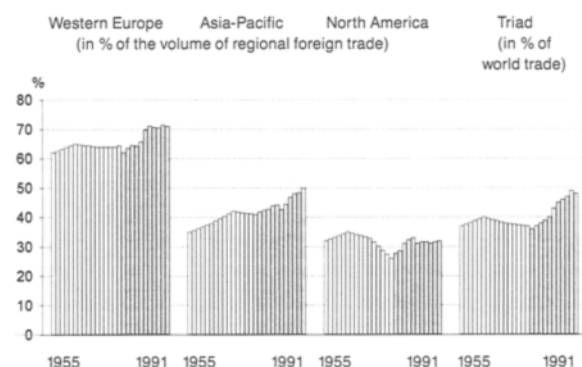
The openness of the three major regions is also

expressed in the fact that the foreign trade sector of their economies is becoming increasingly important compared to the domestic sector. The ratio of imports and exports to GDP in the Triad today is over 30%, and in Western Europe it is even 45% (1990). The international division of labour and specialisation are not limited to the home region. The extraregional linkage of Western Europe, North America and the countries of the Asia-Pacific region (with the exception of Japan) lies between 12% and 15% of GDP; in the Asian developing countries it is even more than 30%.

It is exceptionally remarkable that there is practically no difference between the extraregional involvement of North America (1990: 11.9%) and that of Western Europe (12.8%). This fact puts the wide-spread impression of insulation and bloc-building in Western Europe in quite a different light. In the last forty years the extraregional involvement of the European economy was usually greater than that of North America or the Asia-Pacific region. Whereas for Western Europe and Asia-Pacific there is no recognisable trend of a change in their degree of extraregional openness, North America appears to be opening further towards other regions.

On the other hand it cannot be ignored that especially in Western Europe the importance of intraregional trade is growing and is, at 33% of GDP, almost three times as large as extraregional trade. In the Asian-Pacific developing countries, too, intraregional links are becoming ever more important for the economy as a whole; in 1990 they accounted for 26% of GDP. Japan has shown no change in

Figure 1
Growing Internal Trade in the Regions
1955 – 1991



Notes: Western Europe: EC-12, EFTA-6 etc.; North America: USA, Canada, Mexico; Asia-Pacific: South and Southeast Asia, PR China, Japan, Australia, New Zealand; Triad: Western Europe, North America and Asia-Pacific; 1955-1980: interpolated five-year figures; 1980 onwards: annual figures.

Source: Handbook of International Trade and Development Statistics, various issues.

⁶ Japan Centre for Economic Research: The Coming Multipolar Economy, The World and Japan in 2010, Tokyo 1992; World Bank: Global Economic Prospects and the Developing Countries 1994, Washington 1994.

its traditionally strong extraregional involvement. In North America the macroeconomic importance of trade within the home region is relatively low, at about 8%, although it is increasing.

The growing importance of intraregional trade for foreign trade and the economy as a whole raises the questions

- ☐ which factors accelerate regional integration?
- ☐ what is the extent of preferential trade due to integration?
- ☐ will the new wave of regionalism strengthen this trend?
- ☐ what trade policy will accompany the integration efforts? and finally,
- ☐ can these dangers be controlled by an appropriate form of world trade order and if so, how?

Determinants of Regionalisation

Both theoretical and empirical studies have shown that regionalism is only one determinant of regional integration, and not even necessarily the most important. Natural factors such as geographical proximity and cultural affinity mean considerable transaction cost advantages for firms and lead to a pronounced tendency to seek trading partners primarily in the immediate regional

vicinity. This is true not only for trade in goods and services but also for capital transactions.

There is no doubt, however, that trade policy and integration policy measures can strengthen this regional bias by influencing certain transaction costs, e.g. by improving locational factors (information, telecommunications, transport, financing, education and training etc.), by removing intraregional barriers to foreign trade and also by discriminating against third countries (e.g. with the aid of tariff and non-tariff protection). The forces accelerating regional integration are, among others, the belief that it will be possible to increase the development of the region – at least temporarily – more strongly and effectively than via multilateral liberalisation, as well as regional, foreign policy and security policy motives. The securing of political or economic reforms can also play a role.

Preferential Trade Due to Integration

The removal of intraregional barriers to trade via formal integration now covers a considerable proportion of world trade, namely 45% (cf. Table 1). The lion's share of this preferential trade is taken by Western Europe with the EU and EFTA (33%); almost 8% fall to the North American Free Trade Agreement (NAFTA). Integration in South America, Asia and Africa plays a subordinate role. Recent integration efforts indicate a further expansion of preferential trade due to integration.

Table 1
The Importance of Regional Preferential Trade for World Trade

	Intraregional Exports 1992 in US \$ m	in % of world exports
Western Europe (EC, EFTA, EC-EFTA)	1,198,030	32.49
Western Europe – Central and Eastern Europe (EC-Visegrad, EFTA-Visegrad)	59,457	1.61
Western Europe – Mediterranean Countries (EC with Turkey, Israel, Mashrek and Maghreb) (EFTA with Turkey and Isreal)	77,055	2.09
North America (NAFTA, USA – Caribbean)	280,349	7.60
Central and South America (Andean Pact, MERCOSUR, CARICOM etc.)	12,792	0.09
Asia-Pacific (ASEAN, ANZCERTA)	36,681	1.00
TOTAL	1,664,364	44.88

Source: IMF: Direction of Trade Statistics.

In *Europe*, the EU will expand its preferential trade further with the deepening of the integration process, but also due to the gravitational effect on its neighbours to the east and south. The integration dynamic, which continues to be strongly politically determined, will lead to new member states (Austria and probably the Scandinavian countries), and the importance of EFTA will in return continue to decline. Although there are strong forces within the EU which are pressing for consolidation, the long-term option of membership for Poland, the Czech republic, Slovakia and Hungary is likely to continue and the de facto integration of the countries of eastern Europe via the application and extension of the existing European agreements will continue to make further progress. The free trade agreement among the so-called Visegrad countries and the similar contract between Estonia, Latvia and Lithuania will contribute towards the extension of European preferential trade. Turkey's accession to the EU will also remain on the political agenda. The countries of North Africa, on the other hand, can hope only for the granting of free trade status. There are no perspectives of a significant extension of trade with the ACP countries in view of the already existing broad – and non-reciprocal –

preferences and of the enormous supply-side problems especially in the Black African countries. Altogether, European preferential trade is heading for a share of world trade of about 40%.

In *America* the NAFTA is already proving to have a strong gravitational pull on Central and South American countries. Due to their continuing considerable need of reform, however, it is hardly to be expected that the USA will grant such extensive trade concessions as in the case of Mexico to a larger number of Latin American countries in the near future. The "Enterprise for the Americas Initiative" must therefore be regarded as implying a long-term perspective, which will spur on the reform and integration efforts of the Central and South American states. The new impulse for growth which can be observed here and the progress with the reduction of barriers to trade, but above all the trade potential between North and South America, could lead to a further growth in the preferential trade of the western hemisphere to considerably more than 10% of world trade.

In view of the independent successes of the economies in the *Asia-Pacific region*, which have been based among other things on the unilateral liberalisation of foreign trade, and which have led to a rapidly increasing de facto integration, there has not appeared to be any necessity for a broad, formal integration. This is not likely to change very much. With the conclusion of the Uruguay Round the extraregional interests of the Asia-Pacific region are protected for the time being. Particularly from the point of view of the successful newly industrialising countries there is therefore no need for a broadly based alternative regional model. Furthermore, the economic and political heterogeneity of the region continues to stand in the way of a broad bloc-building and thus of a significant extension of preferential trade. The latter presently represents about 1% of world trade and is conducted by the six ASEAN

countries and the two ANZCERTA countries Australia and New Zealand. A new attempt has been made, with the AFTA, to expand ASEAN trade, but even with an extended membership it is likely to remain of subordinate importance for the world economy. The chances of an institutionalised Asia-Pacific economic zone within the framework of the APEC must also continue to be regarded with scepticism. The heterogeneity of the member countries and the requirement of a balance of power are likely to be the decisive barriers.

In the remaining regions, i.e. in Africa, in the Middle and Far East, and in South and Central Asia, numerous old integration projects are also being brought back to life and new ones are being started. When examined more closely, however, the majority of them turn out to be long-term visions, which in view of very basic economic and political differences are often nothing but wishful thinking and will therefore remain of little importance to the world economy.

Taken altogether, the observed integration efforts lead us to expect that flows of regional preferential trade will soon make up more than half of world trade. This development will primarily be based on the expansion of Western European preferential trade eastwards and of North America's southwards, supplemented in both cases by subregional agreements.

Effects on International Trade

Regional preferential trade forms the largest part of those international movements of goods which do not conform to the ban on discrimination: it is much larger than supranational preferential trade and exceeds by far the trade which is affected by protectionist measures by individual countries or groups of countries directed at particular trading partners. But whereas this latter, selective, protectionism obviously puts a brake on the

Peter Behrens (Ed.)

EEC Competition Rules in National Courts

Les règles de concurrence de la CEE devant les tribunaux nationaux

Part One: United Kingdom and Italy / Première Partie: Royaume Uni et l'Italie

The competition rules of the EEC are directly applicable in the Member States. Therefore, the national courts play an important role in the implementation of European competition law. The editor of this volume has initiated a research project which will analyse the national case law. This volume contains the national reports from the United Kingdom and Italy. Further national reports will follow.

The project is designed to make the national case law accessible to lawyers practicing in the field of European competition law. The Community organs get an overview over the implementation of Community law in Member States. Those interested in research find the materials for further comparative studies. The authors are competition law experts from the different Member States. The editor is Professor of Law at the University of Hamburg and Member of the Board of Directors of the Institut für Integrationsforschung of the Stiftung EUROPA-KOLLEG Hamburg.

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growth of world trade, the effects of selective preferencing, and in particular of regionalism, cannot be judged so simply; it is even possible that an open regionalism could provide strong impulses to international trade.

The external effects of regional integration can, in the final analysis, only be established empirically, since in theoretical terms neither the situation before integration nor that following integration is optimal: in both cases the allocation of resources is distorted by trade barriers. Global free trade would without doubt – apart from a few special theoretical cases – be better than an exclusive, regional free trade. Haberler already warned many years ago of “the erroneous protectionist belief ... that a customs union brings advantages which could not be achieved to an even greater extent by the general removal of customs duties even in the case that the removal of customs duties is limited to the member states of the customs union and the rest of the world does not follow suit”.⁷ At the same time Haberler states that customs unions “should always be welcomed” and are “particularly advantageous ... for small states ... because these suffer particularly from reciprocal barriers”.⁸ He does not fail to recognise that the formation of customs unions may have negative effects on the trade of the union members with third countries, but he does not pay this much attention.

External Effects of Integration

Starting with the work of Jacob Viner⁹ in 1950, the external effects of regional integration began to come more into the limelight. Viner showed that a customs union not only created trade between the member states, but that it also diverted trade flows from third countries to union members: protected by the common external tariff, products from countries within the region, which are now traded duty-free, become competitive in spite of higher production costs and take the place of goods from third countries. The actual external effects involved in the internal opening of regional markets, however, do not consist simply in the non-recurring relocation of production from a cheaper external location to a more expensive internal one. They also include a number of further, mostly dynamic, direct and indirect effects, some of which imply an increase in external trade and others a decline.

□ External trade is suppressed when regional integration makes possible the exploitation of cost-reducing economies of scale, allowing domestic suppliers to substitute for imports. Corden¹⁰ points to this effect, and emphasizes at the same time that the utilisation of regional economies of scale probably means a net gain in world welfare; the reduction in costs plays a greater role than the suppression of trade. The same is similarly true in general

of the productivity-increasing and efficiency-increasing effects of regional integration, e.g. due to more intensive competition.

□ Growing real incomes in the integration area (due to integration) cause an additional expansion of trade. Not only regional suppliers benefit from this, but also exporters from outside the region. At the same time foreign suppliers benefit directly from the creation of larger and more homogeneous regional markets which are no longer segmented into national submarkets by administrative, technical or regulatory barriers. Both effects, direct and indirect, represent external trade creation.¹¹ These effects must, however, be balanced against the negative trade effects of the contraction of incomes abroad caused by the diversion of trade.¹²

□ Regional integration also influences external trade flows indirectly via the direct investment which it induces, suppresses or diverts. It is conceivable, for example, that cost-oriented direct investment could migrate from third countries to the integration area and substitute there for hitherto imported products. Similarly, regional investors, benefiting from local content regulations, could supplant investors from third countries and thus also limit the latter's export opportunities. On the other hand, regional integration could also trigger off a strong flow of market-oriented direct investment, which in turn could create external trade, but which could also supplant it: if investments are based mainly on defensive motives in order to avoid (existing or expected) trade barriers, then trade substitution is the most likely outcome; if the investors, in contrast, are primarily interested in minimising their economic risks, securing markets against competitors and being present in lucrative markets, then the investments are likely to cause an expansion of trade.

□ The external trade effects of regional integration are determined last but not least by the their influence on the foreign trade policies of the partner countries and of the union as a whole. This influence is ambivalent: on the one hand, growing international competitiveness due to the

⁷ Gottfried Haberler: *Der internationale Handel*, Berlin 1933, p. 288. Our translation.

⁸ *Ibid.*, p. 287. Our translation.

⁹ Jacob Viner: *The Customs Union Issue*, New York 1950.

¹⁰ Warner Max Corden: *Economies of Scale and Customs Union Theory*, in: *Journal of Political Economy*, Vol. 80 (1972).

¹¹ On the concept of trade creation cf. E. M. Truman: *The Effects of European Economic Integration on the Production and Trade of Manufactured Products*, in: Bela Balassa (ed.): *European Economic Integration*, Amsterdam 1975, pp. 3-40.

¹² Jaroslav Vanek: *General Equilibrium of International Discrimination: The Case of Customs Unions*, Cambridge (Mass.) 1965.

increases in productivity and efficiency made possible by integration should be accompanied by a growing preparedness to open markets externally, too, in order to guarantee intensive competition on the integrated markets and to achieve correspondingly easier entry conditions for domestic products to third countries; on the other hand, the integrated community could be tempted to compensate for an increase in internal adjustment pressure by an increase in external protection (or the refusal to reduce protection)¹³ and to use its increased international negotiating strength for a strategical trade and industrial policy which reduced the export opportunities of other countries.¹⁴

The Example of EU Integration

The historical test case for the influence of regionalism is the European Community. Three phases in this integration process can be distinguished:

- initial establishment: 1958 to 1972,
- expansion and (inner) stagnation: 1973 to 1985,
- completion of the single market: 1986 to 1992.

The implications of EC integration for world trade can be determined approximately by a comparison of the relative importance of internal and external trade flows. EC internal trade is compared with the total trade of the Community and its trade with third countries is compared with total world trade (without EC internal trade). A simultaneous increase in both shares would indicate a stimulation of world trade from European integration. If, on the other hand, the proportion of internal trade increased while the EC share of (adjusted) world trade fell, this would tend to indicate the opposite effect.

The initial establishment phase from 1958 to 1972 shows an extremely dynamic pattern: the share of internal trade in the total trade of the then Community of Six increased continually from slightly less than one third to

about half and the EC intra-trade's share of world trade increased almost threefold from 6% to 17%; at the same time the Community increased the share of its external exports (imports) of – adjusted – world exports (imports) from 14% (15%) to 20% (18%). These figures imply that world trade received a strong stimulus from the creation of the EC.¹⁵ In contrast, there was no stimulus to world trade from European integration in the expansion and stagnation phase from 1973 to 1985: the intra-trade share of the extended Community of Nine (Ten since 1981) stagnated at 52% while external EC exports (imports) fell from 25% (24%) to 20% (20%) of adjusted world exports (imports).¹⁶

In the single market phase from 1986 to 1992 inner-European trade again showed strong growth – by 1992 it had risen to 61% of total EC foreign trade – while there was no uniform trend in the Community's external trade flows: their share of adjusted world trade fluctuated between 18% and 23%. The completion of the European internal market therefore appears neither to have significantly impaired world trade nor to have stimulated it strongly.

Protectionist Tendencies?

It is difficult to estimate to what extent the expansion of regional trade above all in Europe and North America will be accompanied by protectionist tendencies. Ambivalent tendencies are inherent in the deepening and widening of integration in Europe: the nature of single market programme of the EC is not mercantilistic, but the programme serves the strengthening of the international competitiveness of European firms by increasing their efficiency. The new regulations influence the economic policies of the EC's western and eastern European neighbours and at the same time form the conditions for their closer cooperation or accession. The planned new members of Austria, Norway, Sweden and Finland will strengthen the liberal camp in the Community.

On the other hand the European integration process

¹³ The exporting of integration costs is regarded as "a constant of attempts at regional integration". Cf. Jürgen Bellers and Erwin Häckel: *Theorien internationaler Integration und internationaler Organisation*, in: Volker Rittberger (ed.): *Theorien der internationalen Beziehungen*, in: *Politische Vierteljahresschrift*, Special Issue 21, Opladen 1990, p. 295. The reduction of external competitive pressure is supposed to ease the burden from increased internal competition resulting from market integration. Translated into the language of customs union theory: trade creation is endogenously transformed into trade diversion; cf. Jagdish N. Bhagwati: *The Threats to the World Trading System*, in: *The World Economy*, Vol. 15 (1992), No. 4, pp. 443-456.

¹⁴ Alexis Jacquemin and André Sapir: *Europe Post 1992: Internal and External Liberalization*, in: *American Economic Review*, Vol. 81 (1991), No. 2, pp. 166-170. The authors differentiate in this context between natural and strategic integration. Whereas natural integration refers to a situation in which natural (geographically neighbouring) trading partners amalgamate, strategical integration refers to an agreement the aim of which is to achieve trade gains at the cost of other countries.

¹⁵ A number of econometric studies point in the same direction. For an overview cf. Ali M. El-Agraa: *The Theory and Measurement of International Economic Integration*, Houndmills and London 1989. Most of these studies have shown that the EC (Six) created more trade in the manufacturing sector (but not in the agricultural sector) than it diverted. Of considerable importance here was the creation of external trade due to dynamic integration effects; cf. Peter Robson: *The Economics of International Integration*, London 1987, p. 245. These integration effects are themselves to a considerable extent the result of the application of economies of scale; cf. Nicholas Owen: *Economies of Scale, Competitiveness and Trade Patterns within the European Community*, Oxford 1983.

¹⁶ At the same time, however, in the case of industrial goods the external import shares of EC domestic demand (penetration rates) have increased further. For details cf. Damien J. Neven and Lars-Hendrik Röller: *European Integration and Trade Flows*, in: *European Economic Review*, Vol. 35 (1991). External trade creation took place in this phase, too, and the EC did not collectively turn away from the international division of labour.

contains inherent risks. It invokes a strong need for structural adjustment and experience shows that not all firms whose competitiveness is weak will submit to this without complaint. Candidates for membership and associated neighbouring countries with a marked development gap to the core countries of the EU increase the pressure on the EU authorities to seek protectionist solutions at the cost of third countries. At present considerable efforts are being made to tighten up further the existing trade policy instruments for protection and to strengthen the position of European enterprises in international competition by means of industrial policy intervention. Indications of this are the change from a qualified to a simple majority for decisions on antidumping measures and countervailing duties as well as Art. 130 of the Maastricht Treaty.

In North America, too, the extension of regional integration by the North American Free Trade Agreement, which came into effect on 1st January 1994, has been accompanied by protectionist tendencies in trade and industrial policy, particularly by the United States. The NAFTA itself, however, can be expected to increase intraregional trade between the USA, Canada and Mexico considerably, while these countries' trade with third countries as a whole is not expected to be negatively affected, at least not to any great degree.

Negative effects on trade with third countries could arise above all indirectly as a result of investment relocations into the NAFTA area. Various empirical studies have estimated the diversion of trade via investment diversion to be higher than direct trade diversion by NAFTA.¹⁷ These negative effects must be balanced against the external trade creation, however, which will

result from the growth effect of North American integration. The increases in imports due to the growth of production and incomes in the NAFTA area could in the long run be greater than the diversion of trade.

Implications for the World Trade Order

Whether regionalism will as a whole in future prove to be a pacemaker for world trade and for the development of the world economy generally, or put a brake on them, probably depends not least on the interaction between regional integration and the multilateral trade, investment and competition order. In the past the Gatt had only a slight influence on the design of regional integration agreements. It is difficult to say in retrospect how far the conditions laid down in Gatt Art. 24 on customs unions and free trade zones were taken into account when the agreements were being drawn up. However, it is a fact that hardly any of the 70 regional integration agreements notified to the Gatt between 1948 and 1990 completely fulfilled the requirements of Art. 24 in the eyes of the working groups set up to examine them.¹⁸ Nevertheless, the Gatt members did not explicitly condemn any agreement nor did they impose specific requirements with regard to changes in the sense of Art. 24, Para. 7(b).

The "original sin" and "the beginning of the breakdown of the Gatt's legal discipline"¹⁹ was the tacit acceptance of the EEC Treaty of 25th March 1957 in spite of its considerable effects on third countries.²⁰ In its preference policy towards third countries the EC has taken even less account of the conditions of Art. 24 than it did at its founding, or at the three enlargements of 1973, 1981 and 1986. The requirement in particular has been ignored that the liberalisation must be extended to "substantially all the trade" between the parties to the agreement,²¹ and the impression was created that Art. 24 allowed every type of preferential trade regime.²²

The Leutviler Report of 1985 saw in the practice of the application of Art. 24 a "dangerous precedent for further special deals, fragmentation of the trading system, and damage to the trade interests of non-participants".²³ It was demanded that "the Gatt rules on customs unions and free-trade areas should be ... redefined so as to avoid

¹⁷ Cf. Gary C. Hufbauer and Jeffrey J. Scott: Regionalism in North America, in: Koichi Ohno (ed.): Regional Integration and its Impact on Developing Countries, Tokyo 1993, pp. 274, 280. The authors estimate the direct export losses suffered by Latin American countries because of NAFTA at \$ 270 m and indirect losses of exports due to investment diversion at \$ 1.3 bn per annum. For the Asia-Pacific countries the same authors (pp. 277 ff.) have calculated a direct decline in exports of \$ 820 m and indirect export losses at \$ 1.2 bn. On the importance of the indirect trade effects of the investment diversion induced by NAFTA to the detriment of the countries of East Asia cf. also Mordechai E. Kreinin and Michael E. Plummer: Effects of Economic Integration in Industrial Countries on ASEAN and the Asian NICs, in: World Development, Vol. 20 (1992), No. 9; Robert K. McCleery et al.: NAFTA and its Effect on Other Regions: U.S. Trade Policy and Asia's Concerns in a Global Context, in: Koichi Ohno (ed.) op.cit.

¹⁸ Dickson Yeboah: Regional Economic Integration and the GATT, in: World Competition, Vol. 17 (1993), No. 1, p. 39.

¹⁹ Quoted from John Jackson in: Jagdish N. Bhagwati: Regionalism and Multilateralism: an Overview, Paper presented to the World Bank and CEPR Conference on New Dimensions in Regional Integration, Washington, D.C., 2nd - 3rd April, 1992, p. 8.

²⁰ Controversial were above all the formula for calculating the common external tariff of the Community of Six, the implications of the Common Agricultural Policy and the Gatt-conformity of the association of former colonies.

²¹ Thus, for example, the free trade agreements of the EC with the EFTA countries of 1972 largely exclude the agricultural sector, while in the Mediterranean agreement of the Community EC imports from the partner countries are unilaterally liberalised, and this only incompletely since agricultural products and a few "sensitive" industrial goods are only partially freed of barriers to entry.

²² Frank Schoneveld: The EEC and Free Trade Agreements. Stretching the Limits of GATT Exceptions to Non-Discriminatory Trade?, in: Journal of World Trade, Vol. 26 (1992), No. 5, p. 78.

²³ Gatt: Trade Policies for a Better Future. Proposals for Action, Geneva, March 1985, p. 41.

ambiguity, and more strictly applied so that this legal cover is available only to countries that genuinely use it to establish full free trade among themselves".²⁴

In the Uruguay Round some of the deficiencies of Art. 24 were corrected. The "appropriate period" for the realisation of a customs union or a free trade zone was limited to ten years at the most.²⁵ In addition, no major sector may in future be exempted from the regional liberalisation. A particular procedure is laid down for determining the maximum common tariff of a customs union, which may not exceed by the average protection level of the individual countries. This procedure is based on the actually applied customs duties (which are often much lower than those bound by Gatt) and it weights the individual tariff positions with the imports of a "previous representative period". The compensation rule with regard to third countries was made more precise and the claim of an integration community to "reverse compensation" for the lowering of tariffs (and the reduction of other barriers to trade) by countries joining was explicitly denied.²⁶

Reduction of Barriers to Trade

Nevertheless, the new rule still only offers incomplete protection for the trading interests of outsiders. It is not excluded that more trade is diverted from third countries than is created with them. In order to avoid that, the member countries would have to be obliged to reduce the external level of protection parallel to the reduction of mutual barriers to trade.²⁷ Such a liberalisation obligation could be complemented by an opening clause allowing all countries to join which wished to participate on the same conditions as the original members. In this way the formation of closed clubs could be prevented. It would also be important for multilateral rights to be completely guaranteed, especially in cases of dispute, particularly for smaller member countries.²⁸ It would be important above all, however, to put a brake on the tendency of the member countries to "export" integration costs (in the form of an

increased pressure to adjust due to the creation of regional trade), and to prevent the misuse of the increased trading power resulting from integration by means of improved multilateral discipline and procedures.

Regionalism should not, however, be characterised one-sidedly as an antipode of multilateralism which must be restrained. The "new" regionalism of the eighties has led until now not only to a turning away of regional groupings from the international division of labour. In Latin America, for example, regional integration often goes hand in hand with the unilateral liberalisation of foreign trade towards all countries and deregulation of the domestic economy. The contrast between this and the "old" import-substituting and dirigistic regionalism could hardly be stronger. Similarly, in East Asia the creation of the free trade zone between the ASEAN countries is accompanied by a further reduction in barriers to trade with third countries. In Europe and North America, finally, integration to date has not led to significantly higher barriers to trade and investment between the regions or individually towards single third countries.²⁹

Regional initiatives could also on their part make an important contribution towards the further development of the multilateral system and the multilateral process of liberalisation. The European Single Market, for example, has provided important impulses in various fields of the multilateral negotiations. Examples are the technical barriers to trade, services and public procurement. In some of these areas a more ambitious multilateral opening of markets could be oriented on the European model of mutual recognition of national norms, standards and regulations, on the basis of common minimum requirements. This liberalisation and deregulation would not have to cover all of the WTO members to begin with, but could at first be limited to a smaller, but no longer regionally limited, number of countries. This would however, similarly to the regional groupings, have to be open without limitations to new members.³⁰

²⁴ Ibid.

²⁵ Previously transitional periods of up to 22 years – or no limit at all – were agreed. The new upper limit may, however, be exceeded in "extraordinary cases".

²⁶ On the occasion of Greece's joining the EC in 1981 the EC demanded compensation from the other Gatt members for the easier entry to the Greek market which now also applied to third countries. The Community put forward similar demands to Japan after Spain and Portugal joined the Community in 1986. Such claims cannot be made in future. At the same time, however, the integrated communities will in future be granted not only "internal" but also "external" credits: in the case of tariff increases by individual members a customs union can demand not only corresponding tariff reductions in other member countries but also reductions in other tariffs in the tariff-increasing country.

²⁷ The commitment to liberalise externally could be interpreted as a *quid pro quo* by the member countries to the other Gatt (WTO) members for renouncing their claim to most-favoured-nation treatment and for the losses of exports which this involves.

²⁸ Such a "Gatt acquis" is extensively guaranteed, for example, to the signatories to the agreement of the EFTA countries with the Czech Republic and Slovakia. In the European agreements of the EC, in contrast, there is no corresponding clause. In fact, the special protection mechanism of these agreements is more unfavourable to the eastern European signatories than the general protection clause, since in the first case the Council of Ministers can only overrule protection decisions of the Commission with a two-thirds majority, whereas in the second case the Council itself decides with a qualified majority (and a blocking minority can thus prevent protectionist measures).

²⁹ Cf. Richard Blackhurst and David Henderson: *Regional Integration Agreements, World Integration and the GATT*, in: Kym Anderson and Richard Blackhurst: *Regional Integration and the Global Trading System*, New York 1993, p. 417.

³⁰ Examples are the American-Japanese agreement on semiconductors and the exclusive patent protection agreement between the USA and South Korea, which led to the EC's withdrawing South Korea from its trade preference status.