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Regional Trade Agreements in the Doha Round:  
Good for India?

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## **Abstract**

In recent times, regional trade agreements (RTAs) have become an important factor driving global trade. Though the literature on RTAs continues to grow, few studies highlight the development dimensions of RTAs envisaged in the Doha Development Agenda of the World Trade Organization.

In this context, the basic objective of the present paper is to analyze the issues under the Doha Development Agenda with regard to RTAs. Keeping in view this basic objective, this paper highlights some important issues related to rules governing RTAs in order to produce possible suggestions for India's interest. In conclusion the paper recommends stricter rules governing RTAs in the WTO regime and unilateral trade policies as the keys to growth for developing economies like India.

**JEL Classification:** F10, F15, O24

## I. INTRODUCTION

Regional trade agreements (RTAs) have proliferated since the 1990s, particularly after the completion of the Uruguay Round. Nearly every country in the world now is either participating in or discussing participation in one or more regional agreements. Such agreements have been concluded among high-income countries, low-income countries and more recently starting with the North American Free Trade Agreement (NAFTA) between high-income and developing countries. The structure of regional agreements varies, but all have one thing in common: the objective of reducing barriers to trade between member countries. At their simplest they merely remove tariffs on intrabloc trade in goods, but many go beyond that to cover non-tariff barriers and to extend liberalization to trade and investment. On the whole, the newer agreements tend to have deeper coverage, extending into areas of domestic disciplines beyond the exchange of tariff concessions. A number of agreements now also cover the services sector.

With virtually all World Trade Organization (WTO) members being partners in at least one RTA, these agreements have become by far the most important exception to the most-favored nation (MFN) principle. Moreover, as the number of RTAs multiplies, networks of overlapping agreements may generate intricate webs of discriminatory treatment thereby leading to complex regulatory structures for the conduct of a growing share of world trade. The issue of regionalism vs. multilateralism has generated a vast debate on whether the immediate consequences of regionalism for the economic welfare of the integrating partners encourage or discourage evolution towards globally freer trade. However, most analysts, including the WTO Secretariat, have concluded that on the whole, regional agreements have made a positive contribution to the liberalization of world trade. Keeping in view the other large number of important issues regarding transparency of WTO rules on RTAs, the Doha Development Agenda (DDA) has included the issue of RTA as an area for negotiation in para 29 of the Ministerial Declaration. WTO members agreed to negotiations aimed at clarifying and improving disciplines and procedures under the existing WTO provisions applicable to RTAs. They also agreed that the “negotiations shall take into account the developmental aspects of RTAs.” The economic logic for this is that particularly for the developing countries, the ability to adjust to greater competition in the domestic markets or to take full advantage of additional market access opportunities can be constrained by their individual level of development. This points to the need to examine the flexibilities available during the transitional or implementation period of RTAs, taking into account the needs of developing countries in a properly focused and appropriate manner so as to support their greater integration into the multilateral trading system.

The basic objective of the present paper is to analyze the issues under the Doha Development Agenda with regard to RTAs. Keeping in view this basic objective some of the issues that come to the fore are highlighted in order to produce possible suggestions for India's interest. The remainder of the paper is organized as follows. Section 2 summarizes the General Agreement on Tariffs and Trade (GATT)/WTO provisions on RTAs. Section 3 briefly discusses the global trend of RTAs and Section 4 focuses on the effect of the emerging new regionalism on world trade. Section 5 identifies the RTA-related issues that are of particular interest to India. Section 6 concludes the paper with trade policy recommendations for developing countries.

## II. GATT/WTO PROVISIONS AND RTAs

Nondiscrimination among trading partners who are contracting parties/members of GATT/WTO is the foundation of GATT/WTO. Article I, on most-favored nation (MFN) treatment, requires that members of the WTO (Contracting Parties in GATT terminology) shall extend unconditionally to all other members any advantage, favor, privilege or community affecting customs duties, charges, rules and procedures that they give to members. Yet GATT/WTO articles permitted exceptions to the MFN treatment for customs unions (CUs) and free trade areas (FTAs).

There are basically three routes by which WTO members can form RTAs.

- One is by conforming to provisions of Article XXIV, which remained essentially unchanged between the inception of GATT in 1947 and 1994, when the Uruguay Round Agreement (URA) was signed. The URA merely clarified, but did not change, the provisions of Article XXIV. Paragraphs 4 to 10 of Article XXIV of GATT (as clarified in the Understanding on the Interpretation of Article XXIV of GATT 1994) provide for the formation and operation of customs unions and free trade areas covering trade in goods. Basically, two criteria were laid down in Article XXIV for a CU or FTA to be waived from MFN obligations: first, “substantially all trade” among members of a CU or FTA must be free, and second, post-union (or post-FTA) barriers on trade with non-members must not on the whole be more restrictive than those that members had prior to their forming a CU or FTA.
- The second route open to RTAs among developing countries is the Enabling Clause of the Tokyo Round Agreement invoked in 1979. The Enabling Clause talks about “*differential and more favorable treatment, reciprocity and fuller participation of developing countries.*” In particular, its paragraph 2(c) permits preferential arrangements among developing countries in goods trade. Under this provision, developing countries have exchanged partial tariff preferences within arrangements such as the ASEAN Preferential Trading Area (AFTA) and South Asian Free Trading Area (SAFTA). Para 2(c) says:  
  
*Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs and, in accordance with criteria or conditions which may be prescribed by the CONTRACTING PARTIES, for the mutual reduction or elimination of non-tariff measures, on products imported from one another...*
- The third route is Article V of the General Agreement on Trade in Services (GATS), which governs the conclusion of RTAs in the area of trade in services, for both developed and developing countries.

Table 1 shows the RTAs notified to GATT/WTO and in effect under the different WTO provisions.

**Table 1. RTAs Notified to GATT/WTO and in Effect:  
Summary Statistics, as of 15 June 2005**

<b>WTO provision</b>	<b>Accessions</b>	<b>New RTAs</b>	<b>Total</b>
GATT Art. XXIV (FTA)	4	122	126
GATT Art. XXIV (CU)	4	6	11
Enabling Clause	1	21	22
GATS Art. V	2	36	38
Total	12	185	197

Source: <http://www.wto.org>

Whether or not a CU or FTA that is consistent with Article XXIV would have increased global welfare, it is clear that the procedures laid down for examining such consistency have not worked. Because preferential trade agreements are inherently discriminatory, their proliferation has led to fears that they may undermine the multilateral process of trade liberalization. The issue became a key subject of discussions at several WTO working parties, which had been looking at the regional arrangements notified to the WTO in recent years. In February 1996, recognizing the importance of the issue, the WTO appointed a Committee on Regional Trade Agreements (CRTA) to give coherence to these discussions. A key charge of CRTA is to examine in detail whether regional arrangements are compatible with multilateralism. RTAs falling under Article XXIV are notified to the Council for Trade in Goods (CTG), which adopts the terms of reference and transfers the agreement to the CRTA for examination.

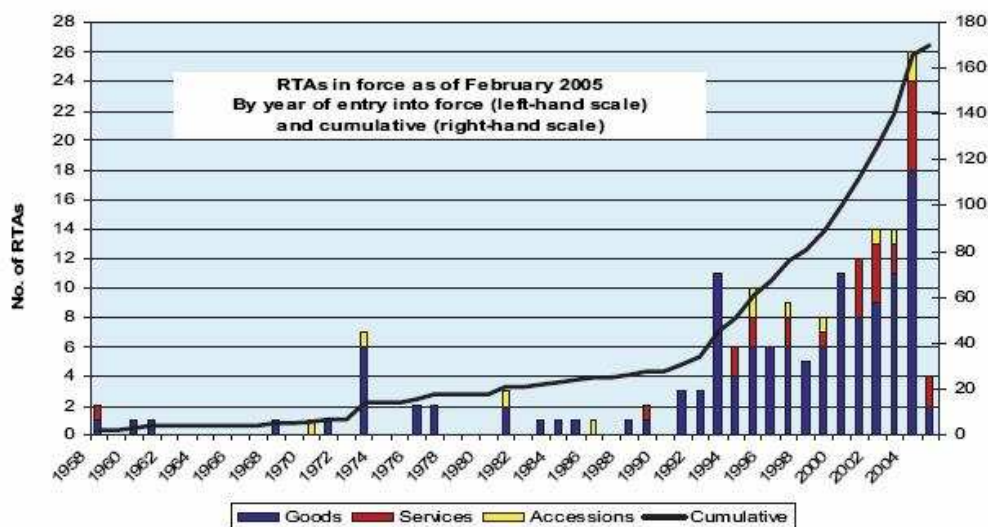
The notification of agreements falling under the Enabling Clause is made to the Committee on Trade and Development (CTD). The agreement is placed in the agenda of the CTD meeting where a debate is held, but, generally, no in-depth examination in the CRTA is requested by the CTD. RTAs covering trade in services concluded by any WTO Member, whether developed or developing, are notified to the Council for Trade in Services (CTS). Although the CTS may decide to pass the agreement to the CRTA for examination, unlike the case of RTAs notified under Article XXIV of the GATT, such examination is optional and not mandatory.

This CRTA, however, has enjoyed no success so far in assessing the consistency of the more than 100 RTAs notified to the WTO, due to various political and legal difficulties, most of which were inherited from the GATT years. One problem derives from the possible links between any CRTA consistency judgement and the dispute settlement process. Members are reluctant to provide information or agree to conclusions that could later be used or interpreted by a dispute settlement panel. Also, there are long-standing controversies about the interpretation of the WTO provisions against which RTAs are assessed, and institutional problems arising from either the absence of WTO rules (e.g., on preferential rules of origin) or from troublesome discrepancies between existing WTO rules and those contained in some RTAs. The rising number of RTAs is also increasing the risk of incoherent trade policy regulations being implemented through these special regimes.

### III. GLOBAL TREND OF RTAs

In the 1990s, the number of notified RTAs began to surge upwards. Uncertainty concerning the outcome of the Uruguay Round has been one of the reasons advanced for such a trend. However, even after the conclusion of the Uruguay Round and the establishment of the WTO the number of RTAs has continued to grow. As of February 2005, about 250 RTAs had been notified to the GATT/WTO, of which 162 are currently in effect. It is estimated that by 2007, a further 87 RTAs<sup>1</sup> will be in effect, if those currently being planned or under negotiation are concluded. Figure 1 shows the unabated growth of RTAs notified to the GATT/WTO.

**Figure 1. RTAs in Force as of February 2005**



Source: Crawford and Fiorentino (2005)

Although RTAs may take the form of free trade areas (FTAs), customs unions (CUs), or agreements leading to the formation of one or the other, the most common category is the free trade agreement, which accounts for 72% of all RTAs. The trend towards the conclusion of free trade agreements, which require a lesser degree of integration and are faster to conclude, has intensified in recent years. In an FTA each party maintains its own tariffs vis-à-vis third parties. Customs unions, which provide for the establishment of a common external tariff and harmonization of trade policy, often, take years to negotiate and have long implementation phases. Customs union agreements account for 19 percent of all RTAs. Eighteen of the RTAs identified (17 FTAs and 1 customs union) contain commitments on trade in services in addition to tariff concessions on goods. The new generation of RTAs, especially those involving developed countries, tend to go far beyond traditional tariff-cutting exercises and even beyond the realm of existing multilateral rules. First, while old regionalism was essentially confined to RTAs between industrial economies or the developing economies, the new regionalism is known for cross alliances between developing and industrial economies. Second, while old regionalism was essentially limited to RTA formations by contiguous economies, the new regionalism does not seem to be limited to neighboring economies. In recent times RTAs have been intercontinental.

<sup>1</sup> Regional Trade Integration under Transformation. Preliminary Draft prepared for the Seminar on Regionalism and WTO. WTO Secretariat, Geneva. 26 April 2002.



Although there may be coordination-related problems, from the gains-from-trade perspective this could be a healthy development. Third, under the new arrangement RTAs are not exclusive, meaning thereby one country can simultaneously be a member of more than one RTA. This may eventually turn out to be an aid to promoting multilateralism through RTAs. Fourth, while old regionalism was limited to shallow integration, the new regionalism is more ambitious. A number of recent agreements aspire for deep integration, with commitments to harmonization of regulatory measures, freeing factor movements, and other close integrating measures. Such trade agreements include more and more regional rules on investment, competition and standards, in a few cases; they also contain provisions on environment and labor. Many more agreements today contain disciplines limiting the use of quantitative restrictions and subsidies among countries forming an RTA.

The configuration of RTAs is diverse and becoming increasingly more complex with overlapping RTAs. The simplest configuration is a bilateral agreement formed between two parties. These account for more than half of all RTAs in effect and for almost 60 percent of those under negotiation.<sup>2</sup> The most noteworthy development expected in the next five years is the emergence of a new category of agreement, namely RTAs where each party is a distinct RTA itself.<sup>3</sup> Several agreements of this kind are currently under negotiation.

The greatest concentration of RTAs is primarily centered around Western Europe constituting about 50 percent of the RTAs currently in effect. Further, the enlargement of the European Union (EU) in 2005 and 2007<sup>4</sup> has increased its membership from 15 to 27 with the addition of 12 new countries. The EU is also negotiating and concluding second-generation bilateral FTAs based on a reciprocal exchange of preferences with partners in the Mediterranean and North Africa, with the objective of establishing a Euro-Med free trade area by 2010. The EU is also looking to forge closer ties with emerging markets in Latin America. Its FTA with Mexico entered into effect in mid-2000 and negotiations on FTAs with MERCOSUR (Argentina, Brazil, Paraguay and Uruguay) and Chile have been taking place.

Countries of North Africa are participating in various other regional trade initiatives both in Africa and the Middle East, such as the recent effort launched by the Arab League to establish an Arab Free Trade Area by 2007<sup>5</sup> and a broader economic union (including a single market and currency by 2010). For their part, the Gulf Cooperation Council (GCC) countries established a common external tariff in 2003, and are engaged in discussions with the EC on the negotiation of a possible RTA.

In Sub-Sahara Africa, the regional integration process is gaining depth, although progress is uneven and far from certain due to the complex web of overlapping RTA membership. In western Africa, there are two advanced levels of RTAs; one is the West African Economic and Monetary Union (WAEMU)<sup>6</sup> and the other is the Central African Economic and Monetary Community (CAEMC).<sup>7</sup> In eastern and southern Africa, members of the Common Market for Eastern and

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<sup>2</sup> This high number of bilateral agreements partly results from regional integration “hub-and-spoke strategies” requiring each “spoke” to conclude a bilateral RTA with the hub. Wonnacott (1996) introduced the terminology of hubs and spokes. A hub arises where one country (customs territory) is a member of two distinct RTAs. Since the development of the new regionalism, many countries are now hubs. The concept has been pushed a step forward by the EC, which (as a “hub”) is often linked to “spokes” which also conclude bilateral RTAs among themselves (e.g., the Euro-Mediterranean Partnership process).

<sup>3</sup> Examples include EC-MERCOSUR, CARICOM-CACM, and SACU-SADC.

<sup>4</sup> Bulgaria and Romania Joined the EU in 2007 taking its membership from 25 to 27 countries.

<sup>5</sup> Gulf Cooperation Council members are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates plus Jordan, Tunisia, Egypt, Sudan, Syria, Somalia, Iraq, Palestine, Lebanon, Libya, Morocco, and Yemen.

<sup>6</sup> Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal, Togo

<sup>7</sup> Cameroon, Central African Republic, Congo, Equatorial Guinea, Gabon, Chad

Southern Africa (COMESA)<sup>8</sup> have achieved their objective of creating a free trade area grouping of 20 countries, and similarly, the parties to the South African Development Community (SADC) established a free trade area by 2004, despite difficulties mainly due to overlapping membership with other RTAs, in particular the long-standing South African Customs Union (SACU) agreement.<sup>9</sup>

The Asia-Pacific is a region undergoing significant changes with respect to its stance towards regional integration, with a number of countries shifting their long-standing policy of MFN trade liberalization to actively consider the regional option. Also, the “open regionalism” typically associated with the Asia Pacific Economic Cooperation (APEC) group appears to be counteracted by a drive towards preferential trade initiatives. Japan, the Republic of Korea, and Singapore have been negotiating and conducting feasibility studies for the establishment of several RTAs both among countries in the region and cross-regionally. Similarly, New Zealand and Australia are exploring the possibility of several RTAs with regional partners and with countries of the western hemisphere. Singapore and New Zealand have already concluded a far-reaching RTA and discussions are being held for a Closer Economic Partnership (CEP) between New Zealand and Hong Kong, China. Japan and Singapore formed their own bilateral agreement in 2002. A notable development in the region has also been the agreement between the members of the Association of Southeast Asian Nations (ASEAN)<sup>10</sup> and the PRC establishing a FTA in 2005. Japan and the Republic of Korea have also initiated similar negotiations with ASEAN. These developments constitute an enormous change in East Asia. Prior to them, Japan and the Republic of Korea, along with Hong Kong, China and Mongolia, were the only four members of the more than 140 members of the WTO that had not participated in a reciprocal regional trading agreement. See Table 2 below for details of RTAs in the region.

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<sup>8</sup> Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia, and Zimbabwe.

<sup>9</sup> Members of SACU are Botswana, Lesotho, Namibia (it became a de jure member on July 1990), Swaziland, and South Africa.

<sup>10</sup> Brunei Darussalam (1987), Cambodia (1999), Indonesia, Lao People's Democratic Republic (1997), Malaysia, Myanmar (1997), Philippines, Singapore, Thailand, Viet Nam (1995)

**Table 2. Preferential Trade Agreements in the Asia-Pacific Region, June 2006**

<b>Already in Effect</b>	
<b>Regional Trading Agreements</b>	<b>Bilateral Trade Agreements</b>
AFTA (ASEAN Free Trade Area), 1992, 1993	Australia-New Zealand (CER, closer Economic Relations, 1983, 1983)
ASEAN-PRC Free Trade Agreement, 2004, 2005	Australia-Singapore, 2003, 2003
Bangkok Agreement, 1975, 1976	Australia-Thailand, 2004, 2005
Pacific Island Countries Trade Agreement (PICTA), 2001	Australia-United States 2004, 2005
SAARC Preferential Trading Agreement (SAPTA), 1993, 1995	PRC-Hong Kong, China SAR, 2003, 2004
South Asian Free Trade Agreement (SAFTA), 2002, 2006	PRC-Macao SAR, 2003, 2004
Trans-Pacific Strategic Economic Partnership Agreement (TPSEPA), 2005 2/*	PRC-Pakistan, 2005, 2005
	PRC-Thailand, 2003, 2003
	India-Sri Lanka, 1999, 2001
	India-Thailand, 2003, 2004
	Japan-Mexico, 2004, 2005
	Japan-Singapore, 2002, 2002
	Korea (Repub. of)-Chile, 2003, 2004
	Korea (Repub. Of)-Singapore, 2002, 2002
	Lao PDR-United States, 2003, 2005
	Lao PDR-Thailand, 1991, 2001
	New Zealand-Singapore, 2000, 2001
	New Zealand-Thailand, 2005, 2005
	Singapore-European Free Trade Association, 2002, 2003
	Singapore-Jordan, 2004, 2005
	Singapore-United States, 2003, 2004
	Sri Lanka-Pakistan, 2005, 2005
	Viet Nam-United States, 2000, 2001

Source: Tumbarello (2006)

Note: \* (2/) Not yet in effect. In both regional and bilateral trade agreements, the first year refers to the year of signing of the agreement and the second year is the year it came into effect.

#### **IV. EFFECTS OF NEW REGIONALISM ON WORLD TRADE**

If looked at from a global perspective, the regional developments mentioned above clearly point to the emergence of a trend towards cross-regional RTAs. Most of the major players at the regional level are increasingly looking beyond their regional borders for partners in selective (often bilateral) preferential trade agreements.

This new regionalism is having significant effects on the world trading system. Some of these effects are positive. For example, one member of a multi-country RTA engaging in bilateralism might be motivated to force the other member of the bilateral RTA to make more progress in trade liberalization and thereby promote deeper integration in the RTA. Rajan et al. (2002a, 2002b) give this as one reason behind Singapore's pursuit of bilateralism. They refer to the "convoy problem" whereby the pace of integration is held back by the "least willing member." Another benefit is that RTAs can set precedents and develop negotiation modalities that can be adopted later in multilateral negotiations. The Canada-US FTA, in particular, developed concepts and modalities in the service trade areas that were important in the development of GATS (Lloyd, 2002).

The negative effects include multiple systems of rules, unequal access to world markets, undermining the MFN principle, and hub-and-spokes strategies. RTAs certainly create multiple systems of rules. This multiplicity may pose a problem for the governments and the traders of one country that is a member of more than one RTA. In areas such as rules of origin, and sanitary and

phytosanitary standards, export traders may face different rules depending on the destination of their exports.

The precedents set by RTAs may be bad as well. There has been concern over some of the RTA precedents. One example is the exclusion of some agricultural products from the trade liberalization under the Japan-Singapore Economic Partnership Agreement; specifically, the Agreement excludes cut flowers and ornamental fish, Singapore's principal exports of agricultural products to Japan, from the list of products imported under the terms of the agreement into Japan. It has been reported that Japan is pushing for a similar exclusion in the negotiations with Australia, the Republic of Korea, and Mexico. Another example is the US predilection for side agreements on environment and labor standards. Having succeeded in embedding these in NAFTA, the US is now pursuing such agreements in other bilaterals and in the Free Trade Area of the Americas (FTAA).

Since the development of the new regionalism, many countries are now hubs. In the Asia-Pacific area, Australia, Canada, Chile, Mexico, New Zealand, Peru, Russia, Singapore, and the US are now hubs on the basis of RTAs already in effect and others such as Japan and Thailand may join them soon. One can measure this effect crudely by considering the number of spokes for each hub, that is, the number of countries with which one hub country has separate bilateral free trade agreements (excluding plurilateral RTAs of which it is a member as these have connections across spokes). One might describe the EU as a super-hub because of the large number of spokes. Hubs create multi-layered preference schemes. One consequence is that the spokes have less market access than the hub (as the hub enjoys preferential access to all spokes but a spoke has preferential access to the hub only) and, for the reverse trade, a hub gets unrestricted imports from the spokes but each spoke gets unrestricted access only from its hub partner.

New regionalism has created unequal access to world markets. Most of the bilaterals are between developed countries or in a few cases between a developed and a developing country; examples of the latter are the agreements Mexico has with the European Commission (EC) and EFTA<sup>11</sup> countries. When the larger size of the markets in developed countries—especially the US and the EU—is taken into account, there is no doubt that the increase in market access resulting from bilaterals has gone overwhelmingly to developed countries and not to developing countries. The one significant exception among the developing countries appears to be Mexico, which has secured mostly free access to its major markets in both North America and Europe. In the APEC area, the countries that have gained improved market access from the bilaterals are all the higher income countries of the region, again with the exception of Mexico.

## **V. RTA ISSUES OF INTEREST TO INDIA**

### **A. India's stand**

India is a marginal player in the global trade scenario. Its share in global trade is below one percent. India is also not a part of any RTA that has substantial influence on world trade. As a part of the integration process with the world, signing of the Bangkok Agreement (signed by Bangladesh, India, Republic of Korea, Lao People's Democratic Republic, Philippines, and Thailand) in 1975 was the first initiative. The agreement failed to go a long way in achieving its objective of trade expansion. Recent developments like proposals of accession of the People's Republic of China to the Bangkok Agreement have given rise to new expectations. India's second initiative on this front is the SAARC free trade agreement (SAFTA) with Bangladesh, Bhutan, Maldives, Nepal, and Pakistan which came into full effect in 2006. Due to political tension between India and Pakistan and also for reasons like the very limited export basket Bangladesh, Maldives and Nepal have to offer to the comparatively larger economies like India, Pakistan, and Sri Lanka,

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<sup>11</sup> The European Free Trade Agreement came into existence in 1960

India has not achieved much from this regional arrangement. India is also a part of Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation (BIMST-EC), with the other member countries being Bangladesh, Myanmar, Sri Lanka, and Thailand. India also entered into a bilateral free trade agreement with Sri Lanka in 2000 and more recently with Thailand in 2004 and negotiated a comprehensive economic cooperation agreement (CECA) with Singapore and ASEAN in 2005.<sup>12</sup> Total SAFTA<sup>13</sup> and BIMST-EC trade constitute about 1.5 percent and 2–3 percent of total world trade, respectively. This implies that about 96 percent of India's trade is outside the preferential zone. More than half of this 96 percent is with countries that are part of one or more RTAs. For instance, NAFTA and EU constitute 50 percent of India's exports, 10 percent goes to ASEAN, and another 10 percent to Japan and South Asia. Therefore on the whole, 70 percent of India's trade is with countries that are part of strong and well established RTAs. So, with India being part of only SAFTA, the Bangkok Agreement, and BIMST-EC, the country needs to take a strong view on whether its interest would lie in seeking tighter discipline in WTO on RTAs.

Within the GATT and the WTO, the examination of specific RTAs has been plagued by disagreement about the interpretation of certain elements of the rules relating to RTAs as well as by certain procedural aspects. In practice, the Committee on Regional Trading Agreements (CRTA) of the WTO has also not been able to resolve many of the systemic issues. The WTO Secretariat has prepared a synoptic paper on procedural and systemic issues (document TN/RL/W/8/Rev.1), which summarizes on a factual basis the discussion that has already taken place on RTAs and highlights the issues.

On the goods side, probably the most important single issue relates to the interpretation of the term “substantially all the trade,” which relates to the requirement that “duties and other restrictive regulations of commerce ... are eliminated on substantially all the trade between the constituent territories” as defined in GATT Article XXIV:8. This is particularly relevant for those agreements where the coverage of agriculture is currently limited, for example, many of the RTAs formed by European countries. A few RTAs have eliminated all duties on agricultural goods, but in general agricultural trade, even on a preferential basis, remains subject to exceptions. Average agricultural preferential tariffs remain high and concessions on agricultural products granted by RTA partners tend to be parsimonious in nature. The debate on “substantially all the trade” has centered on two possible interpretations, which are not mutually exclusive. The first, a quantitative approach, favors the definition of a statistical benchmark, such as a certain percentage of trade between the parties. The second, a qualitative approach, would require that no sector (or at least no major sector) be excluded from intra-RTA trade liberalization. For India too, agriculture is a sensitive sector. But whether India would like to grant concessions on agricultural products will depend much on the partner country's export basket and India's export competitiveness. But perhaps it is logical for India to go with the second option, i.e., a qualitative approach and where necessary use of the positive list approach in granting concessions on agricultural products, as is done in the majority of RTAs.

Another issue deals with “the general incidence of duties,” which are not on the whole to be higher or more restrictive against third parties upon the formation of a customs union (Article XXIV: 5). This issue has been largely clarified with the 1994 Understanding, which specifies that the evaluation of the general incidence of the duties and other regulations of commerce applicable before and after the formation of the customs union shall be based upon an overall assessment of weighted average tariff rates, for which the applied rates shall be used. If it were desired to ensure that even static trade diversion were avoided, this could be also achieved by requiring that the MFN rates also be reduced to a level that would prevent or minimize trade diversion. In relation to “other regulations of commerce (ORCs)” (Article XXIV: 5) and “other restrictive regulations of

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<sup>12</sup> India is also currently negotiating RTAs with Brazil, PRC, Chile, MERCOSUR, and SACU including an EPA with Japan.

<sup>13</sup> India is the major country in SAFTA. India's share in the world is 0.8 percent and the rest of the countries put together make up for another 0.7 percent.

commerce (ORRCs)” (Article XXIV: 8), the systemic debate also runs up against the issue of the definition and measurement of non-tariff barriers. The only exceptions concern quantitative restrictions that satisfy GATT provisions (e.g., agriculture, balance of payments, and health or safety considerations). “Regulations of commerce” is an expression that has been used in the GATT legal texts only in connection with RTAs. No definition of the term is provided. Some Members have argued that what is important is not whether some specific measures fall under the umbrella of ORRCs, but rather if their application among RTA parties leads to a restriction on the trade of third parties. The question that concerns India is whether safeguards and anti-dumping measures are considered as ORCCs. Moreover, should consideration of ORCs and ORCCs be different in fully implemented RTAs and interim agreements? SAFTA has encouraged tariff concessions, but significant non-tariff trade barriers remain in place. Anti-dumping investigations continue to be a major barrier to trade in the South Asian sub region. Also, in terms of measurement of non-tariff barriers, it needs to be clarified, for example, what methodology should be used to aggregate commitments on domestic supports and export subsidies.

There are no explicit WTO disciplines on the use of preferential rules of origin. The rules of origin can multiply distortions as overlapping FTAs have begun to form. Origin rules should be justified to prevent products from non-parties to an RTA gaining preferential access to the market through the party, which maintains the lowest external import restriction (i.e., to avoid “trade deflection”). There are different interpretations on whether or not RTA origin rules constitute ORCs. There have been arguments for and against. However, most member countries of the WTO believe that RTA rules of origin definitely constitute an ORC. Most countries in the world agree that a case by case examination of the preferential rules of origin in RTAs is needed. That would clearly indicate whether these rules had restrictive effects on the trade vis-à-vis third parties.

The meaning of certain aspects of Article V of the GATS has also been raised. The basic provision is that an “economic integration agreement,” the term used in the GATS for an RTA covering trade in services, should have “substantial sectoral coverage,” understood in terms of the number of defined sectors used in GATS schedules of commitments, volume of trade affected, and modes of supply. This coverage is to be achieved through the elimination of existing discriminatory measures and the prohibition of new or more discriminatory measures. For the purposes of evaluation, account may be taken of the contribution of such an RTA to a wider process of economic integration or trade liberalization among the Members. Some flexibility is allowed for such agreements involving developing countries. Many countries including India agree that unavailability of detailed trade data in services makes it difficult to arrive at a percentage-type test for quantitatively measuring “substantially all discrimination.”

One important issue deals with RTAs established under the Enabling Clause, i.e., RTAs in the area of trade in goods between developing countries. As Laird (1999) writes, an RTA formed under the Enabling Clause need not cover substantially all the trade; does not require duty elimination; has no fixed timetable for implementation; and is not subject to periodic reporting requirements. The only main obligations of parties to such an RTA are to notify the agreement or its modification to the WTO Committee on Trade and Development, to furnish information deemed appropriate, and afford the opportunity for prompt consultations with respect to any difficulty or matter that may arise. India is unlikely to oppose this point and would not like to touch the enabling clause while flagging other issues in the negotiating group.

Another point that would be of concern to many developing economies including India is the unclear issues related to transition periods. Could RTA parties apply a longer (exceeding 10 years) transition period to some products? When it is said that any interim agreement shall include a plan for the formation of a customs union or an FTA, it is not clarified as to what should constitute a “reasonable length of time.” When should interim agreements fulfill the requirements spelled out in paragraphs 5 and 8 of Article XXIV? As noted by Laird (1999), the developed countries tend to have wider trade coverage and generally apply their commitments over a stricter time frame than their partners. There is no explicit provision for such asymmetrical application of the WTO rules,

although this would seem consistent with the principle of special and differential treatment for developing countries.

Developing countries have also voiced their concern with other countries on the issue for elaborating disciplines aimed at ensuring that third parties are compensated for the possible negative effects brought by the creation or enlargement of an RTA. Finally, regarding the notification requirements (para 7), it has been observed by India that clarification with respect to contents of notification is required. Ambiguous notification requirements do not obligate members to provide substantial information. Therefore sufficient information should be provided by the RTA members to build up a strong database to help all members.

Since India is not a member of any RTA that has a strong influence on world trade, India will stand to lose because of trade diverting effects of any RTAs and the new formations where it is not involved. The Indian textile sector, for instance, has been badly affected because the US gives preferential treatment and duty free access to textile products from Mexico under NAFTA. The question of what should be India's general stand on RTAs is difficult to arrive at. For this India will have to look at whether or not RTAs promote global welfare, i.e., it has to analyze the extent of trade diversion due to RTAs and its impact on Indian exports. However, all India's present agreements with the regional partners have opened the markets for Indian goods in the countries concerned. All these agreements constitute unilateral tariff reduction except the India-Sri Lanka FTA. India's overall trade balance with SAFTA is positive. The share of India's exports in South Asian countries has increased from 2.73 to 6.2% over the period 1990 to 2006<sup>14</sup>. Hence its existing and recent initiatives in regional/ bilateral trade liberalization may help to divert some trade of the countries concerned from their other trading partners in favor of India given their supply capabilities, and therefore may be beneficial to India.

## **B. Other problem issues in RTAs involving countries at various stages of development**

Some of the other problematic issues in respect of RTAs are (i) use of tariff peaks<sup>15</sup> by developed countries, (ii) equivalence notion under the Sanitary and Phytosanitary Measures (SPS) Agreement not being extended on an MFN basis, (iii) rules of origin problem, and (iv) non-reciprocal tariff concessions. Some of these issues are also quite important as far as the trade diversion aspect of RTAs is concerned. These issues are dealt with here briefly one by one.

### ***(i) Use of tariff peaks by developed countries***

After the implementation of the Uruguay Round, and the consequent tariffication of non-tariff protection in agriculture, dispersion in tariff rates did not fall substantially, and even increased in some instances. Especially in the case of agriculture, protection was lowered mostly on the items already characterized by relatively low barriers, while the tariffication procedures did little to reduce protection on highly protected goods such as dairy, meat, and sugar. Overall, the phenomenon of tariff peaks seems to have been aggravated.

Although the average tariff rates in the industrialized countries are low, they have high peak tariffs for certain products, some of which are of export interest to many developing countries. In certain Quad markets (EU and Japan, especially) MFN tariff peaks in some processed agriculture and food categories can be so high as to displace completely exports from developing countries in the absence of any preferential regime. As can be seen from Table 2, in Canada and the United States, tariff peaks are concentrated in textiles and clothing; in the EU and Japan, they are concentrated in agriculture and food products.

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<sup>14</sup> [www.commerce.nic.in](http://www.commerce.nic.in)

<sup>15</sup> In a tariff schedule, a single tariff or a small group of tariffs that are particularly high, often defined as greater than three times the average nominal tariff.

Preferences granted by the Quad are of a cascading nature: countries with FTAs get the best treatment, followed by least developed countries (LDCs) and other developing countries. The US grants preferences to the members of the Andean Pact, Caribbean Community, and to Mexico under NAFTA. Two different groups of LDC countries are constructed in the EU case: LDCs that are not African, Caribbean, and Pacific group members, and LDCs that are. For Canada, the developing countries are grouped into several categories: those benefiting from LDC, GSP (Generalized System of Preferences), and Mexico and Chile, which benefit from FTA status. Finally, for Japan, developing countries are divided into GSP beneficiaries and LDC beneficiaries. On average, the preferential schemes are quite generous, but are much less generous for tariff peak products. Preference margins on tariff peak items for GSP beneficiaries are only 9 percent in Canada, 18 percent in Japan, and 23 percent in the US<sup>16</sup>. For LDCs the margins fall to 25 percent in Canada, and 30 percent in the US and Japan. The EU by contrast has a 50 percent margin for GSP beneficiaries and 70 percent margin for LDCs in tariff peak items. It is said that tariff peaks in Japan affect about US\$500 million in LDC exports to the world and those in the EU affect about US\$800 million.

Indian exports such as textiles and garments as well as agricultural commodities can be greatly affected by the prevalence of tariff peaks. Market access for these products could be facilitated by our ability to secure reduction in these tariffs in the industrialized countries through future tariff negotiations in the WTO framework. The phasing out by all countries of tariff peaks and escalation (tariffs rising with the degree of processing of imports) is critical to the development dimension of the current round of multilateral trade negotiations, and could best be achieved through formula approaches that ensure deep across-the-board reductions. Hence the issue of tariff peaks and tariff escalation should be addressed very carefully, since this holds back export-led growth and leads to greater trade diversification in countries that are not members of any significant RTA and the developing countries in general. Moreover, the higher the MFN rates of a developed country, the greater the leverage strength it will enjoy in terms of asking for special privilege from the developing countries, particularly in any of the North-South RTA formations.

**Table 3. Distribution of Tariff Peaks by Product Groups in Quad Countries**

Product Group	Total	No. of. Items					No. of Peaks Total	Share in Total (%)
		12-19%	22-29%	32-99%	100-299%	>= 300%		
European Union								
Agricultural and Fishery Products (1-24)	2779	544	313	31	2	1221	97.7	
Mineral Products, Fuels (25-27)	257	0	0	0	0	0	0	0
Leather, Textiles, Clothing (41-43, 50-64)	1565	6	0	0	0	0	6	0.5
Industrial Products (28-96)	7771	27	7	8	0	0	42	3.3
ALL PRODUCTS (1-96)	10807	571	338	341	31	2	1263	100
Japan								
Agricultural and Fishery Products	1897	204	299	111	81	65	760	85.1
Mineral Products, Fuels	194	0	0	0	0	0	0	0
Leather, Textiles, Clothing	2410	42	39	15	28	7	131	14.7
Industrial Products	6880	44	39	15	28	7	133	14.9
ALL PRODUCTS	8971	248	338	126	109	72	893	100
USA								
Agricultural and	1779	138	70	99	15	11	333	36.6

<sup>16</sup> Hoekman & Olarreaga (2002)



<b>Fishery Products</b>								
<b>Mineral Products, Fuels</b>	183	0	0	0	0	0	0	0
<b>Leather, Textiles, Clothing</b>	1814	374	110	40	0	0	524	57.4
<b>Industrial Products</b>	8123	407	127	45	0	0	579	63.4
<b>ALL PRODUCTS</b>	10085	545	197	144	15	11	912	100
<b>Canada</b>								
<b>Agricultural and Fishery Products</b>	1429	65	10	16	68	0	159	27.4
<b>Mineral Products, Fuels</b>	187	5	0	0	0	0	5	0.9
<b>Leather, Textiles, Clothing</b>	1209	320	27	0	0	0	347	60.1
<b>Industrial Products</b>	6791	374	39	0	0	0	413	71.6
<b>ALL PRODUCTS</b>	8407	444	49	16	68	0	577	100

Note: Harmonized System chapters are given in parentheses

Source: Nagesh Kumar (2001), Research and Information Systems for Developing Countries

## ***(ii) Equivalence Clause under SPS Agreement not being extended on an MFN basis***

The SPS Agreement encourages the use of equivalence and mutual recognition agreements in Article 4. According to that article as well as the decision by the SPS Committee, two SPS measures are said to be equivalent to one another when they are not identical but they yield the same level of sanitary and phytosanitary protection.

Developed country representatives noted that equivalence, although a useful principle in theory was in practice difficult to deal with even for large developed countries<sup>17</sup>. Formal equivalence agreements are rare even between developed countries. The reason for this is that negotiations are very demanding in terms of resources and time. At the same time, ad hoc acceptance of the equivalence of specific products, or of the equivalence of certain technical aspects related to SPS measures, are common. The acceptance often takes place without any formal agreements.

The Agreement between the EC and the United States on sanitary measures is aimed at facilitating trade in live animals and animal products between the two parties, by establishing a mechanism for the recognition of equivalence of sanitary measures. The procedure to reach recognition of equivalency is, however, rather complicated and consists of several steps. Basically, the importing country has to explain the objective of the sanitary measure for which recognition of equivalency is sought and identify its appropriate level of sanitary protection. The exporting country has to demonstrate that its sanitary measure achieves the importing country's appropriate level of sanitary protection. On the basis of the evidence provided by the exporting country, the importing country decides whether the foreign measure achieves its appropriate level of sanitary protection and, therefore, can be regarded as equivalent. The recognition of the equivalence is not easy to achieve and usually implies the fulfillment of several requirements. However, for developing countries, this option is worth pursuing since it would greatly facilitate market access for their products.

While the WTO Agreement on Technical Barriers to Trade (TBT) and the Agreement on Sanitary and Phytosanitary Measures (SPS) recognize that countries have the right to introduce measures necessary to protect human, animal and plant life, however, these measures are not to be applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination among the WTO Members. Developing countries have frequently complained about the lack of implementation of Article 4 regarding equivalence particularly on an MFN basis. They state that importing countries often require "sameness" instead of "equivalence," the former implying that the measures must be identical not only in outcome but also in formulation<sup>18</sup>. Moreover, an RTA may enact a regime of positive integration through rules of mutual recognition. The NAFTA Treaty, for

<sup>17</sup> G/SPS/GEN/212

<sup>18</sup> G/L/423, G/SPS/GEN/128

instance, provides for the mutual recognition of SPS measures if the exporting country's regulations achieve the importing country's appropriate level of protection. The burden of proof is on the exporter. The final decision about equivalency stays with the authorities of the importing country, who take decisions on a case by case basis. With the help of such mutual recognition agreements, regional agreements would effectively increase barriers to imports from third countries, thereby leading to trade diversion.

The question remains of whether the SPS Agreement, including the international standards and guidelines, is a sufficiently strong instrument to ensure that developing countries can in practice derive benefits from the use of the principle of equivalence, as well as one that promotes multilateralism. The core of the problem is the lack of trust on the part of developed countries regarding the capacities of the food safety systems of developing countries. More work by international organizations on clear guidelines on the establishment of equivalence agreements could be very helpful and could help distinguish between "equivalence" as defined by the SPS Agreement and "sameness." Developing countries must take part in the international setting of guidelines on how to achieve equivalence in these areas so as not to be left out. In fact, a number of developing countries have requested more information about how and under what circumstances equivalence can and should be implemented through mutual recognition agreements. India has asked the developed countries to notify the WTO of any equivalence agreements they enter into between themselves so that developing countries can study them and negotiate similar agreements with the developed countries.

### ***(iii) Rules of origin problem***

Preferential rules of origin (ROO) are of crucial importance in the functioning of any FTA in administering a number of trade issues and in avoiding trade deflection. ROO in general serve as important elements in the administration of a range of other trade regulations, including duty drawback provisions; antidumping (AD) provisions; countervailing duty and safeguard proceedings; quantitative restrictions; and prohibited imports. Each of these trade regulations involves distinguishing domestic from foreign goods, or distinguishing among foreign goods. A study made by Bhattacharyya and Das Gupta (2000) on triangular trade among the People's Republic of China (PRC), India, and Nepal clearly showed that in the absence of any value addition norm in respect of manufacturing products according to the Indo-Nepal Trade and Transit Treaty, there was large scale trade diversion via Nepal from the PRC to India. However, despite the importance of ROO, their design can result in their development as a trade protectionist tool hence leading to trade diversion. Krishna and Krueger (1995) demonstrate how rules of origin can act as "hidden protectionism" and induce a switch in demand in free trade partners from low-cost external inputs to higher-cost partner inputs to ensure that final products actually receive duty free access.

ROO is also a major problem in an RTA and acts as a barrier to trade when particularly developed and developing countries are involved. In the EU, the ROO criterion is very complex and is discriminatory. Also, satisfying the certification requirements of the ROO of the EU is often too costly. The benefit conferred by the preferential schemes in certain cases becomes marginal in comparison with the administrative workload and cost to plan the product mix to comply with the preferential ROO. This often leads to instances where firms, although they meet the necessary conditions for origin, decide that it is simpler and cheaper to pay the MFN tariff rates. The different rates of value added criteria reflect the discretionary protectionist interests in formulating the ROO in the EU. This has a negative impact on many developing countries, which are engaged with the EU in preferential RTAs, and their exports bundle is concentrated in such sensitive products as textiles and apparel. For example, a study found that about 75% of EC-EFTA trade benefited from the preferential trade regime, while the use of tariff preferences under other schemes such as the GSP was low, mainly as a result of the restrictive ROO. According to Brenton et al. (2002), information on the implementation of the EU's preferential scheme of access for developing countries shows that only one third of EU imports from developing countries that were eligible for

preferences actually entered the EU market with reduced duties. This primarily reflects the treatment of textiles and clothing products, which accounted for over 70 percent of EU imports from countries covered by the GSP but where the utilization rate (the ratio of imports receiving preferences to eligible imports) was only 31 percent.

In some RTAs, ROO can be subject to a “cumulation” procedure. According to this procedure, ROO are broader in their geographical coverage required for a certain product to confer origin. In other words, ROO of a certain product in a given exporting country confer to the required ROO set by the RTA if they are partly allocated in that exporting country on the condition that the rest of the requirements to fulfill the required ROO be done in other countries that are agreed upon from the members of the RTA. This procedure relaxes the restrictiveness of the ROO and reduces their negative impact on production distortions and trade and investment diversion. However, some experts argue that cumulation is likely to have negative consequences on the developmental efforts of developing countries engaged with developed partners in RTAs.

In NAFTA, the change in tariff heading (CTH)<sup>19</sup> supplemented by value added criteria are the main rules applied in determining ROO. Compared to the European Economic Area (EEA) Agreement, NAFTA places a greater reliance on CTH and less use on value added criteria, which is applied more intensively in the case of sensitive sectors as textiles and automobiles. Regarding automobiles, there is an initial regional value-added requirement of about 55%. In the textiles sector, the value added required is so high resulting in a very restrictive ROO in this area. Here the ROO for textiles and apparel are “triple transformation,” implying that all the materials used in producing the goods are made in North America. In other cases, ROOs are based on the material inputs used. The reason why NAFTA does not follow the EEA system is the fear on the part of the US of the low cost Mexican automobile assembly industry, which could result in the import of components from a non-NAFTA country for further processing in Mexico to produce a final product of “Mexican” origin.

ASEAN rules of origin allow up to 60% of non-members’ originating input<sup>20</sup> incorporated in the ASEAN products entitled to the Common Effective Preferential Tariff (CEPT)<sup>21</sup> under AFTA. Also ASEAN applies a cumulative ASEAN original input for CEPT products, so that in practice the net cumulative regional content may be lower than 40% and the eligibility for ASEAN-origin is still valid<sup>22</sup>.

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<sup>19</sup> CTH mainly implies that the intermediate inputs must undergo a change in tariff classification heading within the territories of the exporting member of a RTA in order to be considered originating in the exporter member country. The basic notion underlying this approach is that, for most goods, a reasonable way to measure the degree to which an imported input is transformed within the FTA is to compare the tariff heading under which it was imported with the tariff heading under which the final product would be exported. If these two tariff headings are sufficiently “distant” in the sense that they apply to substantially different goods, regional origin can be attributed.

<sup>20</sup> Rule 3 (ii) of the ASEAN Rule of Origin provides that “(ii) Subject to Sub-paragraph (i) above, for the purpose of implementing the provisions of Rule 1 (b), products worked on and processed as a result of which the total value of the materials, parts or produce originating from non-ASEAN countries or of undetermined origin used does not exceed 60% of the free on board (FOB) value of the product produced or obtained and the final process of the manufacture is performed within the territory of the exporting Member State”.

<sup>21</sup> Article 1 of the Agreement on the CEPT scheme for the ASEAN Free Trade Area states that the CEPT is an agreed effective tariff, preferential to ASEAN, to be applied to goods originating from ASEAN Member States, and which have been identified for inclusion in the CEPT scheme in accordance with Arts. 2 (5) and 3.

<sup>22</sup> For instance, if product A has a value of 100, of which 40% is local content in Singapore, it may be exported to Malaysia at a CEPT rate, where 5% local content is added for a total value-added in Malaysia of 100. Upon export to Thailand it is considered to have 45% ASEAN content even though “net” cumulative content is 22.5% of 200.

In SAFTA, the ROO distinguish between goods that are “wholly produced or obtained” and goods that are not “wholly produced or obtained” in an exporting SAPTA country. In order to encourage regional value addition, the agreement also includes a cumulative rule of origin, which initially said that goods processed in more than one member country can be eligible for concessions provided that the value added in SAPTA countries was at least 60 percent of the free on board (FOB) value. The ROO local content provision has been a contentious issue and was subject to continuous scrutiny by members who realized that the effectiveness of SAPTA was limited, in part due to low value addition in many of their most competitive exports. After much resistance particularly from India, the local content requirement was reduced to 40 percent for the non-LDC members (India, Pakistan, Sri Lanka) and to 30 percent for the four LDC members (Bangladesh, Nepal, Bhutan, Maldives), and the cumulative rules of origin were reduced to 50 percent.

Thus, given the prevalence of PTAs, the question of rules of origin is of particular policy relevance. It is essential that clear-cut principles and criteria for determining the origin of goods be adopted. Rules of origin will vary among the FTAs depending on the underlying sensitivity to intraregional competition and on member countries’ strategic goals and the level of development.

#### ***(iv) Non-reciprocal tariff concessions***

One of the important problem areas is the non-reciprocal tariff concessions exchanged in an RTA. For instance, SAFTA distinguishes between members according to their level of development. The agreement provides “special and favorable treatment” for the LDCs by the non-LDCs, including deeper and wider tariff preferences. Also, tariff and other concessions accorded by a non-LDC to another non-LDC are extended unconditionally to all member countries. However, concessions extended by a non-LDC to an LDC are automatically applied only to other LDC members.

## **VI. CONCLUSION**

There are no clear cut answers to the debate on regionalism and multilateralism. Both are continuing to exercise a strong and powerful influence on world trade. Multilateralism in the form of the WTO has gained popularity in the recent years. The number of countries waiting to seek accession and become members of the WTO corroborates this. At the same time, regional economic groupings have proliferated at a rate and speed never seen before. However, for developing countries, the key to their success lies in reforming their domestic economies: good trade policy begins at home. Whether one follows the regional or the multilateral track, reforming the domestic economy is imperative in order to maximize the gains from trade liberalization. WTO meetings in Seattle, Cancun, and Hong Kong have all affirmed the same bottom line: countries should follow unilateral trade policies suited to their own domestic needs but within the framework of the changing international trade environment comprising both regionalism and multilateralism.

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