



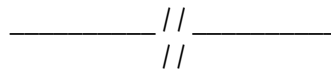
INSTITUTE FOR INTERNATIONAL BUSINESS, ECONOMICS & LAW

Preferential Trade Agreements and the Role and Goals of the World Trade Organization

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Introduction

When Member governments of the World Trade Organization (WTO) went to Cancun, Mexico in September 2003 for their Fifth Ministerial Conference, their objective was to agree frameworks for the key negotiating phase of the Doha Round and otherwise adopt decisions needed to assist in concluding the Round on time by the end of 2004. A series of missed deadlines² in late 2002 and the first half of 2003 complicated the Ministers' task, but most observers expected a result from the meeting which would help to reinvigorate the stalled talks and set new deadlines. The Round, launched in November, 2001, is supposed to be the "development round", promising significant benefits for WTO's poorer Members, so it was important for the Cancun meeting to show some forward movement. When the meeting collapsed, it collapsed completely with no clear direction to negotiators on how to pick up the pieces or any new deadlines against which to measure their progress.

The WTO Round has more or less limped forward since Cancun with very little progress on the frameworks and almost a total lack of real negotiations amongst the Members on issues like market access for goods and services. A lack of progress on agriculture is generally blamed for the absence of forward movement in other areas. Some recent signs of increased flexibility in agriculture from the European Union and the United States as well as something of a *rapprochement* with the Brazilian-led G-20 has encouraged increased optimism in Geneva. There are some important potential pitfalls, however, that could threaten eventual successful conclusion of this WTO Round. The EU Commission will change in October and it is possible that the American election will bring a change in the U.S. Administration, both of which will slow forward movement for some time in a negotiation that is already 18 months to two years behind schedule.

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² Deadlines had been missed in respect of TRIPS and Public Health, Agriculture, Market Access for Non-Agricultural Goods and the re-negotiation of the Dispute Settlement Understanding.

While the WTO's Doha Round languishes, the world is witnessing an unprecedented degree of activity related to the negotiation and implementation of Preferential Trade Agreements (PTAs)³. In the time since the launch of the Doha Round, Australia – long seen as one of the most ardent backers of the GATT-WTO – has negotiated and agreed PTAs with Singapore, Thailand and the United States. Canberra has embarked on a feasibility study of a PTA with China and has been invited by ASEAN members to consider joining New Zealand in a PTA with the regional grouping. And Australia's pace of PTA activity, while impressive, pales in comparison with that of the United States. As of this writing, Washington is simultaneously negotiating PTAs with the Andean Group, SADC, Bahrain and Thailand and there are signs that a negotiation might be possible with Malaysia. Pending before the Congress are recently negotiated PTAs with Australia, the Central American Common Market, the Dominican Republic and Morocco. And the United States has not given up in its now-stalled effort to negotiate a PTA encompassing nearly all of the countries of the Western Hemisphere. Japan and Mexico have concluded a PTA, as have Korea and Chile. Singapore and Panama are exploring a deal. The European Union is in active negotiations on a PTA with Mercosur. Little wonder why, in the face of this activity, a number of commentators have speculated that at least some of the blame for the WTO Round's current sorry state should be ascribed to the enthusiasm key WTO Members are showing for PTA negotiations.

This paper will examine aspects of both the economic and political interface between the WTO and PTAs. It will try to answer the questions of why PTAs are negotiated, what benefits they might produce relative to the WTO's multilateral system and whether PTAs complement or undermine the WTO trading system.

Recent History of PTAs

Notwithstanding the fact that the GATT included rules governing the establishment of PTAs for decades, only a very limited number of PTAs were actually negotiated and implemented prior to 1990. Many of the earlier PTAs were connected in some way with the European Communities, although Australia and New Zealand had CER and the United States had entered into PTAs with Israel and with Canada. Putting the US-Israel agreement to one side, most of the early PTAs were agreements involving neighboring countries.

The number of PTAs notified to the WTO jumped importantly in the 1990-1994 period, when 29 new PTAs were recorded⁴. Recalling that the Uruguay Round of WTO negotiations fell onto hard times following the disastrous 1990 Brussels ministerial meeting, it is possible that this surge in PTAs reflected to some degree a dissatisfaction with the GATT Round. Certainly, Washington's decision to pursue NAFTA negotiations with Canada and Mexico and the United States' emphasis on APEC as a forum for trade liberalization were motivated to some degree by the feeling that GATT had slowed and that the "bicycle of trade liberalization"⁵ had to move forward by alternative means. The break-up of the former Soviet Union and the demise of the COMECON system also helps to explain the rise in PTAs in the 1990s as many of the newly independent transition economies sought to reestablish their trade links with former trade partners.

The successful conclusion of the Uruguay Round in 1993 and the entry into force of the new WTO system in 1995 were widely (and correctly) seen as a triumph of multilateralism and a vindication of

³ The term "Preferential Trade Agreement" will be used to refer to customs unions, regional trade and economic integration arrangements and bilateral free trade agreements.

⁴ World Trade Report 2003, Table IB.9, page 47, World Trade Organization, Geneva, 2003

⁵ Fred Bergsten is credited by some with popularization of the bicycle analogy, wherein a failure to keep moving forward with trade liberalization would likely lead to the bicycle falling over and reintroduction of protectionist measures.

the international trading system. 1996 saw agreement on the Informational Technology Agreement and the launch at Singapore of an impressive WTO work program on some cutting edge issues. The following year, WTO Members concluded two new high visibility multilateral services agreements dealing with basic telecommunications services and financial services. Notwithstanding all of this successful multilateral activity, the number of PTA's recorded in the 1995-1999 period grew by an additional 64 agreements, although 28 of these new PTAs were between the transition economies.⁶

More recently, South-South agreements have accounted for a much larger percentage of the new PTA's notified to the WTO, particularly in the period after 2000. In just three years (2000 through 2002), the world witnessed a 55 percent growth in the number of PTAs between developing countries⁷. Is it possible that the developing countries were motivated to some degree by a disenchantment with the WTO system in the period following the failed Seattle Ministerial Conference?

It is probably not possible to demonstrate a direct relationship between attitudes toward the WTO system and progress (or lack thereof) in WTO trade liberalization on the one hand and the tendency to engage in preferential liberalization through PTAs on the other hand. What one can say with a fair degree of certainty, however, is that the number of PTAs has grown importantly in recent years and continues to grow at a rapid rate. In its World Trade Report 2003, the WTO Secretariat estimated that, in addition to the 176 PTAs notified and in force, 70 PTAs were in force but not notified to WTO and an equal number were under active negotiation.⁸

Explanations for the Proliferation of PTAs

Characteristics of the WTO System

There are a number of political and economic explanations that can be developed for the growth in the number of PTAs in recent years. Some of these explanations are more convincing than others. Because many of the explanations for PTAs relate in some way to actual or perceived failings of the multilateral system of the WTO, we can usefully spend some time here examining the institutional and other difficulties inherent in the WTO system.

Without any doubt, decision-making in WTO can be problematic, but WTO decision-making was purposefully made difficult by those who negotiated the Uruguay Round Agreement Establishing the World Trade Organization because they did not want to see decisions taken easily or lightly that might undercut the results of the Round or undermine the sovereignty of important trading nations. While the WTO Agreement contains many provisions addressed to decision-making by voting, it enshrines consensus⁹ as the practice to be followed in all cases and permits recourse to voting only where a consensus cannot be achieved. In this connection, it is important to note that the Agreement does not instruct us as to how Members are to come to the conclusion that consensus is impossible, justifying a move to voting. As a practical matter then, voting does not take place at WTO. Sovereignty is protected and the WTO "constitution" is not frivolously amended, but the trade-off is that more positively-oriented decisions, such as the initiation of trade liberalizing negotiations, are far more problematic as well. If it is prepared to block consensus, tiny St. Lucia has a power equivalent to the United States.

⁶ World Trade Report 2003, Table IB.9, page 47, World Trade Organization, Geneva, 2003.

⁷ *Idem*.

⁸ World Trade Report 2003, page 46, World Trade Organization, Geneva, 2003.

⁹ In the WTO system, consensus should not be interpreted to mean positive unanimity. Rather a consensus is considered to exist where no WTO Member present at the time a decision is taken objects to the proposed decision.

So decision-making to progress trade liberalization in the WTO requires arriving at a point where none of the WTO's Members will oppose the negotiation. This is where we encounter another problem endemic to today's WTO – the very nature of its membership. At the end of the Uruguay Round, developed country negotiators congratulated themselves on using the combination of the Round's "single undertaking" and the creation of the new Organization to rid the trading system of "free riders". No longer would developing countries be free to reap the benefits of MFN treatment in developed country markets without taking on all of the obligations of the system. All developing countries, including LDCs, were forced to join WTO or risk losing their access to developed country markets. What the negotiators didn't think about in 1994 was that by forcing countries with a very low relative interest in international trade to participate in the new system, they were bound to change the nature of the system. The old GATT was derided as a "rich men's club" but it was also a club of countries for which international trade was important. The WTO of today includes scores of Members that taken together cannot account for even one percent of global trade. If trade is not yet an important element in these countries' international relations, it is much harder for trade-minded countries to persuade or cajole them into cooperating with a forward-looking trade agenda. The problem is, of course, aggravated by these WTO Members' low capacity to participate actively in either the negotiations or in subsequent implementation of negotiated results.

A final aspect of the WTO system that is worth touching on at this point in this paper is the WTO approach to regulating departures from the global non-discrimination rules through PTAs. Ideally, participants in a global system based on non-discrimination should not be able to introduce discrimination through a PTA unless they have some fairly good reasons to do so. On the face of it, the WTO Agreement supposes that the fairly good reason to depart from non-discrimination is the objective of setting up broader and deeper liberalization than is possible under the GATT and GATS. In order to make sure that the PTA partners are being honest about their stated objectives, GATT requires elimination of duties on substantially all of the trade between the partners and GATS mandates substantial sectoral coverage. If two or more countries notifying a PTA to the WTO cannot satisfy these thresholds, then they don't have a legitimate PTA justifying the introduction of discriminatory treatment against other WTO Members. The problem is, the WTO system -- which is supposed to operate through review and analysis of notified PTA's in the Committee on Regional Trade Agreements (CRTA) -- doesn't work. No examination reports have been finalized or adopted for any PTA negotiated and notified to the WTO since the WTO was established in 1995. We will return to this issue later in this paper. For now, and as a practical matter, this means that countries negotiating PTAs need not concern themselves with the possibility that their arrangement might not pass muster under WTO. If you don't have to be particularly worried about satisfying WTO criteria, why not negotiate a PTA?¹⁰

There are then at least three characteristics of the current WTO that argue in favor of pursuing trade liberalization through PTAs: (1) Decision-making in the WTO can be next to impossible and after a point, if you cannot gain agreement to your proposed negotiation inside the WTO, you may want to go down the PTA route; (2) Many current WTO Members are just not that interested in trade or trade liberalization and, as a consequence, are prepared to raise political objections to a forward-looking agenda; and (3) There is currently little downside risk of a negotiated PTA being found to be legally deficient by the WTO review process that has ceased to function effectively. A fourth characteristic of WTO is its more limited scope and coverage. This aspect of the PTA – WTO interface is discussed separately below.

¹⁰ There is, of course, still the risk that the PTA, or elements of it, might be judged as to consistency with WTO as a consequence of a dispute settlement action.

"Third Wave"¹¹ PTAs

The original GATT rules for PTAs were written at a time when the system focused on tariffs and where non-tariff measures that were covered by the rules were nearly always measures that kicked in at the border. The Uruguay Round changed this focus rather importantly as many of the agreements in the system amounted to a "second wave" in the system's scope – moving to behind the border regulatory issues addressed to health and safety standards, prudential regulation, conformity assessment procedures, government procurement and a host of other trade-related measures not covered by the GATT.

While the Uruguay Round resulted in the establishment of the Committee on Trade and Environment and environmental issues gradually becoming regarded as legitimate topics for discussion within the WTO, a number of other issue areas did not make their way onto the WTO agenda until the time of the 1996 Singapore Ministerial Conference. That meeting saw a major debate over the interface of trade and labor standards and resulted in agreement to launch work programs on trade and investment; trade and competition policy; trade facilitation and transparency in government procurement. In Seattle in 1999 and again in Doha in 2001, attempts were made to launch multilateral negotiations on these "Singapore Issues" but without success.

The break-down of the Cancun meeting was attributable in part to the refusal of a large number of developing countries to commence negotiations on any of the "Singapore Issues". Since Cancun, discussions in Geneva seem to have taken us to the point where it may well be possible to gain agreement to begin negotiations on trade facilitation¹². This agreement will, however, likely be conditioned on jettisoning the other three "Singapore Issues" from the WTO's negotiating agenda.

Probably a majority of recent PTA's – at least those involving at least one developed country partner – are "Third Wave" PTAs, the scope of which extends not only to GATT and WTO-era disciplines but also to areas not yet covered in the WTO system. Typically, the agreements include chapters on investment protection and right of establishment, competition policy (with competition policy in some cases replacing recourse to antidumping between the parties), government procurement (today still only a plurilateral agreement in the WTO), environmental protection and, in the case of agreements involving the USA, a chapter on respect for labor standards. Intellectual property provisions in the agreements tend to be more extensive and updated relative to the WTO TRIPS Agreement. It is often also the case that the trade in services chapters of these third wave PTAs are based on a top-down negative list approach that can be far more extensive in its liberalizing effect than the bottom-up approach of the GATS.

Some PTA's included "third wave" provisions before the WTO even included "second wave" rules. NAFTA addressed intellectual property rights, investment, labor and the environment. The Australia-New Zealand CER broke important new ground with its competition policy provisions. Investment, competition policy, government procurement and intellectual property are all important issues for many in the business community and if the business community is pressing government to secure improved access or rules in these areas in overseas markets, that improvement is not going to be

¹¹ The term "Third Wave" PTAs has been used by the Australian Productivity Commission to describe those modern agreements that include provisions addressed to measures and practices not yet addressed in the GATT (first wave) or post-Uruguay Round WTO (second wave).

¹² Proponents of an eventual agreement in the WTO on Trade Facilitation seek to build upon the existing WTO provisions in GATT Article V (addressed to freedom of transit), Article VIII (fees and formalities associated with border processing) and Article X (publication of trade-related rules). The objective of the agreement would be to speed customs clearance times and reduce costs (not related to duties and charges) associated with importing and exporting.

possible – at least in the near-term – through the WTO. Today's limited scope of the WTO's coverage is another important incentive driving the negotiation of PTAs.

Political PTAs

Naturally enough, economic considerations are not the only factors that come into play when PTAs are negotiated. If the motivation for an agreement is essentially political, then the WTO's multilateral route is never a feasible alternative. Economic considerations certainly did not drive the negotiation of the U.S.-Israel, U.S.-Jordan or U.S. Morocco PTAs. The Mercosur agreement linking Brazil, Argentina, Uruguay and Paraguay is another example of a politically-motivated agreement¹³. The fact that an agreement has its origins in political considerations does not, of course, mean that it will not have important economic effects. Reciprocal trade between Argentina and Brazil increased eight-fold between 1985 and 1995 and intra-Mercosur trade tripled in the 1990-1995 period.¹⁴

Mercosur was inspired at least in part by a political desire to lock in institutional changes – many of a non-economic character. There was also an element of using the agreement to consolidate peace in the region (in part by reinforcing the position of non-military governments) and increase regional security. Brazil has long seen itself as a neglected world power and there is little doubt that it sees an advantage in Mercosur in this sense. By first tying in its neighbors and speaking on behalf of Mercosur, Brazil acquired greater bargaining power in external negotiations. Most probably, Brazil would not have been able to sustain its “go-slow” position in the FTAA negotiations were it not for its effective control of the Mercosur position in those negotiations.

Positive and Negative Economic Justifications

Many economists are quick to cite the benefits to a national economy of unilateral trade liberalization on a non-discriminatory basis and there is ample empirical evidence in support of their position. Australia's own experience is a classic case in point. Much of the extensive liberalization of the country's import regime has been undertaken unilaterally over the past two decades. This was made possible by governments that realized protectionist policies were hurting the national economy far more than they were helping. Of course, not everyone shared this enlightened view. There are other countries where governments are also well aware of the potential benefits to their own economies of a liberalized import regime but where political economy considerations make it far easier to liberalize when other countries are doing the same. In addition, economic teaching to the contrary notwithstanding, mercantilist arguments tend to play more successfully with working people. If there are gains from unilateral liberalization, then there should be even more gains from a reciprocal PTA. Multilateral gains are the best, but those advocating “competitive liberalization” policies would argue that pending realization of the multilateral gains, there is no reason why countries should not pursue and pocket the results of interim liberalization through PTA negotiations. Pretty clearly, those who seek to negotiate PTAs out of this motivation will be strong supporters of multilateral liberalization as well and will work for a positive outcome in WTO negotiations.

¹³ In his chapter “Some Lessons from the Mercosur Initial Experience”, Felix Pena writes: “The strategic objective of this political and economic process between nations of South America has been to create a common regional space in order to strengthen their own domestic efforts towards democracy consolidation, productivity transformation and competitive insertion in the global economy. ...Therefore it [Mercosur] cannot be conceived solely from an economic point of view. On the contrary, although it is a process with economic foundations and contents, it also has a clear political nature and consequences”. Regionalism and Multilateralism after the Uruguay Round, European Interuniversity Press, Brussels 1997 p. 163.

¹⁴ Idem, page 167.

There is a potentially dark side to the economic justification for a PTA. If there is a concern one hears expressed frequently by economists in respect of PTA's it is that they are likely to produce some degree of trade diversion. Trade diversion is welfare reducing, but that does not mean that it cannot be saleable on a sectoral basis. It is not impossible that a government might pursue a PTA as a way to realize economic rents from trade in sectors where its companies might not be competitive internationally. In classic trade diversion scenarios, the most efficient suppliers are shut out of the market when less efficient overseas producers (in the PTA partner) are granted preferential access through discriminatory tariff reductions. Clearly, a PTA grounded in an exclusionary motivation will be neither welfare enhancing nor complementary to the WTO multilateral process as participants in such a PTA will have little interest in seeing progress at the multilateral level. Mercosur is sometimes cited as an example of a PTA motivated in part by these negative economic considerations, although we know as well that Mercosur has important political roots and that Mercosur members through their participation in both the Cairns Group and G-20 grouping are strong advocates of agricultural trade liberalization at the multilateral level.

It is apparent that there are many reasons why governments today would find it expedient to negotiate trade liberalization through a PTA either (a) in place of; (b) prior to; or, (c) in tandem with trade liberalization at the multilateral level of the WTO. The underlying economic and political reasons unique to each PTA would most likely instruct us as to whether the PTA is likely to complement or undermine the multilateral system from an economic standpoint.

Ensuring Compatibility of PTAs with the WTO

Apart from considerations of whether the economic effects of PTAs are welfare enhancing and whether the motivations of PTA participants are likely to complement multilateral liberalization efforts in the WTO, there remains the important consideration of ensuring the legal and political compatibility of PTAs with the WTO system.

In 1997, the Carnegie Endowment for International Peace sponsored a report¹⁵ by a study group of eminent persons focused on the interaction of PTAs and the multilateral system. In their report, Study Group members – many of whom had extensive experience in both bilateral and multilateral negotiations – warned that PTAs could have undesirable trade diversion and /or investment diverting effects and that it was therefore desirable for the WTO system to be better equipped to face the challenge of managing compatibility of PTAs with the goals and objectives of the WTO. The Group finished its report with five policy recommendations, most of which contain elements with continued validity today. It can also be seen that many of the concerns expressed by the Study Group and reflected in their 1997 recommendations have found their way into the proposals submitted in the current Doha Round negotiations on the rules governing regional trade arrangements (PTAs). The policy recommendations of the Study Group were the following:

- The WTO should strengthen Article XXIV to provide precise compliance criteria for RTAs, specifically on the following three topics: (a) MFN tariffs; (b) rules of origin; and (c) transparency of enforcement.
- As an RTA matures, the trade rules employed by the member countries should be required to converge to a common set of rules. In addition, non-preferential rules of origin should not become more restrictive during the transition period to harmonization.

¹⁵ Reflections on Regionalism – Report of the Study Group on International Trade, Carnegie Endowment for International Peace, Washington, D.C. 1997. Members of the Study Group included Jaime Serra, Guillermo Aguilar, Jose Cordoba, Gene Grossman, Carla Hills, John Jackson, Julius Katz, Pedro Noyola and Michael Wilson.

- The WTO should require that the architecture and accession conditions of RTAs not have the effect of preventing other countries from becoming members.
- The WTO should develop rules to ensure that RTA investment provisions and other investment treaties do not divert investment.
- The WTO should use its institutional structure and procedures to actively promote compatibility between RTAs and the WTO itself.

Although many of the Study Group's recommendations have continued validity, in some cases, the ground has moved under the Group's initial arguments. For example, the Study Group probably had no idea in 1997 just how long the "transition period to harmonization" would last for the purposes of the rules of origin exercise. In addition, the Group suggested that the WTO should deal with its fourth recommendation by developing an "Investment Rules Policy Roadmap" that should build on the (ill-fated) OECD Multilateral Agreement on Investment (MAI). The "Roadmap" would have been complemented by an Investment Policy Review Mechanism as part of the WTO Trade Policy Review Mechanism that would serve two purposes: (1) monitoring actual investment performance; and (2) promoting accession to the MAI.¹⁶ It is likely to be some time before the WTO gets around to acting on this recommendation. Not only is the OECD MAI long dead and buried, but it now appears that any negotiation in the WTO on anything like an "Investment Rules Policy Roadmap" is no longer a potential objective of the current round of negotiations.

The remainder of this paper will focus on current aspects of three of the 1997 Study Group's policy recommendations: the need to strengthen compliance criteria in order to ensure that PTAs are consistent with the rules of the WTO; architecture and accession conditions of PTAs; and, how the WTO might use its institutional structure to promote compatibility between PTAs and the WTO.

Strengthening Compliance Criteria

Although the Rules Group negotiations of the Doha Round are best known for work on provisions bearing on antidumping and countervailing duty laws' operations, the Rules Group is also charged with a mandate to strengthen, clarify and improve the WTO's rules on PTA's and also to make the CRTA more effective. While a considerable number of proposals have been tabled by a wide range of countries on a large number of substantive and procedural issues, we can illustrate the difficulties associated with the current negotiations by reference to one of the central issues: how to define for the purposes of judging a PTA's legal compatibility with the WTO, the requirement that trade barriers be eliminated on "substantially all the trade" between the parties. One might be tempted at this stage to say that this should be an intuitive concept – you know it when you see it -- but things are far from simple in the CRTA. A note¹⁷ prepared by the WTO Secretariat in August 2002 lays out the complicated debate rather succinctly:

"68. Despite the inclusion of the fourth paragraph in the Preamble to the 1994 Understanding¹⁸, the interpretation of that expression ["substantially all the trade"] has remained contentious. Two approaches, not mutually exclusive, are typical in that respect:

- A quantitative approach favours the definition of a statistical benchmark, such as a certain percentage of the trade between RTA parties, to indicate that the coverage of a given RTA fulfils the requirement.

¹⁶ *Idem*, page 52.

¹⁷ WTO Document TN/RL/W/8/Rev1, Compendium of Issues Related to Regional Trade Agreements – Background Note by the Secretariat, page 18, WTO Secretariat, Geneva 2002.

¹⁸ "Recognizing also that such contribution ... if any major sector of trade is excluded."

- A qualitative approach sees the requirement as meaning that no sector (or at least no major sector) is to be kept out of intra-RTA trade liberalization; this approach aims at preventing the exclusion from RTA liberalization of any sector where the restrictive policies in place before the formation of the RTA hindered trade, which could well be the case if a quantitative approach was used.

Apart from calls aimed at defining RTA's coverage as meaning that all sectors should be included, it has been suggested that the above two approaches could be bridged or complemented by:

- Characterizing an RTA's product coverage not only in terms of trade flows but also in terms of a certain percentage of tariff lines:¹⁹
- As a refinement to the quantitative approach, calculating the percentage of trade between the parties carried out under RTA rules of origin; and/or
- Exploring whether footnote 1 to GATS Article V provides a basis for some clarification of the "substantially all the trade" concept.²⁰

Not surprisingly, this core issue of the RTA part of the rules negotiations in the Doha Round has benefited from a number of delegation proposals. Also not surprisingly, negotiators are still some distance from an eventual agreement on this issue as illustrated by a sampling of the proposals received in the Negotiating Group. In its proposal, tabled in document TN/RL/W/15, Australia argues that "substantially all the trade" should be defined in terms of coverage by a free trade agreement or an agreement establishing a customs union of a defined percentage of all six-digit tariff lines listed in the Harmonized System." Australia further elaborates that "such a percentage criterion should be established at a sufficiently high level to prevent the carving out of any major sector." In document TN/RL/W/32, Turkey argues that "the qualitative approach which does not permit the exclusion of any sectors, or at least no major sector from the liberalization, is not considered to be in conformity with economic realities". India (document TN/RL/W/114) takes the position that "Members may like to define "substantially all the trade" for the purpose of GATT Article XXIV in terms of both (i) a threshold limit of the HS tariff lines at the six-digit level; and (ii) the trade flows at various stages of implementation of the RTA."

If there is anything clear from all of this it is the fact that until such central issues are resolved – in the WTO and through negotiations – the regular machinery of the WTO will remain incapable of addressing the basic legal compatibility of PTAs with the rules of the WTO. There should be a certain urgency to this exercise because – as noted above – if prospective PTA participants start from a presumption (as they would be currently entitled to have) that the consistency of their agreement with the WTO is unlikely to be judged, they will be free to pursue PTAs for the objective of pure discrimination against other Members of the WTO – and this could be a very negative thing, both for the health of the WTO and for economic welfare more globally.

¹⁹ A threshold has also been proposed at 95 percent of all HS tariff lines at the 6-digit level, to be complemented by an assessment of prospective trade flows at various stages of implementation of the RTA, thereby allowing the incorporation of cases where trade is initially concentrated in relatively few products.

²⁰ In referring to the need for EIAs to have substantial sectoral coverage, this footnote reads: "This condition is understood in terms of number of sectors, volume of trade affected and modes of supply. In order to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply."

PTA Architecture and Accession Conditions

The WTO rules permitting departure from the multilateral non-discrimination framework are essentially justified by the idea that a maximum amount of trade liberalization is good for members and the system and that as a result, the system should not prevent its members from going these extra steps where governments are willing and able to move to “WTO Plus” levels of liberalization. A consequence of this is reflected in the 1997 Study Group’s observations in their third policy recommendation. In essence, a good PTA should permit others to join on the same conditions. This is actually an important point.

Although not couched in exactly the same terms, this point is picked up in the WTO World Trade Report 2003, wherein the WTO Secretariat authors suggest two questions we might ask about any PTA to determine its policy compatibility with the WTO²¹. The first question we might ask is whether the participants in a particular PTA negotiation have refrained from engaging in regional commitments which they would be unwilling, sooner or later to extend to a multilateral setting. The second question turns on whether the PTA participants would be willing – eventually – to extend the commitments made in the PTA to non-discriminatory multilateral application. If one gets the correct answers to these two questions, then it is a pretty good bet that the PTA at issue will be complementary to the WTO and multilateral trade liberalization.

Promotion of Compatibility between PTAs and WTO

Apart from resolving the issues undermining the current operations of the CRTA, there is much that can be done outside the strict context of the rules to promote the compatibility of the WTO and PTAs. As a start, it might be suggested that there is little point arguing that there is no such thing as a good PTA and recognize that for all of the reasons discussed earlier, PTAs are a phenomenon that is here to stay. Of the WTO’s 147 Members, only three are not party to a PTA and most WTO Members are party to a number of different PTA arrangements. PTAs will likely grow in number in the years to come. Australia is faced with two seemingly lucrative opportunities in possible PTAs with China and ASEAN.

But we cannot ignore the compatibility question and two areas where there is real potential risk of some incompatibility arise out of possible conflict in dispute settlement and distortions associated with treating the same problem in a given market under two different sets of rules, depending on the origin of the product or service. To take the second problem first, if Chile and Canada agree in their PTA not to use antidumping measures against “dumped” imports from the other party (using competition policy instead) but continue to employ antidumping measures against non-parties to the PTA, it is possible that the government might be pressured to employ the antidumping instrument with anticompetitive effect through a form of discrimination not envisaged by the drafters of the WTO rules governing PTA operations.

The other issue concerns dispute settlement and the unavoidable accumulation over time of jurisprudence on trade disputes. Most modern PTAs have their own internal dispute settlement provisions. Most often, parties to the PTA are able to choose between bilateral and WTO dispute settlement routes where a problem is susceptible to adjudication under either the WTO or the PTA. This is potentially risky business. While compliance with a WTO obligation can clearly only be judged definitively through the WTO DSU and a PTA-only obligation must necessarily go through the agreement’s dispute settlement provisions, there is a risk in the overlapping areas that dispute

²¹ World Trade Report 2003, page 66, WTO Secretariat, Geneva 2003

settlement under the WTO or the PTA could produce two different results on the same issue and that could be both politically and economically problematic. Ideally, PTAs should be written so as to exclude adjudication of questions that are clearly in the province of the WTO.

Conclusions

The world is unlikely to come to a consensus anytime soon on the question of whether or not PTAs assist, complement or undermine the multilateral system of the WTO. Probably no two PTAs are motivated by identical considerations and it is equally likely that no two WTO Members would have the same political and economic policy reactions to what might appear to be identical chapters in a modern PTA.

Clearly, we need to do everything that we can to create an effective WTO review of PTA consistency with the multilateral system. The fact that the CRTA process has broken down so completely is a major systemic loophole that needs to be closed –or at a minimum significantly narrowed. Economically, we know that PTA's can have negative effects, both nationally and globally. Politically, we know that PTA's motivated by the wrong reasons have the potential for undermining support for the WTO. At a minimum, governments should not add to the potential problem by continuing to be in the position that they are in today of not being able to say conclusively whether or not a PTA is consistent or not with the rules of the multilateral system.

Finally, motivation and outlook are important in assessing the interaction of PTAs and the multilateral system of the WTO. Here, the two ground rules of policy behaviour suggested by the WTO Secretariat in the 2003 World Trade Report should be seen as particularly helpful in ascertaining whether a particular PTA is likely to complement or undermine the multilateral system. In addition, the policy underlying the doctrine of "competitive liberalization" can be a valid justification for pursuing PTAs only where the government does not lose sight of what should always be the ultimate objective in trade policy: multilateral liberalization effected through the World Trade Organization.