

Regional Trade Agreements in a Multilateral Trade Regime: An Overview

Parthapratim Pal

I. Introduction

One of the most striking development in the world trading system since the mid 1990s is a surge in Regional Trade Agreements (RTAs). From about 50 till 1990, the number of RTAs notified to the World Trade Organization (WTO) has crossed 250 in 2003 and estimates indicate that over 300 RTAs will be in effect by 2007¹. Initially WTO encouraged the growth of RTAs because it believed that regional integration initiatives can complement the multilateral trade regime. However, the high proliferation of RTAs in global trade and increased diversion of trade through this route is increasingly becoming a cause for concern for the multilateral trading system under WTO.

Regional trade agreements represent an important exception to the WTO's principle of non-discrimination. According to the WTO rules, countries within a RTA can trade among themselves using preferential tariffs and easier market access conditions than what is applicable to other WTO Member countries. As a result, WTO Member countries that are not a part of the RTA lose out in these markets. Also trading within the regional trade blocks does not come under the purview of WTO. As increasing amount of global trade is being diverted through this route, there is a certain amount apprehension about the role of regional trade agreements in WTO. The WTO Annual Report 2003 expresses deep concern about this latest development and comments:

“RTAs can complement the multilateral trading system, help to build and strengthen it. But by their very nature RTAs are discriminatory; they are a departure from the MFN principle, a cornerstone of the multilateral trading system. Their effects on global trade liberalization and economic growth are not clear given that the regional economic impact of RTAs is ex ante inherently ambiguous”. Pp. 27

This recent spurt in regionalism has been further fuelled by the failure of the Seattle and the Cancun Ministerial Conference of WTO. The Economist² suggests that these failures have

¹ http://www.wto.org/english/tratop_e/region_e/regfac_e.htm

² “Unlocking the benefits of world trade” The Economist, Oct 30th 2003

highlighted the inherent problems of the multilateral trading system and are likely to push many countries to divert their negotiating energies into regional trade agreements.

In this backdrop of resurgent regionalism, this paper gives an overview on Regional Trading Agreements (RTAs) and their interaction with the multilateral trading system.

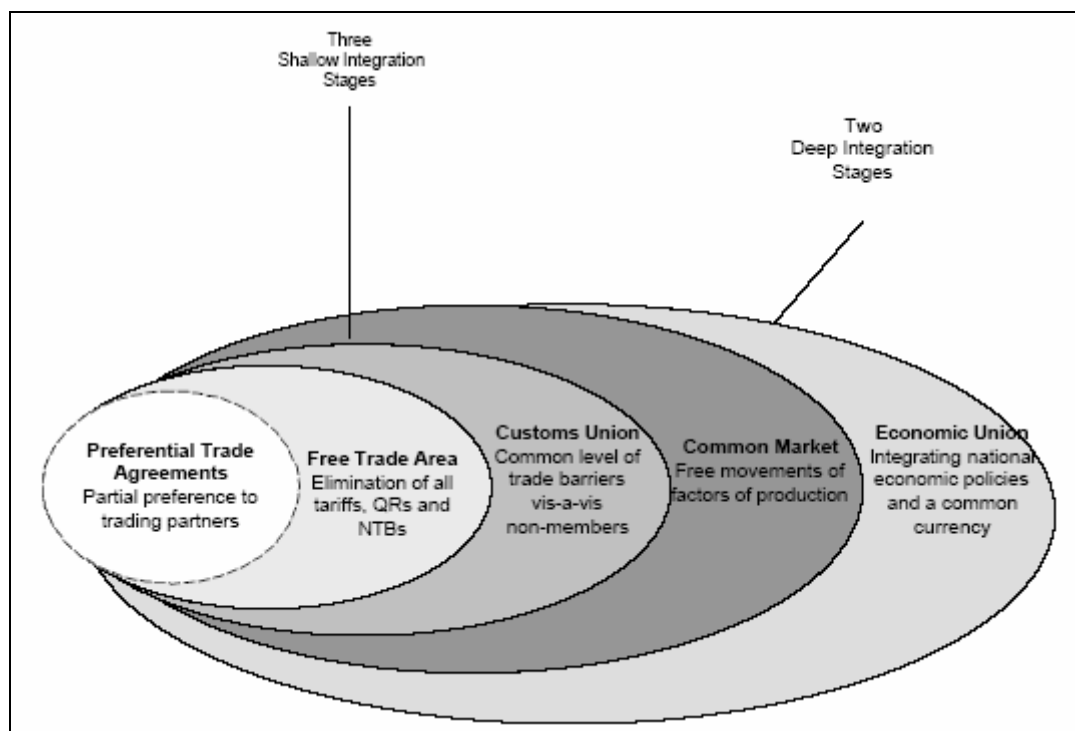
II. Regional Trade Agreements: Basic Issues

Regional Trade Agreements (RTAs) are defined as groupings of countries which are formed with the objective of reducing barriers to trade between member countries. Contrary to what the name suggests, these groupings or unions may be concluded between countries not necessarily belonging to the same geographical region.

Depending upon their level of integration, RTAs can be broadly divided into five categories: Preferential Trade Agreements (PTAs), Free Trade Agreements (FTAs), Customs Unions (CUs), Common Markets and Economic Unions. A PTA is a union in which member countries impose lower trade barriers on goods produced within the union, with some flexibility for each member country on the extent of the reduction. A Free Trade Area (FTA) is a special case of PTA where member countries completely abolish trade barriers (both tariff barriers and non-tariff barriers) for goods origination within the member countries. It should be clarified here that in most cases, countries do not abolish trade barriers completely even within Free Trade Areas. Most agreements tend to exclude sensitive sectors. A Customs Union (CU) provides deeper integration than an FTA because, unlike FTAs where member countries are free to maintain their individual level of tariff barriers for goods imported from non-member countries, in a CU, member countries also apply a common external tariff (CET) on a good imported from outside countries. The CET can vary across goods but not across union partners. PTA, FTA and CU are called 'shallow integration' arrangements in trade literature.

Apart from these shallow arrangements there are two types of regional agreements which provide "deep integration". The first 'deep integration' stage is called Common Markets, where member countries attempt to harmonize some institutional arrangements and commercial and financial laws and regulations among themselves. A common market also entails free movements of factors of production, i.e. removal of controls on free movement of labour and capital. The final 'deep integration' level is the 'Economic Union' where countries implement common economic policies and regulations and adopt a single currency. The relationship between the various levels of regional agreements is depicted graphically in figure 1.

Figure: 1. Various Forms of Regional Trade Agreements



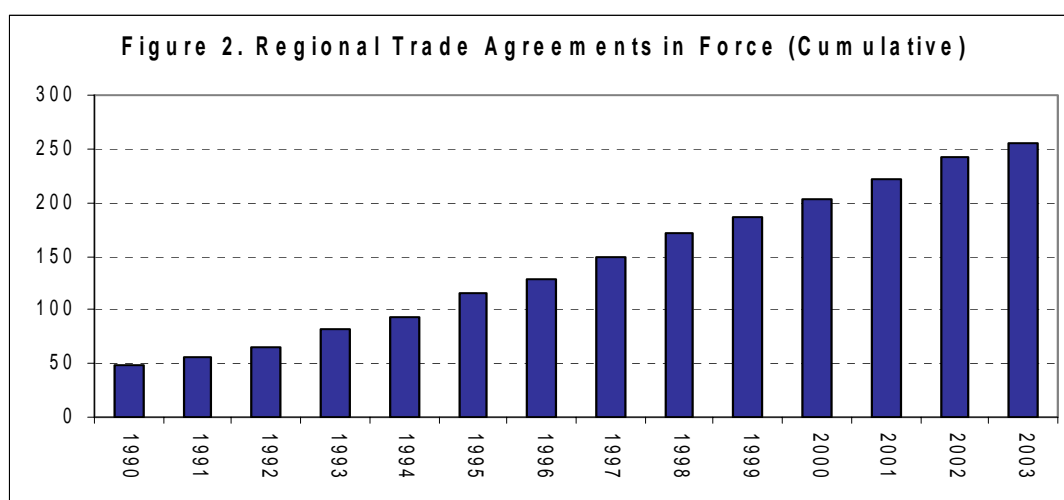
Source: Das (2001)³

Among the Regional Trade Agreements, a large majority of the agreements are shallow integration agreements, i.e. they are mostly PTAs or FTAs. In contrast, there are only a handful of Customs Unions, Common Markets and Economic Unions worldwide. Most of these deep integration arrangements are found in Europe. For example, the Maastricht Treaty and the EU Single Market programme are examples of deep integration schemes. The ANDEAN Pact and the Central American Common Market (CACM) are examples of Preferential Trade Agreements. However, most new PTAs tend to be free trade areas. North American Free Trade Area (NAFTA) and the ASEAN Free Trade Area (AFTA) are examples of FTAs. MERCOSUR is an example of a customs union.

In the last few years there has been an enormous proliferation of Regional Trade Agreements (RTAs) across the world. The WTO Annual Report 2002 points out that currently more than 50 percent of global trade now takes place through the regional trading groups. A recent study by the

³ Das, Dilip. "Regional Trading Agreements and the Global Economy: An Asia-Pacific Perspective." Asian Development Bank, March 2001.

WTO Secretariat shows that 145 out of 146 WTO member countries currently participate in or are actively negotiating RTAs⁴ and according to data up to October 2003, more than 250 RTAs are currently in force (Figure 2). The scope and geographical reach of Regional Trade Agreements have expanded significantly in the recent years. Apart from merely removing tariffs on intra-bloc trade in goods, the newer agreements tend to have deeper coverage. The new generation of RTAs, especially those comprising developed countries, includes more regional rules on investment, competition and standards; as well as provisions on environment and labour. Most of these new agreements also include preferential regulatory frameworks for mutual services trade.



Source: WTO Website (www.wto.org)

WTO (2003)⁵ highlights that in the current wave of regional agreements, two broad trends are emerging. Many countries which traditionally relied on the multilateral trade regime are increasingly joining regional agreements to promote trade. A second important trend is that a number of continent-wide mega trade blocks like the Free Trade Area of the Americas (FTAA) or the Euro-Mediterranean FTA are under negotiation. Once these negotiations are finalized, a significant share of global trade flow will be diverted through these trade blocks.

III. Why Countries are going for Regional Trade Agreements

To explain this rapid growth of RTAs since the 1990s, economists have tried to identify the economic and political reasons which are pushing countries towards increased regionalism. These explanations can be divided into three broad categories. First is the traditional explanation of welfare effects through trade liberalization and the consequent gains from trade at a regional level.

⁴ Source: http://www.wto.org/english/tratop_e/region_e/regfac_e.htm

⁵ "The Changing Landscape of RTAs" Regional Trade Agreements Section, Trade Policies Review Division, WTO Secretariat, prepared for the Seminar on Regional Trade Agreements and THE WTO, WTO Secretariat, Geneva, 14 November 2003

But these theories do not adequately explain the new wave of regionalism of the 1990s. Most economists attribute the current surge in regionalism to the lopsided nature of the current multilateral trade regime and the dissatisfaction associated with it. But according another school of thought, increased adoption of regionalism by big economic powers during the late 1980s and early 1990s is the main reason behind the current surge in regionalism. We discuss these arguments in more detail.

III.1. The Welfare Impact of RTAs: Trade Creation and Trade Diversion

The traditional theory of gains from trade suggests that removal of trade barriers allows consumers and producers to purchase from the cheapest and most competitive source of supply. This enhances efficiency and increases welfare. Following this logic, it was traditionally believed that regional trade blocks should generate gains from trade as member countries reduce trade barriers among themselves.

This view was first challenged by Viner in his 1950 book titled *The Customs Union Issue*⁶. Viner, in his seminal contribution, introduced the concepts of ‘trade creation’ and ‘trade diversion’ and showed that the net effect of trade liberalization on a regional basis is not unambiguously positive. Viner pointed out that RTAs can lead to trade creation if, due to the formation of the regional agreement, RTA members switch from inefficient domestic producers and import more from efficient producers from other members of the RTA. In this case, efficiency gains arise from both production efficiency and consumption efficiency. On the other hand, trade diversion takes place if, because of the RTA, members switch imports from low-cost production in the rest of the world and import more from higher-cost producers in the partner countries. Trade diversion lowers welfare of not only the partner countries but the rest of the world also. In Viner’s own words:

“...where the trade-diverting effect is predominant, one at least of the member countries is bound to be injured, the two combined will suffer a net injury, and there will be injury to the outside world and to the world at large.” (Viner, 1950, p. 44)

This analysis shows that trade creation and trade diversion have opposite welfare implications and the net effect will depend upon which of these two effects dominate. However, Viner did not unequivocally establish the net welfare effect of RTAs.

Viner’s analysis was done on a static and partial equilibrium framework. Subsequently a number of studies tried to address the net welfare effects of RTAs by introducing dynamic effects into the

⁶ Viner, Jacob (1950): *The Customs Union Issue*, Carnegie Endowment for International Peace, New York.

model⁷. A number of papers have also looked at these issues in a multi-country general equilibrium framework (Lipsey 1970). However, even with these analytical advances, the net welfare effect of RTAs, on an ex ante basis, remains theoretically ambiguous.

This ambiguity has led to a big debate among the trade theorists about the relative dominance of these two effects. A group of economists led by Summers (1991)⁸ are of the opinion that regional trade agreements are likely to be more welfare enhancing because according to them, trade diversion is only likely to have a benign impact on the member countries. Lipsey (1957)⁹ and Summers also argue that if the member countries are geographically proximate and have very high trade dependence among each other (Natural Trading Partners), then the risk of trade diversion is minimal. Expressing similar views, Krugman (1991)¹⁰ is of the opinion that the beneficial effect of a regional trade agreement will depend on whether there is enough 'inherent regionalism' in the transport costs between the member countries of the RTA. Frankel (1997)¹¹, Frankel, Stein and Wei (1995)¹², Frankel and Wei (1997)¹³ have also expressed similar views.

This view has been contested by Bhagwati (1995)¹⁴, Panagariya (1996)¹⁵ and Bhagwati and Panagariya (1996)¹⁶. According to these authors, trade diversion is more likely to dominate trade creation in most situations. They argue that when trade is multilateral, i.e. when countries import from and export to union members as well as outside countries, trade diversion is inevitable. Also, if members of the regional trade agreement are small in relation to the outside world, very little trade creation will take place. As a result, under these conditions, trade diversion is likely to be the more dominant effect.

⁷ For a survey of the literature on trade creation and trade diversion, see Lloyd and MacLaren (2003)

⁸ Summers, L., (1991) "Regionalism and the World Trading System". -Policy Implications of Trade and Currency Zones. Wyoming: Federal Reserve Bank of Kansas City

⁹ Lipsey, R. G (1957): "The Theory of Customs Union: Trade Diversion and Welfare"-Economica 24, 40-46.

¹⁰ Krugman, P. (1991), "Is Bilateralism Bad?" in E. Helpman and A. Razin (eds.), *International Trade and Trade Policy*, Cambridge, Mass.: MIT Press.

¹¹ Frankel, J. (1997): *Regional Trading Blocks in the World Economic System*. Washington DC: Institute for International Economics.

¹² Frankel, J., Stein, E. and Wei, S. (1995): "Trading Blocs and the Americas: The Natural, the Unnatural and the Supernatural," *Journal of Development Economics* 47, 61-96.

¹³ Frankel, J. and Wei, S.J. (1997), 'Regionalization of World Trade and Currencies: Economic and Politics', *The Regionalisation of the World Economy*, University of Chicago Press: Chicago

¹⁴ Bhagwati, J. (1995): "U.S. Trade Policy: The Infatuation with Free Trade Areas". In Bhagwati, J. & Krueger, A. eds., *The Dangerous Drift to Preferential Trade Agreements*, Washington, D.C., American Enterprise Institute for Public Policy Research.

¹⁵ Panagariya, A. (1996): "The Free Trade Area of the Americas: Good for Latin America?" *World Economy* 19, no. 5, September, 485-515.

¹⁶ Bhagwati, J. & Panagariya, A. (1996): *The Economics of Preferential Trade Agreements*, Washington, D.C. AEI Press.

It is worth mentioning here that the entire discussion on the negative effects of trade diversion assumes full employment. If the assumption of full employment is relaxed, the welfare effects of trade diversion are ambiguous and may be even positive. For example, though the creation of Mercosur has led to trade diversion, it has helped to preserve employment within the Southern cone countries.

III. 2. Dissatisfaction with the Current Multilateral Trade Regime

The traditional analysis of regional trade agreement does not explain why there has been a sudden increase in regionalism during the 1990s. There is an emerging consensus among economists that frustration with the multilateral trading system is one of the prime reasons behind the current growth of regionalism. In 1993, answering a question about “what are the problems of the GATT that lead countries to turn to their neighbourhood”, Krugman (1993)¹⁷ suggests that countries find regionalism an easier alternative because large number of participants in multilateral trade negotiations reduces the cost of non-cooperation and creates rigidity in the system. Also according to him, modern trade barriers are much more complicated to negotiate in a multilateral forum and most countries find it easier to deal with these issues on bilateral or regional level.

In the post Uruguay Round era the concerns about the multilateral trading system have intensified. Most countries, particularly developing countries are dissatisfied with the progress of WTO because most of the promises of the Uruguay Round agreement to expand global trade has not materialized in practice. Particularly for developing countries, the promised expansion of trade in three key areas of agriculture, textiles and services has been dismal. Moreover, incipient protectionism and lack of willingness among developed countries to provide market access on a multilateral basis has prompted many developing countries to look for regional alternatives. The North-South divide which is appearing in the WTO ministerial meets is strengthening the apprehension of developing countries about the prospect of trade expansion under the WTO regime. This has induced many countries to adopt regionalism as an alternate option for expanding their markets. It is not surprising that there has been a sharp increase in the formation of regional trade agreements after the failure of Seattle Ministerial meet of WTO.

III.3. Bandwagon Effect of Regionalism

¹⁷ Krugman, P (1993): “Regionalism versus Multilateralism: Analytical Notes” in *New Dimensions in Regional Integration*, eds. J. de Melo and A. Panagariya, CUP, Cambridge.

Many economists including Bhagwati (1993)¹⁸, Panagariya (1996)¹⁹ and Bergsten (1996)²⁰ believe that USA's transformation from a supporter of multilateralism to a follower of regionalism is another major reason behind this growth of regionalism since the 1990s. According to Bhagwati (1993), *"the main driving force for regionalism today is the conversion of the United States, hitherto an abstaining party to Article XXIV."* Pp. 29.

To support this hypothesis, it is pointed out that many big developed countries like the USA and the European Union are increasingly getting involved in Free Trade Agreements with developing countries on a bilateral or regional level. This has prompted many developing countries to seek participation in Free Trade Agreements with developed countries as a defensive necessity against a possible exclusion from these markets. The motivation to go for an FTA with a developed country will be particularly strong for a developing country if other countries with which it is competing to supply goods to the developed market, are part of a preferential trade agreement with the developed country. If these non member countries cannot form an FTA with the developed country, they attempt to create their own market by joining a regional trade agreement among excluded members. This creates a bandwagon effect where no countries want to be left of some major regional groupings.

Baldwin (1995, 1997)²¹ in his 'domino theory of regionalism' describes similar motivation for joining regional groupings. However, Baldwin differs with Bhagwati and Panagariya in one important aspect. He believes that regionalism did not occur because countries have lost faith in GATT or because USA has adopted regionalism. Instead he feels *"resurgent regionalism was caused by idiosyncratic events that were multiplied many times over by a domino effect. In particular, announcement of the US-Mexico FTA created powerful forces for inclusion that led to NAFTA and a sequence of NAFTA membership requests. Since these requests were put off, the forced vented themselves in a series of overlapping bilateral and plurilateral agreements in the Americas. One of the –Mercosur-is generating its own domino effect."* (Baldwin 1997, Pp. 884).

III.4. The Other Factors

¹⁸ Bhagwati, J. (1993): "Regionalism and Multilateralism: An Overview," in Melo and Panagariya eds. *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge.

¹⁹ Panagariya, A. (1996): "The Free Trade Area of the Americas: Good for Latin America?" *World Economy* 19, no. 5, September, 485-515.

²⁰ Bergsten, C. Fred (1996): "Competitive Liberalization and Global Free Trade: A Vision for the Early 21st Century." *Asia Pacific Working Paper Series No. 96-15*. Washington: Institute for International Economics

²¹ Baldwin, Richard E. (1995): "A Domino Theory of Regionalism" in R. Baldwin, P. Haarparanta and J. Kianden eds. *Expanding Membership of European Union*. CUP, Cambridge.

Baldwin, Ricard E (1997): "The Causes of Regionalism"- *The World Economy*, Vol. 20, No, 7, pp 865-888, 1997

Among other important economic factors which are propagating regionalism today are foreign direct investment and the advantages associated with economies of scale. According to the World Trade Report 2003, preferential access to large regional markets is one of the key determinants of FDI in developing countries. As FDI has become the most important source of foreign capital inflow for developing countries, the WTR 2003 suggests that countries join RTAs to attract FDI. On somewhat similar reasons, it has also been suggested that smaller countries join RTAs because it can offer domestic firms the advantage of economies of scale. However, this argument does not make the case in favor for regionalism as opposed to multilateralism.

Ghosh (2004)²² provides another angle to this debate and argues that there is a marked difference in motivation between the RTAs which are initiated and pushed through by the major developed country governments and attempts to forge trading blocs within developing countries. According to her, developed countries, particularly USA and EU are pushing regional trade agreements, under the influence of large capital, to force developing countries make deeper trade and investment commitments than is now possible given multilaterally given the divisions in the WTO. On the other hand, the real motivating factor for developing countries to forge regional grouping among themselves is to resist the hegemony of large powers in world trade.

Political factors also motivate countries to join RTAs. Trade linkages between economies can increase the cost of conflict and improve cross border cooperation. Due to this reason, RTAs are used as a strategic move to consolidate peace and increase regional security among member countries. RTAs are often used by developed countries to forge geopolitical alliances and build up diplomatic ties. By providing increased discriminatory access to a larger market, these countries seek to garner increased support on political front. It is apparent that most political RTAs are not driven by economics, however, in the political RTA arrangements, particularly where a large developed is involved, there is always the possibility that the interests of smaller countries would be of secondary concern.

IV. Regionalism in the Current Global Trade System

Apart from the debate about the reasons behind the recent surge in regionalism, there is another big debate in the current international trade literature about whether regionalism can help or hinder the multilateral trading system. The question is, to use Bhagwati's famous terminology, whether regional trading blocks are "building blocks" or "stumbling blocks" of the multilateral trading system. There are opposing views among economists about the role of regionalism in the current

global trade system. Krugman (1991) and Summers (1991) are of the opinion that regional trade blocs are welfare improving in nature and are unlikely to have any negative impact on the multilateral trade system. According to Summers, if the world is divided into a small number of trade blocks, multilateral negotiation will be easier as it will remove the free riders from the system. However, as Panagariya (1998) points out, this argument is questionable because it is not clear why FTAs will have an effect on the number of participants in the multilateral trading system. This is because, unlike Customs Unions, FTA members retain their own external trade barriers and therefore, in a multilateral platform, they negotiate these tariffs individually. Secondly, though the countries belonging to the European Union have participated as a single unit in multilateral trade negotiations, its impact on the progress of these negotiations is questionable. According to Panagariya, EU's preoccupation with its internal problems and agenda has, in fact, hindered the progress of multilateral trade negotiations.

Along with Krugman and Summers, Baldwin (1997)²³, Ethier (1998)²⁴ and Lawrence (1999)²⁵ also do not see regionalism as a threat to the multilateral trading system. According to Baldwin, because trade is "already quite free in major trading nations, few regional liberalizations are capable of creating anti-liberalization forces". Therefore, he concludes that most regional trade agreements will weaken the opponents of trade liberalization and hence will promote and foster multilateral trade liberalization. Similar views have been expressed by Lawrence also. However, Baldwin accepts that his logic might not work for South-South FTAs and the consequences of these trade blocks might be different from what he has suggested. Ethier (1998) suggests that the current form of regionalism do not anyway threaten multilateral liberalism and, in fact, is a direct consequence of multilateralism. He also argues that countries use regionalism as a stepping stone for entering the multilateral trading system and therefore, according to him, regionalism is not going to harm the multilateral trading system.

But the dominant view among mainstream economists suggests that regionalism is harmful for the multilateral trading system. For example, Bhagwati (1992, 1994)²⁶, Bhagwati and Krueger

²² Ghosh, Jayati (2004): "Regionalism, Foreign Investment and Control: The New Rules of the Game outside the WTO" paper presented at a seminar on The Economics of New Imperialism, Jawaharlal Nehru University, January, 2004.

²³ Baldwin, Richard E. (1997). "The Causes of Regionalism"- *World Economy* 20 (7): 865-88.

²⁴ Ethier, Wilfred J. (1998): "Regionalism in a Multilateral World". *Journal of Political Economy* 106(6): 1214-45

²⁵ Lawrence, Robert Z (1996): "Regionalism, Multilateralism, and Deeper Integration". Brookings Institution. Washington D.C.

²⁶ Bhagwati, Jagdish, (1994): "Threats to the World trading System: Income Distribution and the Selfish Hegemon," *Journal of International Affairs*, Spring.

(1995)²⁷ and Bhagwati and Panagariya (2003)²⁸ think that preferential trade agreements are essentially discriminatory in nature and they view the drift towards PTAs as a serious threat to the multilateral trading system. According to Bhagwati and Krueger, increased regionalism is dangerous because it not only leads to inter block trade wars and domination of small countries by bigger partners in the regional blocks but also because it reduces the enthusiasm for participation in the multilateral trade regime. These authors express strong concerns about the negative effects of growing regionalism and they worry that RTAs divert attention from the multilateral trading system. They argue that by their very design, most preferential agreements lead to trade discrimination and thereby harm the multilateral trading system. Similar views have been expressed by WTO officials also. The threat posed by the proliferation of RTAs to the WTO mechanism is summarized in a speech by Dr. Supachai Panitchpakdi, the present WTO Director General, he says:

“Regionalism can be a powerful complement to the multilateral system, but it cannot be a substitute. The multilateral trading system was created after the Second World War precisely to prevent the dominance of rival trading blocks. The resurgence of regionalism today risks signaling a failure of global economic cooperation and a weakening of support for multilateralism. It threatens the primacy of the WTO, and foreshadows a world of greater fragmentation, conflict, and marginalization, particularly of the weakest and poorest countries” dated 26th November 2002.

Bhagwati also argues that the growing number of PTAs may lead to a complex system of regulatory structures and preferences where market access for products in one particular country will vary widely depending on their alleged origin. This phenomenon, known also as the “spaghetti-bowl” problem, may lead to complexity and lack of transparency in the global trading system.

Bhagwati and Panagariya (2003) argue that by pushing aggressive trade treaties on a bilateral basis, developed countries are weakening the power of developing countries in multilateral trade negotiations. In a PTA between a developed and a developing country, the developed country often manages to include aggressive trade liberalization clauses, investment protection clauses and extraneous issues in the treaty. Having abandoned objections about these issues on a bilateral level, the developing country cannot resist these issues on a multilateral platform. This not only helps

²⁷ Bhagwati, J. and A. Krueger (1995): *The Dangerous Drift to Preferential Trade Agreements*, American Enterprise Institute, Washington.

²⁸ Bilateral Trade Treaties Are a Sham- By Jagdish Bhagwati and Arvind Panagariya, Financial Times, July 13, 2003

developed countries push these issues in WTO, but it also breaks the alliance of developing countries in the multilateral negotiations.

It is interesting to note that most of the criticisms against the PTAs are labeled against the regional or bilateral agreements where a developed country is involved in the treaty. However, many developing countries are now looking for PTAs among themselves just to avoid the frustration with the multilateral trading system. The dejection of developing countries about the functioning of WTO is not unnatural because since the implementation of the Uruguay Round agreements, these countries have not gained any meaningful increase in market access in the key areas where they have comparative advantage (textiles and agriculture). Liberalization of services trade also has occurred only in sectors which are of primary interest to developed countries. On the other hand, declining industrial tariff, stricter implementation of TRIPS and removal of all quantitative restrictions have harmed the industrial sector of these countries. The overwhelming dominance of developed countries in the WTO decision making process has not helped the cause of developing countries either.

Given the failure of WTO, it is clear that for developing countries the choice is between a multilateral trading system which is extremely unbalanced and PTAs, mostly South-South PTAs, which help these countries to expand market access without compromising on national policy autonomy. Or, in other words, the comparison is really between two second-best situations – a multilateral trading system, which is lopsided in nature with preferential trade liberalization, which, theoretically, may be an inferior solution²⁹. And between these two alternatives, it is not surprising that many developing countries are now looking for South-South preferential trade agreements to expand their market access. These RTAs are likely to be beneficial for developing countries because lower dependence on developed country markets will not only help these countries to resist the pressures of hegemonic economic powers but also it will help them forge and foster stronger South-South alliances at the multilateral trade negotiations. Given the fact that a clear North-South division has appeared in WTO, this is likely to have a strong impact on the multilateral trading system.

V. Conclusion

This paper gives an overview of the main issues associated with the contradiction between regionalism and multilateralism. As this survey shows, at a theoretical level, economists are divided over the desirability of regional trade agreement in a multilateral trade regime. Even after fifty years of debate, there is still no consensus about this issue. However, regionalism, with its

advantages and drawbacks, is a reality of the current global trade regime. And given the economic and political situation of the current world order, the wave of regionalism is likely to intensify in near future. If the explosive growth of regionalism continues, then it is bound to have a detrimental impact on the WTO regime. If a very high proportion of global trade gets diverted through the regional route, WTO is bound to lose some of its relevance in the global trading system.

The survey of literature indicates that the explosive growth of regionalism in the 1990s happened mainly because of two reasons. Among developing countries, the growth in regionalism took place mostly due to the dissatisfaction with the multilateral trading system. Also, due to a host of political and economic reasons, major developed countries like USA have pursued regionalism aggressively during the 1990s. Many economists believe that this has led to a bandwagon effect of regionalism as most countries wanted to be part of at least some major trade blocks.

Theoretically speaking, trade liberalization through regionalism does not offer the best solution. However, in the current state of distorted multilateralism, regionalism has turned out to be one of the more viable alternatives for developing countries to expand their market access. In this context, South-South RTAs are particularly useful as they allow developing countries to expand their markets without having to bow before hegemonic powers. However, there are some obvious pitfalls with regionalism. Apart from the problems of trade diversion, the complex web of regional agreements can also introduce uncertainties and opacity in the global trade system. Secondly, the problems associated with unequal power structure and exploitation of smaller members by a bigger economic power can be more acute in a regional trade block. Also, it is always possible that if the world is divided in a few mega trade blocks, then the weakest countries will be marginalized.

Reference

- Baldwin, R. (1997) 'The Causes of Regionalism', *The World Economy*, Vol.20, pp.247-281.
- Baldwin, Richard E. (1995): "A Domino Theory of Regionalism" in R. Baldwin, P. Haarparanta and J. Kianden eds. *Expanding Membership of European Union*. CUP, Cambridge.
- Baldwin, Richard E. (1997). "The Causes of Regionalism"- *World Economy* 20 (7): 865-88.
- Bergsten, C. Fred (1996): "Competitive Liberalization and Global Free Trade: A Vision for the Early 21st Century." *Asia Pacific Working Paper Series No. 96-15*. Washington: Institute for International Economics

²⁹ See Lawrence (1999) for a somewhat similar view

Bhagwati, J. & Panagariya, A.(1996): *The Economics of Preferential Trade Agreements*, Washington, D.C. AEI Press.

Bhagwati, J. (1992): "Regionalism versus Multilateralism", *The World Economy*, 15, 5, 535-555.

Bhagwati, J. (1993): "Regionalism and Multilateralism: An Overview," in Melo and Panagariya eds. *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge.

Bhagwati, J. (1995): "U.S. Trade Policy: The Infatuation with Free Trade Areas". In Bhagwati, J. & Krueger, A. eds., *The Dangerous Drift to Preferential Trade Agreements*, Washington, D.C., American Enterprise Institute for Public Policy Research.

Bhagwati, J. (1997): 'The Causes of Regionalism', *The World Economy*, 20 (7): 865-888.

Bhagwati, J. and A. Krueger (1995): *The Dangerous Drift to Preferential Trade Agreements*, American Enterprise Institute, Washington.

Bhagwati, J., Greenaway, D. & Panagariya, A.(1998): 'Trading Preferentially: Theory and Policy', *Economic Journal*, 108: 1128-48

Bhagwati, J., Krishna, P. & Panagariya, A. eds. (1999): *Trading Blocs: Alternative Approaches to Analyzing Preferential Trade Agreement*, Cambridge, MIT Press.

Bhagwati, Jagdish,(1994): "Threats to the World trading System: Income Distribution and the Selfish Hegemon," *Journal of International Affairs*, Spring.

Das, Dilip (2001): "Regional Trading Agreements and the Global Economy: An Asia-Pacific Perspective." Asian Development Bank, March 2001

Ethier, Wilfred J. (1998): "Regionalism in a Multilateral World". *Journal of Political Economy* 106(6): 1214-45

Frankel, J. (1997): *Regional Trading Blocks in the World Economic System*. Washington DC: Institute for International Economics.

Frankel, J. and Wei, S J. (1997): "Regionalization of World Trade and Currencies: Economic and Politics", *The Regionalisation of the World Economy*, University of Chicago Press: Chicago

Frankel, J., Stein, E. and Wei, S. (1995): "Trading Blocs and the Americas: The Natural, the Unnatural and the Supernatural," *Journal of Development Economics* 47, 61-96.

Ghosh, Jayati (2004): "Regionalism, Foreign Investment and Control: The New Rules of the Game outside the WTO" paper presented at a seminar on *The Economics of New Imperialism*, Jawaharlal Nehru University, January, 2004.

Krugman, P (1993): "Regionalism versus Multilateralism: Analytical Notes" in *New Dimensions in Regional Integration*, eds. J. de Melo and A. Panagariya, CUP, Cambridge.

Krugman, P. (1991): "Is Bilateralism Bad?" in E. Helpman and A. Razin (eds.), *International Trade and Trade Policy*, Cambridge, Mass.: MIT Press.

Lawrence, R.Z. (1999), "Regionalism, Multilateralism and Deeper Integration: Changing Paradigms for Developing Countries" in *Trade Rules in the Making* (Eds. M. Rodríguez Mendoza,

B. Kotschwar and P. Low), Brookings Institution and Organization of American States, Washington D.C.

Lawrence, Robert Z (1996): "Regionalism, Multilateralism, and Deeper Integration". Brookings Institution. Washington D.C.

Lipsey, R. G (1957): "The Theory of Customs Union: Trade Diversion and Welfare"-*Economica* 24, 40-46.

Lloyd P. J. and MacLaren, Donald (2003): "The Case for Free Trade and the Role of RTAs" – paper presented at a seminar on Regionalism and the WTO, Geneva, 14 November 2003. Available at: http://www.wto.org/english/tratop_e/region_e/sem_nov03_e/maclaren_paper_e.pdf

Panagariya, A. (1996): "The Free Trade Area of the Americas: Good for Latin America?" *World Economy* 19, no. 5, September, 485-515.

Panagariya, A. (1996): "The Free Trade Area of the Americas: Good for Latin America?" *World Economy* 19, no. 5, September, 485-515.

Panagariya, A. (2000), 'Preferential trade liberalization; the traditional theory and new developments, *Journal of Economic Literature*, 2, 287-331

Summers, L.,(1991): "Regionalism and the World Trading System". -Policy Implications of Trade and Currency Zones. Wyoming: Federal Reserve Bank of Kansas City

Venables, A. (1999): 'Regional integration agreements: a force for convergence and divergence?' Paper prepared for the Annual World Bank Conference on Development Economics, Paris, June 1999. Working paper No. 2260, Washington, D.C., World Bank. Available from <http://www.worldbank.org/research/trade/archive.html> (Also published as *Winners and Losers from Regional Integration Agreements*, CEPR Discussion Paper No. 2528).

Viner, Jacob (1950): *The Customs Union Issue*, Carnegie Endowment for International Peace, New York.