

Philippe De Lombaerde  
*Editor*

2006 World Report on Regional Integration  
UNITED NATIONS UNIVERSITY SERIES ON REGIONALISM 1

# Multilateralism, Regionalism and Bilateralism in Trade and Investment

*In Collaboration with:*

*UNCTAD, ECA, ECLAC, ESCAP, ESCWA, UNECE, UNU-WIDER*



Springer



MULTILATERALISM, REGIONALISM  
AND BILATERALISM IN TRADE  
AND INVESTMENT

Although the most recent years have left us with a number of ‘failed’ or stagnating integration projects in different parts of the world, the underlying idea behind this World Report is that – from a longer time perspective- there is a need for a stronger regional governance level, situated between the national and global levels. This is related to the simple facts that, on the one hand, many challenges (economic, security, environmental, ...) posed to humanity cannot be adequately addressed at the national level, and that, on the other hand, an effective multilateral system needs some form of regional organisation. This regional governance level is complementary to, not in contradiction with, the other governance levels in a modern and flexible system of multi-level governance.

Aware of this emerging reality, the United Nations University-Comparative Regional Integration Studies (UNU-CRIS) took the initiative to launch a new series of World Reports in order to monitor trends and prospects for regional governance. This has been made possible with the support of the GARNET Network of Excellence, UNCTAD, the five regional UN Economic Commissions, and UNU-WIDER.

This World Report on Regional Integration fills a gap in the supply of world reports and is likely to become a leading reference point for future debates among policy-makers, academics and the broader public on the role of regions in world governance.



United Nations  
University

**CRIS**

Comparative Regional Integration Studies



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## ENDORSEMENTS

*The EU Framework VI GARNET Network of Excellence was created to bundle the capacity of more than 40 universities in order to jointly undertake innovative research on globalisation, regionalisation and the role of the EU, and regions in general, in world governance. In this context, GARNET actively supported the launching of this new **World Report on Regional Integration**. The series is likely to establish itself as an obligatory reference for policy-makers and academics involved in thinking and moulding the global governance architecture of the future. It fills a gap in the existing supply of world reports.*

Professor Richard Higgott, Director of the Centre for the Study of Globalisation and Regionalisation at the University of Warwick, and Senior Scientist and Director of the GARNET Network of Excellence

*The African, Caribbean and Pacific Group of States (ACP Group) welcomes the **World Report on Regional Integration**, which provides a holistic and pragmatic perspective on the role of regions in world governance and international affairs. The most significant and unique value of this volume is that it presents an enhanced understanding of the processes of regional integration in political, economic, social and cultural spheres. It is an invaluable reference for the ACP Group in its endeavour to further enhance solidarity and unity amongst its member states, whilst addressing the challenges of poverty eradication, sustainable development and globalization.*

Sir John R. Kaputin, KBE, CMG, Secretary-General of the ACP Group

*Global governance is a concern of not only global organisations but also of all individual states and of regional co-operation agreements among sovereign states. In 2001, the United Nations University has launched UNU-CRIS, a research and training programme on comparative regional integration to study the role of regional integration in global governance. The present first volume of the **World Report on Regional Integration** is a timely product of the research undertaken at UNU-CRIS. This new series of World Reports will certainly contribute to the discussion on the interaction between regional and global governance. And by bringing together insights from different parts of the UN system, in particular the five UN regional economic commissions and UNCTAD, this report will also contribute to a better understanding of the role of regions in the UN.*

Hans van Ginkel, Under-Secretary-General of the United Nations and Rector of UNU

*The **World Report on Regional Integration** brings together a well-balanced mix of economic analysis, facts and political perspectives on the topic of regional integration. The most valuable and unique contribution of this volume is the enhanced clarity it brings to the complex picture of trade and investment integration, the entanglement of which points to the need for more effective regional governance as a building block of multilateral governance in this area. As the world's most dynamic trading region, Asia and the Pacific is a key player in this process, and the UNESCAP secretariat, in its service to the region, will continue to accord high priority to this policy objective.*

Kim Hak-Su, Under-Secretary-General of the United Nations and Executive Secretary of UNESCAP

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Philippe De Lombaerde  
Luk Van Langenhove,  
Bruges

## INTRODUCTION

Regional integration refers to the emergence of a governance level between the national and the global levels within the system of world governance, based on (regional) cooperative behaviour and the design of common policies and institutions by actors that traditionally belong(ed) to the national governance level. “Regional” is here thus understood as “macro-regional”, that is, at the supra-national level, as opposed to “micro-regional”, that is, at the sub-national level. At the same time, regionalisation refers to a complex and multi-dimensional social transformation process, whereby the regional level is becoming a relevant space for many aspects of human behaviour and activities, driven by social and technological forces similar to those driving the globalisation process.

Regional integration has been a booming phenomenon in recent years. Not only is there a proliferation of regional trade agreements, as witnessed by the stock of more than 250 notifications before the GATT/WTO,<sup>1</sup> but other forms of regional cooperation and integration have also emerged in different parts of the world.

Although the most recent years have left us with a number of “failed” or stagnating integration projects in Latin America, Africa, Europe and elsewhere, we are convinced that – in a longer-term perspective – there is a need for a stronger regional governance level, for the simple fact that, on the one hand, many challenges (economic, security, environmental, etc.) that confront humankind cannot be adequately addressed at the national level, and, on the other hand, effective multilateralism requires some form of regional organisation. This regional governance level is complementary to, not in contradiction with, the other governance levels in a modern and flexible system of multi-level governance.<sup>2</sup>

Aware of this emerging reality, the United Nations University decided in 2001 to set up a new Research and Training Programme on “Comparative Regional Integration Studies” (UNU-CRIS; <http://www.cris.unu.edu>). The UNU-CRIS academic environment focuses on the analysis of regional integration processes all over the world and the potential contribution of regional governance to development. In addition, UNU-CRIS created a privileged space to reflect on the future role of regions within the UN and on the regional dimension of UN activities.

Since 2001, UNU-CRIS has gradually developed its research and capacity-building portfolio and has started to generate a growing number of outputs. In a number of specific areas, UNU-CRIS has begun to play an important role in the academic and policy debates; these include: methodological issues of research on regional integration; multi-level trade governance; the role of regional organisations in peace building; the reform of the UN Security Council; and interregionalism. A large number of papers, articles and books on these topics have been published.<sup>3</sup>

As it was clear from the beginning that regional integration should be the core activity of this new research institute, the need was felt to set up in a systematic way monitoring activities that span the whole globe and deal with the many different aspects of regional integration. Available quantitative indicators such as the WTO notifications of free trade agreements (FTAs) and customs unions (CUs) only offer a partial view of the phenomenon and do not allow us to evaluate the depth of these processes or the interregional differences.

Such an activity, however, could not be carried out by UNU-CRIS alone and a network of partners needed to be built as well as adequate resources mobilised. Initially, an informal network of academics was created to address the issues related to the construction of indicators and other methodological aspects. The results of this phase were published in De Lombaerde (2006). A follow-up project was launched in collaboration with the Inter-American Development Bank, focusing on concrete experiences with monitoring tools in different regions in the world.

When in 2005, the EU-funded Network of Excellence “Global Governance, Regionalisation and Regulation” (GARNET; <http://www.garnet-eu.org>) was launched, UNU-CRIS, together with PADRIGU – Göteborg University, was given the responsibility of organising a Workpackage on indicators and monitoring. Together with a number of other academic partners, different activities were launched. These include: the design and implementation of a web-based information system on regional integration (the Regional Information Knowledge System – RIKS), the production of a methods toolkit for analysts in academia and regional organisations, and the publication of an annual report on regional integration.

In parallel, UNU-CRIS, being part of the UN family, also sought to collaborate with the UN regional economic commissions and other parts of the UN system such as UNCTAD. The five Commissions, and more specifically their trade and integration divisions, have indeed already built-up considerable experience with regional integration issues for many years. Some of them already publish annual reports for their own UN-defined “region”.<sup>4</sup> Hence, the idea emerged to gather in one (annual) publication the monitoring work done by the different UN Commissions.

We decided to merge the two initiatives and bring together, for the first time in one single publication and aimed at a global readership, reports from all five UN Commissions, combined with academic input. We are convinced that this World Report on Regional Integration fills a gap and hope that it will become a leading reference point for future debates on the role of regions in world governance.

The Report is organised in two main sections and an annex. The first section is thematic and contains a number of contributions dealing with particular aspects of regional integration and governance. The theme will change from year to year. The choice will depend on supply considerations (academic output of UNU and/or output and activities of UN organs) and on demand considerations (timeliness or urgency of topics). For the first volume, the theme that was chosen is “*Multilateralism, Regionalism and Bilateralism in Trade and Investment*”. With the

Doha Development Agenda on the table, a number of recent developments at the regional level, such as the re-drawing of the map of South American regionalism, and the questioning of a number of proposals of interregional trade arrangements (EU-Mercosur, EU-CAN, FTAA, etc.), the importance and timeliness of this theme need not be further emphasised. The Report draws on the outcomes of recent research projects at UNU-WIDER and UNU-CRIS, and includes also material by UNCTAD.

The second section consists of regional reports, written by the UN regional Economic Commissions (ECA, UNECE, ECLAC, ESCAP and ESCWA) and UNU-CRIS. This part will be a returning feature of the World Report. In the regional reports the Commissions present the situation in the different geographical areas for which they are mandated.<sup>5</sup> These different reports, taken together, offer a unique overview of the current state of regional integration in the world. This should contribute to the further understanding of commonalities and divergences in the regional integration processes in the different regions of the world and to reaching a clearer perspective on the strength and characteristics of the emerging macro-regional governance level. Because of the mandate of the Commissions, these reports will initially focus on socio-economic and trade aspects of regional integration. However, being conscious that regional integration should be seen as a complex and multi-dimensional social process, we aim to broaden the scope of the second part in the future.

The Report concludes with some key data on regional organisations in an annex. These include: memberships, year of establishment, links to official websites, shares of world population and GDP, and intra-regional trade shares. The annex will also be further developed in the future.

This World Report and the statistical information it contains have only academic and informative purposes. They do not, in any way, imply official statements of the United Nations, the United Nations University or any other UN organ regarding regional organisations or UN member states. The authors are personally responsible for the contents of their chapters.

#### NOTES

<sup>1</sup> From 1948 till 1994 (i.e. before the creation of the WTO), 124 new free trade agreements or customs unions (or new memberships of these) were notified to the GATT. Since then, this number has more than doubled. The WTO estimated the number of regional trade agreements in force by the beginning of 2006 at around 300 (see: <http://www.wto.org/>).

<sup>2</sup> See also, Thakur and Van Langenhove (2006).

<sup>3</sup> Volumes containing UNU-CRIS research output include: Van Ginkel et al. (2003), Slocum et al. (2005), Farrell et al. (2005), Graham and Felicio (2005), De Lombaerde (2006), Vinhas de Souza and De Lombaerde (2006), Söderbaum and Van Langenhove (2006) and Woolcock (2006).

<sup>4</sup> See, for example, ECA (2004, 2006) and ESCWA (2005). Developments in regional integration are also covered in ECLAC (2006). See also: UNECE (2005).

<sup>5</sup> UNU-CRIS covers the European Union.

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SECTION I

**MULTILATERALISM, REGIONALISM  
AND BILATERALISM IN TRADE  
AND INVESTMENT**

## CHAPTER 1

DEVELOPING COUNTRIES' PARTICIPATION IN  
REGIONAL INTEGRATION: TRENDS, PROSPECTS  
AND POLICY IMPLICATIONS

## 1.1. INTRODUCTION

In recent years, regional trade agreements (RTAs) among developing countries have expanded, increased and in general gained new momentum. Mixed RTAs (North-South RTAs) with reciprocal commitments between developed and developing countries are becoming more frequent in all regions. These include, notably, agreements with the United States and the EU as the “Northern” partner, but also include agreements with Australia, Canada, and New Zealand.

Overall, new RTAs are increasingly expanding to other regions and becoming more complex inter-regional integration systems between countries at different stages of development (Figure 1.1). Furthermore, economic integration has moved beyond the regional level to become interregional. For instance, almost one-quarter of RTAs signed in the post-1990 period are intercontinental. New inter-continental integration projects with potentially significant impact on global trade and investment have been proliferating. EU-induced regionalism has extended to countries and regions outside of Europe. At the same time, 65 per cent of them are signed between partners at different stages of development (North-South, North-East, or South-East). Developing countries are also major players in this trend, being partners in more than half of all the RTAs formed as part of the “new wave of regionalism”.

The new dynamism in RTAs points to certain emerging results in the system of international trade relations. The creation and rapid expansion of RTAs seems set to remain a lasting feature of international economic relations. Some of the regional projects would combine substantial economic power and would exert a major impact on third countries and on the functioning of the multilateral trading system. In terms of the international trading system, the concern is that the proliferation of RTAs may lead to an erosion and possible fragmentation of the multilateral trading system into some kind of federal system composed of semi-autonomous “stumbling” trading blocs. This concern has led to debate over regionalism versus multilateralism, and whether RTAs are becoming “building blocks” or a “stumbling blocks”.<sup>1</sup>

North-South RTAs with reciprocal commitments between developed and developing countries are becoming more frequent in all regions. These include agreements with the United States and the EU as the “Northern” partner, but also agreements between Australia, Canada, New Zealand and Japan and developing countries, particularly in Asia and Latin America. The countries in transition in Central and Eastern Europe have also adopted an active role in regional integration (42 per cent of post-1990 RTAs), not only vis-à-vis the EU but also among themselves, reformulating

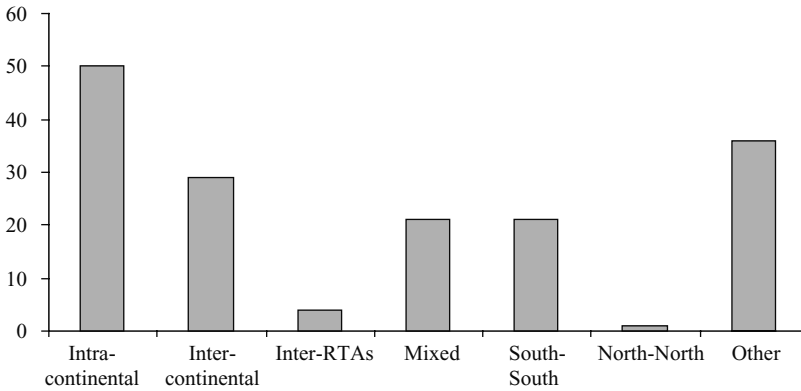


FIGURE 1.1. Trends in RTA formation: RTAs at different stages of negotiations; *Source:* Cernat and Laird, 2003

Legend: **Intra-regional RTAs** refer to agreements between countries belonging to the same geographical region; **Inter-RTA agreements** refer to those trading arrangements between two or more existing RTAs; **Inter-continental RTAs** counts the number of new RTAs between countries situated on different continents; **Mixed RTAs** refer to agreements involving developing and developed countries, while **South-South** and **North-North** refer to developing-only and developed-only agreements, respectively. **Other** refers to RTAs involving transition economies.

their mutual relationships as market economies to forge new trade relationships after the collapse of communism.

The following sections will look into the complex interface between regionalism and multilateralism, in terms of systemic issues and rules, specific negotiating topics, as well as issues that go beyond WTO, the so-called WTO plus issues. In addition, the chapter gives some indications of the various contributions that RTAs could make to further the development objectives of its members through the creation of regional public goods. Such analytical examination is being carried out by UNCTAD with a view to providing policy analyses and options on strengthening the positive, development interface between different trade negotiations and agreements.

## 1.2. THE COMPLEX INTERDEPENDENCE BETWEEN REGIONALISM AND MULTILATERALISM

Multilateral trading rules and rules developed within RTAs have mutually reacted during the last decades of their coexistence. On one hand, the multilateral rules have had a constraining effect (policy anchor) on regional arrangements, most obviously through the provisions of GATT Article XXIV, its post-Uruguay Round understanding, and GATS Article V. On the other hand, regional integration initiatives have also influenced the multilateral system in a number of ways, particularly in the establishment of rules in areas not yet covered by the WTO or in making clarifications

about the operation of WTO rules. Thus, RTAs may act as *policy transfer mechanisms* towards the multilateral system. As a result of developments within RTAs, the WTO agenda has expanded, and new or more far-reaching rules have been introduced on trade-related issues along the lines of RTA provisions. Investment and competition policy are two areas where RTAs have moved ahead of the WTO system, while developments on services at the WTO level were influenced by progress in NAFTA and the EU.

The interface between the multilateral trading system and regional integration processes has important implications for the trade and development prospects of developing countries. They can be complementary and coherent with the multilateral trading system (MTS), and thus facilitate international trade and enhance development prospects, or they can be divergent and hence undermine the collective and national effort to use international trade as an engine of growth and development. The coherence between multilateralism and regionalism becomes an opportunity and challenge for countries, as well as their regional arrangements and the WTO to manage in the evolving international trading system in order to maximize their potential benefits and minimize their potential adverse effects.

Effectively managing the interface between regional and multilateral initiatives requires greater synergy between national development objectives and external commitments (Mashayekhi et al., 2005). Central to this challenge facing developing countries is to design and implement an appropriate and strategic pacing and sequencing of national, regional and multilateral liberalisation, so as to maximise development gains from these processes of trade liberalisation and regulatory commitments, by rendering regional processes and multilateral liberalisation mutually supportive and coherent. A challenge is that simultaneous participation by countries in a web of regional trade agreements while also engaging in the evolving MTS, both of which have overlapping agendas, increasingly affects sensitive development policies. A key challenge is for RTAs to promote preferential trade among members while ensuring that such trade does not undermine, but in fact enhances, the group's trade with the rest of the world. Such interface between multilateralism and regionalism in terms of coherence and compatibility deserves special attention by policy makers and requires careful and in-depth study.

In concrete terms, the interface between the MTS and RTAs operates at three levels. At the first level are WTO rules governing the operations of RTAs. They define specific conditions under which RTAs are allowed to exist and to operate under the multilateral trading system. WTO rules governing RTAs include GATT 1994 Article XXIV on trade in goods, GATS Article V on trade in services, and the Enabling Clause on South-South (preferential) agreements. At the second level, market access commitments, be it goods or services, made on an MFN basis as a result of multilateral trade negotiations determine the degree of preferences available to RTA partners, hence the scope for preferential liberalisation among RTA partners. At the third level, multilateral disciplines constitute a "floor", or common minimum denominator, on trade and trade-related policy disciplines covered by the WTO, including non-tariff barriers and behind-the-border regulatory issues. Such disciplines commit all WTO

Members and determine the conduct of trade policy that has to be observed, including by the parties of RTAs. However, RTAs may lead to the commitments of a level higher than that statutorily defined under the WTO.

### 1.3. WTO RULES ON REGIONAL TRADE AGREEMENTS

The general framework of WTO discipline on TRAs is contained in Article XXIV of GATT 1994, Article V of the GATS and the Enabling Clause. All provisions allow WTO Members to depart from the cornerstone principle of the MFN under certain conditions, and establish the requirements to be fulfilled by members of RTAs to be compatible with the WTO. GATT Article XXIV requirements, which apply to FTAs (free trade agreements), CUs (customs union) and “interim arrangement” leading to either FTAs or CUs, essentially provide that duties and other restrictive regulations of commerce should be eliminated for “substantially all the trade” among RTA members, and that the barriers placed in the way of third countries should not be “on the whole higher or more restrictive”. These requirements are not applicable under the Enabling Clause. The Enabling Clause provides that the MFN clause of GATT Article I.1 is exempted for a limited number of preferential arrangements, including “regional or global arrangements entered into amongst less-developed countries for the mutual reduction of tariff reduction or elimination of tariffs” (paragraph 2c). Thus, it can be argued that the Enabling Clause sets out less stringent requirements than those contained in GATT Article XXIV, primarily owing to the limit impact on international trade of the developing countries. Indeed, most South-South RTAs have been notified under the Enabling Clause. GATS Article V applies to regional integration agreements covering trade in services of all countries.

The examination of notified RTAs with regard to their compatibility with WTO rules is conducted by the Committee on Regional Trade Agreements (CRTA).<sup>2</sup> The CRTA has not been able to adopt final reports on its examination to date. This is in large part due to the very limited progress made by WTO Members in resolving “systemic issues” concerning WTO rules on RTAs. Systemic issues pertain to the interpretation of some of the terms and benchmarks in the relevant provisions. For instance, there has been no agreement among WTO Members as to the exact meaning and measurement of key terms such as “substantially all the trade”, “not on the whole higher or more restrictive”, and “other regulations of commerce (ORC)”; the treatment of preferential rules of origin, “other restrictive regulations of commerce (ORRC)” and obligations during transitional periods. The relationship between RTAs notified under the Enabling Clause and GATT Article XXIV has also been raised. Systemic issues with regard to GATS include the interpretation of “substantial sectoral coverage” and “absence or elimination of substantially all discrimination”.

The improvement and the clarification of the WTO disciplines affecting RTAs are critical in disciplining RTAs in a manner supportive of the MTS – one which minimises the harmful effects of RTAs on third countries and the MTS, as well as to enable countries to benefit from increased trade their trading partners. In this respect, multilateral

negotiations are underway in accordance with the Doha Ministerial Declaration on WTO rules (paragraph 29) applying to regional trade agreements aimed at “clarifying and improving disciplines and procedures”, while taking into account their “developmental aspects”. Negotiations, to be concluded as part of single undertaking, are conducted in the Negotiating Group on Rules (NGR). Submissions by some Members propose a comprehensive review of the relevant provisions, seeking clarification of key benchmark requirements while taking into account the development dimension of RTAs, and the improvement of the WTO’s oversight function in terms of procedural requirements and transparency in respect of notification, reporting and examination procedures.

A major rationale for opening negotiations on WTO rules on RTAs has been to enhance the supervisory function of the WTO to discipline RTAs. This arose from the experience under the previous GATT 1947 and the WTO in that the rules on RTAs have been ineffective in disciplining the formation and operation of an ever-increasing number of RTAs. More RTAs have been created in the 8 years following the formation of the WTO than in the 50 years of the existence of the former GATT. Between 1945 and 1995, some 125 RTAs were notified to the GATT, of which some 50 agreements are still operational. In contrast, between 1995 and 2002, some 250 agreements were notified to the WTO, about 168 of which are currently in force. As a result, some 50 per cent of world trade currently takes place under regional trade agreements. Moreover, the examination of WTO compatibility of RTAs is proceeding slowly in the CRTA, the WTO body responsible for the task. More seriously, there has been a deadlock in respect of issuing reports on the conformity or not of examined RTAs.

In this respect, proposals were made in the course of discussion aimed at rendering WTO rules on RTAs more effective and stringent, particularly in respect of the cornerstone requirement of “substantially all the trade”. Historically, there have been no formally agreed criteria as to the degree of internal trade liberalisation nor as to how to measure it. Some implicit understanding exists that RTAs are deemed to cover at least 90+ per cent of internal trade with no exclusion of a major sector. As to the measurement of SAT requirement, two approaches have been discussed, one based on trade volume (value) and the other on tariff lines (products). Preference differed among countries in respect both of threshold levels and methodology. Similarly, the interpretation of the term, “other restrictive regulations of commerce (ORRCs)”, has been a major systemic issue, as depending on its interpretation, an RTA member may or may not be allowed to impose, for example, trade remedy measures, to other RTA partners. The issue of transition period matters not only in terms of the maximum length of the period during which full internal liberalisation should be completed, but also in terms of at which point in time during the transition period should the SAT requirement be met by RTAs. This is important as depending on the timing at which SAT requiring is met, RTAs may or may not have discretion in designing their liberalisation schedules and commitments. This will have important implication on mitigating impact of adjustment as a result of regional liberalisation, particularly in the case of developing countries.

A most ambitious and comprehensive proposal made to date in this regard is that of Australia. Australia proposed to measure “substantially all the trade” requirement by a rigorous benchmark of liberalisation of elimination of duties and ORRCs (such as tariff rate quotas) on at least: (1) 70 per cent of all tariff lines at HS (Harmonised System) six-digit level on entry into force of an agreement; and (2) 95 per cent of all tariff lines at HS six-digit levels precisely 10 years following the enactment of the agreement. Australia favours a tariff-line based approach in the measurement of the SAT requirement, and call for a relatively high benchmark of 95 per cent coverage at the end of the 10-year transition period, and starting at the entry into force of the agreement with a 70 per cent benchmark. The tariff line approach aims to ensure comprehensive coverage of all major sectors and preempt the exclusion of some sectors (like agriculture). Furthermore, Australia goes on to propose to interpret SAT requirement as requiring no exclusion of any “highly traded” products (i.e. those products accounting for at least 0.2 per cent of intra-RTA imports or top 50 products imported from RTA partners). In addition, Australia proposed to take into account those products that would have been traded if there were no trade barriers between RTA partners. Australia proposes a methodology for this by verifying that the “significant exports” (those products accounting at least 2 per cent of a RTA partner’s exports to the world) of each party is subjected to liberalisation by the other parties even if historically they are not markets for those products.

On its part, the EC, party to a number of RTAs, provides more nuanced approach as regards SAT requirement. Firstly, EC argues that the SAT should be based on the coverage of trade. This reflects the EC’s preference to use the trade volume based approach, which allows for greater flexibility in excluding some sectors (like agriculture) from liberalisation. However, the EC is also willing to consider tariff line approach and suggests using, for instance, a combined average threshold for trade and tariff lines in the measurement of SAT. Secondly, EC argues that the quantitative threshold level is subject to negotiations pending agreement on the methodology to be adopted on a preliminary basis. Thirdly, EC argues that, irrespective of the result of the negotiations in respect of SAT, it should form only ONE guiding element among many for determining likely-WTO-compatibility of an RTA, and not THE determining criterion. This means that any quantitative assessment should be done on a case-by-case basis, and should not automatically guarantee for conformity. Thus, the EU position is that a holistic assessment on a case-by-case basis is needed to determine final WTO-compatibility of RTAs.

Many developing countries engaged in a multitude of regional integration processes, particularly with developed country partners, have sought to introduce flexibility in GATT Article XXIV requirement by way of SDT, so that their developmental concerns in regional trade negotiations are effectively addressed by WTO rules and conditions themselves.<sup>3</sup> Such approach has been considered as in perfect conformity with the aspect of the Doha Work Programme (DWP) in paragraph 29 that provides that the “developmental aspects” of RTAs will be taken into account in the negotiations to clarify and improve existing disciplines affecting RTAs. The

case in point is the proposal submitted by the ACP States. The proposal aims at formally and explicitly incorporating SDT in the application of terms and conditions set out in paragraphs 5–8 of GATT 1994 Article XXIV when these are applied to RTAs formed between developed and developing countries or North-South RTAs, as will be the case of future economic partnership agreement under negotiations between ACP States and the EU. The ACP States argued that, while SDT is integral part of WTO and also found in GATS Article V, a counterpart provision in GATS on regional integration agreements, GATT Article XXIV does not contain any explicit SDT for developing countries, which constrains developing countries' ability to seek "less than full reciprocity" in the context of regional trade negotiations vis-à-vis developed country partners. The key objective is to introduce SDT into GATT Article XXIV and in doing so, secure legal security of an RTA with SDT from legal challenges as to their compatibility with WTO disciplines. The proposal calls for flexibility in the following requirements of GATT Article XXIV: SAT requirement in duties and ORRCs (Article XXIV:8(a)(i) and (b)); "reasonable period of time" (Article XXIV:5(c) and paragraph 3 of the 1994 Understanding on the Article); procedural requirements (Article XXIV:7 and paragraphs 7–10 of the 1994 Understanding); and dispute settlement (paragraph 12 of the 1994 Understanding).

The core pillar of the ACP submission is to introduce SDT into the SAT requirement in respect of duties. This can be provided through the application of a favourable methodology and/or lower (i.e. differentiated) threshold levels in the measurement of trade and product coverage of developing countries' parties to a North-South RTA in meeting the SAT requirement. As regards ORRCs, the ACP proposes to apply a flexible interpretation that allows developing countries' members of a North-South RTA to apply contingency protection measures including safeguards measures on intra-regional trade.

The arguments put forward by the ACP submission, primarily on less than full reciprocity and longer transitional period, have received support from the Report of the Commission for Africa on "Our Common Interest".<sup>4</sup> In March 2005, the United Kingdom's Department for International Development (DFID) and Department for Trade and Industry (DTI) issued a joint policy statement on EPAs in which it *inter alia* expressed that "EPAs must be designed to deliver long-term development, economic growth and poverty reduction in ACP countries".

There is thus a strong link between WTO negotiations on rules on RTAs and various regional and inter-regional integration processes that are being negotiated and concluded. WTO rules negotiations are affecting countries' ability to design RTAs to address individual countries' economic and adjustment challenges, which would have developmental implications. At the same time, effective and clarified multilateral rules are important in effectively disciplining preferential trade arrangements that might result in trade diversion, and in minimising their negative impacts on third countries and systemic implications. It seems especially important to minimise the effects of TRAs on developing third country WTO members. Such multilateral rules would also contribute to the viability of rule-based multilateral trading system. The two spheres of negotiations are thus converging where stakes for countries consist in

finding ways to strike appropriate balance between the need for effective and improved multilateral disciplines and that for flexibility for addressing critical national and regional developmental challenges facing, particularly, developing countries.

The operation of rules of origin is one of the areas of greatest concern in RTAs, having considerable scope for trade diversion. Even today, the WTO has no provisions on the use of either preferential or non-preferential ROOs, and discussions continue to be blocked in this area. Accordingly, WTO Members are free to use a variety of methods for the determination of origin.<sup>5</sup> Some South-South RTAs, as in the case of COMESA, have adopted more liberal and simple rules of origin than North-North RTAs.<sup>6</sup> In many RTAs, rules of origin are prone to become captive to special interest lobbies and could therefore be used as protectionist devices. Stringent rules of origin can have a similar effect on trade as high tariffs, if the effect is precluding producer to use the most efficient source for their inputs. For example, the rules of origin for apparel under NAFTA essentially forbid the use of imported fabrics, yarns and even some fibres in the manufacture of qualifying apparel.

The increased importance of rules of origin has determined certain producers to make use of specialised firms that give tailor-made advice on the right mix of inputs that qualify final products for the preferential regime.<sup>7</sup>

One notable exception to this tendency of complex rules of origin (ROOs) is provided by those rules of origin that provide for cumulation of origin between RTA partners and third countries. Some GSP schemes allow for cumulation of origin between beneficiary countries, or between LDCs and non-LDCs that are part of regional integration initiatives. A large number of EU-generated RTAs have become part of the pan-European system of cumulation of origin, which essentially creates a wide free trade area with harmonised rules of origin.

ROOs are therefore an area where RTAs are again outpacing the WTO system, but it is difficult to argue that, as they are used, they are necessarily an advance on the system. Indeed, the diversity of practices suggests an urgent need for a multilateral agreement in this area.

Other unsettled questions arise when looking at the interaction between regionalism and multilateralism on the so-called “Singapore issues”, in particular investment and competition policy. Although competition policy, for instance, has been dropped from the Doha work programme, it may be brought back into the WTO. In the meantime, RTAs have evolved into a complex web of agreements containing a great variety of competition-related provisions. Given this variety of approaches and the relatively small number of RTAs containing competition provisions similar to the ones that had been discussed at multilateral level, it seems that future discussions on trade and competition issues at multilateral level will have to coexist with a myriad of different competition provisions at regional level.

#### 1.4. RTAs AND NEGOTIATIONS ON MARKET ACCESS IN AGRICULTURE, NON-AGRICULTURAL PRODUCTS AND SERVICES

The core market access negotiating agenda under the DWP concerns agriculture, NAMA and services. As regards trade in goods, since the principal aim of RTAs is

to achieve the elimination of tariff and non-tariff barriers among RTA partners on a reciprocal basis, RTAs have direct relevance to the ongoing DWP negotiations on agriculture and NAMA. Developing countries engaged in RTAs need to take into account the implication of MFN liberalisation and the appropriate level of preference for their RTA partners, while the supremacy of the multilateral trading system requires that such preferential treatment does not hinder multilateral efforts for across-the-board MFN tariff reductions. As exporters, they have to ascertain which forums, multilateral or regional, are the most suited for seeking increased market access in a given market or building one for coherence, and to obtain the best trade deals and opportunities for their exports. Erosion of preferential margins is the major issue for LDCs and those low-income countries that have enjoyed substantial preferential margins either under RTAs or unilateral preferences provided by major developed countries. Those countries facing such challenges have called for some adjustment mechanism and trade solutions to be devised under WTO or otherwise so as to address serious adverse effects on the development prospects of these countries.<sup>8</sup>

While some trade-distorting measures such as agricultural subsidies may be better addressed in the WTO (although regional framework in itself does not preclude such possibility as was debated in the context of FTAA regarding agricultural subsidy), it may be argued that certain market access barriers in sensitive sectors such as agriculture might be better addressed in the limited scope of the regional context. In this respect, it can be noted that protection prevalent on an MFN basis tends to persist under RTAs (e.g. agriculture, textiles). While RTAs may be better suited for addressing specific highly protected sectors on a limited basis, the weaker bargaining position of developing countries in North-South agreements may not allow them to successfully address such barriers against powerful developed country partners.

As regards services, the Uruguay Round negotiations on services have resulted in the establishment of GATS as a multilateral framework of principles and rules for trade in services with a view to the expansion of such trade under conditions of transparency and progressive liberalisation and as a means of promoting the economic growth of all trading partners and the development of developing countries. GATS provides for a positive list approach to liberalisation of services. "Positive list" refers to a liberalisation mechanism that separates general obligations that apply to all countries (such as MFN treatment), from the negotiated specific commitments of market access and national treatment in respect of specific service sectors and activities, which can be subject to limitations and conditions. The commitments undertaken during the Uruguay Round negotiations have largely reflected the status quo except in respect of financial and telecommunication services sectors resulting in deeper commitments. Thus, the Doha negotiations on services are expected to achieve progressive and more substantial liberalisation. Deeper liberalisation has taken place in the regional context, where a number of RTAs including developing countries have embarked on preferential services liberalisation based on "GATS-plus" commitments, some under a negative list approach to provide preferential treatment to their RTA partners. Liberalisation of services in the regional context may be beneficial in improving the cost efficiency of national economies as services account for a significant share of GDP for most developing countries and constitute major inputs to production of

goods and services. Under GATS Article V, “flexibility” is allowed for developing countries forming regional integration agreements (RIAs), and additional flexibility is available for those RIAs formed among developing countries only.

Theoretically, it has been shown that liberalisation of services tends to create static gains for liberalising countries as compared with the status quo, be it on a preferential or a non-preferential basis. This is because trade barriers in the services sector tend to be higher while being revenue-neutral for government. Gains are likely to be greater with multilateral than regional liberalisation of services. The sequencing of liberalisation matters more in the services sector than in the goods sector because of greater sunk costs and the incumbent advantages associated with some capital-intensive services. It has been estimated that the greatest gains under the DWP for developing countries would stem from liberalisation of Mode 4. Winters et al. (2002) showed that a flow of natural persons equivalent to 3 per cent of the skilled and unskilled work forces in developed countries would generate an estimated increase in world welfare of over \$ 150 billion, shared fairly equally between developed and developing countries. On Mode 4-related access, progress may be more forthcoming in the regional context, including through recognition of qualifications and visas for service provider. This highlights the fact that the stakes are particularly high for developing countries in multilateral and regional negotiations on the liberalisation of services. It should be noted that Article IV and XIX.2 of the GATS allows for a measure of flexibility for developing countries in respect of liberalisation commitments and a commitment by developed countries to give priority attention to sectors and modes of interest to developing countries.

#### 1.5. RTAs AND WTO+PROVISIONS

In the area of the trade-related regulatory dimension, RTAs increasingly assume prominence as they embark on new trade-related behind-the-border regulatory measures. Multilateral rules in these areas are currently underdeveloped. Of particular relevance to developing countries are those areas where no multilateral rules exist. Some RTAs have given precedence, by way of “WTO-plus” agreements, to the multilateral rules, as was the case with investment under NAFTA, or competition policy and other economic policies under the EU. Some have seen this as evidence to support the “building block” thesis of the interrelationship between the MTS and RTAs, as RTAs serve as a platform for a new rule-making exercise. As noted earlier, such developments may also run the potential risk of increased fragmentation of trade rules at regional levels, making it difficult to subsequently agree multilaterally on these new issues.

Even where multilateral rules exist, negotiations for “WTO-plus” RTAs can transform themselves into standard-setting negotiations, thereby entailing the risk of upward harmonisation of regulatory standards in developing countries. A case in point is intellectual property protection. While minimum statutory standards are provided in the multilateral rules, namely the TRIPS Agreement, in the absence of provisions equivalent to GATT Article XXIV or GATS V (or because it does not

entail market access elements and preferential treatment may not in itself be desirable economically or practicable), IPR standards negotiated regionally are automatically multilateralised.<sup>9</sup> The implication of the regulatory standard-setting nature of RTAs is particularly significant in the North-South context, as developing countries would be under pressure to adopt higher standards, such as patent protection in terms of coverage, level of protection or enforcement, with a consequent restriction of the scope of policy flexibility available under multilateral rules, including for the purpose of ensuring access to essential medicines for all. New issues are often negotiated and included in the North-South agreements, including investment, competition policy, government procurement, environment and labour standards. In this sense, RTAs may serve to bypass, dilute and override SDT for developing countries available under WTO rules and create new obligations in areas not covered by WTO, which would be higher than would have been agreed at the multilateral level.

However, although a vast majority of RTAs contain some WTO+ provisions, little is known about the actual implementation of such provisions. For instance, in the case of competition policy, although more than 140 free trade agreements (bilateral or regional) contain a large variety of competition-related-provisions, the existing evidence suggests that the implementation record is very modest worldwide, including in those agreements involving large, developed trading partners (Brusick, Alvarez and Cernat, 2005). Furthermore, although these "WTO+" provisions are becoming widespread, their scope is not always geared towards addressing pressing economic issues. For instance, despite the growth in cross-border mergers and acquisitions and its obvious implications at regional level, with the exception of those RTAs establishing regional competition rules, substantive provisions in this field are virtually nonexistent.

#### 1.6. RTAs: TRADE DIVERSION AND CREATION ISSUES

Apart from the legal analysis of actual RTA provisions and their consistency with WTO rules, another way of analysing the effects of South-South RTAs is to gauge their actual impact on trade flows among members, and between members and third countries: in the final analysis the multilateral system is not an end in itself but the means of promoting economic progress among Members (see Preamble to the WTO Agreement). A vast literature discusses the trade and welfare effects in great theoretical and empirical detail. One typical yardstick applied to any RTA is whether the overall effect is *trade creation* or *trade diversion* à la Viner. From this perspective, a large number of South-South RTAs do not seem to be more trade diverting than North-North RTAs. Cernat (2001), for instance, used a gravity model to estimate the impact of South-South RTAs on both intra- and extra-trade flows. Contrary to widespread opinions and standard theoretical predictions, the empirical evidence suggests that several South-South RTAs (such as COMESA, ASEAN, CARICOM) are not trade diverting but trade creating, both with regard to intra- and extra-RTA trade.<sup>10</sup> For instance, the empirical estimates suggest that two COMESA members traded in 1998 2.6 times as much as otherwise-similar countries. At the same time,

trade between COMESA members and third countries increased by 25 per cent as a result of COMESA formation (Cernat, 2001). What these findings suggest is that even though some of these South-South RTAs faced implementation problems and delays in liberalising intra-regional trade, the formation of these RTAs succeeded in removing some “invisible” trade barriers between members despite the absence of major tariff preferences. This may well be from the reduction of non-negligible transport costs, border formalities, technical or health standards and other measures that are captured by what is referred to as “trade facilitation” measures may also impose significant costs.<sup>11</sup> All these “invisible” cost-increasing elements may all be reduced through the formation of a South-South RTA. Eliminating such trade barriers implies no welfare loss since there are no tariff revenues forgone (Baldwin, 1994).

Despite these analytical advances, difficult questions still arise from the theoretical ambiguity of RTA formation. For instance, when imperfect competition is taken into account, there is a wide consensus that anti-competitive practices can impair or even nullify the predicted welfare benefits and the dynamic competition effects as a result of RTA formation. Hence RTAs need to contain competition-related provisions. However, in terms of net trade effects (trade creation vs. trade diversion), the impact of such provisions on the trade and welfare effects of RTAs are dependent on the nature of specific provisions. For instance, an RTA that provides for members to adopt national competition laws and apply them in a non-discriminatory manner vis-à-vis national, intra-RTA, and third-party firms will, *ceteris paribus*, have *trade creation* effects. On the other hand, an RTA that only contains CRPs that would tackle anti-competitive practices *in so far as they may affect trade between RTA members*, has a *de jure* discriminatory effect on non-RTA firms and may induce an additional trade diverting potential against competitive third-party producers.

This points to the fact that RTAs, regardless of their direct net trade effects, may also have positive (but also negative) spillover effects, creating new opportunities for the provision of public goods at regional level.

### 1.7. RTAs: PROVIDING REGIONAL PUBLIC GOODS

While most analyses on sources and impacts of economic integration have focused on commercial policy, integration may also result from a desire to coordinate public goods provision. Many public goods like public R&D, global environmental protection, enforcement of regional competition rules, and standardisation generate cross-country spillover, either directly or indirectly. Consequently, countries integrate such policies at regional level to avoid wasteful duplication of investment and inappropriate level and quality of public goods provisions. Standardisation and regulations, which facilitate compatibility of technologies and reduce wastes of producing goods in different specifications, also generate cross-country externality.

The development of regional markets can help African countries overcome constraints arising from small domestic markets, allowing them to reap the benefits of scale economies, stronger competition and more private cross-border investments and foreign direct investment. Enlarged regional markets should generate faster growth

and income convergence in regional economic communities. Integration of sub-regional markets should create subregional growth poles that can generate sufficient externalities for the less developed members. The development impact of South Africa on the smaller member states of SADC is a case in point.

Such developments can raise productivity and facilitate the diversification of production and exports. The combination of a stable investment climate, transport and communication infrastructure, and sound regional economic policy could provide adequate incentives for large-scale investment in manufacturing and service projects subject to economies of scale. Regional market arrangements can provide a framework for coordinating policies and regulations and help to ensure compliance. Other studies have shown that when regional integration include regional socio-economic projects and other types of integration, for example, in providing infrastructure or regional public goods more generally, regional integration process may matter a lot for poverty reduction (te Velde et al., 2004).

Another form of regional public goods is provided through a "trade facilitation" effect of RTA formation. This is evidenced in the case of African RTAs by Glenday (1997), who showed that RTAs can strengthen intra-regional cooperation among African countries to promote intra-regional trade and to allow more efficient border controls through sharing of import documents, common control system could make circumvention less attractive. Inter-governmental cooperation can also render border corruption and red tape more difficult. Among African economic communities COMESA has the most extensive programme for trade facilitation and promotion. Because two (out of the three) EAC members also belong to COMESA, EAC applies many of COMESA's trade facilitation and promotion measures. EAC has also developed a protocol for cooperation on standardisation, quality assurance, metrology and testing. EAC is supplementing COMESA's trade facilitation measures with a regional database of trade and investment opportunities, laying the groundwork for a regional investment promotion centre. EAC is also developing a comprehensive plan to strengthen the role of the private sector and associated bodies such as the East African Business Council. Central to the plan is adopting a common competition policy to promote investment and development in the community. EAC members hope to reach agreement on this policy in tandem with the establishment of their customs union. The collective regulatory framework will also cover harmonised principles to govern investment incentives and promote domestic and foreign investment.

Many other RTAs among developing countries have led to regional cooperation in a number of areas with direct relevance for trade patterns: upgrading transport and communication, infrastructure, harmonisation and simplification of custom procedures, trade facilitation measures for transit goods, etc. Such objectives and concrete initiatives have been carried out, more or less successfully by many of the South-South RTAs. In the SADC region, for instance, a subcommittee on trade facilitation is responsible for harmonising trade documentation and procedures. Half of SADC members use the Automated System for Customs Data, and the community has set up institutions to eliminate technical barriers to trade, promote quality production and

increase cooperation on standardisation, quality assurance, accreditation and metrology. A key area where regional public goods could also be fostered through RTA formation is access to finance. The availability to trade finance is often poor for developing country exporters and importers. This may be one of the explanations for the very low level of intra-regional trade witnessed by some RTAs. Such shortcomings handicap enterprises from developing countries, keeping them from using the full potential of the international marketplace and hampering developing countries' economic growth.<sup>12</sup> Therefore, well-established RTAs among developing countries could put in place various regional mechanisms to address these weaknesses.<sup>13</sup>

#### 1.8. CONCLUSIONS: NORTH, SOUTH, EAST, WEST – WHAT'S BEST?

Despite institutional shortcomings and other economic difficulties, the importance of economic integration among developing countries as a policy option for fostering development and overcoming the constraints of small domestic markets has been already recognised (Bhagwati and Panagariya, 1996). Integration into the regional economy may also be seen as a “stepping stone” to future integration into the world economy. However, a key question for developing and transition economies is the model or approach to follow in pursuing this gradualist and strategic approach to greater integration in the global economy.

One approach for developing and transition economies is to pursue integration among neighbours at equivalent levels of economic development, progressively undertaking liberalisation as their economies develop and deepening the integration process beyond the frontiers. This may be seen as an intermediate step for developing countries towards pursuing liberalisation at a multilateral level, balancing the lower benefits of fuller integration against the adjustment process.

Another option for developing and transition countries is to form or join “mixed” RTAs in partnership with a developed country, with important flexibility provisions including different transition periods. In principle, mixed groupings with major trading partners should provide improved stability of access to product and factor markets for developing countries than those available from sub-regional groupings with neighbouring developing countries as well as enhanced investment and growth. The developed country partner may also provide finance or other support for its partners in such grouping, as in the case of the Europe and Euro-Med Agreements. Apart from enhanced market opportunities and investment flows, an agreement with a developed country is more likely to lead to deeper integration and a stronger legal and institutional framework for trade, benefiting national producers and traders as well as partners (World Bank, 2000).

Although mixed RTAs have been praised by some authors for their potential “lock-in effects”, issues of implementation capacity, asymmetry, reciprocity and traditional concerns about particularly sensitive product sectors render the negotiation of mixed agreements difficult. Furthermore, not all mixed RTAs aim at producing a more level-playing field than the multilateral trading system. “Post-modern”, hidden protectionist trade instruments such as antidumping practices are still present even in advanced

North-South or East-West RTAs. They become even more acute when potential developing partner countries have a large production capacity for sensitive products such as staple foods, fruit and vegetable products, clothing or textiles that are protected by tariff peaks and escalation or other non-tariff barriers in the developed market.<sup>14</sup> In sum, even though they are in most of the cases less ambitious in their achievements than North-North RTAs, several South-South RTAs could serve as “building blocks” for more open trade in line with WTO objectives.

Overall, despite the lack of detailed evidence on the operation of many agreements, our examination of the provisions, a reading of the WTO examination process and a range of studies suggest that RTAs have anticipated the WTO in a number of areas and continue to do so, particularly where there are lacunae in the regulatory framework or weak WTO provisions. There are cases, however, when multilateral trade negotiations have influenced the shape of regional integration schemes, in particular with regard to those issues that were brought recently on the WTO agenda. In recent years, changes have been most marked in behind-the-borders measures – deeper integration – and current discussions on investment and competition policy indicate that this process is ongoing.

While there is an argument that such deeper integration is beneficial in increasing the security and predictability of trading conditions, some developing countries in particular feel that pressures to extend WTO rules put a constraint on their capacity to absorb and implement as well as limiting the flexibility they have to pursue their own developmental policies. The relatively slow pace of South-South agreements reflects this concern as well as concerns about adjustment costs in much the same way as many view trade liberalisation in general.

The scope and pace of South-South RTAs has led some commentators to favour the “North-South” model, in which a developed country or group of countries act as the anchor for an agreement. Apart from the improved market opportunities (and perhaps other assistance), this model may also be seen as a way of forcing the pace and expanding the scope of RTAs and ensuring that what is agreed is fully implemented. Some developing countries have themselves seen this as an advantage in locking in their own reforms.

The history of regional integration has shown that “deep integration” rules, such as competition provisions, need time to fully materialise, particularly in RTAs involving developing countries. However, expeditious progress can only be expected if strengthening of implementation capacity in developing and transition RTA members is accompanied by reinforced commitment from developed countries to effectively address the main competition-policy concerns of their trading partners.

#### NOTES

<sup>1</sup> For surveys of the literature on this debate, see Bhagwati and Panagariya (1996) and Laird (1999).

<sup>2</sup> The examination of those regional trade agreements notified under Enabling Clause is conducted in the Committee on Trade and Development.

- <sup>3</sup> For a discussion of developmental aspects of rules negotiations on regional trade agreement with particular reference to ACP-EU negotiations for economic partnership agreements, see Onguglo and Ito (2003).
- <sup>4</sup> [www.commissionforafrica.org](http://www.commissionforafrica.org).
- <sup>5</sup> See WTO (2002) for a comprehensive survey of ROOs contained in more than 90 RTAs notified to the WTO.
- <sup>6</sup> For a description of the COMESA rules of origin, see in particular Rule 2 of Annex 1 – Protocol on the Rules of Origin for Products to be Traded between the Member States of the Common Market for Eastern and Southern Africa.
- <sup>7</sup> This is particularly true in the case of NAFTA where several companies offer online specialised services on how to fulfil the NAFTA ROOs requirements to interested producers.
- <sup>8</sup> For a comprehensive analysis of the various trade policy options available for LDCs, see Puri (2005).
- <sup>9</sup> It can be noted that, under the TRIPS Agreement, the only exception permitted to the MFN principle is “grandfathering” of preferential IPR protection under plurilateral treaties predating to the WTO.
- <sup>10</sup> Similar results are reported by Frankel (1997) and Winters and Wang (1994) on ASEAN, Primo Braga et al. (1994) found positive trade-creating effects for CACM.
- <sup>11</sup> Hoekman and Konan (1999) found compelling evidence of such “invisible” costs. Thus, according to them, only redundant testing and idiosyncratic standards alone imposed extra-costs from 5 per cent to 90 per cent of the value of traded goods.
- <sup>12</sup> For more details see for instance UNCTAD (2005a).
- <sup>13</sup> One initiative that could be applied in various regional contexts is UNCTAD’s G-NEXID initiative. G-NEXID promotes the creation of effective policies for more effective South-South financing, acting as a vector for further development of South-South economic interrelations – a necessary complement to increasing trend in South-South trade.
- <sup>14</sup> See UNCTAD (2003) for detailed analyses of the tariff peaks and escalation faced by developing countries.

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## CHAPTER 2

PREFERENTIAL TRADING ARRANGEMENTS  
FOR DEVELOPING COUNTRIES

## 2.1. INTRODUCTION AND BACKGROUND

Free trade is supposed to augment world output by guiding resources to their best possible usage at any point of time, and it can also help sustain this efficient usage of resources over a period of time, resulting in higher growth rates. Therefore, policies that try to shelter economic agents from the competitive forces of the world market impede the spillover benefits and dynamic gains from trade. Given the potential role of trade in poverty alleviation through higher growth rates, the main dilemma for developing country governments is to figure out how trade policy should take into account the fact that the current global trade environment is indeed distorted by numerous policies pursued by trading partners. Measures, originating at home or abroad, which restrict market access for developing countries' exports, or raise the prices of their imports, have negative effects on investment incentives and the growth potential of their economies. For example, high rates of subsidisation and trade barriers in agriculture in the developed countries drive developing countries out of major markets and often lead to import surges that bestow extreme adversity on their farmers. It is well known that the existence of such policies has become a major political barrier to further trade policy reform in developing countries.

Since 1995, the (World Trade Organisation) WTO has been a forum to set the rules of the game, while at the same time, to negotiate improved market access. A rules-based world trading system is beneficial to developing countries as many of them are small players in world markets with no real ability to influence the policies of richer and larger countries. A rules-based system can in principle also be beneficial by reducing policy uncertainty, potentially boosting domestic investment. Obviously, the realisation of these potential benefits depends on getting the rules 'right'. Ensuring that the majority of stakeholders, especially the developing countries, perceive the rules as supportive of development is the most important challenge for the WTO (Hoekman et al., 2003).

Granting trade preferences for development purposes originates in the Prebisch–Singer findings on the secular decline in the terms of trade for agricultural commodities. This, coupled with the notion that only manufacturing could provide stability and jobs in developing countries, led to two important policy prescriptions including intervention in favour of import-competing manufacturing industry, and the creation of non-reciprocal tariff preferences to boost manufactured exports from the developing countries.

Developing countries have since held on to a strategy of seeking 'differential and more favourable treatment' (Hudec, 1987; Finger, 1991, 2002; Michalopoulos, 2000,

2001). In this chapter, I will review the trade-enhancing capability of some of these schemes, drawing mainly upon a UNU-WIDER research volume titled ‘The WTO, Developing Countries and the Doha Development Agenda: Prospects and Challenges for Trade-led Growth’. I will also draw on other existing literature on the topic. Bacchetta and Bora (2004) examined where the WTO members stand with regard to their objective of achieving a substantial reduction of tariffs and eliminating discriminatory treatment in the area of non-agricultural tariffs. Two indicators are examined: The first is the percentage of MFN bound duty-free tariff lines for a sample of members, and the second indicator is the share of imports under MFN bound duty-free tariff items for a sample of members. Approximately 6 per cent of the total number of non-agricultural items in the sample of WTO members’ tariff schedules is bound duty-free. This small number of duty-free items, even though they account for one-third of the value of world trade in industrial products, confirms that there is still a considerable amount to be achieved in multilateral tariff negotiations.

One of the ways by which developing countries have tried to circumvent the slowness of the multilateral process and tap the benefits of trade expansion, *albeit* in a piecemeal fashion, is the so-called “Special and Differential Treatment” (SDT). The 1979 ‘Enabling Clause’ made SDT a central element of the trading system. It calls for preferential market access for developing countries, limits reciprocity in negotiating rounds to levels ‘consistent with development needs’ and provides developing countries with greater freedom to use trade policies than would otherwise be permitted by GATT rules.

There are currently three major dimensions of SDT in the WTO: preferential access for developing countries to developed country markets; technical assistance for lower-income economies to help them implement multilateral rules; and exemptions from certain WTO rules. Some of the exemptions are transitory, for example, for rules on customs valuation, the abolition of trade-related investment measures (TRIMs), and implementation of stronger protection of intellectual property rights under the Agreement on TRIPS, and some permanent, for example, limited reciprocity under the Enabling Clause or Article XVIII GATT. In the next sections, we examine the first dimension of SDT, which is preferential trade access.

## 2.2. PREFERENTIAL TRADING AGREEMENTS

The universal adoption of the Most Favoured Nation (MFN) principle remains the cherished goal of the ongoing process of trade negotiations, but its all-inclusive character makes it a time consuming, long-term possibility at best. Preferential Trading Arrangements (PTA) are crucial as quick and stop-gap solutions. At the end of the day, it is through PTAs that the rich and poor countries interact in more substantive ways. PTAs have proliferated in recent years.

Developed countries, especially, the European Union (EU), Japan, Canada and the United States (US) offer a number of preferential trading arrangements to developing countries. These include the well-known Generalised System of Preferences (GSP) and more recent ones such as the African Growth and Opportunity Act (AGOA) of the

United States, the Everything But Arms Initiative (EBA) of the European Union and the 99 per cent Initiative of Japan. The drive to grant substantial trade preferences to the Least Developed Countries (LDC) is relatively new. The 'least developed countries' are selected by the United Nations Economic and Social Council based on a number of criteria and confirmed by a vote of the UN General Assembly. First created in 1971, the list is updated every three years, and by 2004, there were 49 UN-designated LDCs.

### 2.3. THE GENERALISED SYSTEM OF PREFERENCES (GSP)

The GSP was proposed at the first session of the United Nations Conference on Trade and Development (UNCTAD), in 1964. As it violated in principle the Most Favoured Nation clause, a GATT amendment was required to allow members to grant trade preferences to developing countries. The amendment, known as the 'enabling clause', was approved for a limited period of ten years in 1971, legitimising GSP programs, and then was made permanent in 1979. At least 18 economies (as of 2004) have offered benefits under this scheme at some point of time.

The US first approved a GSP program in the Trade Act of 1974 with the program taking effect on 1 January 1976. Like most GSP programs, it excluded certain textile and apparel items, watches, import-sensitive electronic items, steel and glass products, and some footwear. It also required a product from a particular country to come off the GSP list if its exports to the US hit a certain value. The Trade and Tariff Act of 1984 authorised the U.S. president to waive this so-called "competitive needs limits" for LDCs, who gained even more benefits in 1997 when President Clinton named about 1770 additional items duty-free for them. The US, however, retains discretionary power to exclude an LDC from its list of beneficiary, if the country harbours terrorists, or, has a communist government.

The European Economic Community – the European Union (EU) currently, was the first to implement a GSP after approval of the GATT enabling clause. The EU traditionally designated goods as non-sensitive and sensitive, the latter of which compete more directly with European producers. Non-sensitive goods enter at zero duty, and sensitive goods attract reduced duty compared to the MFN rate. Although not all GSP products enter duty-free, the EU eliminated quotas and quantitative restrictions on these products in 1995. The EU provided more favourable treatment for LDCs from the beginning and now offers these to a number of countries, depending on their policies for promotion of labour rights, protection of tropical forests, combating of drug production and trafficking etc. The EU's expanded benefits over the last three revisions of its programs apply to all UN-designated LDCs. The latest expansion is the Everything But Arms (EBA) initiative, effective 1 March 2001, in which the EU allows duty-free and quota-free access to all products except arms and ammunition. This is reviewed in more detail later in the chapter.

Japan first offered its GSP in 1971, initially for 10 years, later extended until 2011. The program offers benefits on a "positive" list of 226 agricultural products and all industrial products except for a "negative" list of 105 items. Tariffs on agricultural

products range from zero to a reduction of the MFN rate, and tariffs on industrial products are zero except for items designated sensitive. Currently the programme includes 149 countries and 15 territories, granting special LDC benefits to all but two of the 49 UN-designated LDCs (Comoros and Djibouti have not applied for benefits under the programme).

Special benefits to LDCs, include duty-free treatment to all products covered by the GSP and the elimination of import ceilings. As of 1 April 2001, Japan launched its 99 per cent Initiative, in which it added about 360 items duty-free and quota-free to the GSP list exclusively for LDCs. The initiative covered all UN-designated LDCs, including those not in the regular GSP programmed at the time.

#### 2.4. THE EBA INITIATIVE

The EBA initiative, started in March 2001, extends duty-free access without any quantitative restrictions to 919 agricultural products originating in the least developed countries. More than 50 per cent of the liberalised tariff lines covered meat and dairy products, beverages and milled products. Unlike the GSP, which is subject to periodic renewal, the special arrangements provided for in the EBA initiative for market access for LDCs would be maintained for an unlimited period of time, reducing the uncertainty of preferential market access. However, unlike the negotiated EU-ACP arrangements, it can be modified unilaterally by the EU.

While the original GSP, in the Prebisch–Singer spirit, focused on manufactured products, the products included in the EBA initiative are agricultural products. Only three products were not liberalised immediately: bananas, rice and sugar. Their phase-in periods for full market access are as follows:

- Bananas – Duties gradually eliminated, by a 20 per cent annual reduction, starting on 1 January 2002. All duties to be eliminated from 1 January 2006.
- Rice – Duties will be reduced by 20 per cent on 1 September 2006, by 50 per cent on 1 September 2007 and by 80 per cent on 1 September 2008.
- Sugar – Full liberalisation will be phased in between 1 July 2006 and 1 July 2009.

#### 2.5. ASSESSING THE IMPACT OF EBA

Cernat et al. (2004) used a computable general equilibrium model to assess the impact of EBA, both in terms of trade expansion as well as welfare. They look at the effects of the policy on each country's welfare, and on their sectoral trade and production patterns, by simulating the complete removal of both tariff and non-tariff barriers faced by LDCs in the EU market. Welfare changes are further decomposed in their allocative effect and the terms of trade component (Table 2.1).

They find that all beneficiary countries gain from the EBA initiative in welfare terms, while the donor (the EU) loses slightly from the initiative. Net world gains from the EBA initiative are positive. In absolute terms (equivalent variation in mln USD), the biggest gain accrues to rest of SSA, while the greatest loss occurs for the

TABLE 2.1. Welfare changes (1997, mln USD)

Regions	Allocative effects	Terms of trade effects	Total
NAFTA	0.2	-17.9	-26.4
EU	-24.0	-186.9	-212.3
China	-0.7	8.6	4.2
Japan	-2.9	-14.9	-24.3
Rest of Asia	-5.8	-11.6	-20.9
Latin America	-0.4	-4.1	-7.7
Rest of developed countries	4.2	4.3	7.6
Transitions economies	2.4	2.4	3.9
Rest of Africa	-2.4	-5.8	-8.5
Malawi	10.0	23.6	31.6
Zambia	-5.3	34.2	27.4
Mozambique	1.1	2.9	6.7
Tanzania	12.9	28.3	52.2
Uganda	0.2	1.1	1.7
Rest of SSA	35.8	119.0	174.1
Bangladesh	0.2	1.4	2.0
Middle East	4.1	14.4	18.1
Rest of the world	-0.8	-0.6	-2.3
Total	28.8	-1.5	27.2

Source: Cernat et al. (2004).

Notes: A number of GTAP welfare decomposition effects are not reported so the allocative and terms of trade effects do not add up to the total.

EU. Uganda and Bangladesh are the beneficiary countries whose gains are estimated to be the lowest. For countries which are outside the direct scope of EBA, those that reap positive gains are the rest of developed countries (mainly Oceania and EFTA countries), Transition Economies and the Middle East. Conversely, NAFTA and Asian countries are those that suffer the biggest losses.

The results point to an improvement in allocative efficiency, especially for LDCs. A shift towards agricultural goods and food production (which faced the highest pre-EBA levels of protection in the EU) induces a better exploitation of comparative advantages in these countries. However, the bulk of welfare changes for individual countries are associated with terms of trade effects with countries benefiting from increased prices for their exports to the EU market. As far as third countries are concerned, Japan and NAFTA countries incur a particularly strong negative terms of trade effect, while Middle East and China gain.

Table 2.2 shows the sector-wise impact of the EBA on beneficiary exports.

The beneficiary countries register the greatest percentage increase in exports in paddy rice, sugarcane, sugar and processed rice. The rise in vegetable and fruit exports is substantial only for Zambia, Bangladesh and the rest of SSA, while that in meat and meat products is concentrated in Uganda and rest of SSA. Some export industries for LDCs that do not benefit from EBA may actually contract, as is the case

TABLE 2.2. Exports, percentage changes

	NAFTA	EU	China	Japan	Rest of Asia	Latin America	Rest of developed countries	Transition economies	Rest of Africa	Malawi	Zambia	Mozambique	Tanzania	Uganda	Rest of SSA	Bangladesh	Middle East	Rest of the world
Paddy rice	-0.57	-2.25	-0.81	1.32	-1.33	-0.67	-0.43	-0.21	0	30.16	139.2	199.8	243.16	266	363.40	23.35	-0.93	-0.98
Cereals	-0.01	-0.09	-0.02	0.19	-0.02	-0.01	0.01	-0.03	0.68	32.1	28.8	6.02	66.33	12.31	30.77	35.59	-0.06	-0.02
Vegetables, fruits and nuts	-0.02	-0.12	0.05	0.01	0.01	-0.07	0.03	-0.07	-0.11	-8.68	49.46	-1.63	-7.67	4.15	5.87	7.3	-0.12	0.1
Oil seeds	0.02	0.05	0.03	0.02	0.06	0.02	0.05	0.03	0.16	-8.94	-19.75	-1.25	-8.84	-0.45	-1.6	-0.23	0	0.08
Sugar cane, sugar beet	-0.04	-69.69	-0.46	-32.44	-25.41	-25.03	0.74	-1.04	-27.33	31.24	403.7	816.5	1063.1	2808	1266	1085	-29.91	-13.63
Natural fibres	0.2	0.34	0.23	0.29	0.24	0.27	0.23	0.19	0.35	-7.37	-16.86	-1.23	-5.42	-0.23	-1.24	0.24	0.3	0.33
Crops (nec.)	0.25	0.42	0.28	0.27	0.28	0.29	0.33	0.45	0.4	-9.09	-18.74	-1.98	-7.94	-0.15	-1.17	0.15	0.3	0.37
Livestock, animal products	-0.01	0	-0.04	-0.01	0	-0.02	-0.04	-0.08	-0.03	-4.73	-14.66	4.16	-7.06	4.84	5.71	2.29	-0.1	-0.02
Forestry	0.1	0.18	0.11	0.19	0.16	0.18	0.1	0.13	0.16	-16.15	-11.41	-2.75	-12.21	-0.65	-1.04	0.05	0.18	0.12

Fishing	-0.01	-0.04	-0.01	0	0.01	-0.01	0.02	-0.01	-16.23	-11.64	-2.42	-14.09	-0.88	-1.38	-0.18	-0.04	-0.01	
Coal oil gas and minerals	0.03	0.03	0.02	0.03	0.01	0.04	0.02	0.01	0.02	-10.46	-4.3	-1.83	-7.04	-0.41	-0.49	-0.04	0.01	0.03
Meat and meat products	-0.01	0.01	-0.02	-0.01	-0.02	-0.02	-0.03	-0.03	-5.3	-5.77	-1.51	3.8	45.64	21.65	-0.04	-0.02	0	
Vegetable oils and fats	0	0.03	-0.01	-0.06	0.02	0	0	-0.03	-0.02	-11.71	-16.38	-1.78	-7.08	0.43	-0.47	0.13	0	-0.01
Dairy products	-0.03	0.01	-0.03	-0.02	-0.02	-0.02	-0.03	-0.04	0.02	74.16	24.84	-1.9	59.93	2.05	12.1	56.12	-0.03	-0.01
Processed rice	-0.67	-6.04	-0.67	-2.62	-0.38	-1.2	-0.39	-2.15	0.01	-5	212.3	379.3	471.02	158	452	385.4	-0.88	-2.04
Sugar	-1.17	-5.23	-0.8	-1.23	-1.07	-1.37	-0.18	-1.47	-7.72	468.7	429	19.35	680.47	293	391.7	264.7	-1.25	-8.52
Other food products	-0.01	0.05	-0.01	-0.01	-0.02	-0.02	-0.04	-0.04	0.01	-11.58	-10.5	-1.26	-7.15	0.22	-0.34	0.35	-0.05	-0.03
Beverage and tobacco	-0.06	0.07	-0.06	-0.05	-0.06	-0.06	-0.1	-0.07	0.13	-18.66	-18.49	-2.95	-12	-0.83	1.91	-0.14	-0.04	-0.04
Textiles, apparel and leather	0	0.03	0	0.01	0.01	0.02	0	0.01	0.03	-20.62	-13.17	-3.37	-11.84	-0.92	-1.92	-0.17	-0.01	0.03
Other manu- factures	0	0.02	-0.01	0	0	0.01	-0.01	-0.01	0.13	-18	-8.65	-2.13	-8.9	-0.45	-1.35	-0.11	-0.01	0.01
Services	0.01	0.02	0.07	0.01	0.01	0.02	0.01	0.01	0.01	-10.14	-5.17	-1.64	-6.59	-0.35	-0.87	-0.07	0	0.01

Source: Cernat et al. (2004).

Note: not elsewhere classified (nec.).

for textiles and clothing from Bangladesh and services from Mozambique. Overall, results indicate that the EBA policy has a positive impact of LDCs exports and welfare, but the impact appears to be very concentrated in few sectors, in particular sugar and rice. The increased market access for LDCs comes mostly at the expense of other preference-receiving countries, ACP countries in particular.

## 2.6. REGIONAL NON-RECIPROCAL PREFERENCE PROGRAMMES

Haveman and Shatz (2004) examined the regional non-reciprocal trade preference programs of the US, EU and Japan in detail. The first regional and unilateral preference programme of the US is the Caribbean Basin Economic Recovery Act (CBERA), passed in 1983 and popularly known as the Caribbean Basin Initiative (CBI). Since then, the US added the Andean Trade Preferences Act in 1991 (ATPA), and in 2000, the Caribbean Basin Trade Partnership Act (CBTPA) and the African Growth and Opportunity Act (AGOA). Nearly all the countries of the Caribbean, including those of Central America, participate in the Caribbean programmes. ATPA was enacted on 4 December 1991 with the stated purpose of promoting economic development and export diversification to provide alternatives to the production of drug crops. The original act extended eligibility to four of the five members of the Community of Andean Nations, Bolivia, Colombia, Ecuador, and Peru. None of the beneficiaries are LDCs.

US preferences for Africa come under the African Growth and Opportunity Act (AGOA). It locks in GSP preferences for beneficiary countries for eight years, adds 1835 new products to the GSP list, and removes the competitive needs limits. It includes benefits for textiles and apparel, provided beneficiaries show they have procedures in place to prevent transshipments and meet rules-of-origin requirements. The law named all sub-Saharan African countries as eligible to apply, and 34 became beneficiaries on 2 October 2000. Eligible countries must request beneficiary status and must fulfil certain requirements, such as making progress toward establishing or having established a market-based economy, having policies to reduce poverty, combat corruption and protect worker rights, and helping combat terrorism. Accordingly, only 22 of the 34 UN-designated African LDCs currently receive AGOA benefits.

The EU has provided preferences to its former colonies in Africa, the Caribbean, and the Pacific (ACP) almost since the beginning of its formation. The newest agreement, the ACP-EC Partnership Agreement is known as the Cotonou Agreement, which includes 39 LDCs.

## 2.7. TRADE EFFECTS OF PREFERENTIAL TRADING ARRANGEMENTS

According to the estimates of Haveman and Shatz (2004), for the Caribbean beneficiaries, total trade under the programmes has expanded considerably since 1989. While total US imports from the 24 countries in this region rose more than 200 per cent between 1989 and 2001, total preference trade rose more than 500 per cent. Similarly, in 2001, AGOA imports totalled almost US\$8.2 billion, making almost 50

per cent of all imports from these countries duty-free. They use an econometric model that incorporates tariff reduction as well as diversion effects.

Their estimating equation can be written as:

$$\begin{aligned} \ln M_{I,j,t,h} = & \alpha + \beta_1 \ln \text{TAUBAR}_{I,t,h} + \beta_2 \ln \text{TDIVER} + \beta_3 \text{NTM}_{I,j,t,h} + \beta_4 \text{SPEC}_{I,j,t,h} \\ & + (\beta_5 + \beta_6 \ln \text{GDP}_{j,t}) \times \sum_{l=1}^4 \beta_{6+l} \text{INC}_{I,j,t} + \beta_{11,t} \text{YEAR}_t \\ & + \beta_{12} \ln(\text{DISTANCE}_{I,j}) + \beta_{13} \text{BORDER}_{I,j} \\ & + \beta_{14} \text{LANGUAGE}_{I,j} + \varepsilon_{I,j,t,h}, \end{aligned}$$

where the dependent variable,  $\ln M_{I,j,t,h}$  is imports by country  $I$  from country  $j$  of commodity  $h$  in year  $t$ . Here,  $I$  indicates one of the US, the EU, or Japan,  $j$  is one of 240 potential exporters,  $t$  is one of the years listed above, and  $h$  is a six-digit HS product line within a specific three-digit SIC industry. TAUBAR is the trade-reduction effect, calculated as the trade-weighted average tariff that country,  $I$ , imposes on imports of commodity  $h$  from all countries in year  $t$ . TDIVER is the trade-diversion effect and is the difference between the actual tariff imposed on imports by  $I$  from  $j$  of product  $h$  in year  $t$  and the average tariff that country  $I$  imposes on all countries but  $j$ .  $\beta_1$  and  $\beta_2$  are expected to be negative with  $\beta_2 > \beta_1$ .

Table 2.3 provides the estimates. For the US, on average, a one per cent increase in the average tariff imposed on imports reduces imports by 8.3 per cent. Further, a 1 per cent tariff preference leads to a 19.4 per cent increase in trade for the exporter in question. The numbers for the other two regions may be interpreted similarly. Next, the coefficient estimates are used to estimate first the amount of LDC exports to Triad countries attributable to tariff preferences, and then to forecast the increase in LDC exports that might result from the elimination of all tariffs only on the imports of LDC products. The first two columns of Table 2.4 present actual trade data. The third and fourth columns present counterfactual results generated from the coefficient estimates presented above. The figures in Column 3 are predictions of the amount of trade that would not have occurred were all beneficiaries of Triad unilateral preference programmes subject to MFN tariffs.

TABLE 2.3. Summary of tariff effects on Triad trade (Standard deviations of the coefficient estimates are in parentheses)

	Mean coefficient estimates	
	Trade reduction	Trade diversion
US	-8.3(32.2)	-19.4(25.9)
EU	-3.3(21.4)	-8.5(16.2)
Japan	-7.8(17.8)	-13.1(21.7)

Source: Haveman and Shatz (2004).

TABLE 2.4. Triad LDC imports and preferences programmes in force in 2000

Triad member	Total imports in 2000 (USD billions)	Imports from LDCs in 2000 (USD Billions)	Imports from LDCs resulting from preferences (USD Billions)	Change in LDC imports (per cent)
US	1058.2			
All LDCs		4.6	0.40	10.5
CBERA <sup>2</sup>		0.3	0.03	13.7
EU	614.3			
All LDCs		9.2	2.80	45.0
ACP		5.8	0.70	14.5
Japan	234.2	0.8	0.30	65.1

Source: Haveman and Shatz (2004).

Of the three members, the EU imports more from LDCs than do either of the others, both in value terms and as a per cent of total trade. The US imports about half as much, while Japan's imports from LDCs are a distant third at less than USD1 billion.

The Triad's LDC imports due to unilateral preferences follow a similar pattern. The EU has experienced the largest effect, with trade increases of USD2.8 billion, followed by the US, USD0.4 billion, and then Japan, at USD0.3 billion. However, as a per cent of LDC imports, Japan's programmed does the most to expand trade, with preferences increasing trade by 65 per cent. The EU programmes are in the middle, raising trade by 45 per cent, while US programmes have provided only a 10.5 per cent boost to imports from LDCs.

The preferences as implemented affect slightly different sectors in the three country groups. Preferences from the US in the mineral products and mechanical machinery sectors account for more than half of the increased imports. EU preferences also increase trade in the mechanical machinery sector, but the preferences also result in a significant expansion of textile imports, which is not the case for the US. Japanese preferences expand imports in the textiles, wood and wood products, and headwear and footwear sectors.

Haveman and Shatz (2004) argue that there is still much room for trade liberalisation, as recognised in the plans for the Doha Round of multilateral trade negotiations. As of 2000, the US still maintained significant barriers to imports from LDCs, with an import weighted average tariff in excess of 5.3 per cent. The remaining barriers in the EU and Japan were much lower, at 0.02 and 1.8 per cent, respectively. As a result, the elimination of all tariffs on imports from LDCs by the Triad members would be expected to expand exports the most for US partners and the least for EU partners. Table 2.5 provides evidence.

The projections indicate that LDC exports would have been almost USD7 billion, or 148 per cent, higher in 2000 than was observed had the US levied no tariffs on imports from LDCs. These increased imports are highly concentrated in the textiles, footwear, and transportation equipment sectors. The remaining EU barriers on the other hand

TABLE 2.5. Changes in Triad imports from LDCs as a result of eliminating all tariffs on LDC exports in 2000

Triad member	Total imports in 2000 (USD billions)	Imports from LDCs in 2000 (USD billions)	Imports from LDCs resulting from enhanced preferences (USD billions)	Change in LDC imports (per cent)
US	1,058.2			
All LDCs		4.6	6.8	147.9
CBERA		0.3	0.5	162.3
EU	614.3			
All LDCs		9.2	0.2	2.6
ACP		5.8	0.0	0.1
Japan	234.2	0.8	0.6	69.3

Source: Haveman and Shatz (2004).

are relatively few and their elimination would lead to a 2.6 per cent expansion in imports from LDC countries. Predictably, agricultural and food related sectors are responsible for nearly all of this increase. Japan represents the middle ground with a projected increase in imports from LDCs of approximately 69 per cent. However, this represents an increase in imports from LDCs of only USD0.6 billion, the vast majority of which is in the animal and animal products sector.

## 2.8. CONCLUSIONS

Preferences do lead to trade expansion for developing countries, although at highly variable rates, providing partial justification for this particular dimension of SDT. The estimates showed that only a handful of LDCs would see total trade increase by more than USD100,000, from a combination of trade creation and trade diversion effects under the EBA. Malawi, the biggest winner, stands to increase its cane sugar exports by more than USD25 million. Other African LDCs (Madagascar, Tanzania, and Zambia) are likely to see their cane sugar exports increase by between USD5 and USD10 million. The only Asian LDC that shows incremental exports of more than USD100,000 is Myanmar. The estimates also suggest that Sudan is likely to see significant increases in its exports of molasses and cereals. Generally however, preferences often come with restrictions, product exclusions, and administrative rules that prevent beneficiaries from utilising them fully. They may also divert trade away from equally poor but excluded developing countries. For the EBA initiative, the largest losers from negative trade diversion, in absolute values, are the current major ACP sugar exporters (Mauritius, Aruba, Fiji and Guyana). There are some small negative effects on other countries that currently enjoy duty-free access to the EU market or enjoy MFN market access (e.g. Polish and Romanian exports of live animals or US and Argentine exports of cereals).

The relevance of preferential trade for poverty reduction may also be questioned because the majority of the world's poor live in India and China—countries which do not receive too many preferences. Hoekman (2004) argues that multilateral non-discriminatory liberalisation of trade is a more effective and efficient approach to expand trade opportunities. An important reason for this being a non-discriminatory approach would result in reduction in barriers to trade maintained by middle income as well as developed countries. The former are increasingly important potential markets, and have been among the most dynamic traders in recent years.

The upshot of the findings is that the beneficial effects of PTAs need to be complemented by domestic policies in both sets of countries, developed and developing. In the former, export subsidies deemed as unfair by the developing countries must go, especially in the field of agriculture. The developing countries themselves need to work away at internal reforms of health, investment and infrastructure policies, in order to build up real competitiveness in world markets. The multilateral process is also of utmost importance, as the eventual realisation of universal MFN will imply greater market access for the LDCs in the emerging economies.

#### NOTE

<sup>1</sup> The author is a Research Fellow at UNU-WIDER, Helsinki. The views expressed are those of the author only.

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CHAPTER 3

MAKING MULTI-LEVEL RULES WORK: TRADE  
AND INVESTMENT RULES IN REGIONAL  
AND BILATERAL AGREEMENTS

3.1. INTRODUCTION

This article looks at the role of regional and bilateral agreements in trade and investment rule-making. Two themes have shaped much of the recent debate on trade, the scope of the World Trade Organisation (WTO) rules and the growth of regional and bilateral agreements. These themes are linked in that difficulties dealing with rule-making issues in the WTO have contributed to the growth in regional and bilateral agreements. The article argues that rule-making has always been a multi-level process. For much of the post 1945 period up to the second half of the 1990s the Organisation for Economic Co-operation and Development (OECD) played a prominent role in developing framework rules that were then applied at the multilateral and regional levels. In the last ten years the pattern has changed. The OECD is no longer inclusive enough, the WTO is too focused on reciprocity to be an appropriate forum for devising framework rules, so regional and bilateral levels are filling the vacuum. This raises the question of how to ensure that rule-making at the regional and bilateral levels is compatible with multilateralism. The article proposes practical criteria for assessing the impact of regional and bilateral rule-making and argues that work on framework rules should continue at a plurilateral if not multilateral level.

3.2. THE IMPORTANCE OF RULE-MAKING

In the case of rule-making<sup>2</sup> the Doha Development Agenda (DDA) has had very modest aims. Three of the “Singapore issues” (investment, competition and transparency in government procurement) were effectively dropped from the agenda at the 2003 Cancun WTO Ministerial meeting and the focus on trying to make progress on the core market access issues has meant that work on a range of other rule-related issues in Geneva has been blocked.

Dropping the Singapore issues of the DDA does not mean they have disappeared altogether. The main vehicle of globalisation markets has been investment and investment agreements abound at the plurilateral, regional and bilateral levels. There are a growing number of bilateral co-operation agreements on competition policy as national competition authorities seek to get to grips with international cartels and cross border acquisitions and mergers. In public procurement, bilateral Free Trade Agreements (FTAs) are extending the number of countries that comply with rules modelled on the WTO’s 1994 plurilateral Government Procurement Agreement (GPA) (OECD, 2002). In other policy areas also rules will continue to shape trade and investment. Domestic regulation determines the access for an increasing range of tradable

service sectors and limited progress in services in the DDA can be expected to lead to more GATS-plus provisions in FTAs and Regional Trade Agreements (RTAs). The interpretation of the precautionary approach may be too controversial to address in the DDA, but recent FTAs include SPS provisions that reflect divergent interpretations. A similar position is developing in intellectual property where TRIPS-plus provisions are finding their way into bilateral agreements.

This multi-level approach to rule-making is not new. Three of the “Singapore issues” were dropped from the multilateral agenda with the demise of the International Trade Organisation (ITO) in 1950, but all have been subsequently addressed on other levels for the past 50 years. Even during the “high-point” of multilateralism as the Uruguay Round has come to be seen, framework rules were being developed and implemented at different levels. Regional initiatives in the shape of the EU’s Single Market Programme (SEM), the Canada–US free Trade Agreement (CUSFTA) and the North American Free Trade Agreement (NAFTA) were both shaped by rules in the OECD and GATT (Woolcock, 2006). Indeed, the Uruguay Round was characterised by a close synergy between the multilateral and other levels of rule-making.

Rule-making will also continue to shape the trading system. As tariffs and other immediate barriers to market access become relatively less important rule-making will assume a central role, unless there is a shift back towards overt protectionism. Tariffs have a limited “half-life” and have been subject to preference erosion over the past 40 years (Schott, 2004).<sup>3</sup> National regulatory regimes also reflect preferences in the form of the balance between liberalisation and other legitimate policy objects. These regulatory preferences have shaped and will continue to shape trade and investment rules. The diffusion of such regulatory preferences through regional, bilateral or plurilateral rules will be far less subject to erosion than tariff preferences, especially if there is no ambition in the multilateral level efforts to agree on framework rules.<sup>4</sup> It is therefore important to know more about the role of RTAs and bilateral agreements in rule-making.

### 3.3. THE MULTI-LEVEL NATURE OF RULE-MAKING

The multi-level nature of rule-making can be illustrated in almost any policy area. In some rule-making has taken place on all levels most of the time, in others the focus has shifted between levels, with, for example, the focus of activity moving from the plurilateral to the regional and up to the multilateral and then back down again to the regional or bilateral. Investment is probably the clearest case of an international regime being established as a result of a patchwork of bilateral, regional, plurilateral and multilateral rules (UNCTAD, 2004). After repeated failures to establish international rules in the 1930s and 40s (Snyder, 1963), bilateral agreements were used for investment protection from the 1950s (UNCTAD, 2000) and the plurilateral agreements in the OECD for investment liberalisation from the 1960s (OECD, 1993). The regional level in the shape of NAFTA then brought protection and liberalisation together in a model comprehensive investment agreement that has subsequently found application in a network of FTAs (Reiter, 2006). The sanitary and phytosanitary case

provides an example of how rule-making started at the regional (European) level, in the shape of the *Codex Alimentarius Europeas* in the 1950s, shifted to the international level in the 1960s under the World Health Organisation and into the WTO in the shape of the SPS Agreement in the 1980s. In the post Uruguay Round period there has been pressure for a re-regionalisation of rules as divergent preferences on the interpretation of the SPS Agreement have found expression in FTAs.

A similar picture of multi-level rule-making emerges in virtually every policy area. Rule-making has always been multi-level, with the various levels in a state of flux. It is not that rule-making in a particular policy area becomes assigned to a level and then remains there. The focus can progress to the multilateral level and then “regress” back to the regional or bilateral level. Even stringent rules established at a multilateral level, such as the TRIPs and SPS rules adopted in the Uruguay Round are subject to erosion as shifting preferences and interests exploit the “regulatory safeguards”.<sup>5</sup>

Given this state of flux it is still possible to identify some general trends over the past 40 years. From the 1960s until the Uruguay Round, the OECD played an important role in rule-making. It provided the forum for (relatively) like-minded negotiators to develop common approaches to rules. These framework rules<sup>6</sup> were then incorporated in the multilateral negotiations such as in the case of TBT and procurement rules in the Tokyo Round qualified MFN codes of the 1970s and services, intellectual property, procurement and investment in Uruguay Round in the 1980–90s. The OECD has continued to be the forum for discussion of framework rules, such as on investment and competition, but with less success.

Broadly speaking the regional level is assumed to be more important in the “second phase of regionalism” (Bhagwati, 1993) from the mid 1980s to the middle of the 1990s.<sup>7</sup> This relative growth in the importance of the regional level went hand-in-hand with the multilateral level negotiations during the Uruguay Round that facilitated a synergy between the regional and multilateral levels (OECD, 1995). After the end of the Uruguay Round there has been a shift towards a greater emphasis on bilateral FTAs (WTO, 2005). The OECD has continued to work on a range of issues such as competition and indeed the role of RTAs/FTAs (OECD, 2002). The WTO has also remained the forum for services, although mostly in terms of negotiations on the coverage of framework rules. But in the absence of serious multilateral negotiations on rules, there has been less mutually reinforcing interaction between RTAs/FTAs and multilateral rule-making.

### 3.4. THE IMPACT OF REGIONAL AND BILATERAL RULE-MAKING

In order to assess the impact of regional and bilateral agreements in rule-making it is necessary to have a clearer idea of what might be positive and what negative implications of such agreements.<sup>8</sup> This is by no means straightforward but analogies with conventional customs union theory may help to clarify the potential effects of preferential rule-making. First, a form of preference could be said to exist when the coverage of the rules exceeds multilateral agreements. Second, rule-making could

be said to facilitate (create) trade and investment through enhanced transparency, increased competition or when common regional rules reduce frictional costs by replacing different national rules. Rules could be said to restrict (divert) trade or investment when the level of the norms or standards embodied in the preferential rules means that some third country suppliers face higher standards. To use GATT terminology this would occur when an RTA or FTA results in a “higher incidence of protection” due to “other regulatory restrictions on commerce” (Trachtmann, 2002).<sup>9</sup> The third analogy is with optimal tariffs. Just as optimal tariff theory envisages the use of asymmetric bargaining relationships to shift the terms of trade, a dominant “hub” could use FTAs to shape rules in its own narrow mercantilist interests. Preferential agreements that “export” the domestic rules of dominant “hubs” might still benefit third parties even if all the costs of adjustment fall on the latter. For example, such “benign” rules might promote regulatory best practice, greater transparency and thus economic welfare or make for greater predictability and thus attract foreign investment (Ethier, 1998).

### 3.5. A TYPOLOGY OF RULE-MAKING

By breaking down rule-making into a number of common elements it is possible to develop some broad criteria for determining the degree of preference, whether an agreement is more likely to facilitate trade or restrict it, and whether regional or bilateral rules go beyond the WTO in such a fashion as to favour narrow mercantilist interests rather than multilateralism.<sup>10</sup> A typology of rule-making derived from a series of agreements at different levels and from different policy areas cases is provided in Table 3.1. This indicates seven core elements found in all rules: coverage and provisions on principles of non-discrimination, transparency, substantive rules, co-operation, “regulatory safeguard” and enforcement.<sup>11</sup>

*Coverage* can be defined by sectors, entity coverage (central government, sub-central government and/or quasi independent regulatory bodies) and instruments covered (statutes, implementing directives of regulations, individual decisions etc.). Greater coverage will mean a preference if more sectors are covered. For example, negative listing is used in NAFTA to define coverage of services and investment and is thus GATS-plus. Greater entity coverage of the EU procurement rules (to state and local government) takes these beyond the WTO’s plurilateral GPA commitments.

With the inclusion of *non-discrimination principles* such as national treatment in a regional/bilateral agreement there is clear preference. How important this is will depend on the case. For example, NAFTA requires national treatment for technical barriers to trade (TBTs), as opposed to policy approximation. But the NAFTA parties are already bound to provide *de jure* national treatment in the TBT field under the WTO, so there is no preference. On the other hand, the pre-investment national treatment provided to NAFTA investors is equivalent to the right of establishment and therefore preferential access.

*Transparency* rules can relate to statutes or reach deeper into national regulatory policies by including secondary instruments. “Due process” rules might also come

under this heading. These grant parties the right to make submissions to – and demand responses from – regulators. Transparency rules tend to facilitate trade and investment and promote regulatory best practice by shedding light on any abuse of regulatory discretion to restrict trade or investment. Transparency rules seldom constitute much of a preference except where “due process” rules are limited to legal persons with an established presence in a signatory state.

*Substantive rules* can reduce frictional costs and facilitate trade and investment through harmonisation, partial harmonisation or mutual recognition/equivalence. But if full or partial harmonisation sets higher standards than those that existed under the previous national rules in some signatories, this may have restrictive effects. Mutual recognition facilitates trade but also constitutes a form of preference by excluding third country suppliers. Regional rules that go beyond existing international norms or standards may also pose a systemic threat.

*Co-operation* in regional and bilateral agreements will tend to be more concrete and better resourced to provide technical support, exchanges of experts and regulators etc. than, for example, in the WTO, and might constitute a modest form of preference, but one that could benefit smaller signatories to agreements.

All trade and investment agreements contain safeguards and those that create framework rules that discipline regulatory autonomy will tend to have a “*regulatory safeguard*”. These offer scope for exemptions or exclusions from commitments in agreements, such as “right to regulate” provisions in investment agreements, the right to impose higher standards in TBT rules or SPS rules and national interest exemptions from contract suspension provisions in cases of illegal contract award decisions in public procurement. On the one hand, these can be subject to abuse and used to restrict trade and investment in a disproportionate fashion. On the other hand, regional/bilateral rules may exert tighter discipline on the abuse of such discretionary powers by national governments or regulators than equivalent WTO provisions such as Art XX of GATT 1994.

This brings us to *implementation and enforcement*, because how the rules are actually applied will ultimately determine their impact. If RTAs or FTAs offer better, more immediate access to reviews and remedies this will tend to facilitate trade by helping to ensure regulators to not abuse their powers. There is some preference here if third country legal persons do not benefit from the same rights. But the more important form of “preference” would flow from regional “jurisprudence” if this interprets “regulatory safeguards” or other measures in such a fashion that it conflicts with the interpretation of similar rules in the WTO or other bodies.

### 3.6. POSITIVE INTERACTION DURING THE “SECOND PHASE OF REGIONALISM” BUT LESS CLEAR DURING THE POST-URUGUAY ROUND PERIOD

Research using the above approach suggests that regional agreements had a positive interaction with multilateral rule-making during the “second phase” of regionalism between the mid 1980s and the mid 1990s (Woolcock, 2006). During this period regional agreements did not constitute much of a preference, rules were generally

in line with existing WTO rules and when they went beyond the WTO it was predominantly in terms of coverage, closer cooperation, enhanced transparency and “due process” rather than substantive measures. This finding is consistent with the view that deep integration is inherently less discriminatory (Hufbauer, 1995; Winters, 1996), but at odds with the image of conflicting rules suggested by Bhagwati’s spaghetti bowl of conflicting rules.<sup>12</sup> For the post Uruguay Round period one comes to a less positive or at least a more qualified judgment. Bilateral FTAs have become more prevalent and these show signs of going beyond existing international rules in some areas of substantive rule-making. There have also been signs of active forum shopping in order to press narrow sector interests rather than use FTAs to “show the way” for multilateral approaches. These findings on the impact of RTAs/FTAs in the “second phase” and the post Uruguay Round phase can be illustrated by examples from empirical case studies.

The case of public procurement illustrates the interaction between levels of rule-making. Rules on public procurement were considered too intrusive into national competences and thus too ambitious for the ITO and GATT so the issue was taken up at the plurilateral level in the OECD during the 1960s. The OECD developed framework rules covering transparency and contract award procedures that were then transferred to the GATT during the Tokyo Round (1973–79). Difficulties emerged, however, because of efforts to build reciprocity objectives into the rules (Blank and Marceau, 1997). The complex scheduling that resulted from this reciprocity was one of the reasons why many countries, including almost all developing countries, were not ready to sign up the rules. The GATT therefore only produced the plurilateral 1979 Government Purchasing Agreement (GPA).

During the “second phase of regionalism” there was a positive interaction between the regional and – in this case – the plurilateral rule-making in the GATT that led to the strengthened GPA of 1994 (Woolcock, 2006). Advances at the regional level enabled increased coverage of the GPA; for example, the EU internal rules were extended to include utilities that enabled the coverage of these in the GPA. Regional initiatives also considerably improved transparency, something that in the case of PP makes a far more important contribution to better regulatory practice than prohibitions of *de jure* preferences. The regional level substantive rules were in line with the 1979 GPA framework and were therefore also compatible with the modified rules of the 1994 GPA. Regional initiatives also brought about a significant strengthening of enforcement, a difficult area in procurement given the diversity and number of contracts awarded. This took the form of “bid-challenge” rules first introduced in the CUSFTA but then emulated in the EU and NAFTA rules. The 1994 GPA and subsequent discussions in the WTO’s Working Group on Transparency in Government Procurement after 1996 have also run into the difficulties of combining negotiation of framework rules with reciprocity (Evenette 2004).

In the post Uruguay Round period FTAs have not gone beyond the 1994 GPA but have effectively increased the number of countries using GPA-type rules. Countries that declined signature of the GPA such as Chile, Australia and some less developed countries have, through the FTAs, agreed to comply with GPA framework rules.

As the biggest impact of GPA rules has been to enhance transparency this has not created significant new preferences and promises to contribute to better procurement practices.<sup>13</sup> Whilst this extension of rules through asymmetric bilateral FTAs is less than ideal, it has at least been based on an agreed plurilaterally approach and not simply dictated by the mercantilist interests of the dominant “hub”.

In the case of *services* also the interaction between the levels of rule-making has tended to be positive, with developments at the regional/bilateral level facilitating more progress at the multilateral level. Initial work on services was done in the OECD. This fed into negotiations at the multilateral level in the GATS during the Uruguay Round. At the same time the CUSFTA and EU were developing approaches to services that complemented the multilateral level and resulted in the emergence of a set of broadly liberal norms for regulating services (Ulrich, 2006). Given the diversity of services the interaction between levels is best observed at a sector level. In telecommunications, for example, rulemaking started in the International Telecommunications Union before moving to the GATT/WTO during the 1980s where the GATS and the 1997 Telecommunications Reference Paper (TRP) were produced. The TRP then provided a model for subsequent regional agreements.

In the post-Uruguay Round period the US has pushed for GATS-plus and TRP-plus rules. For example, the US–Singapore FTA, which has replaced the NAFTA as the US model agreement for services (and investment), includes judicial review for cases of non-compliance with national telecommunications rules. This is a further illustration of the push for enhanced access to remedies for private parties analogous to the use of “bid-challenge” in procurement and investor-state dispute settlement in investment. The services sector more generally illustrates how the coverage of RTAs can be wider than multilateral rules (Sauve, 2003). This is especially the case for NAFTA type FTAs that use negative lists to define coverage. The EU FTAs appear to be more GATS-consistent than GATS-plus. But the RTAs/FTAs have been broadly consistent with the GATS when it comes to substantive rules.

As noted above the *investment* case shows how a *de facto* international investment regime has been created out of a patch-work of bilateral, regional, plurilateral and multilateral agreements. The GATS covers investment in services through the Mode 3 provisions on establishment. Outside of services, however, the absence of negotiations on comprehensive investment rules in the GATT meant there was little scope for positive interaction between levels as in procurement and services. During the Uruguay Round there was a continued growth in bilateral investment treaties, work on a wider investment instrument in the OECD (OECD, 1992) that led ultimately to the negotiations on a (plurilateral) Multilateral Investment Agreement (MAI), the adoption of comprehensive investment rules covering investment protection and liberalisation in CUSFTA and NAFTA, as well as the conclusion of the GATS and a limited Trade Related Investment Measures (TRIMs) agreement. The NAFTA investment model with negative listing to determine coverage, pre-investment national treatment, bans on a wide range of performance requirements, “*de facto*” expropriation rules and investor-state dispute settlement became the highest standard agreement

(UNCTAD, 2004). This was a standard that the MAI could not reach and the WTO will not reach with investment off the agenda. NAFTA has served as the model for the post Uruguay Round FTAs and found application in US-centred FTAs as well as FTAs concluded by Mexico, Chile and Singapore (Reiter, 2006). The willingness of countries to sign up to FTAs with comprehensive investment rules appears to be based on a belief that such FTAs will help them attract investment in the short to medium term (Ethier, 1998). In the long run comprehensive international investment rules shaped by bilateral FTAs may work against the interests of developing countries (World Bank, 2005).

The case of *intellectual property rights* (IPR) illustrates how existing international standards and norms were integrated into trade rules within the WTO. The WIPO developed standards in a similar fashion to the International Standards Organisation (ISO) in the TBT field and the Codex Alimentarius in the SPS field. In the Uruguay Round pressure from a number of sectors and from the US in particular, led to the integration of IPR rules into trade regime in the shape of the TRIPs. As is well known the TRIPs established a strong multilateral discipline in the field, which created some opposition from developing countries. The TRIPs agreement has subsequently come under pressure from those seeking to interpret it in different ways. Developing country governments and non-governmental organisations (NGOs) have been seeking an interpretation that leaves more policy space for developing countries. These pressures led for example to the Doha Declaration on TRIPs and Public Health of 2001 and the 30 August 2003 agreement on patents.

For those sectors interested in tighter rules the TRIPs agreement is perhaps beginning to look too flexible rather than too rigid with the result that attention has shifted to the use of TRIPs-plus rules in FTAs that tighten rather than loosen disciplines on IP protection, scope and duration. These have taken the form of detailed provisions on issues such as data exclusivity, patents and copyright, where the TRIPs agreement left gaps or ambiguities. A comparison between the provisions of the IPR provisions in the US centred FTAs and the EU bilaterals, shows that the US approach to be both more vigorous and more TRIPs-plus. As in investment, procurement and services the US has also emphasised ensuring effective enforcement. The EU bilateral agreements include reference to IP, but in most cases this involves confirming obligations under existing international standards of rules of the WIPO and other conventions (Pugatch, 2006).

The *sanitary and phytosanitary* measures case shows how rules initially developed at a (European) regional level in the Codex Alimentarius Europeas after 1945, prompted multilateralisation under the UN Food and Agricultural Organisation and the World Health Organisation. Similar multilateralisation occurred in the animal (Office of Epizootics) and plant health (International Plant Protection Convention) sectors. From the 1960s to the 1990s there was a scientification of SPS issues under the influence of the most developed regulatory regime of the time in the United States (Isaac, 2006). The US also pressed for greater discipline of SPS measures under the GATT. When the "Standards" Code of the Tokyo Round did not meet this need there were moves to

establish specific rules for SPS within the trading system that resulted in the Agreement on SPS Measures in the Uruguay Round. SPS shows similarities with IPR in that dissatisfaction with existing international rules led to strict disciplines that integrated the existing standards into the trade regime and thus an enforced harmonisation of standards. In SPS as in IPR the strict discipline of the multilateral rules has come under pressure; in the SPS case from those countries, led by the EU that are seeking a particular interpretation of the “regulatory safeguard” rules of the SPS Agreement on the use of precaution (Woolcock, 2001). In other words shifts in preferences at the regional level and ambiguities in the SPS have meant that the regional level of rule-making has begun to re-assert itself (Isaac, 2006). Free trade agreements concluded by the EU are arguably SPS-plus in that they embody the “social-rationality” model of rule-making in contrast to the “scientific rationality” that the US and Canadian FTAs defend.

The danger of “regulatory regionalism” inherent in the regional responses to strict multilateral rules in the cases of IPR and SPS should not be generalised to all policy areas. For example, the case of technical barriers to trade (TBT) that attracts fewer headlines than food safety issues but covers more trade shows a more positive interaction similar to the procurement and services cases.

The danger of national rules creating TBTs was addressed by discussions in the OECD in the 1960s that shaped the 1979 plurilateral “Standards” Code in the GATT. But this was still largely based on the proscription of *de jure* discrimination and was limited in coverage to central governments. This left the many TBT measures untouched.

During the 1980s more effective TBT rules were developed at the regional level and in particular in the EU that sought a more sophisticated middle ground between ineffective (*de jure*) non-discrimination and harmonisation. The approach developed including mutual recognition and the use of agreed international standards to show compliance with regulations and was subsequently adopted in part at the multilateral level in the WTO. The EU initiative led to a rejuvenation of work at the international level, promoting a greater awareness of the importance of TBTs and resulting in more resources being devoted to work in this area, even if this was in part to contain EU “hegemony” in the field. This in turn contributed to more capacity, not only to negotiate rules and international standards, but also to implement the rules.

Regional and bilateral measures significantly improved transparency. In standards making agreements were concluded to ensure positive linkages between the regional and international levels (Joerges, 1998). Finally, the regional level measures facilitated trade by replacing multiple national technical regulations, standards and conformance assessment rules with common rules or avoiding the restrictive effect of such rules with mutual recognition (Chen and Mattoo, 2004).<sup>14</sup>

In the post Uruguay Round period some of the positive impetus has gone, but equally neither regional nor bilateral rules are undermining international rules. There has been a steady growth in bilateral mutual recognition agreements (MRAs) but

these have to date not yet created the kind of two-tier system that some had feared (Baldwin, 2000).

Rules of origin (RoO) are perhaps even more mundane and shrouded in technicalities than TBTs. The RoO case illustrates how national and preferential rules fill the vacuum left by the absence of agreed framework rules. The Kyoto Convention provided the framework for RoO, but as the definition of origin as substantial transformation in the customs territory of the exporter (WCO, 2006) was too broad, national and regional rules adopted divergent definitions and origin rules came to constitute an important barrier to trade (World Bank, 2005: 46) whose restrictiveness increased as tariffs were reduced (Estevadeordal and Suominen, 2003). Following difficulties in the 1980s, the issue was raised in the Uruguay Round with the result that the World Customs Organisation (WCO) was given the job of harmonising non-preferential rules of origin, but nothing has been done on preferential rules of origin. Recent work shows there is a trend towards the creation of a number of dominant “poles” in the “spaghetti bowl” (Bhagwati, 1995) of different origin rules (Garay and De Lombaerde, 2006). The RoO case also illustrates how once divergent rules have developed, it is very difficult to bring order to the system. As RoO have become as important a barrier to trade as tariffs in many trading relationships, the case clearly illustrates the enduring importance of rule-making for the trading system.

Finally there is the case of the third “Singapore” issue, competition, which like investment has not been addressed at the multilateral level in any comprehensive fashion. Again it was the OECD that developed rules on co-operation in competition policy, but one that focused on enforcement of national competition rules (OECD, 1986). This co-operation in enforcement model was then subsequently used in a range of bilateral agreements, such as the US–EU bilateral agreement of 1991. As with investment, lessons learned in the application of these bilateral agreements then informed developments in the plurilateral rule-making process (OECD, 1998).

At a regional level the EU consolidated and extended its comprehensive model of competition during the “second phase of regionalism”. Unlike the TBT case for the EU and the NAFTA model for investment, the EU competition model has found little application in multilateral or bilateral rule-making. The one area in which there was a close interaction was state subsidy rules, where the EU rules seem to have had a clear impact on the substance of the WTO subsidies and countervailing duties (SCVD) rules. The EU model has also been spontaneously emulated (i.e. without any agreement) in a range of other regions, but most of these are still at the early stages of development.

One of the main reasons for the lack of multilateral rules in competition has been the US preference for bilateral agreements between competition authorities based on the OECD co-operation in enforcement model. Little has changed in the post 1994 period. The US has continued to conclude bilateral agreements, and the EU has unsuccessfully sought to promote the idea of competition rules at a multilateral level in the WTO. Perhaps the one development of note is the steady growth of voluntary co-operation in global dialogues.

### 3.7. FACTORS INFLUENCING THE RELATIONSHIP BETWEEN REGIONAL AND MULTILATERAL RULES

There are a number of factors that could have contributed to the positive interaction between levels of rule-making during the “second phase of regionalism” that are no longer as present today. First, there was a general trend towards liberal trade and investment policies that have weakened since the Uruguay Round, as indicated by the failure of the MAI and difficulties in launching and progressing a major new multilateral round of negotiations.

Second, the rule-making at the regional and bilateral levels during the late 1980s and early 1990s drew on a stock of agreed framework rules developed in the OECD over many years. As both regional and multilateral rules invariably took the OECD framework as a starting point, this helped ensure they were broadly compatible. In the post Uruguay Round the influence of such OECD rules has waned as illustrated by the MAI, although the OECD continues to produce guidelines in a range of policy areas, such as competition.

Third, regional and bilateral rules were drafted against the background of active multilateral negotiations in the GATT. Even if not always fully successful, the GATT negotiations acted as a constraint on negotiators who went to considerable lengths to ensure that the regional rules were consistent with the emerging multilateral framework. This was clearly shown in the cases of TBTs and public procurement with respect to GATT rules. In the case of investment and competition it was the OECD that provided the wider framework. In the cases of IPR and SPS existing international standards in the shape of Codex and WIPO standards were used as the “technical” criteria for rule-making. The post Uruguay Round period lacks ambition in multilateral or plurilateral rule-making.

Fourth, the second phase of regionalism was a period in which there was close cooperation between the EU and US, both in the OECD and the GATT. Indeed, the Uruguay Round was, like the previous Tokyo Round of the GATT, characterised by the central importance of the transatlantic negotiations. This was especially the case with regard to rule-making in which the US and EU were the main protagonists. In recent years however US-EU cooperation has weakened as illustrated by the limited results coming out of the efforts in US-EU regulatory cooperation.

### 3.8. POLICY IMPLICATIONS

What does this all mean in terms of policy? First RTAs/FTAs can be good or bad when it comes to rule-making, just as they can be good or bad, trade creating or trade diverting in terms of tariff preferences. It all depends on the substance of the specific RTA/FTA and how it interacts with other levels of rule-making.

Second, it is possible to devise a set of general qualitative criteria for assessing the impact of rule-making based on the expected impact of regional or bilateral provisions in the different elements of rule-making. For example, a simple traffic light system similar to that used for WTO Agreement on Subsidies and Countervailing Duties could

be used to provide an initial rough assessment of different elements of bi-regional rule-making measures. This rough but practical approach is based on the assumption that unambiguous results from quantitative assessments of the impact of RTAs/FTAs in rule-making will not be forthcoming.<sup>15</sup> The application of such an approach would follow the time-honoured practice of first improving transparency. It must be assumed that strict WTO discipline of RTAs/FTAs, at least without any economic or legal criteria on which to base an interpretation of Art XXIV GATT, is not about to be accepted by WTO members. But progress has been possible in WTO discussions on transparency provisions for RTAs/FTAs. The enhanced transparency approach set out in Table 3.1 therefore also represents a realistic proposition. Here it is only possible to provide a broad outline. More work will be needed to develop a workable set of criteria. The principle would be to require closer scrutiny for those elements of RTAs/FTAs that are more likely to have negative effects on third countries or on the trading system. This would mean, for example, notification of any norm or standard that is not consistent with existing, agreed international norms or standards or any regional interpretation of rules that could have wider implications. In these cases notification of the measure would be required to the WTO CRTA as it is introduced. For those elements of rule-making that can be expected to have positive effects, there would only be a need for periodic notification, that is, when transparency rules are adopted and then at regular intervals depending on the importance of trade and investment covered by the agreement.

As noted above, WTO-plus sector or entity *coverage* constitutes a form of preference that will be subject to erosion provided multilateral negotiations continue to increase the coverage. Notification of WTO-plus coverage would serve to flag up areas for negotiations to extend the coverage of other regional agreements or ideally multilateral level agreements.

Regional and bilateral agreements would have to be allowed to maintain preferences in the shape of not extending *de jure non-discrimination* to third parties otherwise preferential agreements would lose much of their substance.<sup>16</sup> But *de jure* preferences should still be subject to notification to the WTO, for example, if an RTA or FTA stipulates a price preference for public contracts. *De facto* preferences, that is, preferences that result from the application of rules or laws are more important than *de jure* preferences, but notification of all *de facto* preferences is impracticable and would impose excessively high compliance costs. Such preferences can only really be addressed by effective rules on transparency and enforcement in which regional and bilateral agreements have something to offer.

*Transparency rules* in RTAs should be subject to only periodic notification as they seldom constitute a significant preference, tend to promote best regulatory practice and are unlikely to pose any systemic risk. As transparency rules constitute a significant share of RTA provisions this would reduce the notification requirements considerably. Freeing RTA/FTAs from notification obligations in this area would also signal a permissive approach to preferential rules in these elements of rule-making.

TABLE 3.1. Simplified overview of criteria for enhanced WTO transparency rules for RTAs

Element of rule-making	Probable impact	Notification requirements	Indicator <sup>a</sup>
Coverage	Preference if coverage goes-beyond existing WTO coverage	Notification of WTO-plus coverage	Amber indicator
Non-discrimination	Preference if national treatment limited to signatories	Notification of <i>de jure</i> preferences	Green light
Transparency	Limited preference, promotes better regulation through clear objective criteria for regulation	Periodic notification only	Green light
Substantive rules	Can facilitate or restrict trade depending on the case	Notification of any substantive measure that is not consistent with existing relevant international agreements	Amber light, but red for measures that clash with existing WTO rules
Co-operation	Can channel more resources to cooperation than under multilateral rules	Only periodic notification	Green light
Regulatory safeguard	Scope for re-regionalisation/re-nationalisation of regulatory policy Or use as protection	Notification of any interpretation of regional “regulatory safeguard” that could undermine existing WTO rules	Amber
Enforcement	More rapid remedies, Amber light	Notification of any interpretation that diverges or threatens to diverge from WTO interpretations	Amber

<sup>a</sup>Amber = subject to scrutiny Red, Green = permitted, Red = indicates need for work to ensure compatibility of RTA/FTA with international rules.

*Substantive provision* is much more complex. The proposal here is that all those substantive rules, standards or regulations that are compatible with existing international rules, would be assumed to be consistent with wider multilateral aims and not subject to closer scrutiny. As many substantive rules have been drawn up in fora other than the WTO, “existing international rules” would have to be defined to include norms and standards agreed in bodies such as WIPO for IPR, the ISO for TBT, the Codex Alimentarius for SPS and the WTO plurilateral agreements, such as the GPA for procurement. Including plurilateral agreements under the definition of “existing international rules” might be seen as second best option to multilaterally agreed rules, but the constraints on global rule-making mean that requiring global

agreement (or multilateral agreement in the WTO) is likely to stymie multilateral rules with the result that there will be no discipline on regional and bilateral norms and standards.

Where an RTA or FTA goes beyond existing international rules to establish a regional or bilateral standard this poses more of a threat. Such standards may serve the mercantilist interests of selfish hegemons or may constitute a form of regulatory regionalism. Any RTA/FTA measure that establishes such norms or standards should therefore be immediately notified to the WTO with the presumption that such measures are inconsistent with the maintenance of a wider multilateral order. A more ambitious policy prescription could follow-on from such notification. This could involve linking the notification of such measures to the opening of negotiations on agreed international rules on the topic concerned. The regional measure would then be suspended for a specified period until the international negotiations had had an opportunity of finding agreed international rules.

*Co-operation provisions* in RTAs do not constitute much of a preference and can often result in more effective promotion of best regulatory practice than is possible at the multilateral level. Inevitably, when dominant parties such as the US or EU provide technical assistance under co-operation arrangements they will be promoting their own approaches to regulation and standards. But if regional initiatives can help increase technical assistance there would seem to be no point in discouraging them.

*Implementation* of an RTA or FTA is not something that can be closely monitored by at the multilateral level, but regional or bilateral interpretations of core rules may clash with the equivalent WTO interpretations. Regional or bilateral interpretations of principles such as proportionality or a “regulatory safeguard” are also likely to set precedents for future trade and investment rules and should be notified. For example, an interpretation of the use of precaution in an SPS case at the regional or bilateral level could have a bearing on the future interpretation of the WTO rules and should be notified as it occurs. In cases of bilateral or regional rulings clashing with existing WTO interpretations there may well be scope for WTO members to bring the case under WTO dispute settlement, but this would not cover cases where the regional interpretation is WTO-plus. These cases should be brought to the attention of all WTO members.

Application of the traffic light system might mean, for example, that anything with a red light would be subject to immediate notification and close scrutiny at the WTO level. An amber light would mean perhaps notification only at regular intervals along the lines of the frequency of the Trade Policy Review Mechanism (TPRM) of the WTO. A green light would mean there would be perhaps only an obligation to notify such rules when they are introduced or modified.

Such an enhanced transparency system could be carried out along the lines of the Trade Policy Review Mechanism (TPRM) and would in effect bring all RTAs and FTAs into the remit of the TPRM. By limiting notification to those areas that pose a potential risk for third countries of the trading system such criteria could help to reduce

the volume of work that has to be carried out in the Committee on Regional Trade Agreements and thus enable it to be more effective in addressing the more important areas. Non-participants in the FTAs would have an opportunity of commenting during the TPRM-type procedures. By highlighting areas where regional or bilateral rules are likely to constitute significant preferences or pose systemic risk (i.e. of regulatory regionalism or developing rules that undermine existing agreed international rules) the system will have fulfilled its function. As with existing transparency provisions in the WTO such as the Trade Policy Review Mechanism (TPRM) there should be no direct link to dispute settlement.

### 3.9. THE NEED FOR CONTINUOUS DIALOGUE ON RULE-MAKING

There is a debate in trade policy on the relative merits of multilateral “rounds” and continuous negotiation. Rounds are probably indispensable as long as market access negotiations are based on reciprocity. But there are a number of significant drawbacks in linking agreement on framework rules with reciprocity based negotiations.

The existing fora within which trade and investment rules are discussed are not appropriate for developing framework agreements. For such framework agreements to be developed there is a need for negotiations to be based on detailed, impartial information and research that will enable rules to be developed that are balanced and sustainable. This is unlikely to be achieved when negotiations on rules are linked to mercantilist, market access negotiations. In the past the OECD has provided such an objective balanced forum for developed countries. Despite its efforts to reach out to developing countries and its increased membership, the OECD is still not inclusive enough to make progress in the current climate in which far more countries need to understand and support the rules developed.

The WTO discusses a range of rule-making issues, such as in the various Working Groups set up to discuss the Singapore issues between 1996 and 2003, but the nature of the WTO means that these are linked to reciprocity. The link is at least two-fold. First, rules in the WTO have, in the past, been used as a means of market opening, so the expectation is that any proposal on rule-making is motivated by the offensive market access interests of the government making such proposals rather than the establishment of rules that will benefit all parties. The public procurement case has illustrated this very clearly, as has services.

Second, multilateral negotiations have included broad trade-offs between framework rules and market access, most famously that between textiles and clothing liberalisation and TRIPs in the Uruguay Round. Agreed rules for trade and investment will only function if their benefit is recognised by all countries. The TRIPs agreement shows how rules accepted reluctantly as part of a global package are unlikely to be sustainable.

UNCTAD could, of course, provide an inclusive forum to discuss framework rules and it has served this purpose to some extent in competition, for example. But

UNCTAD is seen as a developing country forum, just as the OECD is seen as a developed country forum. Regional or bilateral FTAs are not appropriate fora for negotiating framework rules, because they can be too easily exploited by selfish hegemons that want to make sure that their trading partners adopt their own domestic rules regardless of the level of development or needs of their trading partner. Rule-making at a regional/bilateral level also runs the risk of regulatory regionalism (competition between a few dominant regions with different approaches to rules) in the longer term.

In the past, close transatlantic co-operation has formed the basis of many approaches to rule-making, because of the central importance of the US and the EU in this field. Indeed, much of the work in the OECD had a strong transatlantic flavour. In the 1990s there were efforts to maintain and strengthen transatlantic regulatory co-operation through various bilateral channels, such as those serving the New Transatlantic Agenda (NTA) after 1995. Whilst some would like to preserve transatlantic co-operation, there are clear limits to how far this can provide the basis for international rules in the 21st century. There is therefore a need for an organisation (not just a negotiating forum) in which the pros and cons of any given approach to rule-making can be discussed on the basis of objective research and with a view to ensuring that rules can benefit all countries. This organisation would have to be inclusive, that is, include all major countries and representation (perhaps at a regional level) of smaller developing countries. It would be something like the OECD in that the aim would be to develop agreed rules, not simply have a dialogue on voluntary guidelines. The aim of such an organisation would be to develop general approaches to framework rules that can be applied in regional and multilateral level agreements or for that matter on a voluntary basis at a plurilateral level.

### 3.10. THE NEED FOR CONTINUOUS NEGOTIATIONS ON RULES COVERAGE

Finally, even if there were a body working on the development of framework rules, there would still be a need to determine the extent to which these should be applied in the WTO. Ongoing multilateral negotiations can also help to ensure a positive interaction between the multilateral and regional rules. If multilateral rule-making is blocked because of the difficulties finding a consensus among all the WTO members, then a second best option would be plurilateral negotiations. Agreement among a core group of major economies on the kinds of norms that should form the basis of rule-making would be better than leaving rule-making to the bilateral or regional level. Whilst dropping new rule-making from the DDA may be expedient in the short term, rule-making at the plurilateral or multilateral level cannot be neglected for too long without running the risk of regulatory regionalism and divergent regional norms or rules that will prove difficult, if not impossible, to reconcile in the future (Table 3.2).

TABLE 3.2. An analytical framework for assessing RTAs

Element of rule	Typical provisions	Likely impact	Typical WTO provision	Degree of preference
Coverage	<ul style="list-style-type: none"> <li>• Sector schedules</li> <li>• Type of entity (e.g. central, state, local, independent regulator or private entities)</li> <li>• Regulatory instruments covered (e.g. directives, codes, decisions of agencies)</li> </ul>	More extensive coverage means wider application of the rules	Positive list approach Generally central government and statutory measures only	Third parties do not benefit from the WTO-plus coverage Analogous to tariff preference <i>De jure</i> preference
Principles	<ul style="list-style-type: none"> <li>• National treatment</li> <li>• Most favoured nation status</li> </ul>	Precludes discrimination against foreign suppliers No discrimination between third party suppliers	WTO embodies national treatment and MFN principles but with exceptions, specifically for customs unions and free trade agreements	
Transparency	<ul style="list-style-type: none"> <li>• Notification of legislation, secondary provisions and decisions</li> <li>• Opportunity for parties to comment</li> <li>• Obligation on regulator to explain decisions</li> </ul>	Promotes regulatory best practice Facilitates compliance and guards against capture	General transparency provisions in all areas Some agreements also require regulator to explain decisions	Generally no significant preference
Substantive measures	<ul style="list-style-type: none"> <li>• Prohibitions</li> <li>• Harmonisation</li> <li>• Partial harmonisation</li> <li>• Approximation as a general aim</li> <li>• Equivalence</li> <li>• Mutual recognition of regulations or test results</li> </ul>	Eliminates or reduces "frictional" costs  Reduces costs but retains regulatory autonomy	Selective harmonisation  Encourages but does not require mutual recognition or equivalence	If standards are higher than international Preference for partners in mutual recognition

(Continued)

TABLE 3.2. (*Continued*)

Element of rule	Typical provisions	Likely impact	Typical WTO provision	Degree of preference
Co-operation	<ul style="list-style-type: none"> <li>• Common decision-making institutions</li> <li>• Intergovernmental committee to oversee agreement</li> <li>• Specialist bodies for specific policy areas</li> <li>• Technical co-op. and capacity building</li> </ul>	<p>Promotes convergence and Helps identify regulatory barriers</p> <p>Help for DC regulators</p>	<p>Co-operational difficult with large membership</p> <p>Mostly general provisions and technical assistance thinly spread</p>	<p>Third parties excluded from more intensive cooperation</p> <p>Third parties excluded from assistance</p>
Regulatory “safeguard”	<ul style="list-style-type: none"> <li>• Exemptions</li> <li>• “Right to regulate”</li> <li>• Proportionality</li> <li>• Required use of least or less trade distorting measure</li> </ul>	<p>Tight discipline promotes predictability</p> <p>Loose limits allows discretion</p>	<p>Generally broad exceptions that offer considerable scope for regulatory discretion, but some tightening e.g. SPS agreement</p>	<p>Potential for greater discretion vis-à-vis third parties</p>
Enforcement and implementation	<ul style="list-style-type: none"> <li>• Requirement to have an independent agency</li> <li>• Companies have standing in dispute settlement</li> <li>• Independent reviews of decisions</li> <li>• Remedies (e.g. financial penalties)</li> </ul>	<p>Effective implementation promotes confidence and thus trade and investment flows</p>	<p>State-to-state dispute settlement only, focuses on national legislation (rather than secondary legislation)</p>	<p>Third parties no recourse to more immediate remedies and reviews</p>

## NOTES

- <sup>1</sup> Stephen Woolcock is an Associate Research Fellow at UNU-CRIS in Bruges and Lecturer in International Relations at the London School of Economics. UNU-CRIS and LSE are members of the GARNET Network of Excellence.
- <sup>2</sup> Rule-making is the framework that determines the scope of (national) regulatory autonomy with a view to facilitating trade and investment and avoiding conflicts between national rules. In practice it defines the balance between liberalisation and other legitimate policy objectives in a range of regulatory/deep integration issues.
- <sup>3</sup> This does not mean that tariffs are not important for developing countries or that there are no tariff peaks, tariff escalation and rearguard actions by entrenched interests to retain tariff preferences.
- <sup>4</sup> Negotiating framework rules implies some degree of policy convergence. The pros and cons of policy convergence have been the subject of much heated debate. On the one hand, it is argued that harmonisation risks locking all into inappropriate policies and tends to mean in particular the imposition of inappropriate standards or norms on developing countries by developed countries. On the other hand, it is argued that rules benefit all by establishing a clear and predictable framework for trade and investment that will benefit developing countries (Bhagwati, 1996). Trade economists have also argued that deep integration in RTAs is by its nature less discriminatory than tariffs, implying that there is no need for agreed framework rules (Hufbauer, 1995; Winters, 1996).
- <sup>5</sup> Regulatory safeguards are defined broadly here to mean all those provisions in framework rules that provide for exceptions and exclusions from the rules. They may take the form of sector exclusions, general exemptions on national interest or security grounds etc. or specific "right to regulate" provisions etc.
- <sup>6</sup> Framework rules are those that establish a broad approach to dealing with deep integration issues but do not include specific sector or activity related details that might determine market access.
- <sup>7</sup> Bhagwati identified two phases of regionalism, one in the 1960s and one starting from the early to mid 1980s. Given the increased number of FTAs, their increasingly north-south as well as inter-continental nature and deeper integration they represent, it would be reasonable to assume that we are now in a different third phase of regionalism.
- <sup>8</sup> With regard to tariffs there has been half a century of analysis on the impact of preferential agreements (Bhagwati, 1999). Imperfect competition approaches have explained how deeper integration measures can promote economic growth within a region by improving competition. Political economic models have been developed that help to understand the interaction between sectors that stand to benefit from trade diversion and those that stand to lose. There have also been studies that have explored the range of motivations behind a country's motivations in seeking regional or bilateral agreements. To date however, there has been relatively little empirical work on the impact of deeper integration or rule-making in bilateral or regional agreements (Hufbauer, 1995; Lawrence, 1996). The WTO and OECD have produced valuable material on the nature of RTAs and whether they are WTO plus that includes discussion of the deeper integration issues (OECD, 2002; WTO, 2005) and the World Bank has looked at some regulatory issues in its discussion of the impact of regional agreements on developing countries and on the wider multilateral system (World Bank, 2005). In general however, trade economists have tended to assume that deeper integration will constitute less of a preference than tariffs. This view is generally based on first principles, i.e. without reference to the detail of agreements and on the generalisation that much rule-making is inherently un-discriminatory (Winters, 1996).
- <sup>9</sup> Efforts to measure the quantitative trade creation and diversionary effects of rule-making in RTAs are in their infancy and given the ambiguous results of tariff based quantitative measures there can be no expectation of early conclusive results from quantitative studies of the more challenging deeper integration issues (Maskus and Wilson, 2001).
- <sup>10</sup> Multilateralism in this context can be defined as the progressive evolution of rules that offer benefits to all WTO members by promoting open, competitive markets while respecting a range of other legitimate national policy objectives.
- <sup>11</sup> For a more detailed description see Woolcock (2006a).

- <sup>12</sup> Some recent comprehensive work on preferential rules of origin (Garay and De Lombaerde, 2006) suggests that in the medium to long term there may well be some consolidation of rules of origin around a number of major models. Not surprisingly these include the NAFTA and PanEuro models of preferential rules of origin. Consolidation is occurring as countries approximate to one of the major models. The negative effects of different rules of origin are also being reduced by the increased use of cumulation.
- <sup>13</sup> There are clear indications that procurement rules tend to lead to enhanced competition within procurement markets, through greater transparency and better procurement practices, rather than increased market access (Evenett, 2003).
- <sup>14</sup> Chen and Mattoo (2004) is one of the few quantitative assessments of the impact of RTAs in the field of technical barriers to trade and found a positive correlation between common standards and especially mutual recognition agreements and increased trade for signatories.
- <sup>15</sup> This seems a fairly safe assumption given that empirical work on the impact on trade and investment of deeper integration and on the systemic effects of regional rule-making is very limited.
- <sup>16</sup> Open regionalism defined as the extension of all commitments to third parties via MFN is of course an alternative here, but not one that appears likely to make much practical headway against the tide of regional and bilateral preferential agreements.

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CHAPTER 4

RECONCILING REGIONALISM AND MULTILATERALISM:  
TOWARDS MULTILEVEL TRADE GOVERNANCE

4.1. INTRODUCTION

Much ink has flowed on the question of the relationship between regionalism and multilateralism. There is still, however, no definitive answer. So the debate goes on. Is regionalism a substitute or a complement to multilateralism? Put another way, is regionalism a building block or a stumbling block to multilateralism?

The re-invigoration of regionalism in developing countries over the past decade has given a new twist to the old debate. Developing countries are increasingly turning to regionalism as a strategy for development (UNCTAD, 2005). But their regionalism is part of a multilevel strategy which needs to be synchronised with their national development plans as well as their efforts to achieve development friendly multilateral trade rules in the World Trade Organisation (WTO).

Developing countries are increasingly concerned about how to achieve coherence between development, regionalism and multilateralism. The multilateral trade system (MTS) is currently in a state of flux as the outcome of the Doha Development Agenda is yet unknown. Nevertheless, the regional trade agreements (RTAs) that are currently being negotiated all depend on WTO rules. Moreover, the policy space that developing countries need to carry out their national development plans, is increasingly determined by the market access rules of the WTO. In short, developing countries are faced with an increasingly complex, multilevel process in which they are trying to combine trade and development (Abbugatas, 2004).

The concept of multilevel governance (Marks et al., 1996) emerged in the European Union (EU) where it was used to explain the increasing complexity of policy making in the 1990s. It was a period of upheaval resulting from the far reaching structural change that was uprooting many traditional policy practices across Europe. As a consequence of that change a new model of multilevel governance (MLG) began to take shape that challenged the traditional state-centric model.

Has the experience of the EU generated a hypothesis that could be generalised to other systems of governance? That question has received growing interest in the academic literature. “*Is there Room for the Multilateral in Multilevel Governance?*” McGowan (2001) asked, and explored the emergence of multilevel governance in three sectors of the new trade agenda. The conference on “*Globalisation, Multilevel Governance and Democracy*”, held at Queen’s University in Canada (2002), explored comparative aspects of MLG in regional and global governance.

The Organisation for Economic Co-operation and Development (OECD), which has worked extensively on regulatory reform since the 1990s, has now produced a study on *Multilevel Regulatory Governance* that for the first time concentrates on the

multilevel dimension of regulation. Multilevel regulatory governance is defined as regulatory strategies and activities covering the development, execution and reform of regulation between national, supranational and sub-national levels.

This chapter will explore how the model of MLG could be used to reconcile regionalism and multilateralism in global trade governance. The chapter will be structured around three topics. First, the origin and development of the concept of MLG in the EU. Second, the generalisation of the concept in the context of globalisation. Third, the application of the model to the multilateral trade system, in particular to the field of trade and development.

#### 4.2. THE CONCEPT OF MLG IN THE EU

The concept originated in the EU from attempts to understand the policy process by looking at it in a broader manner than the traditional state-centric approach. From the MLG perspective authority and policy making power are shared across multiple levels of governance. States are no longer the exclusive actors in the EU as some of their autonomous powers have been taken over by supranational and sub-national authorities. While states are still the most important actors in the EU they no longer have a monopoly on policy making or in the aggregation of national preferences. The EU is seen as a multilevel polity where direct links are established between actors in diverse political arenas, where political control is more diffuse and where states no longer serve as the sole nexus between domestic politics and international relations.

MLG is based on the organising principle of subsidiarity which, in its broadest philosophical meaning, asserts that no community at a higher level should interfere with the life of a community at a lower level. The principle was introduced into the EU treaty in the 1990s to govern policy making in areas where there are shared powers between the European institutions and its member states. It says that action should only be taken at the EU level when it has been proven that action at the national level is inadequate and that there is a value added from EU action through greater efficiency. The objective is to achieve the optimal assignment of regulatory powers. The new European Constitution strengthens the principle by giving national parliaments a direct role in exercising subsidiarity for the first time (Gavin, 2003).

MLG is used to describe a relatively new pattern of policy making in the EU. It was developed in response to the state-centric approaches of theories of European integration, especially liberal inter-governmentalism, and its strongest conclusion is that states no longer serve as the exclusive nexus between domestic and international political relations. We need to ask how solid is the concept before attempting to apply it to global governance.

Some critics considered that its main purpose was to provide a route for bringing sub-national regions into the political analysis of the EU. Others argued that it was merely describing the actual situation of federalist oriented 'multilevel government' that could be applied to the EU itself and many of its member states (Best, 2002). Moreover, MLG was originally confined to a limited set of policies, those of budgetary-redistributive policies in relation to regional policy and the structural funds.

#### 4.2.1. *MLG in Regional and Global Governance*

Although MLG and global governance have common features, they are not similar as O'Brien (2002) argues. MLG focuses on formal political institutions and assumes a high degree of community under the governed. It has been primarily concerned with efficiency. Global governance has been mostly concerned about the interaction between governments and non-state actors. It has focused on the imbalance between trade liberalisation and the neglect of citizens' demands for environmental and labour standards. Moreover, global governance has been concerned with issues of equity more than efficiency.

Could the model of MLG be applied beyond the bounded territorial area of the EU to the open-ended global system? McGowan's three case studies show the emerging system of MLG in the fields of competition, regulation of public utilities such as telecommunications, and in public procurement at the multilateral level. However, we need to be aware of the potential pitfalls involved in transposing the concept from regional to global level. Table 4.1 presents a comparative typology of MLG characteristics in the regional (EU) and multilateral context.

Both models have three different levels of governance but the institutional framework within which they operate are quite different. Behind the institutional framework lies different philosophies and organising principles. Subsidiarity has close affinity with the theory of fiscal federalism which has been generalised as a principle for the optimal assignment of jurisdictions in federal systems of power sharing (Gavin and De Lombaerde, 2005).

Multilateralism is based on international trade theory and is primarily concerned about how to achieve the optimal sized market for trade, which is the global market. Viewed from this perspective, multilateralism is "first best" and regionalism is "second best", which implicitly asserts a hierarchical relationship. The optimal size of the market is global and the MTS is the best available forum for disciplining

TABLE 4.1. Two Models of MLG

Characteristics	Regional model of MLG	Global model of MLG
Analytical boundary	Preferential system closed loop	Non-discriminatory system open ended
Institutional framework	Supranational structure	Intergovernmental structure
Policy sectors	Redistribution policy/environmental regulation	Trade regulation
Levels of governance	Sub-national, national, supranational	National, supranational multilateral
Organising principle	Subsidiarity	Hierarchy
Role of region in relation to other levels of governance	Empowers sub-national actors	Seeks compatibility with multilateral regime
Monitoring/compliance	Political	Legal

Source: Adapted from Mc Gowan (2001).

trade-distorting policies, as argued by the World Bank in its most recent *Global Economic Prospects* (2005). Thus a hierarchical relationship has been established whereby regional trade agreements must be made compatible with multilateral rules.

MLG in the EU has evolved in a co-operative style of partnership and more as 'soft law' than hard constitutional law. Monitoring of subsidiarity has been through political rather than legal means. In the global context the compatibility of regional agreements with multilateral rules is subject to judicial review and dispute settlement in the WTO. In summary, different principles and practices in the regional and global contexts will affect how multilevel governance operates at regional and global level. Before discussing the possibilities for cross-fertilisation between the two systems, we first look at a wider model of MLG that has emerged across the OECD region in response to the forces of globalisation.

#### 4.3. MULTILEVEL REGULATORY GOVERNANCE AND GLOBALISATION

The OECD has been actively involved in the analysis of regulatory reform since the 1990s. For the first time it has now produced a study which focuses on the multilevel dimension of regulation. One of its main conclusions is that the multilevel dimension has been considered as a side issue up to now and has not received sufficient attention by its member governments. That needs to change. The OECD no longer considers the state as a unitary actor but rather sees it as an integral part of a multilevel system of regulatory governance. How has this come about?

The process of globalisation has led to more, not less regulation. There has been a proliferation of new actors in regulation making and the nature of regulation itself has changed. The new regulatory landscape has become more complex, more sophisticated, more dense and more participatory. The overall result has been the emergence of a multilevel system and it is essential for policy makers to consider the interaction between all the new players. The objective is to achieve 'regulatory quality', which the OECD defines as regulations that contribute to achieving public policy objectives without placing unnecessary constraints on economic actors.

##### 4.3.1. *Downscaling of Regulatory Power*

Globalisation has brought a dual movement of downscaling to lower orders and upscaling towards higher orders. Downscaling has been driven by decentralisation, deregulation and privatisation. The theoretical argument in favour of decentralisation is that the preferences and needs of citizens are better known to local government than to national government. Contiguity provides better information and hence makes for better decisions, while distance does the opposite. The importance of information has been given priority over efficiency considerations of economies of scale in the provision of public services.

Privatisation has been a powerful force in downscaling. Many activities that were in the domain of national government have now been passed to the private sector. Examples of activities such as broadcasting, telecommunications, transport, and electricity

come to mind. This has been a universal trend although the scale of privatisation has differed between countries. Some countries have gone much further than others including health services, education, water management and even jails in their privatisation activity.

Local and municipal authorities are creating new regulation. It was the London municipal authority, and not the British government, that introduced the congestion tax. In fact, a large proportion of regulations affecting economic activity and citizens' lives are made by local government in all countries. Each layer of government can make regulation to pursue its own objectives and that even without the revenue raising power of taxation. However, fiscal federalism has led to increasing decentralisation of revenue raising powers as well.

Delegation of power to statutory independent agencies has also become widespread. In the past standard-making power was usually nested in some central government department. Today the power of standard making is increasingly outsourced to non-governmental bodies. Private sector organisations are active in industrial standards, scientific experts dominate the making of food safety standards and technical experts are responsible for standards in telecommunications and broadcasting, environmental standards are frequently shaped by ecologists. Thus, there has been a proliferation of actors at the horizontal level bring non-state actors into the regulation making process.

#### *4.3.2. Upscaling of Regulatory Power*

In parallel to devolution of regulatory power towards sub-national levels, there has been a simultaneous movement towards supranational regulation making. Deregulation at the national level has been frequently accompanied by re-regulation at the supranational level. In the field of competition policy, for example, the policy of merger control comes to mind. As the movement of capital was deregulated at national level, there was need for supranational regulation to control cross-border mergers and acquisitions. Deregulation of financial institutions required new prudential regulation at the supranational level to ensure the safety of banks. Industrial standards needed to be harmonised at the international level. And public procurement practices required supranational regulation to ensure standards of open international competition.

#### *4.3.3. Multilevel Governance in Developing Countries*

The emergence of MLG has not been confined to OECD countries. The wave of globalisation, decentralisation, deregulation, privatisation that swept across the industrial countries in the 1980s, began to take effect in the developing countries a decade later. In response to the "sound economic policies" advocated by the Bretton Woods institutions under the slogan of "the Washington consensus", devolution of regulatory power began to take root in many countries in the South.

The new wave of regional integration among developing countries has led to increasing supranational regulation of South-South trade. Developing countries have reinvigorated their regional activity by deepening their integration to go beyond trade

in goods to opening up in services and investment. This trend has spread across the whole South leading to what UNCTAD calls an emerging new trade geography. In parallel with proactive regionalism in the South to boost development efforts, there has been a rise in North-South-South agreements such as the EU-ACP negotiations for economic partnership agreements.

Developing countries must also be concerned with the multilevel dimension of their strategies. Countries have their national development plan which is based on the Poverty Reduction strategy papers of the World Bank. They are simultaneously engaging in regional integration as a development strategy that will foster economies of scale, attract FDI, and to create regional infrastructure in transport, communications and energy. At the multilateral level they are engaged in the Doha round of trade negotiations which will be crucial to getting the optimal policy mix between trade and development.

The generalised model of multilevel regulatory governance, which has now spread across the world, shows the increased interaction between the different levels of policy making and between the different policy actors. This complex interaction is depicted in Figure 4.1.

What are the implications of this new complexity? The well-known principles of good governance such as accountability, transparency, efficiency etc. are no longer sufficient to ensure high quality regulation. The multilevel dimension has created a new set of problems relating to quality and coherence. There is need for clear demarcation of responsibilities in an environment where the quality of regulation depends on co-ordination between multiple players. Who regulates what, and why, are questions that need to be clearly answered. The principle of subsidiarity reflects the

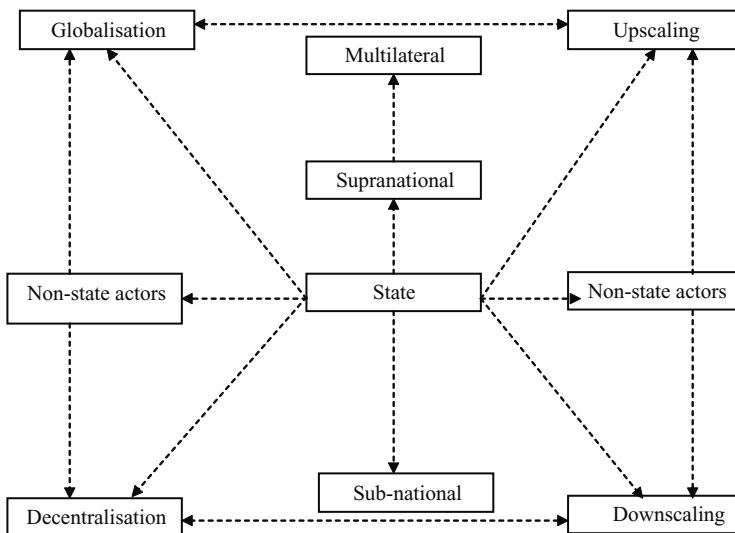


FIGURE 4.1. Generalised Model of Multilevel Regulatory Governance

concern for clarity about assignment of responsibilities. It seeks to avoid overlapping rules by stressing the need for co-ordination mechanisms.

With decentralisation and a proliferation of new players, there is increasing disjunction between the responsibility for making decisions and implementing them. If the dichotomy between the two levels widens there may be perverse effects on the quality of regulation. Co-ordination must be fostered through a clear assignment of responsibility. The recently developed tool of “regulatory impact assessment” offers a methodology for measuring the costs and benefits of rule-making at each level. This tool should be used before taking decisions to transfer regulatory powers to new levels of government.

The transfer of power to a lower or higher level is not just a question of shifting responsibility. The capacity of each level to carry out the regulatory function must be first verified. It must be based on the comparative advantage of each level. There needs to be co-ordination between different levels of government before the transfer of power. This would lead to an ongoing process of a dynamic separation of powers.

The key element in the new situation is coherence. In the absence of coherence there will be a risk of contradictory rules, excessive regulation or regulatory gaps. New co-ordination mechanisms are needed to avoid this. The old approach to regulation, which relied on coercion and control, is no longer sufficient. Regulatory strategies must use more co-operative, more innovative and more persuasive strategies.

The MLG system requires new management style. It requires attention to horizontal as well as vertical interdependence. If MLG is not properly managed there is a risk of accumulating overlapping rules. The most promising framework for avoiding cumulative regulatory pile up is subsidiarity, which is a principle for the exercise of shared powers.

#### 4.4. FROM MULTILATERAL TO MULTILEVEL TRADE SYSTEM

Looking at the multilateral trade regime today, it is hard to avoid the conclusion that it has, in practice, already become a system of MLG. It is made up of hundreds of agreements all of which have been entered into voluntarily by governments at multilateral, regional and bilateral levels. The multilateral trade system is only a small part of a much larger regime that has grown up over the past two decades. The proliferation of regional trade agreements has been spawned by the forces of globalisation. Indeed regionalisation and globalisation may be viewed as the two sides of the same coin.

##### *4.4.1. Proliferation of Regional Trade Agreements*

Since the 1990s some 250 preferential trade agreements of different types have been notified to the GATT/WTO and over 50 per cent of them since 1995. From the total number of PTAs notified, over 170 are in force. An additional 70 agreements are estimated to be operational although not yet notified. According to the *World Trade Report* of 2003, if all agreements planned and notified come into force, there will

be over 300 agreements operating by the end of 2005. More than 50 per cent of world trade is now taking place under actual or planned RTAs. Almost all countries in the world are now members of one or more RTAs. And even countries like Japan and South Korea that have always been so strongly committed to the MTS are now turning to RTAs. Regionalism is not so much the cause as the reflection of much deeper transformation of the MTS. The history of the GATT/WTO shows how the nature of the regime has changed in a number of important ways. The work of the MTS has been transformed from its original focus on classical trade liberalisation to positive rule-making. This evolution has been the outcome of what Michael Hart (1998) has called the “cautious pragmatism” of its members during the first 50 years of its history.

The work of the original GATT was oriented towards the elimination of border tariffs and quotas. But as the GATT progressed down this road it began to turn its attention to the problem of non-tariff borders. The new direction was reflected in the Tokyo Round Agreements. For example, the Agreement on Technical Barriers to Trade reflected the beginning of the new trend that was moving towards positive rule making and the harmonisation of standards. The Uruguay Round proved to be the decisive and major turning point in this process. The new agreements on Trade Related intellectual Property Rights (TRIPS) and the Agreement on Sanitary and Phyto-Sanitary (SPS) measures were hallmarks of the new direction. Prior to the UR all of those areas were governed by domestic regulation that was embedded in the institutions and traditions of national governance.

#### *4.4.2. Proliferation of Policy Actors*

As the WTO moved to regulation of sectors that were previously beyond the domain of trade rules, a much wider range of government ministries got involved. The new trade policy agenda impinges upon a number of domestic policy spaces such as public health, food safety, environment, public services, social policy and the ability of governments to carry out redistribution. Prior to the Uruguay Round the management of trade policy was confined to a small number of government ministries notably, trade and industry, agriculture and finance.

The new trade agenda has made trade much more political. In the traditional system of global governance, it was the United Nations that dealt with issues of high politics. The specialised agencies were left to get on with the technical work, of which trade liberalisation was regarded as a prime example. That has now changed completely. The WTO has become linked with an increasing number of public policy issues which are in the domain of high politics. The interaction between the Millennium Development Goals and the Doha Development Agenda reflects the growing coherence between the multilateral institutions.

New political actors have mobilised to contest the impact of the new trade policy on countries, which has changed and the costs–benefits balance. The benefits of traditional trade liberalisation were spread widely across whole countries but that is no longer the case. The benefits have become more diffuse and the costs of implementing

the new trade agreements may be onerous for the poorest countries. Moreover the new policy stance that increasingly revolves around standards has given momentum towards more litigation and less mediation. The role of independent agencies has been increasingly contested because of their powerful influence on rule making in the WTO. *Codex Alimentarius*, the body that is responsible for setting food safety standards, has been in the eye of a storm of criticism by consumer groups that have challenged the infiltration of the body by industrial interest groups.

Prior to the UR it was almost exclusively business groups that were involved in international trade negotiations. The arrival of non-governmental organisations (NGOs) in a cross section of areas including, *inter alia*, human rights, environment, consumer protection and development has expanded the trade policy debate beyond economic criteria to include the principles of good governance, notably transparency, accountability and legitimacy.

In summary, as the WTO increased its powers with regard to national regulation, many national parliaments perceived this as a threat to 'sovereignty impairment' in socially sensitive sectors such as consumers' protection, environmental regulation and food safety standards. Regionalism was viewed as a more appropriate forum for dealing with those 'deep integration' issues where agreement on standards could be found more easily among a more limited group of countries with closer cultural and historical traditions.

#### 4.4.3. *Implications for the Developing Countries*

The Developing countries have been drawn into a multilevel approach to development since the 1990s. At the national level they are committed to carrying out poverty reduction strategy programmes that have been co-ordinated with the World Bank and the International Monetary Fund. At the same time they are actively pursuing regional integration as a development strategy to help their gradual insertion into the global economy. They are now faced with a whole new set of challenges in the MTS as they try to cope with the simultaneous process of regional and multilateral trade negotiations. The greatest challenge is the lack of co-ordination between the two levels of regulation. Many developing countries feel that they are currently building their regional development strategy on quicksand. In other words, the MTS, which sets the standards for overall compatibility, is in a state of flux itself and appears to be increasingly unable to control the coherence of the multilateral trade regime. Three dimensions of this multilevel regulatory governance are important for developing countries. One, the contours of the new regionalism are determined by the rules of the WTO. Two, it is the WTO that sets the minimum standards for all regional agreements in those areas that are governed by WTO rules. Three, the developing countries' policy space for regional integration is largely defined by the market access commitments in the WTO. Regional governance under the WTO has evolved in conditions of legal uncertainty. It has depended more on the inactivity of the Committee on Regional Trade Agreements (CRTA) than on the elaboration of positive rules. During the past 50 years only one RTA has been approved and none have been rejected. But this leaves

the whole area of RTAs in a legal limbo and potentially open to judicial review in the future. This legally grey area has contributed to a feeling of unpredictability about the future of regional governance for developing countries. The GATT/WTO has always emphasised the importance of creating a rule-based system that would provide stability and predictability for traders and policy makers. The most important challenge of the Doha “development” round is to get the rules right for trade and development. The uncertainty concerning the interface between regional and multilateral governance has increased in the Doha round of trade negotiations. The policy space for a regional development strategy is determined by Article XXIV of the GATT, Article 5 of the GATS and the Enabling Clause. All of those rules are under review in the Doha Round to see whether they take into account the development aspects of RTAs. The Doha round aims to clarify the key benchmark requirements of RTAs that would make them development friendly. But little progress has been made so far.

What is needed is a thorough review of WTO rules regarding RTAs. The revised rules should provide development benchmarks for RTAs that would allow the developing countries to pursue their strategy of regionalism for development while making this compatible with the WTO. A number of possible options exist. The first best option would be the incorporation of special and differential provisions into Article XXIV to address the current issues in North–South agreements. The GATS Article V has not yet been tested in practice but it mirrors Article XXIV in goods trade. Another possibility would be introduction of flexibility clauses into Article XXIV with respect to transition periods and product coverage. Alternatively, Part IV of the GATT on non-reciprocity could be improved, making it enforceable and rendered applicable to the negotiation of RTAs.

The current situation is leading to contradictory rules. At the multilateral level a certain amount of retrenchment is taking place with regard to the implementation of the UR agreements notably with the TRIPs agreement, also the Subsidies and Countervailing Duties agreement. The implementation of those agreements would impose significant costs on developing countries thus having a negative effect on their development. Side by side with this the Doha Round is committed to a general review of the special and differential provisions that would allow developing countries more policy space for implementing their own autonomous national development strategies.

However, in the North–South regional agreements, the industrial countries are pushing ahead with the type of “WTO-plus” agreements that demand obligations from developing countries in those same areas that are under review. Thus the developing countries are faced with contradictory rule-making at the multilateral and regional levels. Gains that are made by the developing countries at the multilateral level are cancelled out at the regional level. For example, despite the decision that was taken at the WTO Ministerial meeting in Cancun to exclude the Singapore issues, they continue to be pursued at the regional level in the economic partnership agreements being negotiated between the EU and the ACP countries. The new challenges are in the North–South–South RTAs such as the FTAA initiative and the EU-ACP economic partnership agreements.

Although trade is hugely important it is not a magic bullet for achieving development (Sachs, 2005). Trade reform must be complementary to other parts of development policy such as infrastructure investment and social policies to develop a healthy and well-educated workforce. Therefore flexibility in the MTS is needed. Special and differential treatment makes sense for developing countries as they usually have limited capacity to take advantage of trade liberalisation measures at the multilateral level and to finance the adjustment cost. S&D provisions should emphasise flexibility, longer time for transition periods and capacity building assistance for implementation of the rules. The focus should be on longer times to adjust to liberalisation and to improve technology. A special fund should be set up to finance the adjustment costs associated with the implementation of the Doha trade reform agenda.

Developing countries need to pursue their development strategy at different levels. At the multilateral level they need to gain market access provisions to foster their exports to the global economy. At the same time they need to carve out policy spaces at the regional level. Regional integration is the best means to foster development by increasing South–South trade. That trade, which has almost doubled over the past twenty years, is still mostly in commodities, agricultural products and merchandise trade. But it is moving towards trade in services. And as intra-regional and inter-regional trade grows in the South there will be need for regional regulation. Development still depends primarily on domestic conditions and the challenge is to build national institutions that provide the right springboard for development to take off.

#### 4.5. CONCLUSIONS

This chapter has presented an analysis of multilevel regulatory governance in three different contexts, the EU, the OECD region and the multilateral trade system. In all three contexts, the emergence of MLG has been triggered by the forces of globalisation. MLG has been determined by decentralisation, deregulation and privatisation – all of which have been considered as essential conditions for maximising the benefits from globalisation. MLG has become a generalised practice around the world today.

MLG presents new challenges that go beyond the ‘good governance’ debate. The key issue is how to ensure coherence between the multiple layers of regulation. Without proper co-ordination there is a risk of cumulative regulatory pile-up that will have a negative impact on the quality of regulation. Given that regulation is an important ingredient for competitiveness and a factor of comparative advantage, the quality and integrity of the regulation is of major importance.

Global trade governance has been the locus of significant upscaling of regulatory power to the multilateral level since the creation of the WTO. The optimal size of the market is global, as posited by international trade theory, so the multilateral trade rules has always tended towards the global. Primary importance is given to achieving the economies of scale that the global market provides.

In contrast, MLG is concerned about the optimal jurisdiction for policy making. Its origins are closer to the theory of fiscal federalism than international trade economics.

One of the strongest arguments in favour of downscaling regulatory power is that better information is provided at local level and, hence, better policy decisions are made at the level closest to citizens.

The multilateral trade system has gradually evolved into a *de facto* multilevel system but without the operational principle of subsidiarity. This is the source of much tension. Multilateral trade rules now intrude into public policy issues that directly affect the daily lives of citizens. But information about local preferences can not be adequately incorporated into global, universal rules. Carving out a special space for developing countries is of primary importance in this context. Developing countries need policy spaces to make their national and regional strategies work on the ground. The major challenge facing the MTS is how to achieve coherence between its different levels of governance by effective, functioning subsidiarity.

#### NOTE

<sup>1</sup> Research Fellow, UNU-CRIS, and member of GARNET. The views expressed in this chapter are those of the author only.

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SECTION II  
**REGIONAL REPORTS**

## CHAPTER 5

ASIA–PACIFIC REGIONALISM QUO VADIS? CHARTING  
THE TERRITORY FOR NEW INTEGRATION ROUTES

## 5.1. INTRODUCTION

Over the past five years, members and associate members of UNESCAP have led the world in initiating negotiations on new preferential trade agreements (PTAs)<sup>2</sup> – among each other and with economies outside the region. This proved to be a dramatic change for a region that was known as the least regionalised – a true friend of multilateralism with Japan and the Republic of Korea featuring prominently in the “MFN club”. While Asia is still home to a single WTO member with no signed preferential trade agreement, it now features almost 80 preferential trade deals under implementation, of which more than half did not exist six years ago.<sup>3</sup>

This sudden outburst arose in a region with a rich experience in using trade as an engine of growth. Trade led economic growth during economic booms while it enabled quicker recoveries when deep crises struck, notably in 1997. So why did Asia-Pacific turn out to be such a fertile ground for breeding discriminatory trade? From a theoretical perspective, there are two mutually re-enforcing drivers of preferential trade in this region: the *domino effect* and *competitive regionalism* (or regionalism as insurance). The domino effect (Baldwin, 1993) refers to the desire of countries to avoid marginalisation as more and more countries become members of (multiple) PTAs. In other words, no country wants to be left outside without being able to share in the benefits of belonging to PTAs, as the presumption of net gains is the one that made others join PTAs in the first place. While this trigger was originally used to explain the transfer of members from European Free Trade Area (EFTA) to the European Communities (EC), following three successive rounds of EC enlargements, Baldwin (2006) uses it to describe the sudden shift towards PTAs in Asia. With economic and political balances in the region in a state of flux, particularly after the financial crisis, China, Japan and the Republic of Korea, to varying degrees started to roll the domino blocks through their FTA/EPA negotiations with ASEAN. Excluded nations were faced with a new situation which in turn strengthened pro-PTA political forces. We return to discuss the domino effect later in the paper in the context of devising a better managed process of regionalism.

Competitive regionalism, on the other hand, refers to countries seeking “to secure their trade interests as well as establish spheres of influence that include but also go beyond trade policy” (Majluf, 2004). Bergsten (2004) suggest that competitive liberalisation is a strategy designed to place pressure on non-members of individual trade agreements either to join the grouping itself or to conclude broader agreement. Motive behind competitive regionalism is associated with an aggressive trade strategy, in contrast to the more defensive strategy embodied in the demonstration effect

(“domino effect”). However both should lead to either expansion of current blocs or formation of new ones.

There are a number of other factors, perhaps “push factors” that explain the rapid growth in PTAs in Asia–Pacific, further<sup>4</sup>:

(a) *Asian financial crisis*. The spurt in the number of signed preferential trade deals is particularly evident in the aftermath of the financial crisis. The ESCAP database records 38 signed PTAs in 2001–05 period, as compared with 16 in 1996–2000 period, and 13 in 1991–95 period.<sup>5</sup> The crisis, and the ensuing policy prescriptions applied by lenders of last resort re-oriented Asian communities towards regionalism. As the contagion left few countries untouched, the sharing of a similar destiny led to a search for a common way out and a strengthening of the regional identity, with China and Japan each playing their part in mitigating the depth of the crisis. In comparison, ASEAN and APEC proved too disjointed to make a significant impact.

(b) *The role of the United States as trend setter*: After practicing “benign neglect”<sup>6</sup> of Asian regionalism, the United States is prominently negotiating a number of important bilateral formal trade agreements (FTAs), in pursuit of “clearly defined systemic and sectoral objectives” and of partners “dictated by strategic foreign policy objectives, rather than the value of the trade involved” (UNDP, 2005: 31). The largely unpredicted war on terrorism that ushered in the millennium cemented the importance of bilateral trade agreements (BTAs) as a means of locking in partners for long-term political objectives. At the same time, it has allowed the US and perhaps also the EU (belatedly) to maintain a clear foothold in the trading and economic relations emerging from any potential future Asia-Pacific bloc.

(c) *Human development* and the increased recognition that poverty in developing countries could be effectively fought through increased trade and investments. Additional preferential access to world markets could provide added incentives while also locking in economic and other reforms in “emerging markets”.

(d) *Fatigue with multilateralism* and need to rationalize scarce human resources (“negotiating capital”) capable of handling trade negotiations especially in developing countries.

(e) Short-term *political trade-offs* and gains to political leaders in power.

The above enumeration is by no means comprehensive, given that these trends have roots that stretch back decades in other parts of the world. Furthermore, an event of the magnitude of September 11, has unfolding repercussions with geopolitical alliances in a constant state of flux. The surge in BTAs therefore has a complex interface with political and foreign policy objectives of all countries involved. While it is important to understand how and why the region arrived at its current state of affairs, for purposes of this paper, we move on to the main objective, namely an examination

of the alternative routes whereby PTAs can be designed to foster both trade and development for its members.

This chapter's objective is to provide a *tour d'horizon*, an exploratory journey that marks the tracks for the next stage in the evolution of regionalism and multilateralism. The organization of the paper is as follows. Section 5.2 draws on the secretariats database (APTIAD) and presents the state of play in Asia-Pacific regionalism with respect to number and type of various PTAs. Section 5.3 examines some alternative routes for improving the management of regionalism and strengthening its development-oriented contribution. Section 5.4 discusses the future work of the secretariat in benchmarking and monitoring the performance of PTAs which will provide governments with policy guidelines on the design of future agreements. Section 5.5 concludes the paper.

## 5.2. CURRENT MAP OF ASIA-PACIFIC REGIONALISM

PTAs, whether already signed or under negotiation come in many shapes and sizes, ranging from bilateral agreements linking geographically distant countries (Thailand – United States or Republic of Korea – Chile) to AFTA or SAFTA which share relatively well-defined geographically congruent spaces that have always insisted on cooperation in more areas than trade. Structures also vary, from relatively loose partnerships (e.g. EEC in Central Asia) to deeper integration and harmonisation (FTA++) agreements (e.g. ANZCERTA). The emerging multilayered configurations of developed–developing and developing–developing country trade agreements has led to the deepening of narrowly defined industry-specific interests while fragmenting trading relations – with economic and political effects that have yet to be determined.

The map that emerges after jotting in all available information on trade routes – different colouring for depth of integration (at present or as promised in the future), extent of coverage of common regulatory frameworks, height of barriers faced by non-members in addition to other specificities of each and every agreement – is simply an information overload. Such a map has no practical use. Furthermore, it does not provide any clues as to the exit routes out of the entanglement. Nevertheless, an attempt is made in Table 5.1 to provide a summary status of the types of trade agreements that are hidden in this tangle, by randomly choosing “trade liberalising” elements of the agreements.

The following emerges: despite the density of agreements, for the time being, at least, it appears that the agreements in force are relatively light. Many do not cover all goods, rarely cover services, bypass investment, and for the most part contain restrictive rules of origin (with the possible exception of APTA). Furthermore, full liberalisation is pushed forward to dates that feature considerable time lags. At the same time, unilateral liberalisation that most countries of this region have implemented, as part of their development strategies facilitated the creation of vertical and horizontal production linkages in industries that matter most to these economies. *De facto* integration and the creation of region-wide competitive advantages has thus proceeded. If (ever) discriminatory liberalisation should start to bite, a potentially

TABLE 5.1. Selected Asia-Pacific PTAs – liberalising or not?

PTA <sup>a</sup>	Effective from	Years to cut tariffs	Negative list based	Services included	Investment included	Common RoO
AFTA	1992	10++	+ with exclusion and sensitive lists	+	+	+
APTA	1975 <sup>b</sup>	na	–	–	–	+
BIMSTEC	2004	8–13	+	+	+	na
PICTA	2006	4–6	+	–	–	+
SAFTA	2006	10+	–	–	–	+
ASEAN-China	2004	6–11	–	–	+	+
ANZCERTA	1983	Implementation Complete	+	+	–	+

Source: ESCAP Secretariat, APTIAD, March 2006.

<sup>a</sup>For the full name of the PTA please see list of acronyms.

<sup>b</sup>Bangkok Agreement in existence since 1975 was renamed Asia-Pacific Trade Agreement in 2005.

dangerous series of mutually reinforcing effects could set in that would reverse the integrative domino effect. This could be made worse by the current lack of a supra-national regional management mechanism to prevent this from happening. Should the Doha Round settle for a minimalist package, or collapse in the worst case scenario, degeneration of the world and regional trading systems into hegemonic trade powers linked to developing countries through discriminatory spokes seems all but inevitable.

### 5.3. RE-DRAWING MAPS: MARKING OUT NEW ROUTES

In tracing new routes for PTAs the focus shifts from using PTAs exclusively or dominantly for trade liberalisation to using them to foster integration of services and factor markets, monetary and financial systems: in a nutshell establishing deeper regional cooperation.<sup>7</sup> This shift allows parties to an agreement to benefit from large scale arising from effective pooling of resources and combination of markets, both at the firm level and national (even regional) levels.

Trade diversion welfare reducing effects occur not only when the PTA is among members which are all much less efficient than world averages (with whom they traded previously), but also when there are too many shallow PTAs in one area. In that case, as we argue below, preferential treatment does not go “deep” enough into creating an integrated market in which forces of dynamic efficiency could take effect. Ideally a reduction in the number and range of complex and transaction-cost-increasing rules and procedures would take place which would then work together to merge markets rather than to keep them segmented as in the current spaghetti bowl-syndrome. The question that arises is how to re-instate “integration” into the regionalism equation.

Of course this task would be made redundant if multilateral trade negotiations offered a superior outcome for all involved – the point of departure is that multilaterally agreed “free” trade is the optimal solution.<sup>8</sup> However even the theory is not unison is prescribing what that outcome would be.<sup>9</sup> Consequently, are there routes that would allow a transfer of self-interest of PTAs into a collective interest of many (all), thus replicating the outcome of multilateralism?

Two routes of integration are discussed: (1) geographical consolidation which results in a reduced number of PTAs<sup>10</sup> and (2) functional harmonisation which could increase the market areas operating under common rules.

### *5.3.1. Geographical Consolidation<sup>11</sup>*

Perhaps intuitively, the way to coalesce and fast track a reduction of PTAs would be for one PTA to fold into another “geographically” larger PTA that, in turn, would fold into ever-larger geographic spaces until global trade is fully encompassed.<sup>12</sup> This reasoning was behind the design of GATT-WTO Article XXIV and the idea was central to the design of APEC and its principle of open regionalism. Figure 5.1 provides an illustration of the first phase of this process, showing how friction-creating borders disappear on the way. Despite these lofty principles and the early enthusiasms with the APEC process, implementation has come undone. For agreements to fold into ever-wider geographic spaces, at least two conditions appear to be necessary: an inner dynamic force, and an institution that will manage the process.

First what conditions might trigger the dynamics? It relates to the creation of added benefits from a bigger PTA. Each country joining an agreement would need to increase the incentives for other countries to join. In a static sense, increased membership would increase the likelihood of a net trade creation, as there would be a higher chance that the most efficient suppliers become part of the PTA, thus minimising trade diversion. In a more dynamic sense, adding a country to a PTA would create a larger market, thus allowing for better utilisation of economies of scale and providing incentives for firms to locate to that market, that is, for foreign direct investment to be redirected from other markets to this enlarged market. This is in line with the creation of positive network externalities as an increased number of firms join the market, leading to additional incentives for more producers to join, thus further increasing the costs of those remaining outside. Evidence from the expansion of the European Union market to 25 members suggests that this effect does occur – if a country is left out of the enlarged market, it loses firms. With firms, it loses investment, jobs and growth.

Notwithstanding these static and dynamic effects, for geographical consolidation to emerge, existing members have to show willingness to allow unrestricted entry. There is no guarantee that this condition will be met. Uncertainty over whether the volume of net benefits will increase with a larger number of partners is a major constraint and there will be reluctance to share benefits. However, perhaps more importantly is the uncertain role played by political, historical, social and cultural considerations. Political economy compulsions and a fear that deep-seated differences

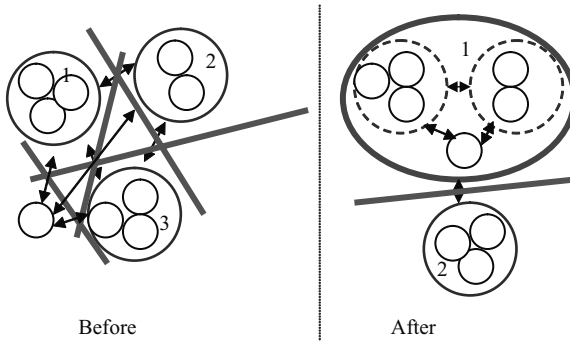


FIGURE 5.1. Illustration of a domino effect at work

*Legend:* Full thick lines = economic borders; Small circles = national political borders; Large circles = original PTAs; Oval = newly established PTA which encompasses previous PTAs (dashed large circles) and national economies (small circles); Double arrow lines = trade and investment flows.

among countries will make harmonisation of policies all but impossible, has stifled geographical consolidation. These perceptions of irreconcilable differences leave the concept of “geographic consolidation” untested to a large extent, a common refrain being that “proliferation” is preferable to “paper tiger” integration.

In this regard, the EU process offers useful signposts.<sup>13</sup> Importantly, it showed that a meeting of the minds at the highest political levels can nurture an integration process that rises above historical differences. A key difference between the EU and the trade configuration of the Asia-Pacific region however is that the postwar European integration process started off as a customs union (CU), with a relinquishing of national sovereignty on trade policy, and was able to grow geographically and achieve a far greater degree of harmonisation among all members on an ever widening net of policies, notably monetary policies. As Venables (2000) points out this is indeed the most important trade-off in making integration work: a trade-off between the benefits of deeper integration secured by the customs union and the increasing complexities that an enlarging membership brings through geographic consolidation.

This brings us to the second condition, namely the role played by institutions. An institution-driven process of integration while not necessarily the driving force, appears to play a crucial role in transforming a series of PTAs into one common bloc. If this top-down approach is weak or missing, responsibility for “collective action” might never be taken up. Is this the situation in which Asia-Pacific finds itself at the moment? Do the current intergovernmental regional institutions such as ASEAN, ADB, ESCAP have the mandate to forge such collective action? The multicoloured map outlined in Section 5.2 speaks for itself. Has the time arrived for a supranational institution that will delve deeper into national policy areas and forge the collective action required? A corollary of this question, in the context of Asia-Pacific integration, is whether such an institution could evolve if the level of integration is shallow and not of the depth and type envisaged by a CU?

Given that all of the Asia-Pacific preferential agreements have primarily aimed at shallow trade liberalisation, while preserving trade policy-making within the confines of national sovereignty, it does not come as a surprise that there is no example of real geographical consolidation having taken place in the Asia-Pacific region. Its highly differentiated market driven style of integration, makes it more difficult to predict whether a geographic consolidation process could be triggered, or at which configuration the current proliferation might find equilibrium. In other words, will existing regional groupings coalesce into outward-oriented PTAs that bridge sub-regions and continents in a WTO-supportive manner? It also raises a question of direct concern to the *raison d'être* of regional organisations such as ESCAP and ADB. Will a region-wide trade and economic cooperation agreement emerge and can these regional organisations promote such an agreement?

Notwithstanding these questions, there are a number of initiatives that appear to be seeking to consolidate regional integration initiatives. One example of the type of geographic consolidation that could be envisaged is given in Figure 5.2, panel c. In this case, the Asia-Pacific Trade Agreement (APTA) as the only trade agreement that currently links South and East Asia, with three of its members sharing common membership with SAFTA (panel a), and BIMSTEC (panel b) might eventually coalesce into an initiative that promotes a wider East, South-East and South Asian FTA. A fourth circle encompassing all three agreements forming an Asian Economic Area could evolve. Therefore, an agreement open to all developing members and associate members of ESCAP, such as the APTA, could serve as a useful vehicle for domino-style consolidation even if at a shallow level. The interest in APTA<sup>14</sup> lies in the simultaneous access it provides to a unique combination of markets, its future market potential (encompassing two of the most populous and fast growing economies), and its relatively evolved and operational text (true and tried provisions which are the product of a long history of negotiations). Common rules of origin, based on domestic value added criteria (45 per cent for developing, 35 per cent for LDCs), with full cumulation are in operation. Perhaps more importantly is that APTA represents the full development spectrum across the region (with the Republic of Korea at one end, and the Lao People's Democratic Republic at the other end). APTA thus encompasses a set of rules reflecting a common denominator that has proven workable across the development cross-section of the region. On the downside, integration has been slow, limited and shallow: after more than 30 years, coverage has focused only on tariffs and goods (about 4000 items with narrow margins of preference).

After China acceded in 2001, in line with its increasing interest in regionalism, a number of developing countries are considering joining APTA. These include Mongolia, which at present is the only WTO member not yet part of any PTA, Pakistan which is already negotiating separate BTAs with China and Republic of Korea among others, Bhutan and Nepal as strategic landlinking transit countries between China and India, Azerbaijan and Kazakhstan as the first CIS countries seeking to establish trade and investment linkages through a FTA with the rest of Asia. Macao, China is also studying prospective membership, opening up new routes for trade and wider economic cooperation. Realising the full potential of APTA will depend on the extent

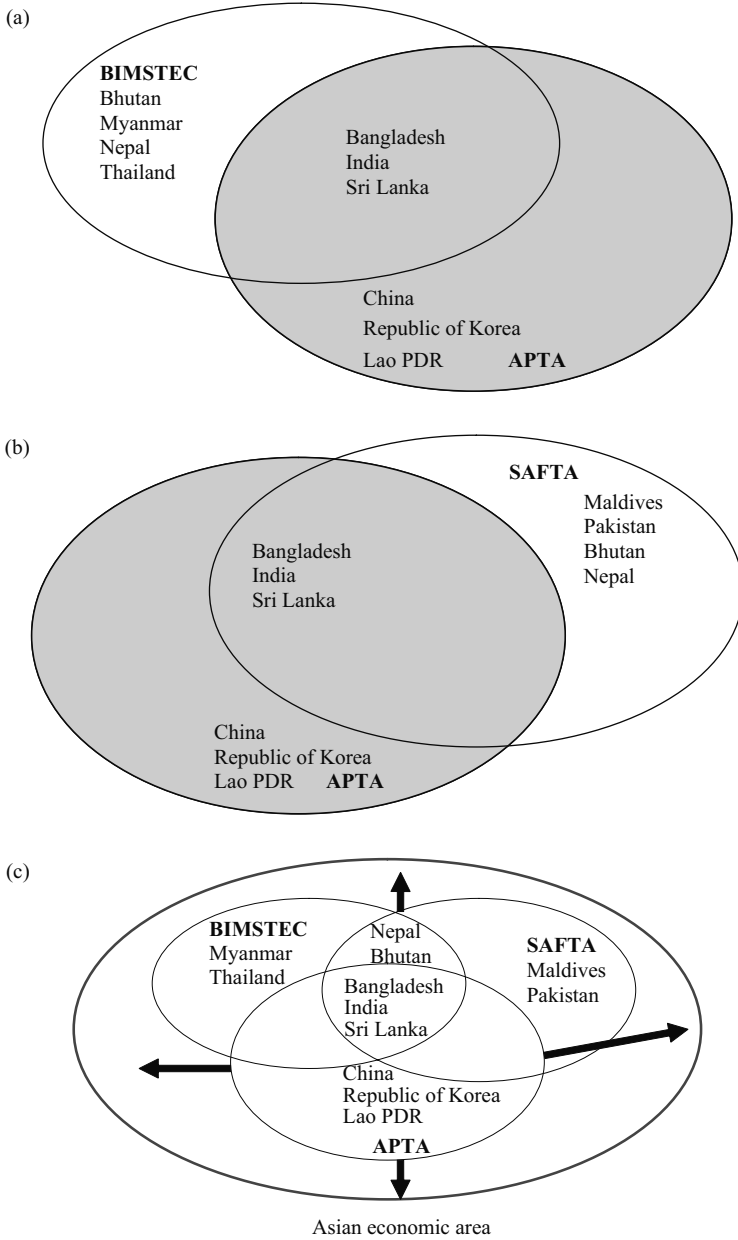


FIGURE 5.2. (a) An example of a geography-based consolidation: Asian Economic Area. (b) An example of a geography-based consolidation: Asian Economic Area. (c) An example of a geography-based consolidation: Asian Economic Area (Source: APTIAD, 2005).

to which the agreement is able to broaden and deepen trade benefits in subsequent rounds of negotiations, while the unfolding geopolitical alliances in the region will impact further on prospective membership.

China's role in pan-Asian integration stands out given both its size and dynamism as the region's fastest growing trading nation. Figure 5.3 shows the region-wide integrative forces at play<sup>15</sup> through APTA and APTA+China and Central Asia.

The role of the Russian Federation as the *de facto* (and *de jure*) hub of Central Asia also needs to be factored in. Traditionally, the Russian Federation and its history were intertwined with that of the rest of Europe while for most of the twentieth century, economic relations were driven by political ideology and thus focused on the CMEA (also known as Comecon) and selected likeminded countries in Asia. However, in the wake of its transition to a market economy, the Russian Federation and other Central Asian countries have increasingly looked east, while not ignoring relations with the Western world. The linkages are evolving, driven in part by complementarities between supplies of natural resources in Central Asia and needs of energy-deficient, rapidly growing countries in China and the rest of East Asia and South-East Asia. Upon completion of its WTO accession, it is expected that the Russian Federation will become a more active regional player through ASEAN+1, or APTA configurations which in turn would further accelerate applications of other Central Asian economies for membership in the same bloc.<sup>16</sup>

In reality, the current axis of integration in the region appears to be centered on the ASEAN + China + Japan + Republic of Korea process. This, together with the addition of India (+1), the US (+1) and Australia and New Zealand (+2), is bringing about a regional and cross-continental expansion of trading routes. At the same time there are fragmenting forces that are gaining traction. The three-way linkage between China, Japan and the Republic of Korea and the prospects for it to link up to the ten economies forming AFTA, in an ASEAN+3 configuration has lost momentum,<sup>17</sup> with each of the +3 countries negotiating separately with ASEAN in a +1+1+1 configuration (with the China link already completed). In other cases, ASEAN integration with the +1 country is proceeding on a bilateral basis (e.g. Japan-Thailand, US-Thailand, India-Thailand and many others), which raises the question of how the regionalisation of commitments (on MFN basis) under ASEAN will be brought into effect. For the time being, it appears that integration may be proceeding more along the lines of a fragmented series of +1 spokes, rather than the more inclusive widening circular approach outlined in Figure 5.2 above. A second unanswered question is who will be taking the position of a hub: ASEAN or any of the +1 countries? Shallow integration and principles of national sovereignty is likely to continue to preclude ASEAN from functioning as a hub. APEC perhaps came the closest to forging geographical consolidation, but it has since proven that despite its laudable principles of open regionalism, its trade liberalisation architecture had flaws.<sup>18</sup>

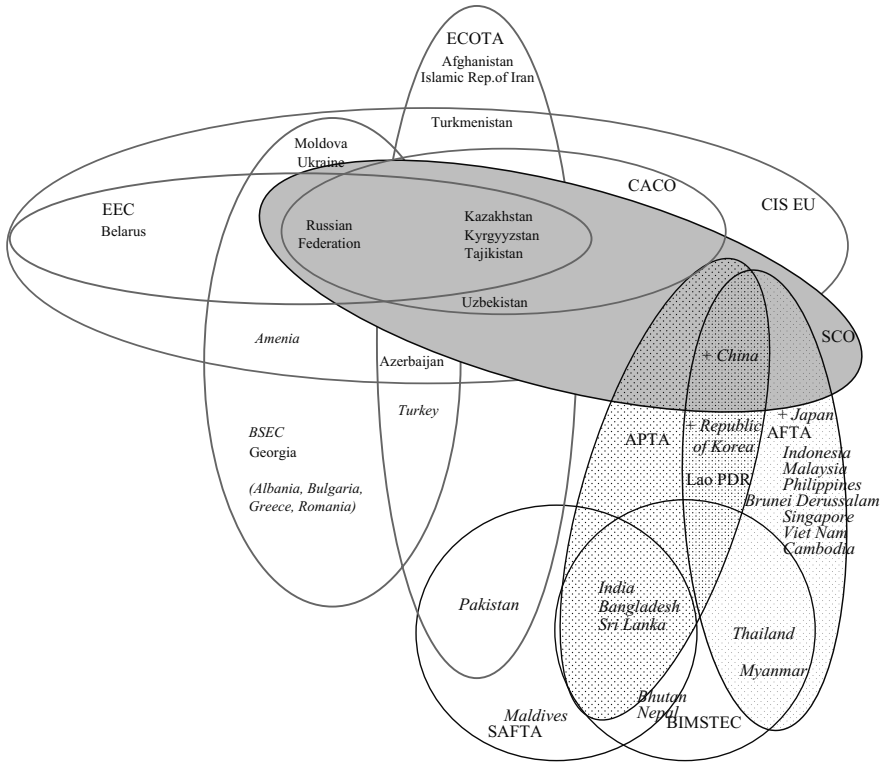


FIGURE 5.3. Integrating Central Asia with the rest of Asia. (Note: World Trade Organization members are in italics; Source: ESCAP, 2005).

5.3.2. *Functional Harmonisation: Removing Frictions Faster*

Questions abound as to the nature of geographical consolidation, political leadership and the trade policy architecture that will promote it. A second type of consolidation is considered, namely functional harmonisation, where disciplines on PTAs would be imposed at the regional level through a common framework of principles, practices and procedures. Evolving such a framework poses a dilemma, similar to that posed by GATT Article XXIV (and GATS Article V). How does one devise rules that are universally acceptable and operational? There is a trade off between the two because rules that are too broad become non-operational, while the specificity required to make rules implementable may not find universal application. In a region as diverse as Asia-Pacific, finding the balance will be a challenge.

Furthermore, without a legally binding and clear domestic legislative basis, such initiatives may remain on the shelf as best endeavor efforts. This concern would be exacerbated, if enforcement mechanisms, including monitoring and performance surveillance, and dispute resolution through adjudication, are lacking. The WTO

presents all of the above. An avenue worthy of further exploration is thus how the evolution of a common framework of principles could be embedded in the WTO system. In other words can a minilateral (Asia-Pacific) common framework be devised that would be an inextricable component of the legal text of the WTO, and would thus serve as a building bloc of the multilateral trading system?

The intricate and never-ending complexities involved in bringing about legal changes affecting rights and obligations of WTO members cannot be underestimated. Therefore, a bottom-up approach is proposed. As a pilot case, a WTO *minilateral* (Asia-Pacific) working group could be set up to devise practices and procedures on rules of origin (RoO) based on a commonly agreed set of trade and development principles.

*Rules of origin* Why RoO? The current proliferation of agreements has spun a complex RoO web (see Table 5.2). Not only does each agreement have its own RoO; in addition, a bewildering array of product-specific RoO is emerging. Adopting the less restrictive RoO could result in significant trade deflection and redundancy of a trade agreement, while adopting the most restrictive RoO may result in no trade taking place under the agreement. Several chances have been missed, both at the WTO and regional levels to bring some uniformity to the formulation of preferential RoO. GATT Article XXIV, quite remarkably, is silent on the use of preferential RoO. Should RoO not be viewed as other regulations of commerce that should not raise barriers to third countries any higher than they were prior to the formation of the PTA? The most that is said is embodied in a non-binding common declaration on principles. This increases the urgency of establishing an overarching, region-wide common framework of principles, guidelines and procedures to which BTAs and RTAs would be anchored. Notwithstanding its non binding nature, the point of departure should be the WTO common declaration. Ongoing work, notably in APEC, and other useful trade and development elements found in other agreements should be built on. For example, APTA recently agreed to common RoO (representing a wide spectrum of industrial development among the members) that are relatively simple, general and liberal – namely a flat rate of minimum 45 per cent of local value content (35 per cent for LDCs) in bilateral RoO and at least 60 per cent (50 per cent for LDC) regional content with full cumulation.

*Investment rules* Achieving gains from PTAs is difficult without at the same time increasing investment. While static efficiency gains could be obtained by a “simple” reshuffle of resources, dynamic gains can only be materialised through larger investments. Often, however, PTA members lack sufficient domestic resources, and thus it is left to foreign inflows. FDI in turn is attracted to the region because of the promise of gains from PTAs. Consequently, many PTAs feature the promotion of (foreign direct) investment as an objective so the circle of interdependency between trade and FDI closes.

Given this interdependency (see Box 5.2 on trade-FDI nexus), it is not surprising that there are many different routes through which governments, whether as home or host country, have tried to make these flows secure, predictable and beneficial.

TABLE 5.2. Rules of origin provisions in selected PTAs

Agreement	Change in tariff classification	Specific manufacturing process	Local value addition	Cumulation
<b>BTAs</b>				
India–Thailand	Yes (or VA) 4, 6 digit level product specific	—	20–40% product specific F.O.B. value	Bilateral
India–Sri Lanka	Yes (or VA) 4 digit level	—	35% F.O.B. value	Bilateral
Japan–Mexico	—	No specific process required	50% with some exception F.O.B value	Bilateral
Republic of Korea–Chile	—	No specific process required	45% build down method calculation, 30% build up method calculation	Bilateral
Singapore–Japan	Yes (or VA) 4 digit level	Yes	60% F.O.B. value	Bilateral
Singapore–USA	Yes (or VA) 2, 4, 6 digit level	Yes	30–60% Product specific	Bilateral
Singapore–New Zealand	—	—	40% Factory cost	Bilateral
Singapore–Australia	—	—	30–50% product specific factory cost	Bilateral
Thailand–Australia	Yes (and/or VA) 4,6 digit level Product specific	Yes	40–55% product specific F.O.B. value	Bilateral
<b>RTAs</b>				
Asia–Pacific Trade Agreement	No tariff heading change necessary	No specific process required	45% (35% for LDC)	Full
ASEAN Free Trade Agreement	No tariff heading change necessary	No specific process specified	40% F.O.B. value	Full
<b>GSPs</b>				
EU	Yes (and/or VA)	Yes	50–70% F.O.B. value	Bilateral Regional among certain regional groups
USA	—	—	35% (List of eligible products) Factory price	Bilateral Regional Among certain regional groups
Australia	—	—	50% Factory price	Regional Among beneficiary countries

Source: ESCAP Secretariat and APTIAD, March 2006.

This has added a second spaghetti bowl, perhaps even more content-specific and stylized than the trade-related bowl. At the last count there were about 2200 bilateral investment treaties (BITs) in place, while most PTAs make reference to investment rules. Add to this, Trade Related Investment Measures (TRIMs), and those related to establishment of commercial presence or Mode 3 of delivery of services under General Agreement of Trade in Services (GATS) and the bowl overflows. Efforts to manage regionalism more effectively would thus need to forge a more integrated and streamlined link between trade and investment.

Before discussing this further, it is necessary to emphasize that the jury is still out on what the impact of PTAs and other treaties are on the overall volume of investments. It appears that the spaghetti bowl syndrome is not detrimental for FDI flows, to the extent that the magnitude and direction of bilateral FDI flows will mostly depend on economic characteristics of the investing country, host country and the individual investors, that is, economic fundamentals rather than presence of PTA (cf. Sapsford, Griffith and Balasubramanyam, 2002 among others). However, Hoekman and Newfarmer (2005: 950–951) isolate four possible channels through which PTAs may have positive effects on investment:

1. Trade liberalization associated increase in the size of regional market.
2. New investment rules providing lesser restrictions on market entry.
3. New investment rules providing tighter protection for investors.
4. Agreement-associated improved credibility of national policies (with regard to investments and in general).

We comment briefly on these, in turn.

First, as discussed above and in Box 5.1, a PTA does not simply add together national markets to obtain a new integrated market. From the point of view of a firm and an investor, the regional market size is not a simple sum of individual national markets. Integrated markets mean more competition and rationalisation. The market share of each firm might increase allowing it to use more of economies of scale, reduce unit cost and thus improve returns from previous investment. This provides sound incentives for new investments. In this way integrated market size becomes positively correlated with investment, from within and from outside the integration. A study by Hoekman and Newfarmer (2006: 962–963) finds that on average, a 10 per cent increase in market size linked to a PTA produces an increase in FDI of 5 per cent. This implies that integration with a large market has a greater positive impact than integration among small markets. Furthermore, the larger market may divert investment away from other areas into this new enlarged (and easier to access, see below) market.<sup>19</sup>

Second, most PTAs are negotiated with the goal of removing existent barriers to cross-border flows of goods, services, and factors (so-called “*negative integration*”). In relation to investment flows this means that barriers to entry in sectors that were once *non-tradable* are now being removed: the services sectors are increasingly

being opened up to FDI, with commercial presence being the dominant mode of supply. Another sector receiving lots of attention in recent years are natural resources, predominantly oil.

Third, with regard to investment protection, the traditional approach of providing such protection through BITs, does not provide unambiguous evidence that countries with BITs received more investment. Among other references, World Bank (2005: 107) cites Hallward-Driemeier (2003) study of bilateral investment flows between OECD and 31 developing countries over two decades in which it was found that BITs “had virtually no independent effect in increasing FDI to a signatory country from a home country”. Schiff and Winters (2003) find that BITs facilitate investment flows through the prohibition of certain policies rather than by set of policies that directly encourage investment, while noting that other effects of PTAs (such as credibility enhancement) is a more important factor.

Finally, PTAs/BITs can increase policy credibility of members, which on their own could not muster such credibility. However, most analysts agree that this is merely the “cherry on the top” – treaties cannot grant credibility where sound economic performance is lacking and inconsistent. Furthermore, with the current diversity in place, much depends on who the “players” are. Generally, agreements among developing countries “are unlikely to do this and may in fact hinder investment if they are not accompanied by liberalisation of trade with the rest of the world” (Schiff and Winters, 2003: 17). PTAs between developed and developing countries may be more effective in improving the policy credibility of the latter but then only if the developed members are willing to enforce investment-encouraging “club rules”.

In summary, although PTAs may attract investment, a sound investment policy climate, is fundamental. Furthermore, unless a PTA is in full compliance with the principles of open trading regime, it is more likely to increase costs and uncertainty for foreign investors and thus hinder investment and FDI inflows. Thus the task is to create a more integrated approach between trade liberalisation and the treatment of FDI while also exploring the feasibility of setting up a regional common framework.

As a first step in devising this common framework, an in-depth examination of what investment provisions exist in the PTAs of the ESCAP region (Table 5.3) and comparison with BITs would be necessary. This paper briefly makes a few observations. From the literature on the linkages between PTAs and FDI, it is evident that any provisions on investment included in the PTAs should be of the same quality as stand-alone investment agreements. What should such quality consideration be based on?

For example, the Institute for Sustainable Development has developed a model agreement on investment for sustainable development (year), based on the following principles:

- investors rights are protected in a legitimate, transparent and accountable manner,
- aspirations of developing countries and promotion of global sustainable development as primary objectives of the agreement,

- balance investors rights with responsibilities, and both home and host countries state rights and obligations,
- clearly set out dispute settlement process,
- understanding of the need for appropriate funding.

Devising common rules on investments is haunted by past failures, notably the decade long work under the so-called Singapore work programme of the WTO, the OECD Multilateral Investment Agreement, and the continuing presence of relatively weak frameworks at the subregional level such as the ASEAN Investment Area. Considering the strong preponderance for national policy space in this arena, to what extent is a common framework on investments, such as the one indicated above, implementable at the regional level. Should it be combined with a common regional framework on trade, or should there be a sequence? What is the configuration that would most enhance the development impact of trade and investment liberalisation? The economic rationale for an integrated comprehensive and mutually supportive trade and investment liberalisation process was outlined above. The socio-political rationale at the national level, particular in so far as it impinges on domestic policy making and national sovereignty is much more complicated. This will require more analytical work and consensus-building if resistance on the political economy front is to be overcome. Another alternative in connecting trade and investments more formally, is focused on solving shortages of resource. Through a PTA “surplus (reserve abundant)” and “deficit” countries are linked and an investment pool can be created. It is plausible to suggest that there will be an interest among countries signing a PTA to commit certain funds into the common investment pool (according to individual economic strength). This proposal finds resonance in the EU’s regional policy and its structural and cohesion funds. Nevertheless, even the EU with a much deeper level of integration than any of the PTAs in this region has had problems with “additionality and subsidiarity” and it is difficult to perceive its functioning without the PTA having a strong institution.

#### **Box 5.1. Trade–FDI nexus**

Kawai (2004), Katseli (1997) and OECD (2005), among others, track the evolution in the trade–FDI nexus as a host country graduates through the various “comparative advantage stages”. This typology, leaning heavily on both traditional trade theory and OLI approach to multinational companies (drivers of FDI), suggests that trade and FDI will become more complementary as a host country develops (see Table 5.4).

*Other areas* Obviously, the above two areas of functional harmonisation are not exhaustive. There are other equally good or better candidates for harmonisation that deserve further exploration. One such area without doubt is standards that relate to products. They include various technical, sanitary and phytosanitary regulations.

TABLE 5.3. ESCAP-region PTAs with commitments in investment

Agreement	Scope of agreement	Type of agreement	Year into force	WTO notification	Year notified to WTO
1 ASEAN – China Free Trade Area (ACFTA)	Country – Bloc	Framework agreement	2005	Enabling Clause	2004
2 Agreement between New Zealand and Singapore on a Closer Economic Partnership (ANZSCEP)	Bilateral	Free Trade agreement	2001	GATT Art XXIV and GATS Art V	2001
3 ASEAN – India Framework Agreement on Comprehensive Economic Cooperation	Country – Bloc	Framework agreement	2004	No Notification	–
4 Australia – United States Free Trade Agreement (AUSFTA)	Cross – Continental Bilateral	Free Trade agreement	2005	GATT Art XXIV and GATS Art V	2005
5 Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC)	Regional (ESCAP)	Framework agreement	2004	No Notification	–
6 EFTA – Singapore Free Trade Agreement	Country – Bloc	Free Trade agreement	2003	GATT Art XXIV and GATS Art V	2003
7 India – Singapore Comprehensive Economic Cooperation Agreement	Bilateral	Free Trade agreement	2005	No Notification	–
8 India – Thailand Framework Agreement for establishing a FTA	Bilateral	Framework agreement	2003	No Notification	–
9 Japan – Mexico Economic Partnership Agreement	Cross – Continental Bilateral	Free Trade agreement	2005	GATT Art XXIV and GATS Art V	2005
10 Japan – Malaysia Economic Partnership Agreement	Bilateral	Free Trade agreement	2005	No Notification	–
11 Japan – Philippines Economic Partnership Agreement	Bilateral	Free Trade agreement	2004	No Notification	–

12	Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership (JSEPA)	Bilateral	Free Trade agreement	2002	GATT Art XXIV and GATS Art V	2002
13	Korea – Chile Free Trade Agreement	Cross – Continental	Free Trade agreement	2004	GATT Art XXIV and GATS Art V	2004
14	Korea – Singapore Free Trade Agreement (KSFTA)	Bilateral	Free Trade agreement	2005	No Notification	–
15	New Zealand – Thailand Closer Economic Partnership Agreement	Bilateral	Free Trade agreement	2005	No Notification	–
16	South Asian Association for Regional Cooperation Free Trade Arrangement (SAFTA)	Regional (ESCAP)	Free Trade agreement	2006	Enabling Clause (for SAFTA)	1997
17	Singapore – Australia Free Trade Agreement (SAFTA)	Bilateral	Free Trade agreement	2003	GATT Art XXIV and GATS Art V	2003
18	Singapore – Jordan Free Trade Agreement	Cross – Continental	Free Trade agreement	2004	No Notification	–
19	Thailand – Australia Free Trade agreement (TAFTA)	Bilateral	Free Trade agreement	2005	GATT Art XXIV and GATS Art V	2005
20	Framework Agreement Between Thailand and Bahrain	Cross – Continental	Framework agreement	2003	No Notification	–
21	Turkey – Romania Free Trade Agreement	Bilateral	Free Trade agreement	1998	GATT Art XXIV	1998
22	Turkey – Tunisia Free Trade Agreement	Bilateral	Free Trade agreement	2005	GATT Art XXIV	2005
23	United States – Singapore Free Trade Agreement (USFTA)	Cross – Continental	Free Trade agreement	2004	GATT Art XXIV and GATS Art V	2003

Source: APTIAD, 2006, March.

TABLE 5.4. Typology of Trade–FDI linkages

Type of FDI activity	Basis for FDI activity	Trade–FDI relationship
Labour-seeking	Relative abundance of labour with low relative wage	Substitution – FDI reduces trade (imports) and vice versa If host country used as export-production platform, it could be export increasing
Market-seeking	High protection wall in host country Significant market imperfections in host country	Substitution – FDI reduces imports (trade); opening of markets leading to more trade would reduce FDI
Resource – extracting	Absolute advantage in natural resources in host country Security and predictability of raw material sourcing	Trade creating -FDI creates exports of resources and imports of extracting machinery, larger exports pools more imports in so it is trade creating
Component – off shoring	Low relative total cost of processing (comparative advantage) / vertical differentiation / EOS	Complimentary – Intra-firm trade creating IIT creating
Horizontal differentiation	Demand for horizontally differentiated goods creates production facility in host country which is still cost efficient relative to home	Complimentary – intra-firm trade creating IIT creating
Services – outsourcing	Low relative cost of service provision (comparative advantage)	Trade creating as creates trade where it did not exists (services was provided in home country now exported by host country)
Services-market seeking	High protection wall in host country Significant market imperfections in host country due to regulation (e.g. financial sector, telecommunication, energy, transport, etc.)	Depending on the service sector – if deemed non-traded, it is trade neutral Most probably biased towards trade creating as commercial presence will be more import-intensive than previous domestic provider Can it be trade reducing?

Source: Modified version of Table 5.3, Kawai (2004a) (cf. Katseli, 1997, Table 5.1).

Compliance with standards increases costs and if the standards remain diverse across the PTA members these high costs have an adverse effect on volume and direction of trade within the PTA. It is therefore logical to expect that harmonisation of technical standards and sanitary and phytosanitary standards will reduce barriers to trade and will facilitate intra-regional trade. Similarly, there is a strong theoretical support for harmonisation of product standards from the perspective of non-members

who claim that a PTA with harmonised standards is easier to access and more in compliance with the WTO principles (or their spirit at least). Empirical evidence, however, is sketchy and more research is required to provide a consistent and systematic support to this claim. Nevertheless, anecdotal evidence (EU, ANZCERTA) and strong theoretical support for this area of harmonisation should be sufficiently inviting for a regional approach. Other possible area for harmonisation/mutual recognition arises from arguably increasing need to integrate provisions on temporary mobility of labour into the PTAs. Common standards referring to skills and qualifications could be removing some of the impediments to easier movements of providers of services across the borders within the bloc.

#### 5.4. STAYING ON COURSE: TRACKING AND ASSESSING

In addition to exploring and promoting, as appropriate, the routes outlined above under geographic consolidation and functional harmonisation, and in order to provide stakeholders (governments, researchers, policy analysts and civil society) with a tool to monitor and analyse developments in preferential trade area, the ESCAP secretariat is developing a “one-stop” Web-based database that collates descriptive and quantitative information on more than 120 RTAs/BTAs applicable to the ESCAP region. The database is called Asia-Pacific Trade and Investment Agreements Database (APTIAD) and is available online at <http://www.unescap.org/tid/pta%5Fapp/>. Its present coverage will be expanded to include trade flows and the development of indicators.

APTIAD, when fully developed, will contain:

- (a) Detailed descriptive and up-to-date information on the provisions of bilateral and regional agreements;
- (b) Statistical data on trade flows, commodity composition and services trade (where available) by individual agreements; and
- (c) Selected indicators of performance of individual agreements for pre-defined time periods.

The first phase in developing this database has been completed. The current phase focuses on:

- (a) Adding information related to the coverage of each agreement (contingent protection, standards, services and other areas) by each agreement.
- (b) Testing the online use of the database.
- (c) Developing statistical data sets related to each agreement.
- (d) Developing analytical measures and indicators for tracking and assessing PTA performance on various dimensions and preparing for the results to be presented online.

Indicators of PTA performance will be useful not only for assessing the PTAs already in force, but also to provide insights into the potential outcomes of proposed agreements. This will be used to set out guidelines on policy direction, including best practices that could be consulted by ESCAP members and associate members when

considering negotiating a PTA. Ultimately, the database will provide the information and analytical basis for work on the design of a modal trade agreement for developing countries, using existing agreements and their performance, including APTA.

Traditional economic theory has focused primarily on assessing PTAs against standards of welfare maximisation for members through static concepts of trade creation, trade diversion and trade deflection. More recently, other standards have been applied when evaluating a PTA. Drabek (2004) cites the following as benchmarks of “effectiveness”:

- (1) Enforcement of common external policy. A custom union is meant to dilute national political powers and minimise influence of local interest and lobby groups (de Melo et al., 1993). Arguably, if PTA aims for a deeper integration it is capable of giving rise “to *negotiated and rules-based political space* including confidence-building measures, common rules and procedures, political dialogue and co-operation”;
- (2) Reduction of policy uncertainty and improvement in overall economic governance. Policy uncertainty inhibits growth capacity as it derails investment by increasing the risk and cost of capital. A PTA’s contribution to enhancing predictability of economic policy, reducing overall uncertainty and reducing discretionary decision-making is valuable;
- (3) Increase in global trade liberalisation. In design PTAs should be WTO-consistent and supportive of its systemic objectives. This last standard is another spin on “stepping stone versus stumbling blocs” dilemma of regionalism. All of these standards are important in determining long-term developmental impacts of PTAs and in devising our indicators we try to incorporate various aspects of those standards, both when assessing proposals and effective PTAs.

In terms of assessing PTA proposals, ESCAP work is directed at enhancing the economic rationale for PTAs. Based on the theoretical foundations underlying the economic analysis of PTAs, indicators and analytical methods are under consideration, among which are the following:

- (a) Examination of existent patterns of trade among countries intending to enter into an agreement. The simplest way to examine the patterns of trade is to look at indices of revealed comparative advantage (RCA). This index gives an indication of potential benefits of the proposed PTA because in countries where RCA indices are similar, there may be limited potential for mutually beneficial trade of the inter-industry variety, which remains of importance for some countries in the region.
- (b) Assessment of potential for cooperation in trade by calculating trade complementary indices, which measure how well one country’s specialisation in exports complements another country’s import demands.
- (c) Gravity estimation provides yet another dimension of extent of potential trade among the countries intending to negotiate a PTA.
- (d) Measurement of coverage of “substantially all trade” for concluded PTAs, in line with strengthened disciplines on Article XXIV that may emerge from the Doha

Round, for example, by calculating the proportion of tariff lines covered by the agreement and other methods that have been proposed to the WTO Negotiating Group on Rules.

Once PTAs are in force, their performance needs to be monitored and contrasted against objectives set by them and WTO disciplines. Stakeholders are expecting to know much more than in the past and policy makers need better tools at their disposal to devise trade policy. Answers are needed for questions like the following which we find particularly pertinent although they do not exhaust the list of important questions to be asked:

- Do some PTAs perform consistently better than others? Do they support disciplines and enforce commitments which are formulated and agreed on?
- What are differentiating features of those PTAs that perform consistently better?
- What are common features, if any, of PTAs that under-perform?
- Is there a systematic relationship between level of depth of PTA/its institutions and its performance?

In search of answers to the above and other questions, PTA performance monitoring may focus on some of the following:

- (a) Trade dimensions by looking at changes in regional and sectoral patterns of trade, including a regional orientation index at aggregate and sectoral levels
- (b) Compliance with non-discriminatory principles by measuring the level of trade barriers against non-members. This can be deduced by using an index of intra-regional bias. This is a new index formed by taking the ratio of intra-regional openness to extra-regional openness, where value of unity will indicate the absence of bias (compliance with the non-discrimination principle). This index can be tracked over time so that inferences of “stumbling bloc” or “stepping stone” impact of the PTA could be done easier.
- (c) In a limited number of cases (depending on data availability and availability of resources) a counterfactual analysis will be performed so that an outcome of PTA could be compared to “what if” situation.
- (d) More complex development dimensions of PTAs could also be assessed by using variants of Human Development Index (HDI) and Trade and Development Index (TDI).

## 5.5. CONCLUSIONS

Looking at regionalism from the trade perspective, albeit a narrow perspective, the future configuration at which BTAs/RTAs will come to rest will, to a great extent be influenced by the pace, depth and scope of WTO negotiations. At the end of the day, the more WTO negotiations achieve significant reduction in trade barriers on an MFN basis, the weaker the rationale for pursuing alternative discriminatory, more PTAs, and the less problematic they will be to third parties. A conclusion to the Doha Round by 2006, with sufficient depth and scope that neutralises perceived benefits

of BTAs/RTAs is a critical piece of the spaghetti bowl. Tighter disciplines governing RTAs/BTAs (of note are recent proposals by, among others the EU and Japan, to the WTO Negotiating Group on Rules) would help. Multilateralism is no easy task, as is amply evident.

The question thus returns to the regional level. How can regionalism and multilateralism be put on a more solid legal foundation? Future initiatives aimed at developing a set of common and cohesive principles, practices and operational procedures for regional economic integration will need to be more than best endeavour practices. Absent a supranational structure of governance, a la EU, ways of embedding Asia-Pacific wide initiatives, in the form of *minilateral* binding agreements as a future building bloc of multilateralism is worthy of further analytical study. Preferential rules of origin may be a useful pilot case.

#### NOTES

- <sup>1</sup> Research assistance of Ms Ying Qiu is gratefully acknowledged. The opinions, figures and estimates set forth in this paper as well as any errors and omissions remaining are the responsibility of the authors and should not be attributed to the United Nations. Authors thank the participants of the “Brainstorming on FTAs: Issues and Challenges in Designing Effective Trade Agreements in Asia” organised by the Asian Development Bank, Manila, 20 March 2006 for insightful and useful comments.
- <sup>2</sup> In this paper preferential trade (agreements) and regionalism/regional trade agreements (RTAs) are used interchangeably to refer to any form of preferential trade liberalisation. The early stages of preferential liberalisation in Twentieth century saw countries extend trade preferences to countries in geographical proximity and this path became known as regional integration with the agreements themselves called RTAs. With time ‘regional’ feature weakened giving way to agreements between countries rarely sharing borders. Cf. Bonapace and Mikic (2005: 85, ft.1).
- <sup>3</sup> Some commentators describe how this region nurtured a particular style of regionalism (i.e. driven by market/business forces over politics) which relies on de facto and not de jure trade preferences. For a summary of views and some anecdotal evidence see Baldwin (2006: 4–11).
- <sup>4</sup> Of course larger number of PTAs notified to the WTO can also be due to larger membership of the WTO (an increase from 123 in 1995 to 150 in 2006) and more rigorous notification obligations.
- <sup>5</sup> Cf. Bonapace and Mikic (2005: 86, Figure 1). UNESCAP Asia-Pacific Trade and Investment Agreements Database (APTIAD) is accessible at <http://www.unescap.org/tid/pta/%5Fapp/>
- <sup>6</sup> Although Bergsten extend this “benign neglect” to all observers outside the region (Bergsten, 2005: 1).
- <sup>7</sup> This of course immediately opens the issue of the type of institution which would manage this new type of integration. A better institutional arrangement must be found to see the integration through. Baldwin (2006: 20) picks ASEAN+3 as the body for East Asia.
- <sup>8</sup> Theoretical and empirical evidence support the claim that the outcome of globally maximised welfare achieved by multilateralism cannot be replicated by a complex network of bilateral and regional trading agreements in lieu of the multilateral solution – the sum of welfare-maximizing interests of a number of PTAs falls short of the collective interest of all.
- <sup>9</sup> In an ideal world, the best candidate would be “free trade for all”, but in world of large countries, imperfect competition and externalities this proposition may not hold always and for all.
- <sup>10</sup> We do not explore the optimal number of these areas and likelihood of ending with an equilibrium of “trisome” has been explored in Krugman (1993).
- <sup>11</sup> This section borrows from Bonapace and Mikic (2005: 96–99).
- <sup>12</sup> “Geographically” larger means both increasing a number of countries and covering larger physical areas.
- <sup>13</sup> The domino effect which led European states one after the other to join the customs union – the core of the EU –, provides an illustration of how the European PTA-spaghetti bowl is being emptied through

- geographic consolidation. When ten new members joined the EU on 1 May 2004, 65 WTO-notified RTAs were abrogated. When they became members of the customs union at the EU level, the ten new members terminated BTAs among themselves, trade agreements between themselves and third parties, and between themselves and the customs union itself.
- 14 See Ministerial Declaration adopted at First Session of the Ministerial Council of APTA, Beijing, China, 2 November 2005, available from <http://www.unescap.org>.
- 15 The meeting was planned for early April 2006 in Fiji. See: <http://www.forumsec.org.fj/>.
- 16 However it is difficult to see how any of these enlargements would be happening before Russia becomes a full member of the WTO.
- 17 Baldwin (2006) explains in detail how he sees ASEAN+3 being the instrumental force in consolidating East Asian regionalism.
- 18 In future, it is still not inconceivable that APEC might abandon its "open regionalism" design and move forward with the formation of an FTA+ type of agreement, using the ASEAN+1+1+1 configuration as the building bloc.
- 19 See also Dee and Gali (2003) for linkages between PTAs and investment creation/diversion.

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## CHAPTER 6

REGIONAL INTEGRATION IN THE WESTERN  
HEMISPHERE: AN OVERVIEW

## 6.1. INTRODUCTION

The Western Hemisphere integration process has started a new phase. After an active policy based on trade agreements among countries within the region, and as a consequence of the delay for the Free Trade Area of the Americas and the Doha Round negotiations, a group of countries have negotiated trade agreements with United States, European Union and the Asia–Pacific region. This multilevel negotiation makes it essential to achieve greater coherence among trade policies at the multilateral, hemispheric, subregional, bilateral and unilateral levels. Given the multiple tiers of negotiations, together with the kaleidoscope of decisions involved, a clear and stronger domestic consensus must be reached on international trade priorities and on means of ensuring consistency among the different public policies.

In this multifaceted situation, there is no sign that integration mechanisms have corrected the shortcomings of the past: weak dispute settlement mechanisms; adoption of trade regulations that are not incorporated into national legislation or are not fully implemented; lack of effective institutional arrangements; absence of macroeconomic coordination and inadequate or non-existent efforts to deal with the development asymmetries of the integration scheme. These challenges exist, albeit with different shades and variations, in the Southern Common Market (MERCOSUR), the Andean Community, and the Central American Common Market (CACM), although greater institutional progress has been made in the latter two.

MERCOSUR–European Union negotiations were not completed in 2004 as planned, and apparently the political momentum will not be regained until after the Doha Round. MERCOSUR has expressed interest in launching free trade talks with CARICOM, Mexico and Morocco, respectively, as well as partial trade agreements with India and with the Southern African Customs Union (SACU). In addition, free trade negotiations between the Andean Community and MERCOSUR have concluded, and the agreement is already in effect. In early July 2005, the MERCOSUR countries became associate members of the Andean Community. Talks are also taking place between the Andean Community and El Salvador, Guatemala and Honduras. In 2004, three Andean Community Member States (Colombia, Ecuador and Peru) started negotiations on a free trade agreement with the United States. Peru concluded these negotiations in December 2005 and also signed a trade agreement with Thailand. Colombia concluded the negotiations with United States in February 2006. It is clear, then, that there is a broad agenda for international negotiations that also calls for the region to participate actively in the multilateral scenario of the Doha Round. Such a demanding agenda can sometimes distract attention

from the efforts necessary to update and streamline the subregions own integration schemes.

This chapter examines the recent trends of the integration process in Latin-American and the Caribbean countries (LAC), the following section analyses the changes that are taking place in the international landscape and its probable impact in the region. Section 6.3 addresses the relevant trends in trade performance. Section 6.4 deals with the main issues that are currently part of the integration debate in LAC. The fifth section discusses more specifically the main debates and challenges in regional integration schemes and the final section presents the conclusions.

## 6.2. A FAST CHANGING INTERNATIONAL LANDSCAPE

In 2004–2005 the international economy has been influenced by two phenomena that have been taking shape for a number of years now. The first is a new geography of international trade and financial flows, one of whose most salient features is China's greater presence in the world economy and financial system. The second has been the United States economy's strong reactivation in 2004, which has made the global economy's growth pattern more dependent on this country. These two factors, which go a long way towards accounting for the robust expansion of the international economy and trade flows in 2004 and 2005, have both direct and indirect effects on the LAC economies, given the importance to the region of the United States and China as trading partners. The nature of these effects is largely determined by these two economies' particular modalities of growth, as well as the structure of their trade and financial ties. The impact is also shaped, however, by the specific ways in which the region is linked to these two economies and by the profile of its trade and financial relations with the global economy.

The short-term outlook for LAC trade activity is encouraging, thanks to the dynamic growth of the world economy, and particularly the emergence of China, India and other developing Asian countries as new global players in the world economy, in particular, in trade and financial flows. Although there are still factors that provide grounds for a certain degree of pessimism (including the United States' hefty twin deficits, high petroleum prices, the possibility of interest-rate hikes, an increase in antidumping complaints and in the use of safeguards), on balance, the situation has been encouraging.

The world economy's momentum drove up the growth of merchandise trade in 2004 and 2005 to a 25-year high. Within this framework, the trade activity of developing countries has risen sharply. This is mainly attributable to the expansion of intraregional trade flows that is occurring among the Asian countries as their production linkages with China multiply, thereby spurring on the Asian region's already ample intra-industry trade flows. Thanks to the global upturn, in 2004 merchandise trade expanded faster than it had for a quarter of a century, rising at a nominal rate of 21 per cent. This surge reflected sharp increases in the dollar-denominated prices of many products, as well as the large volumes traded. South America's goods trade in real terms picked up especially strongly, outpacing the other world regions. The

increases in the prices of petroleum and other commodities and the upturn in trade in electronics and telecommunications equipment helped the developing countries to achieve a truly extraordinary 31 per cent share of global merchandise trade, which was the largest proportion recorded since 1950. The value of trade in services rose by 16 per cent in 2004, after an even higher increase in 2003. Both these figures reflected a powerful upswing in transport and travel.

Net financial flows to Asian and emerging European economies jumped by 40 per cent in 2004. This was mirrored in LAC, whose inward FDI flows climbed by a robust 44 per cent in 2004. At the global level, private capital flows declined as both direct and portfolio investment slipped. The decrease was counterbalanced by official flows, as State authorities in the Asian countries, particularly China, bought United States treasury bonds. This is, in effect, the financial manifestation of a shift in the structure of global demand, with large trade surpluses in the Asian economies helping to finance the United States' current account deficit, which was equivalent to 6.3 per cent of GDP at the end of 2004. Since the upturn in world growth is closely tied to United States consumption levels and, to an extent, investment, the situation calls for increased savings rates on the part of other countries and the expansion of exports to that market in order to satisfy a demand that is outstripping supply.

Most projections point to a slackening of growth in world output in 2005 and 2006, with rates of between 3.0 per cent and 4.3 per cent. The main factors involved here are: (i) the dampening effect on global demand of higher oil and commodity prices; (ii) exchange-rate adjustments among the main international currencies; (iii) the uncertainty generated by steeper interest-rate hikes; (iv) difficult fiscal situations in many countries, and (v) the threat of global neo-protectionism associated, in particular, with reactions to the increase in Chinese exports. The current state of the world petroleum market suggests that prices will remain high. According to the conventional calculations, a US\$10-per-barrel increase causes world output to fall by half a percentage point and Latin American output to dip by 0.2 points. In 2005 the price of oil (West Texas Intermediate) averaged US\$56.4 per barrel and is projected to reach US\$60 in 2006.

With a tighter fiscal policy and the recent upward revisions in economic growth projections, the United States grew by 3.5 per cent in 2005 and is expected to grow in a range of 3.0 per cent and 3.4 per cent. At the end of March 2006, the US Federal Reserve increased its reference rate to 4.75%. The euro zone is projected to grow by 1.8–2.0 per cent in 2006 in comparison with 1.4 per cent in 2005. In Japan, due mainly to greater domestic consumption, expansion in exports and industrial production, the economy will grow at a rate close to 3 per cent in 2006. Thanks to China's present efforts to cool its economy, economic activity is expected to expand at a rate of 8.0 and 9.2 per cent in 2006. Even this somewhat lower growth rate in China will still be high enough to keep GDP growth in the developing countries above the world average, however.

Tariffs have tended to decline in importance as barriers to trade, but new measures such as technical regulations and conformity assessment procedures, sanitary and phytosanitary standards and requirements on transport and logistical security are now

having a growing impact and are starting to have a decisive impact on systemic competitiveness. In addition to low prices, systemic competitiveness is determined by such factors as adequate infrastructure, efficient transport systems, and streamlined customs procedures. Economic agents that are able to meet these new quality and safety standards are in a position to secure competitive advantages. Steps therefore need to be taken to strengthen the institutions involved in trade logistics, harmonise standards and regulations at the regional and multilateral levels, reduce regulatory burden, and improve capacity-building, especially for small and medium-sized exporters.

The agricultural sector is both the icon of industrialised economies' protectionism and the focus of recent victories won by developing countries protesting these distortions. One such example is provided by the favourable rulings won by Brazil from multilateral bodies in the cases it has brought against European sugar subsidies and United States cotton subsidies. The reports adopted by the WTO Dispute Settlement Body on subsidies and domestic support have backed up the developing countries' position on these matters and have upped the stakes of the Doha Round, since certain aspects of these issues could have been addressed in the negotiations had the WTO not already ruled them incompatible with its rules and therefore in need of adjustment.

China's role in Latin American trade has expanded during this decade, and bi-regional trade between the LAC region and Asia and the Pacific is increasingly shaped by the predominance of China. Japan was the region's biggest customer until recently, but China has now largely displaced it as the leading Asian buyer of Latin American products. The marked concentration of China's trade with LAC as a whole is notable for its dynamism (see Figure 6.1) and is gradually diversifying to include a broader range of countries and products.

For the South American countries, China – with its strong demand for the natural resources that abound in the subregion – represents the world's most populous and fastest-growing market. If Chinese demand for commodities and natural resources involving a low or intermediate degree of processing remains high, the South American countries can expect their exports and terms of trade to be reinforced for some time to come. China also offers investments, especially in infrastructure, energy and mining, where these funds could provide supplementary financing for the implementation of major works.

An interesting challenge in this regard is to identify the cases in which Chinese investment would be the most helpful in accelerating the implementation of infrastructure and energy projects. As well as strengthening investment and trade facilitation links with China and the Asia-Pacific region, this would generate externalities for the integration process itself. The region's trade with China suffers from the same constraint that limits all of its international trade activity, namely the high proportion of commodities and semi-processed goods in its export basket. The LAC region must make every effort to increase the degree of processing of its natural-resource-based exports and seek new Chinese markets for differentiated, higher value-added products. The current product mix, which is highly dependent on the business cycles of importing countries, does little to stabilise export earnings.

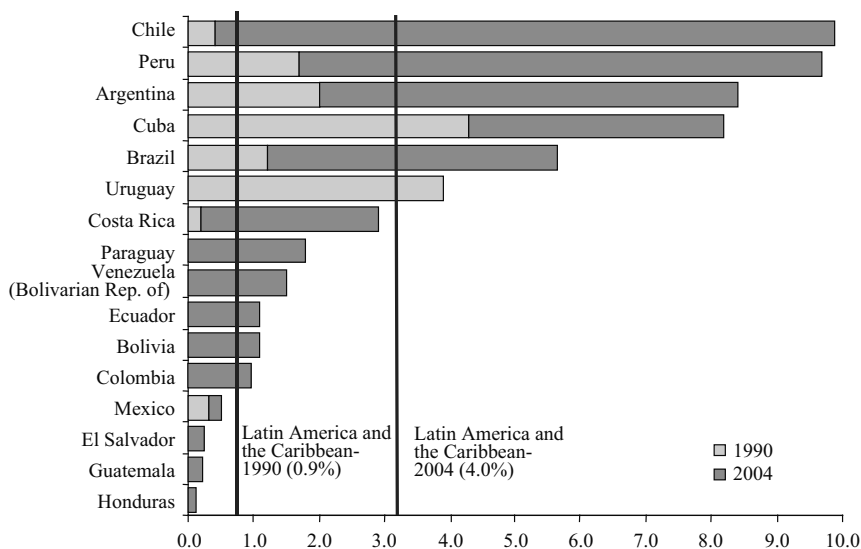


FIGURE 6.1. Latin America and the Caribbean: China's share of total exports, 1990 and 2004 [Exports to China as a percentage of total exports; *Source*: ECLAC (2005)].

China has come to represent 4 per cent of world GDP and is the sixth largest economy (or the second, measured by purchasing power) in the world. It has thus become a major player in world markets following its accession to WTO and the opening of its economy. From less than 2 per cent of total exports in 2000, China came to account for almost 6.5 per cent in 2004, ranking as the world's third largest exporter. It also ranks third in the world in imports, which expanded by 36 per cent in 2004.

China's exceptional contribution to this global recovery has been in the making for a number of years. Its strong economic growth has had a major impact on the rest of the world, since it has become a large consumer of raw materials, minerals, energy and, to some extent, foodstuffs and industrial products. China is the world's top consumer of coal, tin, zinc, copper and cereals and is one of the leading consumers of fertilizers; iron and steel; bananas; oilseeds and oils; plastics; electronic equipment; optical, photographic and medical equipment; and nuclear reactors and machinery. China accounts for at least 20 per cent of world consumption of 8 out of 16 selected products (see Table 6.1).

China is now a key trading partner for many of the region's countries, and the LAC region is China's main supplier of a number of very important mining and food products. Since China's manufacturing exports are less expensive, it has clearly been influential in the decline seen in the prices of steel, zinc, tin, toys, textiles and clothes, and electronics. This has added up to a net improvement in the terms of trade for South America, but to a lesser extent for Mexico and Central American countries.

TABLE 6.1. China: selected products having a strong influence on the world economy, 2004  
(Percentages of world totals)

Products	Production	Consumption	Imports	Exports	Consumption/ output ratio	Consumption ranking
Coal	41.1	38.6	–	13.7	93.8	1
Iron ore	22.8	36.2	27.6	–	158.6	1
Tin	37.1	27.6	–	13.5	40.4	1
Meat	27.2	27.1	3.1	3.5	99.8	1
Zinc	23.6	25.9	6.8	13.0	56.1	1
Steel	25.8	22.4	2.6	13.5	86.7	1
Aluminium	22.8	21.0	5.6	–	90.5	2
Lead	25.0	19.6	2.6	29.9	77.2	2
Copper	12.9	19.6	25.3	–	157.3	1
Cereals	18.3	18.8	7.1	2.7	102.5	1
Soybeans	8.6	16.8	34.3	0.4	165.6	2
Nickel	7.6	10.6	21.7	3.9	144.4	3
Bananas	9.0	9.7	3.0	0.4	106.0	3
Petroleum	4.3	8.3	7.1	0.8	191.5	2
Sugar	7.4	8.1	2.1	1.0	107.8	2
Natural gas	1.5	1.5	–	–	95.6	14

*Source:* Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Food and Agriculture Organisation of the United Nations (FAO), *The State of Agricultural Commodity Markets*, 2004, The Economist Intelligence Unit, *BP Statistical Review of World Energy*, June 2005 [online] <<http://www.bp.com/>>, Heren Energy Ltd., Secretariat of the Organisation of Petroleum Exporting Countries (OPEC), United Nations Conference on Trade and Development (UNCTAD), *Commodity Yearbook 2003*; *World Metal Statistics Yearbook*, 2005; *ISSB Monthly World I&S Review* [online] <<http://www.steelonthenet.com/production.html>> and International Iron and Steel Institute, *World Steel in Figures*, 2005.

The region's basket of exports to China has also changed significantly. It now includes a growing number of mid-level or high-technology manufactures, which could represent an avenue to the incorporation of higher-value-added products in the future. Both China and the LAC countries would benefit from cooperation to position the region's firms in Chinese value chains. Of course, FDI flows would have to increase substantially in both directions in order for this to happen.

In 2004, Chinese government authorities embarked on a particularly busy itinerary of South American visits. President Hu Jintao conducted State visits to Argentina, Brazil and Chile, as well as Cuba, and Chinese ministers and deputy ministers accompanied high-level business delegations to practically every South American country. During all of these tours, important commitments were made to strengthen economic and trade relations. The Presidents of Argentina, the Bolivarian Republic of Venezuela, Brazil, Colombia, Chile and Peru have also recently paid visits to Beijing, and many more ministerial and business visits have been paid by these and other countries to China in 2004–2006.

The events of 11 September 2001 in New York and the attacks of 11 March 2004 in Madrid, as well as other incidents of a similar nature, have prompted countries to adopt a series of measures to defend themselves against terrorist threats to food security and merchandise transport. The United States, for example, has passed the

Bioterrorism Act, which came into effect in mid-December 2003 and is intended to protect the security of the country's food supply.

In order to access these countries' markets, food shipments must comply with new legislation requiring them to provide a full account of the relevant production chain. The life history of a foodstuff is referred to as its "traceability" or "trackability" and provides certain assurances of food security, improves quality management and risk evaluation, boosts consumer confidence and permits the implementation of corrective measures in the event of quality or safety shortfalls. Firms that do not provide proper and timely information to a destination-market country seeking to track a product's entire production chain in the event of any suspicion of tampering may find the product barred from that market, impounded, returned or destroyed. Although these rules have been created in response to a justifiable demand for security, the exporting country faces the challenge of ensuring that they do not turn into market-entry barriers, especially for SMEs that may not have the capacity to meet the new requirements quickly.

The recent cycle of trade expansion has brought with it significant increases in maritime cargo and therefore in the total value of shipments, which began to rise all over the world in 2003. Several factors explain this situation. First, the huge surge in trade between China and the United States has drawn much of the storage capacity in container carriers onto this route, causing a severe shortage of ships on other routes (including Latin American and Caribbean ones) and generating an unprecedented degree of congestion in transport and port systems, especially on the west coast of the United States. In addition, cargo flows are clearly unbalanced. The rise in shipping costs has been further compounded by a steady increase in the price of fuel for cargo vessels. The downturn in shipping rates seen in the second quarter of 2005 may reflect either seasonal factors or the recent slowdown in economic growth in the United States and in growth projections for other Organisation for Economic Co-operation and Development (OECD) countries. These events, and the repercussions they have on infrastructure and transport security, have not only led to the adoption of more stringent international regulations (International Ship and Port Facility Security Code (ISPS), Bioterrorism Act, traceability, technical standards, sanitary and phytosanitary measures), but have also pushed up the costs of international trade. In mid-2005, a sample of 107 ports worldwide revealed that the average increase in security costs was US\$8.53 per container, with a mean incremental cost for the region that is much higher than the average and three times higher than the average in Australia and the United States, even though many countries in the region have not yet invested in electronic scanners to check container contents (see Figure 6.2).

### 6.3. INTEGRATION PROCESS AND INTRAREGIONAL TRADE

#### *6.3.1. Intraregional Trade Still Very Low*

Intraregional trade is still low compared to what is being seen in Asia and the European Union, for example. While in LAC this figure amounts to 17 per cent of exports, in

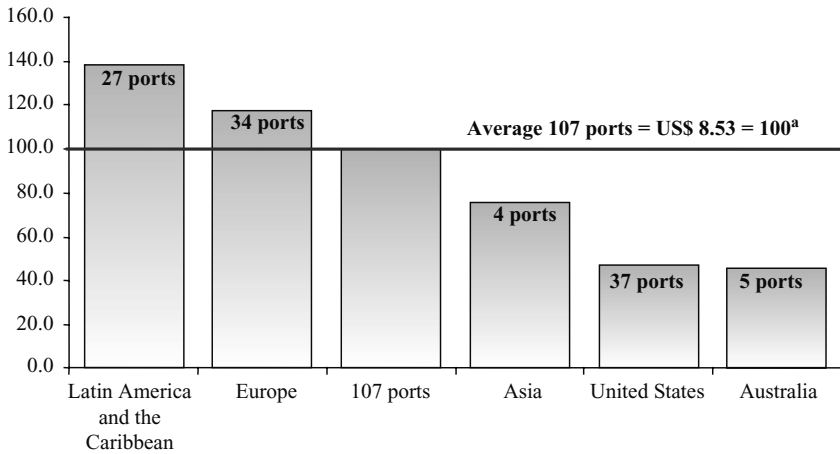


FIGURE 6.2. International charges for port protection, June 2005; *Source:* ECLAC (2005b), weighted average for trade to December 2004.

Asia it is just over a third of them, and it is nearly two-thirds in the European Union. There is a slowly rising trend in Asia, but in Latin America this trade is lower than it was a decade ago, which shows that intraregional trade has not managed to become an engine of growth. The CARICOM and CACM figures are much higher than the averages recorded in MERCOSUR and the Andean Community. The latter is the furthest behind in terms of the weight of its intraregional trade, as only 10 per cent of its exports go to the Community market; Peru and the Bolivarian Republic of Venezuela report even lower amounts (see Tables 6.2, 6.3 and 6.4). According to the figures for 2005, the greatest amount of intra-group trade is in CACM and the least in the Andean Community. Trade with the United States is more significant than intra-group trade in every case, and the same is true with respect to the European Union in every case except CACM. Intra-group trade in MERCOSUR and CARICOM is less than their trade with the United States, the European Union and Asia, respectively (see Table 6.3).

One prominent feature of this trade is the greater propensity to export manufactured goods within the subregions (see Table 6.4). This is particularly important in view of the fact that regional integration offers an attractive possibility to expand markets, scales of production, and the growth of higher quality, higher value-added exports, especially of knowledge-intensive goods. These markets can also provide an excellent opportunity to learn and gain experience in trade, as well as a launching pad to reach extraregional markets. Such export diversification, which makes it possible to export goods with a higher value added to the subregions, is especially important for the Andean Community and CARICOM. Given the low coefficients of intraregional trade, however, it is evident that this potential is far from being realised.

TABLE 6.2. Latin America and the Caribbean: total exports and exports by subregional integration scheme, 1990-2005  
(Millions of current dollars and percentages)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>d</sup>
<b>Andean community</b>																
Total exports (1)	31,751	28,583	28,100	29,683	33,706	39,134	44,375	46,609	38,896	44,603	60,709	53,543	52,177	54,716	74,140	94,751
Percentage of annual growth	25.7	-10	-1.7	5.6	13.6	16.1	13.4	5	-16.5	14.7	36.1	-11.8	-2.6	4.9	35.5	27.8
Exports to the Andean Community (2)	1312	1769	2118	2892	3752	4812	4762	5628	5504	3940	5167	5656	5227	4900	7361	9056
Percentage of annual growth	26.3	34.8	19.8	36.5	29.7	28.2	-1	18.2	-2.2	-28.4	31.1	9.5	-7.6	-6.3	50.2	23.0
Percentage of intra-Community exports (2:1)	4.1	6.2	7.5	9.7	11.1	12.3	10.7	12.1	14.2	8.8	8.5	10.6	10.0	9.0	10.5	9.6
<b>MERCOSUR</b>																
Total exports (1)	46,403	45,869	50,487	54,328	61,890	70,129	74,407	82,596	80,227	76,305	85,692	89,078	89,500	106,674	134,196	162,512
Percentage of annual growth	-0.3	-1.2	10.1	7.6	13.9	13.3	6.1	11	-2.9	-4.9	12.3	4	0.5	19.2	25.8	21.1
Exports to MERCOSUR (2)	4127	5101	7190	10,062	12,049	14,199	17,075	20,546	20,322	15,162	17,710	15,298	10,197	12,709	17,319	21,406
Percentage of annual growth	7.6	23.6	41	39.9	19.7	17.8	20.3	20.3	-1.1	-25.4	16.8	-13.6	-33.3	24.6	36.3	23.6
Percentage of intra-MERCOSUR exports (2:1)	8.9	11.1	14.2	18.5	19.5	20.2	22.9	24.9	25.3	19.9	20.7	17.2	11.4	11.9	12.9	13.2
<b>Central American Common Market (CACM)</b>																
Total exports (1)	3907	4352	4610	5126	5496	6777	7332	9275	11,077	11,633	11,512	10,185	10,171	11,288	12,467	14,163
Percentage of annual growth	9.2	11.4	5.9	11.2	7.2	23.3	8.2	26.5	19.4	5	-1	-11.5	-0.1	11.0	10.5	13.6
Exports to CACM (2)	624	812	1076	1138	1326	1594	1388	1559	1944	2010	2615	2829	2871	3077	3472	4064
Percentage of annual growth	89	30.1	32.5	5.8	16.5	20.2	-12.9	12.4	24.6	3.4	30.1	8.2	1.5	7.2	12.9	17.0
Percentage of intra-CACM exports (2:1)	160	18.7	23.3	22.2	24.1	23.5	18.9	16.8	17.5	17.3	22.7	27.8	28.2	27.3	27.9	28.7
<b>Caribbean Community (CARICOM)</b>																
Total exports (1)	4118	4034	3958	3779	4471	5598	5683	5861	4790	5170	6358	6072	5732	6712	7880	-
Percentage of annual growth	11.6	-2	-1.9	-4.5	18.3	25.2	1.5	3.1	-18.3	7.9	23	-4.5	-5.6	17.1	17.4	-

(Continued)

TABLE 6.2. (Continued)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005 <sup>d</sup>
Exports to CARICOM (2)	509	458	463	536	666	843	875	976	1031	1096	1230	1384	1220	1419	1810	-
Percentage of annual growth	2.9	-10.1	1.1	15.9	24.2	26.5	3.9	11.5	5.7	6.3	12.3	12.4	-11.8	16.3	27.5	-
Percentage of intra-CARICOM exports	12.4	11.3	11.7	14.2	14.9	15.1	15.4	16.7	21.5	21.2	19.4	22.8	21.3	21.1	23.0	-
(2:1)																
Latin America and the Caribbean																
Total exports <sup>b</sup> (1)	130,214	126,818	131,731	140,903	187,987	227,922	253,921	283,632	280,065	292,919	359,396	345,484	347,610	376,590	461,323	548,975
Percentage of annual growth	19.7	-2.6	3.9	7	33.4	21.2	11.4	11.7	-1.3	4.6	22.7	-3.9	0.6	8.3	22.5	20.0
Exports to Latin America and the Caribbean <sup>c</sup> (2)	18,727	20,788	24,931	29,669	36,552	45,180	53,156	59,731	56,644	48,483	62,552	58,607	53,424	59,635	79,484	100,016
Percentage of annual growth	8.2	11.0	19.9	19	23.2	23.6	17.7	12.4	-5.2	-14.4	29	-6.3	-8.8	10.8	33.3	25.8
Percentage of intraregional exports/Total (2:1)	13.9	16.4	18.9	21.1	19.4	19.8	20.9	21.1	20.2	16.6	17.4	17.0	15.4	15.8	17.2	18.2

Source: ECLAC (2005a).

a Figures do not include maquila industry.

b Includes Latin American Integration Association (LAI), CACM, all countries of CARICOM, Panama, Cuba and the Dominican Republic.

c Combines intra-group trade (Andean Community, MERCOSUR, CACM, CARICOM and exports from Chile and Mexico to LAIA) as well as trade between groups, plus the flow of exports from Cuba, Panama and the Dominican Republic to the other countries of the region.

d Preliminary figures.

TABLE 6.3. Structure of exports of principal subregional integration schemes in Latin America and the Caribbean, 2004 (Percentages of total exports)

	Intra-group	Other LAC countries <sup>a</sup>	United States	European Union	Asia (including Japan)	Other countries
MERCOSUR	12.9	15.4	18.3	23.0	15.7	14.8
Andean Community	10.4	16.8	46.6	11.0	9.6	5.6
Central American Common Market <sup>b</sup>	17.7	8.5	57.8	10.0	2.0	4.0
Caribbean Community <sup>c</sup>	17.1	3.9	51.7	14.5	3.1	9.7
4 Customs Unions <sup>d</sup>	12.7	14.8	32.1	17.7	12.1	10.7

Source: ECLAC (2005a).

<sup>a</sup> Latin America and the Caribbean.

<sup>b</sup> Totals used to calculate coefficient include maquila and free-zone exports.

<sup>c</sup> Includes information from five countries: Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

<sup>d</sup> Excluding Chile and Mexico.

TABLE 6.4. Structure of exports from main subregional integration schemes in Latin America and the Caribbean, 2004<sup>a</sup> (Percentages of total exports)

	Intra-group export coefficient within total exports		Exports (2004/2003) (growth rates: percentages)		Propensity to export manufactured goods <sup>b</sup> (percentages)	
	1998	2004	Intra-subregion	Extra-subregion	Intra-subregion	Extra-subregion
MERCOSUR	25.3	12.9	36.2	25.8	83.8	67.7
Andean Community	14.2	10.4	58.5	35.5	85.7	35.1
CACM	17.5	27.6	11.8	7.2	84.2	78.3
CARICOM	21.5	–	16	1.2	78.4	55.6
4 Customs Unions	21.3	12.9	36.4	31.2	84.1	57.2

Source: ECLAC (2005a).

<sup>a</sup> Preliminary figures.

<sup>b</sup> Refers to the coefficient of manufactured goods exports within total exports to different areas.

### 6.3.2. Intensity of Intra-regional Trade in South America

An examination of intraregional trade matrices reveals that CACM has consistently more intensive intra-bloc trade than any other subregional integration scheme, and that El Salvador is more committed than any other country to this trade, with 55 per cent of its exports oriented towards the subregion.

These coefficients should be viewed with caution. Indeed, the larger scale of big economies such as Brazil in MERCOSUR, the Bolivarian Republic of Venezuela in the Andean Community, and Trinidad and Tobago in CARICOM, as well as the greater specialisation in natural resources of the members of the subregional schemes, make the intraregional trade coefficient lower. In contrast, in other regions such as the EU,

intraregional trade coefficients are higher because of greater homogeneity, economic size, and a greater incidence of intra-industrial trade in patterns of production.

The size effect is most evident in the case of Brazil. The weight of trade within the subregion is slight, as less than 10 per cent of exports are oriented towards MERCOSUR, but these exports still account for half of the group's exports. At the other extreme are Paraguay and Uruguay, where between one-fourth and one-third of exports are sent to MERCOSUR, and together they represent less than 10 per cent of that bloc's exports (see Table 6.5).

In the case of the Andean Community, the intra-group trade coefficient within total exports is 10 per cent, after two years of consecutive reductions. The largest increase in this indicator was seen in Colombia, which in turn appears to be the country with the greatest export penetration in the subregion. Indeed, 41 per cent of exports within the Andean Community correspond to Colombia, while that country sends only one-fifth of its total exports to that market. Peru and the Bolivarian Republic of Venezuela are not very dependent on the Andean Community market, whereas Bolivia sends nearly one-fourth of its exports there (see Table 6.6).

The Central American Common Market is important for most of its members. With the exception of Costa Rica, it receives between 20 per cent and 56 per cent of its member countries' exports. This stands in contrast to the Andean Community, for example, where three out of five members send less than 12 per cent of their exports to the subregional market (see Table 6.7).

Among the countries of the North American Free Trade Agreement (NAFTA), imports to the subregion are especially significant for Canada and Mexico, whose exports are highly concentrated on the United States. The latter country, in turn, also sends a major share of its exports to Canada and Mexico, which are its main trading partners (see Table 6.8). The obvious increase in the weight of trade has translated into a mutual interest among the three countries in exploring the possibility of moving towards a single market.

#### 6.4. REGIONAL INTEGRATION: MAIN DEBATES AND CHALLENGES

##### *6.4.1. Strengthening Institutions*

The region urgently needs to address the shortcomings of its integration institutions. The first priority is to enforce agreements. This means that customs unions must function as such; that agreed-upon preferences must be honoured; that progress must be made towards improving trade regulations; and fundamentally, that dispute resolution mechanisms must be strengthened. There is no doubt that greater legal certainty must be provided for all decisions made by economic agents involved in the subregional integration schemes.

Customs unions are not yet fully operating – especially in the cases of MERCOSUR, the Andean Community and CARICOM, and to a lesser extent in CACM – so in practice these are “imperfect” customs unions. There are still “perforations” in the common external tariff (CET), both within schemes (in the form of lists of exceptions, special trade regimes including partial or total tariff exemptions, specific duties,

TABLE 6.5. Southern Common Market (MERCOSUR): Intra-subregional trade market share matrix, 2004 (Millions of dollars and percentages of total)

2004	Millions of dollars						Percentages				"Intra" coefficient <sup>a</sup>						
	Argentina		Brazil		Uruguay		MERCOSUR		Argentina			Brazil		Uruguay		MERCOSUR	
Argentina			5552	515	703	6770						32.1	3.0	4.1	39.1	19.9	
Brazil	7373			872	667	8912	42.6						5.0	3.9	51.5	9.4	
Paraguay	106	307			449	863	0.6	1.8						2.6	5.0	32.9	
Uruguay	226	487		59		771	1.3	2.8	0.3						4.5	26.5	
MERCOSUR	7705	6346		1445	1819	17,316	44.5	36.6	8.3	10.5	100.0					12.9	

Source: ECLAC (2005a).

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

TABLE 6.6. Andean Community: intra-subregional trade market share matrix, 2004 (Millions of dollars and percentages)

2004	Millions of dollars					Percentages					"Intra" coefficient <sup>a</sup>	
	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Rep. of)	Bolivia	Colombia	Ecuador	Peru	Venezuela (Bolivarian Rep. of)		
Bolivia	118	4	137	219	478							
Colombia	57	992	531	1583	3163	0.7	1.5	0.1	1.8	2.8	6.2	23.5
Ecuador	5	188	578	83	854	0.1	2.4	12.8	6.8	20.4	40.7	19.3
Peru	134	266	204	198	802	1.7	3.4	7.4	7.4	1.1	11.0	11.1
Venezuela (Bolivarian Rep. of)	4	1064	514	887	2469	0.1	13.7	2.6	2.6	2.6	10.3	6.5
Andean Community	200	1636	1715	2132	7766	2.6	21.1	22.1	27.5	26.8	100.0	10.4

Source: ECLAC (2005a).

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.



TABLE 6.8. North American Free Trade Agreement (NAFTA): Intra-subregional trade market share matrix, 2004  
(Millions of dollars and percentages)

2004	Millions of dollars			Percentages			"Intra" coefficient <sup>a</sup>
	United States		Mexico	United States		Mexico	
	Canada	NAFTA		Canada	NAFTA		
Canada	269,028	2261	271,289	37.2	0.3	37.5	85.9
United States	187,713	110,775	298,488	25.9	15.3	41.2	36.6
Mexico	10,359	143,474	153,833	1.4	19.8	21.3	86.7
NAFTA	198,072	412,502	723,610,	274	57	100.0	55.2

Source: ECLAC (2005a).

<sup>a</sup> The intraregional trade coefficient is defined as the share of all intra-group exports in the group's total exports.

and trade defence practices) and outside schemes (through special regimes such as capital goods, or through preferential trade agreements with third countries). All of this makes it very difficult for economic actors to know the real level of protection that is in place. Furthermore, the application of sometimes excessive trade defence practices (safeguards, antidumping and compensatory duties) for exports within the communities poses serious obstacles to free circulation within blocs.

#### *6.4.2. Convergence of Disciplines*

Once compliance with the agreed-upon regulations has been achieved, the natural next step is to expand the universe of partners committed to compliance. In that regard, one underestimated factor in regional competitiveness is the gain associated to a gradual convergence of the various rules and disciplines contemplated in the existing subregional integration schemes.

It is well known that the multiplicity of rules of origin and their extreme complexity can hinder the business sector by adding administrative and transaction costs that distort economic decisions. In this connection, an innovative feature in the Free Trade Treaty between the Dominican Republic, Central America and the United States (DR-CAFTA) is the possibility of “accumulating rules of origin” in some textile categories; in other words, inputs that qualify under the rules of origin can come from each of the five signatory States in Central America, from the Dominican Republic, or from Canada, Mexico or the United States. This is an appropriate approach that should be expanded to the greatest possible number to other agreements. Similarly, if MERCOSUR and the Andean Community are already joined by a trade agreement, and each Member State has an agreement with Chile, then a great effort should be made to regionalise the rules of origin, making them multilateral for all of the countries involved; and this would give a considerable boost to intraregional trade and investment decisions.

Moreover, the countries in the region that have trade agreements with the United States and that also have agreements among themselves could also move towards making their rules and disciplines more compatible with the objective of expanding their respective markets. Such a move clearly creates more trade, expand regional markets by improving interconnection between agreements and pushes towards the building blocks of liberalisation, reinforcing the compatibility of free trade agreements with multilateral regulations.

The regionalisation of rules of origin and the mutual recognition of technical, sanitary and phytosanitary regulations, together with common rules and disciplines between agreements, would send a strong signal of substantial progress towards the formation of a unified market, not only stimulating domestic investment but also enhancing the attractiveness of the region for foreign investment. It would also create special opportunities for local producers, encourage businesses in the subregions to form associations and, above all, contribute to the development of border areas. These processes would facilitate the learning process that businesses must undergo, forging strategic alliances to maintain and reinforce competitiveness.

TABLE 6.9. Subregional integration schemes: comparison of selected macroeconomic convergence indicators, 2002 and 2004

Country	Indicator		Inflation		Current-account deficit (% of GDP)		Public deficit (% of GDP)		Public debt (% of GDP)	
	2002	2004	2002	2004	2002	2004	2002	2004	2002	2004
Targets	5% in 2006		-		-3% of PIB		40% in 2010			
Southern Common Market (MERCOSUR) <sup>a</sup>										
Argentina	17.8	6.8	0.4	2.1	1.9	-0.7	64.6	56.4		
Brazil	41.0	5.4	9.4	2.5	-0.3	1.3	131.5	105.0		
Paraguay	12.5	7.2	-1.7	1.9	2.6	-1.2	49.4	42.7		
Uruguay	14.6	2.1	1.4	-3.4	-0.4	0.7	51.2	34.8		
Targets	10% each country		-		-4% of GDP		50% of GDP			
Andean Community <sup>a</sup>										
Bolivia	10.0	9.9	1.3	5.6	-3.6	-3.4	45.7	45.3		
Colombia	4.9	4.9	-4.5	2.7	-9.0	-6.1	55.1	58.0		
Ecuador	5.8	5.8	-1.8	-1.4	-5.0	-5.6	46.3	47.4		
Peru	2.0	2.0	-5.6	0.4	-0.8	-1.7	66.8	59.1		
Venezuela (Bolivarian Rep. of)	4.1	4.1	-2.0	0.0	-2.1	-1.3	49.3	47.4		
Targets	4% each country		-3.5% of GDP		-2.5% of GDP		50% of GDP			
Central American Common Market (CACM) <sup>a</sup>										
Costa Rica	6.5	9.0	-5.6	-5.9	-2.9	-2.4	5.1	52.6		
El Salvador	9.7	13.8	-5.4	-4.7	-4.3	-3.0	56.0	96.0		
Guatemala	2.8	5.3	-2.9	-4.6	-3.1	-1.6	46.0	47.0		
Honduras	6.3	8.0	-5.3	-4.1	-1.0	-2.0	28.0	27.0		
Nicaragua	8.1	8.4	-3.3	-6.6	-5.2	-3.4	67.8	69.0		
3 groups <sup>a</sup>	4.0	9.0	-21.7	-17.5	-4.1	-3.7	155.0	120.0		
	14.7	7.8	0.2	2.5	0.0	-1.6	58.1	53.5		

Source: ECLAC, (2005a).

<sup>a</sup> Averages weighted by each country's GDP.

If the main economic actors believe that one of the main weaknesses of integration schemes is legal uncertainty surrounding the decisions made by exporters, importers and investors, it is likely that, in this regard, the most profitable investment is an investment in credibility. Hence the need to strengthen rules and disciplines, including dispute settlement mechanisms.

#### *6.4.3. Macroeconomic Coordination*

The essence of the discussion lies in whether macroeconomic coordination is necessary as a complement to trade integration. The answer is not entirely obvious during the current phases of subregional integration, although in the medium and long terms it is unequivocally in the affirmative. Among the various positions that have been taken are, at one extreme, those promoting close coordination, including convergence in a monetary union with the dollar as the common currency, or convergence on the basis of flotation; and at the other extreme, those claiming that coordination is not necessary because the critical mass of trade does not exist, nor is there any monetary authority or central bank with the reputation necessary to provide leadership in the process. In the middle are those who recognise the difficulties pointed out and propose a “minimum” degree of cooperation in the coordination of macroeconomic policy. The idea is to coordinate both fiscal and monetary policies by strengthening national fiscal, monetary and regulatory institutions. In addition, quantifiable goals are proposed with respect to fiscal balances, inflation, current account deficit, public debt and other indicators, as well as mechanisms to offset the effects of abrupt changes in trade flows due to external disturbances. All of this would be accompanied by a system of incentives to encourage compliance with the agreed-upon coordination with a view to stimulating demand through coordination. At present, the countries of MERCOSUR have achieved convergence with respect to the growth cycle, currency flotation schemes, fiscal results, the application of anti-inflation policies, and a significant reduction of debt as a percentage of GDP, especially in Brazil and Uruguay (see Table 6.9). In the Central American Common Market and the Andean Community, the extreme cases of Nicaragua and the Bolivarian Republic of Venezuela have raised the averages.<sup>1</sup> Nevertheless, the figures reflect a noteworthy period in the region’s macroeconomic accounts, with significant progress in controlling inflation and budget deficits. The favourable external cycle in 2004–2005 explains much of this success, but officials have failed to take advantage of the positive circumstances to move forward on macroeconomic coordination schemes that would cushion the impact of future external shocks or prevent the subregions themselves from generating macroeconomic turbulence.

### 6.5. REGIONAL INTEGRATION IN LATIN AMERICA: RECENT TRENDS

#### *6.5.1. MERCOSUR*

MERCOSUR has been expanding its role as a means for political synchronisation and coordination in South America, among the Member States, with associated countries

and with Mexico, which has expressed an interest in associating itself with this sub-regional integration scheme. The trade agreement between MERCOSUR and the Andean Community and the political dialogue of the South American Community of Nations are manifestations of this trend. The recent association with Colombia, Ecuador and the Bolivarian Republic of Venezuela, prior agreements to associate with Peru, Bolivia and Chile, and Mexico's interest in associating with MERCOSUR, all reveal an unprecedented constellation of convergences between MERCOSUR, Chile, the Andean countries and Mexico. In this new situation, with the addition of Mexico, MERCOSUR will have six associate members and four full members. After Mexico joins, the associate countries' GDPs will be 40 per cent higher than those of full members and will account for 58 per cent of the expanded GDP, while their total exports will be 2.2 times those of the full members. MERCOSUR's growing importance as a political forum does not, therefore, assure it of corresponding economic and commercial influence. In fact, MERCOSUR's greater political relevance has been accompanied by an unprecedented amount of criticism – at the highest level – of its performance as a customs union.

This subregional entity is currently facing a test of its credibility and objectives. Its founding protocol, signed in Ouro Preto in 1994, defines it as a customs union, which assumes free trade within the zone, a common external tariff and a common external trade policy. Eleven years later, that objective is far from being attained, and the prospects for the future are complex. There are still too many tariff exceptions: with respect to both the intra-zone zero tariff and the common external tariff, advances in technical and tariff harmonisation have been smaller than expected. Moreover, since the late 1990s new exceptional treatment plans have been introduced – sometimes by consensus, sometimes unilaterally – that undermine these principles. Trade preferences that were negotiated have been undermined by unilateral decisions using measures not always consistent with the rules agreed upon by the Member States. In turn, regulations approved by the members have not been translated into domestic legislation, which widens the gap between trade community standards rules and public policies actually adopted by the nations within the community, further complicating the future convergence of public policies. Inconsistencies cause delays in strategic decision-making, and eventually hinder domestic consensus-building, thereby creating additional difficulties for convergence in integration processes, which paves the way for future non-compliance with community rules. This is why the recognition of differences in MERCOSUR today is so critical for the future of the community.

The relatively smaller countries have renewed their complaints that they do not have effective access to the larger markets, which makes it hard for them to attract investments that would come with access to a broader market. There are also allegations of non-compliance with a common investment policy promoting the coordination of production in MERCOSUR and creating competitive advantages for exports to other markets. Another complaint is that larger countries are still subsidising investment, making it even more difficult for smaller economies to attract investment. And finally, the failure to make progress on macroeconomic coordination also costs these economies dearly, as they have absorbed without any compensation the effects of the

larger economies' macroeconomic crises. In other words, not only are the size asymmetries among the MERCOSUR partners not being addressed adequately, but they are also being aggravated by the lack of macroeconomic coordination between the larger economies and by the persistence of tax incentives for investment and export promotion in these economies, which distorts relative competitiveness. Lastly, there are allegations of a failure to meet the timetable of commitments under the Asunción Treaty to undertake trade negotiations for services, investment, public procurement, macroeconomic coordination and integration of production chains.

### *6.5.2. Andean Community of Nations*

The Andean Community Commission, at a meeting in March 2005, adopted a working plan designed to expand the integration of trade, with the following elements:

- allow the free circulation of goods and services, basically by detecting and removing barriers to access; regulating Andean Community safeguards; simplifying and harmonising customs procedures; harmonising technical, sanitary and phytosanitary standards; establishing automatic recognition practices; and eliminating measures that have no technical support, along with liberalising professional services;
- promote a customs union, adopting a CET and agreeing on a farm price stabilisation system;
- reinforce the dispute resolution system, incorporating arbitration between private parties and improving the enforcement provisions of rulings;
- establish a joint investment and production development plan, especially with respect to energy and agroindustry, moving towards a system of guarantees for SMEs; and
- foster special support programmes for Bolivia and Ecuador, ensuring that the Andean Community process yields balanced benefits and addresses the most obvious asymmetries.

A special issue for this community organisation is the fact that three of its members (Colombia, Ecuador and Peru) have concluded or are engaged in free trade negotiations with the United States. This agreement will result in commitments that are considerably broader and deeper than those the Member States have with each other. In other words, in the coming years, barring decisive action to update the Andean Community regulations governing goods, services, investments and trade disciplines, integration may take place on two levels, with the community level being the less intense. Needless to say, if this duality grows, the business climate will gradually turn towards the schemes with more far-reaching provisions and more binding dispute resolution settlement mechanisms. In this regard, these negotiations offer the Andean Community a great opportunity to update its procedures, something that the annotated working plan calls for. This plan is certainly the minimum necessary to move in the right direction, and the pace will have to quicken if this effort is to keep up with the new commitments.<sup>2</sup>

On 1 January 2005, the Andean Community-MERCOSUR and Peru-MERCOSUR free trade agreements took effect, immediately freeing up 80 per cent of the trade between the two blocs. The remaining 20 per cent, including sensitive products, will be freed over the next 14 years.

*6.5.3. Free Trade Agreement between Central America, the Dominican Republic and the United States (DR-CAFTA): a Noteworthy Accord*

Trade with the United States is the most important for the Central American subregion, and since 2000 it has been governed by the Caribbean Basin–United States Trade Partnership Act, due to expire in 2008. The negotiations for a free trade agreement began in January 2003 as part of a regional objective of increasing exports to the United States market and also attracting investment in the subregion. It is estimated that, on average, the treaty could boost growth in the subregion by between 0.5 and 1 per cent of GDP and create between 20,000 and 25,000 jobs, as well as starting a downward trend in poverty.

Studies show that advances in customs cooperation among CACM countries have yielded an average gain of at least 0.5 per cent of GDP. The treaty with the United States and the Dominican Republic (DR-CAFTA) opens up the possibility of expanding the range of tariff preferences for Central American businesses by about 60 per cent of overall trade, and it could boost subregional GDP by 0.8–2.3 per cent, with an increase in total exports of 1.6–5.2 per cent. Nevertheless, the two main effects of this type of agreement must be taken into consideration: (i) regulatory consequences and (ii) the possible diversion of intraregional trade due to competition between subregional products and those coming from the United States.

The commitments made under DR-CAFTA differ in coverage and content from those of CACM (see Table 6.10 and 6.11). In practice, the commitments undertaken by these countries vis-à-vis the United States are different in magnitude and content from those prevailing in CACM.

In general, North–South bilateral agreements allow access to a broader and more stable market and lead to an increase in worldwide trade flows. In addition, a strong signal is sent to investors and business sector, since the agreements tend to be seen as an irreversible process with a major component of transparency and greater legal certainty. This results in positive externalities for the design of the signatory country's economic policy. There may also be incidents of trade diversion within regional integration accords.

Diversion of trade in CACM would basically affect chemicals, agroindustrial products, the paper industry, food and fertilizer, and the plastics industry, which will pose a challenge for non-competitive sectors to restructure their industrial complexes, especially some SMEs. This should be viewed in the context of the expected increase in investment as the market expands and rules become more stable.

The fiscal impact should also be considered. The elimination of tariffs entails a decline in tax revenues, which is expected to be major in Honduras (nearly 5 per cent of revenues), less significant in Costa Rica and Nicaragua (less than 2 per cent) and

TABLE 6.10. Central American Common Market (CACM): Principle topics covered in bilateral accords signed by the subregion and comparison with current community regulations

	Elimination of tariff escalation	Rules of origin	Trade in services	Investment	Technical barriers	Normalization	Public procurement	Safeguards, antidumping	Competition policy	Intellectual property	Dispute resolution
Central American Common Market (CACM)	✓	-	✓	✓ <sup>a</sup>	-	✓	✓ <sup>b</sup>	✓	-	✓	✓
DR-CAFTA <sup>c</sup>	✓	✓	✓	✓	✓	-	✓	✓	-	✓	✓
CACM-Chile	✓	✓	✓	✓ <sup>d</sup>	✓	✓	-	✓	✓	-	✓
CACM-Dominican Republic	✓	✓	✓	✓	✓	-	✓	✓	✓	✓	✓
CACM-Panama	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Costa Rica-Mexico	✓	✓	✓	✓	-	✓	✓	✓	-	✓	✓
Mexico-Nicaragua	✓	✓	✓	✓	✓	✓	✓	✓	-	✓	✓
Mexico-Northern Triangle <sup>e</sup>	✓	✓	✓	✓	-	✓	-	✓	-	-	✓

Source: ECLAC (2005b).

<sup>a</sup> With subregional regulations ratified only by Honduras.

<sup>b</sup> With community regulations pending ratification by Honduras.

<sup>c</sup> Free trade agreement between Central America, the Dominican Republic and the United States.

<sup>d</sup> Includes all investment protection and promotion agreements signed by Chile with the countries of the group.

<sup>e</sup> Comprises El Salvador, Guatemala and Honduras.

TABLE 6.11. Central American Common Market (CACM): Competition in the intra-subregional market after the signing of DR-CAFTA: possible diversion of intra-subregional trade (Percentage changes in exports from base year = 1997)

Destination	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	United States	Mexico	Rest of the world	World <sup>b</sup>
Origin									
Costa Rica <sup>a</sup>		-0.17	-0.17	2.47	-0.46	0.39	0.49	2.16	1.56
El Salvador <sup>b</sup>	-0.48		0.31	-0.12	0.37	3.62		4.17	3.55
Guatemala <sup>a</sup>	-0.28	-1.67		-0.15	-1.84	2.73	1.71	2.29	5.24
Honduras <sup>a</sup>	1.26	-0.23	-0.26		-0.52	0.44	0.44	3.18	1.72
Nicaragua <sup>b</sup>	-0.76	-0.63	-0.58	-1.14		2.01	6.54	2.36	2.6
Mexico <sup>b</sup>	7.73	-0.71	-0.50	-1.83	0.59	3.61		19.56	7.27
United States <sup>b</sup>	7.56	11.28	12.01	2.58	16.53		3.51	-0.14	0.37

Source: ECLAC (2005a).

<sup>a</sup> Results of a Computable General Equilibrium (CGE) model that includes static effects.

<sup>b</sup> Results of a CGE model that includes dynamic effects and complete mobility of labour (migration).

much smaller in Guatemala and Nicaragua (under 0.5 per cent of total tax revenues). As for GDP, Honduras will again suffer the greatest losses (between 0.82 and 1.59 per cent of GDP).

#### 6.5.4. *Caribbean Community (CARICOM)*

The Caribbean Community has stepped up its integration efforts with a view to implementing the CARICOM Single Market and Economy (CSME). The main features of the treaty are the free movement of goods and services, capital and labour; the harmonisation of laws and regulations affecting trade, including customs procedures; intellectual property, competition policy, taxes, dumping legislation and subsidies.

When fully formed, CSME would encompass a market of 6.4 million inhabitants with an estimated GDP of US\$39 billion and a labour force of nearly 3 million people. This small regional market includes economies with major asymmetries, four of them with external sales principally of goods. In the case of Trinidad and Tobago, the sales are of natural gas and petroleum, in that order, along with products of the related petrochemicals industry. Guyana and Suriname export mining products (bauxite and gold) and agricultural goods. The fourth one, Belize, has already expressed a considerable interest in tourism.

Despite significant progress in the execution of the CSME protocols, the integration scheme is only that of an imperfect customs union. The final phase of the common external tariff has not yet been implemented uniformly in all countries. There are also still major disparities in the average tariffs (either simple or weighted) that have actually been imposed, primarily due to the magnitude of tariff exemptions for imports. In some cases, especially in the smallest economies, these amount to 5 or 6 per cent of GDP. In addition to exemptions, non-tariff duties are still common, even for products traded within the region. Non-tariff levies include excise taxes, customs surcharges, taxes on foreign currency transactions, environmental fees and special taxes. The Caribbean countries are also facing an external situation characterised by the gradual elimination of preferences and even special and differentiated treatment, as evidenced by the Cotonou Agreement and paragraph 43 of the Ministerial Declaration of Doha. In fact, the Caribbean countries see CSME as the establishment of a common front to respond jointly to the liberalisation of trade in the external context.

The countries' authorities have announced that CSME should be functioning fully by 2008, which coincides with the elimination of extra-regional trade preferences. The CARICOM Heads of State have also decided that the improvement of intraregional trade in goods and services and of the customs union should be the first step in forming CSME.

The negotiations between the countries that make up the Caribbean Forum (CARIFORUM) and the European Union with a view to signing an association agreement were launched in April 2004 in Kingston, Jamaica. It has been agreed that the association instrument should facilitate sustainable development, the structural transformation of the Caribbean economies and the regional integration process, including special and differentiated treatment. The basic difference of

opinion lies in the number of products to be covered by the agreement. Europe advocates 90 per cent coverage, while the CARIFORUM countries want a much smaller percentage.

Finally, CARICOM is also considering the possibility of negotiating a free trade agreement with the United States, a decision that is certainly not without difficulties and costs. Both the stagnation of FTAA talks and the progress of other bilateral negotiations with the United States are influencing the decision, as is the fact that the latter country (along with Europe) is the primary source of tourism and investment flows in CARICOM.

## 6.6. CONCLUSIONS

The multiplicity of levels at which negotiations are taking place and the large number of decisions that must be adopted at those different levels require a clear internal consensus regarding priorities, improve trade policy-making and consistency that must be maintained among the various domestic public policies that come into play in the international sphere. Improving policy mix: more and more bilateral trade agreements are being negotiated at the same time with partners both inside and outside the region, making it necessary to reinforce consistency among trade policies at different levels: multilateral, hemispheric, subregional, bilateral and unilateral.

Intraregional trade is low in all subregional integration schemes. This may be caused by multiple factors, such as infrastructure deficiencies, size of partners' economies with relation to that of the bloc, and heavily commodity-oriented exports (commodities are exported primarily to industrialised economies), as well as other reasons. Among the most decisive factors are probably the weakness of trade disciplines and the institutional framework within which integration efforts are taking place, including dispute settlement mechanisms, and the absence of mechanisms for macroeconomic coordination that would help manage major macroeconomic shocks.

The main issue to address in subregional integration schemes is legal certainty for the decisions of exporters, importers and investors. This means that steady progress must be made on incorporating trade disciplines into domestic legislation and on the enforcement of these. Regarding the later, dispute resolution settlement mechanisms must be increasingly binding, which demands a serious political commitment on the part of member countries.

The Latin American region urgently needs to address the shortcomings of its integration institutions and convergence of trade rules to enhance interconnection among bilateral/regional trade agreements. The first priority is to enforce agreements. There is no doubt that greater legal certainty must be provided for all decisions made by economic agents involved in the subregional integration schemes. Second, improved rules and disciplines that governed trade among countries; and third, promote convergence among trade disciplines in order to improve their quality and promote further trade.

## NOTES

- <sup>1</sup> The General Secretariat of the Andean Community in March 2004 prepared a Follow-Up Report that reviews the situation in each Member State. The results for 2003 and 2004 indicate that the Bolivarian Republic of Venezuela, with an inflation rate of 19.2 per cent, still cannot meet the target of 10 per cent, while Bolivia still has a public deficit higher than the target of 4 per cent of GDP. Its debt level of nearly 80 per cent also exceeds the established threshold (50 per cent).
- <sup>2</sup> For example, in the Free Trade Agreement with the United States, the three above-mentioned Andean nations will have to grant national treatment to investments and services from the United States, and will have to do the same in public procurement. Such treatment is clearly superior to that accorded by the Andean Community members in the same areas.

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## CHAPTER 7

## REGIONAL ECONOMIC INTEGRATION IN AFRICA

## 7.1. INTRODUCTION

Economic integration in Africa has a long and chequered history dating back to the turn of the last century in some instances. The two oldest regional groupings in Africa are the East African Community (EAC) and the South African Customs Union (SACU). During the British colonial rule, Kenya and Uganda were brought under a customs union in 1900, later to be joined by the then Tanganyika (now Tanzania) in 1922. The South African Customs Union, which was formed in 1910, is arguably one of the oldest customs unions in the world. The West African Economic and Monetary Union (UEMOA) and the Central African Monetary and Economic Community (CEMAC) owe their origin to the earlier establishment of the CFA common monetary zone by France after the Second World War. In the pre-independence period, these economic groups were primarily designed to serve the economic interest of the coloniser more than the welfare of the colonised, but the benefit of the cumulative experience cannot be denied.

Over the last 40 years, from the post-independence period in the later part of the 1950s to the inception of the African Economic Community (AEC) in 1991, the imperative of African economic integration can be attributed to the dynamics of several factors. Early on, the founding fathers of political independence made continental economic integration a cornerstone of the developmental agenda of the continent. The leadership of the continent realises that economic synergy could be derived from economic integration, as the economies of most African countries were very small and under-developed to attain sustainable development on their own. Furthermore the economic advantage of a whole regional community is greater than the sum of the economic advantage of its separate member states.

The creation of regional economic groupings in Africa is also fuelled by the changing nature of the global economy. Borderless globalisation, fast-paced digital age advances in information and communication technology and the WTO have forced the creation of regional economic blocs in various part of the world to help member countries to respond collectively to global economic challenges as well as achieve potential economic growth. Economic integration of the continent has therefore become a major priority of governments and the people of many African countries.

7.2. THE BUILDING BLOCKS FOR AN AFRICAN ECONOMIC  
COMMUNITY (ABUJA TREATY)

Cognisance of the slow pace of a continent-wide integration, African heads of state at a Summit in 1991, in Abuja, Nigeria, laid down a timetable for the full economic

integration of every square millimetre of the continent. Under the framework of the Abuja Treaty, Africa would become an economic union by 2027, with a common currency, full mobility of the factors of production and free trade among the 53 countries that make up the continent. To achieve this vision, the Treaty suggests that the process of integration, or the creation of Africa Economic Community (AEC) be carried out over a period of 34 years (1994–2027), in six different stages of different duration.

The first three stages of integration are expected to take over 23 years (1994–2016). In this period, the Treaty calls for the establishment of *free trade areas and custom unions* at the regional level. The first stage, which covers 1994–1999, calls the strengthening of existing RECs and if necessary new ones created. Although not explicitly stated in the Treaty, the strengthening of the RECs could include mergers and consolidations provided these actions leads to convergent integration.

The second stage (1999–2007) requires three plans of action. First, member states, through the RECs, are asked to stabilise existing tariff and non-tariff barriers, customs duties and internal taxes. Studies are suggested to be undertaken which would inform the RECs on a timetable for the gradual removal of barriers to intra-trade and the introduction of common external tariffs. Second, member states would have to work towards the strengthening of sectoral integration at the regional and continental levels in areas such as trade, agriculture, transport, money and finance. Third, the activities of RECs are to be coordinated and harmonised.

The third stage, which should take not more than 10 years (2007 to 2016), calls for the creation of free trade areas and customs unions at the level of the RECs. At this stage, member countries would gradually eliminate internal tariffs and non-tariffs on intra-community trade and also adopt common external tariffs with third states.

Stage four (2017–2018) builds on the first three stages. This stage concentrates on the coordination and harmonisation of tariff and non-tariff barriers among RECs. Africa would at this point be a customs union, with a common external tariff. Although the Treaty does not spell out, the fourth phase sets the stage for a free trade area and a customs union at the AEC level.

An African Common Market is to be established at the fifth stage (2019–2022). The *common market* would be established through: (1) the adoption of a common policy for all sectors of the economy, (2) a continent-wide harmonisation of monetary, financial and fiscal policies and, (3) the free mobility of factors (capital and labour) of production, including the rights of residence and establishment.

The sixth and final stage of the Treaty would see the establishment of the *African Economic Community (AEC)*. This phase, which should not last more than 5 years, would begin in 2023 and end in 2027. The creation of AEC would start with the consolidation and strengthening of the African Common Market. Citizens of the continent, at this stage, would be free to reside in any part of the continent. In addition, there will be a single domestic market and no restrictions placed on the movement of capital, goods and services, as all sectors of the continent become fully integrated. All these factors would culminate in the creation of a Pan-African Economic and Monetary Union with a single currency for the continent. A common African central

bank would be created to manage and preserve the value of the single currency and conduct a monetary policy for the entire continent. The final plan of action at this phase is the establishment of a Pan-African Parliament, with members elected through continental universal suffrage.

### 7.3. THE IMPLICATION OF THE ABUJA TREATY FOR TRADE LIBERALISATION IN AFRICA

The *promotion of trade between African countries* is the basic tenant of the Abuja Treaty. Member States are required to make greater use of goods – both intermediate and finished – that originate from the continent, and to promote and diversify the markets for manufactured goods within the Community.

The Abuja Treaty provides the gradual reduction of *tariffs and non-tariff barriers*. The Treaty call on African countries to establish customs union through the elimination of customs duties, the establishment of a common external tariff, removal of non-tariff barriers, as well as administrative and other non-tariff barriers. The Treaty also prohibits the levying of customs duties after the end of the third period, not only on goods originating from a member State and imported into another member State, but also goods imported from third parties. In addition, the Treaty provides for the gradual abolition of internal taxes designed to protect domestic production. It also prohibits any national legislation tending to put in place restrictive measures against goods originating in the sub-region through the direct or indirect application of taxes. There are however exemptions, particularly in regard to the protection of persons, firms and public morality. Exemptions also apply in situations where strict adherence to trade liberalisation would entail balance of payments problems.

The Treaty also has provision for the definition of *rules of origin* for the free movement of goods within the Community. The basic condition is that the goods are considered to originate from a given country or group of countries when they are produced entirely within the Community or are partially derived from inputs originating in a third country (the degree of derivation being at least 35 per cent of local value-added or at least 60 per cent of inputs coming from elsewhere). Production in an assembly line from inputs wholly imported from third countries is not considered as originating from the Community.

The Treaty seeks to promote the free movements of African by calling on member States to espouse the principle of free movement of persons, right of residency and right of establishment, which are considered to be of primary importance to the trade liberalisation process.

Since the proclamation of the Treaty, the regional economic communities have put in place a number of liberalisation schemes. The common objective of these schemes is to establish a free trade area in each REC, followed by a customs union and eventually by a common market and an economic union. The implementation strategy for this objective comprises plans aimed at stabilising and gradually eliminating tariff and non-tariff barriers, adopting a common external tariff in regard to trade relations

with third countries, harmonising macroeconomic policies and promoting the free movement of all factors of production.

#### 7.4. PROGRESS MADE BY THE REGIONAL INTEGRATION GROUPINGS IN AFRICA

The creation of regional economic communities (RECs) in Africa dates back to the beginning of the 1900 with the creation of the South Africa Customs Union (SACU) and East African Community (EAC). The French, at the end of the Second World War, also created the monetary zones of the Economic and Monetary Union of West African States (UEMOA) and the Economic and Monetary Union of East Africa (CEMAC) in 1945. In the era of pre-independent Sub-Sahara Africa, these RECs were constituted as vehicles for the smooth running of the colonies. In post-independence, particularly in the last 30 years, we have witnessed the establishment of a number of RECs in various sub-regions of Africa. To date, the number of regional economic groupings in Africa stands at 14 with overlapping and duplicating mandates and functions.

Under the framework of the Abuja Treaty, The African Economic Community is to be built on the regional economic communities. Hence the current status of the RECs should serve as the barometer needed to gauge where the continent is from achieving its aim of full economic integration. In the next section a brief backgrounds of the regional economic groupings on the continent are briefly reviewed with a focus on their integration programmes, particularly in areas of trade and infrastructure.

##### 7.4.1. Arab Maghreb Union (UMA)

*L'Union du Maghreb Arabe* (UMA) or the Arab Maghreb Union was created in 1989, under the Marrakech Treaty. The member countries of UMA are: Algeria, Libya, Mauritania, Morocco and Tunisia, with a secretariat based in Rabat, Morocco. The cardinal objective of the organisation is the pursuit of a common market for the region, through the free mobility of goods and services and factors of production (capital and labour).

UMA's strategy of attaining regional economic integration is set in four stages: (1) the elimination of all tariff and non-tariff barriers to intra-regional trade in goods and services, through the creation of a free trade zone in the region; (2) the establishment of a customs union with a common external tariff against trade with the rest of the world; (3) the creation of a common market, by allowing for the free mobility of goods, services, capital and labour and; (4) an eventual transformation of the whole region into an economic union. In pursuit of its objectives, UMA, in 1991, adopted an agreement on trade and tariffs which were supplemented by four protocols covering the rules of origin, trade liberalisation, provisions for safeguards and the list of products sheltered under non-tariff barriers. Under the protocol on the rules of origin, a customs duty of 17.5 per cent is to be levied on goods manufactured with imported inputs. Despite UMA's numerous proclamations it is only those on trade in agricultural products, surface passenger transport, goods and transit, investment

transit and guarantees, prevention of double taxes and unified bilateral payment that have been implemented.

For reasons of geography and access through the Mediterranean, UMA member countries' major trading partners are the Europeans. As a result, UMA is a vital part of a plan to establish a Euro-Mediterranean free trade area by 2010, beginning with free trade arrangements with individual countries surrounding the Mediterranean. Next is the creation of a broader free trade area for the economies of the whole Mediterranean region. The process of integration is to be pursued through the Mediterranean Development Assistance Programme (MEDA) provided by the EU. UMA, as integral part of the Arab League, is also involved in the creation of an Arab free trade area by 2009.

#### *7.4.2. Common Market for Eastern and Southern Africa (COMESA)*

The Preferential Trade Area for Eastern and Southern African (PTA) was constituted in 1981, and reconstituted as the Common Market for Eastern and Southern Africa (COMESA) in 1994. The 24 member countries of COMESA are: Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe. Among its other objectives COMESA aims at achieving a free trade zone, customs union and a common market spanning the economies of the member countries.

The process of creating a free trade area by COMESA started in 1984 when the then PTA laid down a timetable for the complete elimination of tariffs on selected commodities by 1992. Due to the adverse impact on the revenue of some the member countries, the tariff elimination timetable was extended to 2000. The extension was accompanied by an increase in the scope of goods, covering all products meeting the five criteria stipulated under the protocol on the rules of origin.<sup>1</sup>

In 31 October 2000 COMESA formally launched its Free Trade Area (FTA). The FTA was launched with an immediate removal of tariffs and restrictive quotas by nine of its member countries: Djibouti, Egypt, Kenya, Madagascar, Malawi, Mauritius, Sudan, Zambia and Zimbabwe. Burundi, Rwanda and Swaziland declared, at the Eighth Summit of COMESA held in Khartoum in 2003, to join the FTA. The remaining member countries have in place policies that range from a reduction of tariffs by 80 per cent (Comoros, Eritrea, Rwanda and Uganda) to full MFN (Angola, Congo DR, Namibia, Seychelles and Swaziland). Although, only nine member countries have implemented the full FTA, non-tariff barriers, such as quota restriction, licensing requirements, import permits and foreign exchange control have been lifted or abated in most of the 24 member countries. COMESA is working hard to establish a Custom Union. It launched a common tariff nomenclature and was to introduce a common external tariff (CET) at the end of 2004. However, the timetable for implementing the CET has been deferred to a future date. Under the COMESA common external tariff, goods imported from third states are classified into four groups: capital goods, raw materials, intermediate goods and finished goods. In its bid to have a harmonised

tariff across member countries, COMESA have just completed the coding all tradable goods according to the current eight-digit classification system of the Harmonised Commodity Description and Coding System (HS).

COMESA has also taken measures to reduce non-tariff barriers. In 1996 it introduced a single, standard and highly simplified declaration form to replace the complicated forms required for customs clearance, warehousing, re-export and transit. Furthermore, in 1986 a Protocol on Third Party Insurance was adopted to harmonise regional road insurance. This was followed in 1987 with the introduction of the Yellow Card insurance scheme as a minimum insurance protection against third party inter-state road accidents. Besides facilitating intra-community trade, the Yellow Card insurance to help promote tourism in the region through the free mobility of people. A traveller wishing to go to one of the participating countries can buy an insurance premium for protection of up to 1 year from a designated national insurance company.

COMESA has also in place a comprehensive programme for establishing a common market. The programme allows for free mobility of factors of production (capital and labour), goods and services by 2025. The Monetary Harmonisation Programme (MHP), which had been initiated by the PTA in 1991 and endorsed by COMESA in 1994, is the centrepiece for regional macroeconomic policy coordination and harmonisation within the COMESA area. Under the MHP, member countries are expected to follow a convergence criteria: a maximum fiscal deficit of 10 per cent of GDP, fiscal deficit financing by central banks of less than 20 per cent of previous year's revenue, a maximum of 10 per cent in the growth of broad money supply, the utilisation of indirect monetary policy instruments, a maximum debt service of 20 per cent relative to external debt, an annual inflation rate below 10 per cent, a liberalised and positive interest rate in real terms and a free floating exchange rate.

COMESA has deepened its integration efforts, particularly in the area of financial cooperation, creating three institutions: COMESA Clearing House, Eastern and Southern Africa Trade and Development Bank (PTA Bank) and PTA Re-insurance Company (ZEP-Re). The COMESA Clearing House was established in 1984 to alleviate the effect of foreign exchange scarcity on intra-regional trade. The PTA Reinsurance Company (ZEP-RE) was formed in 1991 and began service 3 years later. The PTA Bank was established in 1985 to assist financially, in the development of regional trade and economic integration.

#### *7.4.3. Central African Economic and Monetary Community (CEMAC)*

The Central African Economic and Monetary Community (CEMAC) was established in 1994 by six member states: Cameroon, Chad, Central African Republic, Congo, Equatorial Guinea and Gabon. The objectives of CEMAC is to foster stronger ties between member states through the strengthening geographic, cultural and social bonds; to promote intra-trade among the countries by eliminating tariff and non-tariff barriers; the creation of a truly African common market; and the coordination and harmonisation of development programmes and industrial projects.

In 1993, CEMAC introduced the Generalised Preferential Tariff (GPT) that sought to liberalise trade and establish a common external tariffs or customs union for the region. In addition to the establishment of a free trade area and a customs union, another objective of the GPT is to encourage vertical and horizontal industrial integration and the productive employment of factors of production and efficient use of natural resources. Under CEMAC common external tariff structure, goods imported from outside the community are classified into four groups: basic necessities (0 per cent), primary raw materials and capital equipment (10 per cent), intermediate or semi-processed goods (20 per cent) and final consumer goods (30 per cent). Since 1993, the tariff on final consumer goods has dropped from a high of 50 per cent to its current rate of 30 per cent. CEMAC, by fully eliminating internal tariffs, reducing non-tariff barriers, and adopting a common external tariff, qualifies as a full free trade area and customs union.<sup>2</sup>

CEMAC has taken a number of steps in the area of trade facilitation. These steps include the simplification of transit and customs procedures to two forms – the simplified declaration (SD) without bank guarantee and the standard declaration (D15) with bank guarantee. As a way of increasing productivity and the cost transit services, CEMAC has also implemented the international standard Inter-State Transit of Central African States and harmonised customs and statistical nomenclature and classification of 7,000 items according to the system of the World Customs Organisation (WCO).

Through its initiatives, CEMAC is moving towards the creation of a common market. These initiatives include the free mobility of factors of production (labour and capital) and the harmonisation and coordination of macroeconomic and sector policies. The labour codes of member states have been harmonised to allow CEMAC citizen to work in another member state, after obtaining a valid contract and work permit. In an attempt to have a common standard of education and training for its labour force, CEMAC has encouraged community-sponsored training institutions distributed among different member states. In 2000, it also introduced its own Passport and a Red Card for motor vehicle. The responsibility for issuing and administering CEMAC Passports rests with individual member states. The Red Card motor vehicle insurance was adopted in compliance with the 1996 agreement of issuing an international insurance card for protection against civil liabilities within CEMAC.

CEMAC is common currency zone. All member states use the CFA, which is pegged at a fixed exchange rate to the Euro. The monetary policy of the region is conducted by a common central bank, *le Banque des Etats de l'Afrique Centrale* (BEAC), and banking activities in the region are supervised by one entity, *le Commission Bancaire de l'Afrique Centrale* (COBAC). There is virtually no restriction on monetary transfers for current transactions within the region. CEMAC has also adopted various accords covering industry, tourism, transport and telecommunications, agriculture, food security, environment, mines, energy and technology. It has in place serious programmes and policies which seek to coordinate and harmonise various sectors of the region. With a common currency zone, and serious attempts at creating a free trade area and a custom union, CEMAC is on its way of creating an Economic Union in the region.

#### *7.4.4. Community of Sahel-Saharan States (CEN-SAD)*

The Community of Sahel-Saharan States (CEN-SAD) was formed in 1998. It is the youngest regional economic community. The member countries are: Benin, Burkina Faso, Central African Republic, Chad, Djibouti, Egypt, Eritrea, Gambia, Libya, Mali, Morocco, Niger, Nigeria, Senegal, Somalia, Sudan, Togo and Tunisia. Unlike the other RECs, which are synchronised to a geographical location, the membership of CEN-SAD is drawn from the East, West and Northern Africa. The objectives of CEN-SAD are the improvement of living standards of community members by promoting political security, socio-economic cooperation and development, and intra-regional trade.

CEN-SAD is aiming at creating a common market through the movement of goods and people. However there is no timetable set for the removal of tariffs, non-tariff barriers and the creation of a custom union. It is also pursuing programmes that seek to reverse desertification and environmental degradation as well as agricultural development to ensure food security. CEN-SAD also established African Development and Commerce Bank (ABDC) in 1999 as a source of financing projects that contribute to the strengthening of economic cooperation and integration. In addition it is embarking on massive infrastructure programmes. However due to the disperse nature of its membership, it would be a challenge for CEN-SAD to develop networks of transport and communications.

#### *7.4.5. East African Community (EAC)*

East African Community is one of the oldest regional economic communities in Africa. It began in 1900, when Kenya and Uganda formed a customs union. Tanzania (then Tanganyika) joined later in 1922. The custom union was created to serve the interests of the then colonial administration. However, in 1967, after the independence of the countries, Kenya, Tanzania and Uganda formally established the East African Community (EAC). Due to political differences of the three member countries, the EAC ceased to exist in 1977, having made a lot of progress towards economic integration of the sub-region. In 2000, after being disbanded for 25 years, the EAC was re-constituted under the Arusha Treaty.

The objectives of the East African Community, under the framework of the Arusha Treaty, include: broad-based cooperation among the member countries; the gradual creation of a custom union, a common market, a monetary union and a political federation; equitable and sustainable growth and development in the region; sustainable utilisation of natural resources and the protection of the environment; mainstreaming of gender issues in all aspects of development; the promotion of regional peace, security and stability as the foundation of regional development and integration; the active involvement of the private sector and civil society as integral development partners; and above all the improvement in the living standards and better quality of life for all in the sub-region.

The re-constituted EAC is progressing swiftly on the establishment a customs union and a free trade area. It has embarked on a progressive reduction of internal tariffs that takes into account the structural and developmental differences in the economies of the member states. Tariff reductions therefore vary in member states, Kenya reducing by 90 per cent and Tanzania and Uganda by 80 per cent. The EAC has also adopted a single entry customs document, harmonised the last two digits of the customs classification code and, until the protocol on the rules of origin is endorsed, has a consensus on the percentage of value-added to goods manufactured from imported raw materials. A common external tariff structure has been proposed. The structure classifies customs duties on imports from third states into three groups: a minimum of 0 per cent, a medium of 10 per cent and a maximum in the range of 20 to 25 per cent.

Although there remain some impediments, such as bureaucratic inefficiency and inadequate infrastructure, the EAC has taken bold steps to remove conventional non-tariff barriers. It has also harmonised the standards of goods and services by instituting a precedence rule. The rule signifies the acceptance of a product standard by one member state as equally applicable to the rest of the community. It has also embarked on a comprehensive and harmonised system of standards for quality and safety. WTO recognises 91 out of 207 its harmonised standards as EAC standards.

As part of the steps towards the creation of a common market, the EAC has introduced measures to harmonise the financial sector of the sub-region by establishing the supra-national East African Securities Regulatory Agency (EASRA). The EASRA, whose mandate extends beyond national interests, has the responsibility of regulating the banks and stock markets in the three countries. In order to ensure the free flow of capital within the community, the Capital Markets Development Committee was established by the EAC to promote capital markets and facilitate the cross-listing of shares across the community. The East African Association of Investment Promotion Agencies (EAFIPA) and the East African Development Bank (EADB) have also been established by the EAC. While the EAFIPA is responsible for the standardisation of incentives and related issues to attract investment into the community, the EADB is a regional financial institution dedicated to economic development in the industrial sector.

The EAC is in discussions on the coordination of monetary and fiscal policies. A framework for macroeconomic convergence, which is based on a commissioned study, is being analysed by the member countries. The framework suggests the following convergence criteria for the member countries: real GDP growth of 7 per cent; inflation should not exceed 5 per cent; low current account deficit; maximum fiscal deficit of 5 per cent; foreign exchange reserve covering 6-month imports; minimum domestic savings rate of 20 per cent; and maximum external debt service of 15 per cent. In term fiscal policy coordination, the EAC has a programme that includes the harmonisation of national value-added taxes, elimination of double-taxation and uniform budgetary procedures. Although the EAC priorities are focused on the establishment of a free trade area and a customs union, it is taking steps to ease restriction on the mobility of people and the rights of establishment. It plans to introduce an East African Passport and temporary passes for its citizens. Inter-state

passes are to be introduced and charges on temporary movement of vehicles across national borders are also to be abolished. National airports are to have an immigration window for its citizens.

#### *7.4.6. Economic Community of Central African States (ECCAS)*

The Economic Community of Central African States (ECCAS) was established in 1983 but became operational in 1985. ECCAS grew out of the Central African Customs and Economic Union (UDEAC) and the Economic Community of the Great Lakes Countries (CEPGL). The creation of ECCAS has however not brought about the dissolution of UDEAC and CEPGL. Both continue to co-exist as autonomous entities separate from ECCAS. The 11 member states of ECCAS are: Angola, Burundi, Cameroon, Central African Republic, Chad, Democratic Republic of Congo, Congo, Equatorial Guinea, Gabon, Rwanda, and Sao Tome and Principe.

The objectives of ECCAS include improving the living standards of the member states, through coordinated and harmonised programmes that promote a balanced and sustainable development in the region, economic stability, peace and security, and contribute to the overall development of the continent. ECCAS has formulated about 20 protocols covering trade liberalisation, trade facilitation and sector cooperation. Additional protocols include transit and transit facilities; customs cooperation; compensation fund for revenue loss; freedom of movement and rights of establishment of community citizens; clearing house; sector development cooperation in agriculture, industry, transport and communication, science and technology, energy, and natural and human resources. However, these protocols have not been adopted and implemented because in the past few years the region has been plagued by civil strife and regional conflicts between some of the member states. As a result the restoration and preservation of regional peace and security has taken precedence over the agenda of regional economic cooperation and integration. In addition to conflicts, the lack of financial support from member states and donor groups have prevented ECCAS from implementing its economic integration agenda. In addition, the infrastructure in the region lags far behind that in other parts of the continent. Attempts are currently underway to revitalise the economic agenda of ECCAS. A recent summit of the leaders of the member states called for renewed efforts and programmes in four areas: capacity building for peace, security, and stability as a pre-requisite for economic and social development; development and integration in social, cultural, economic and physical sectors; and achieving the financial autonomy of the secretariat. Proposals are on the table for the re-introduction of an ECCAS passport.

#### *7.4.7. Economic Community of the Great Lakes Countries (CEPGL)*

The Economic Community of the Great Lakes Countries – *la Communauté Economique des Pays des Grands Lacs* (CEPGL) – was established in 1976. The member states of CEPGL are: Burundi, Democratic Republic of Congo (then Zaire) and Rwanda. The aims and objectives of CEPGL include the attainment of regional

economic cooperation and integration, the establishment of a common market, and regional economic security and stability through the coordination and harmonisation of macroeconomic and sectoral policies. The organisational structure of CEPGL is made up of five Specialised Technical Commissions: (1) political and judicial; (2) social and cultural; (3) planning, industry, agriculture, and natural resources; (4) commerce, finance, immigration, and tourism and; (5) public works, transport and energy. Unfortunately, protracted internal and external conflicts involving all member states have made it impossible for the CEPGL to carry out its agenda on cooperation and integration.

Prior to the conflict in the region, CEPGL had taken some preliminary initiatives on economic cooperation and integration. Among these initiatives were the agreement by the central banks of the three member states to coordinate and harmonise national monetary policies; the adoption of the *Social Security Convention* that allows government officials and businessmen to move freely in the sub-region; and the establishment of four multinational enterprises engaged in the supply of electricity and production of glass bottles, cement and hoes. CEPGL has also set up a few regional institutions on which to build its future integration programmes: the Development Bank of the Great Lakes States (*le Banque de Développement des Etats des Grand Lacs* (BDEGL)) in the Democratic Republic of Congo; the Energy Organisation of the Great Lakes Countries (*l'Organisation de la CEPGL pour l'Energie* (EGL)) in Rwanda; the Institute of Agricultural Research (*l'Institut de Recherche Agronomique et Zoologique* (IRAZ)) in Burundi; and the Organisation for the Management and Development of the Karega River Basin (*l'Organisation pour l'Aménagement et le Développement du Bassin de la Rivière Kagera* (KBO)). KBO is a joint cooperative venture among Burundi, Rwanda and Tanzania.

#### 7.4.8. *Economic Community of West African States (ECOWAS)*

The Economic Community of West African States (ECOWAS) was established in 1975. However, in line with the objectives of the African Economic Community, ECOWAS, in 1993, revised the original treaty so as to speed up and strength its process of full integration. The objectives of ECOWAS include the following: improving the living standards of the citizenry; the promotion of sustainable and stable economic growth and development in the region; strengthening the relationship between the member states; contributing towards the development of the continent and an eventual establishment of continent-wide economic union. The 15 member states of the community are: Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Ghana, Gambia, Guinea, Guinea Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone and Togo.<sup>3</sup>

ECOWAS is vigorously pursuing a programme under a framework of its Trade Liberalisation Scheme (TLS), which it introduced in 1990. The TLS calls for the creation of a free trade zone and the complete elimination of tariff and non-tariff barriers within 10 years. Goods eligible for duty free status under the scheme consist of raw materials, traditional handcrafts and some industrial goods. Out of the 15 countries only eight member states have eliminated tariffs on unprocessed products

and handicrafts. The only member country that has also eliminated tariffs on industrial goods is Benin.

ECOWAS has also introduced measures and programmes of trade facilitation. It has adopted the Protocol on Inter-State Road Transit (ISRT) and the transit guarantee bond. In addition, it has also introduced a common certificate of origin for goods crossing the borders, a uniform and simplified customs declaration form and a common statistical nomenclature, which is in line with the WCO harmonised system. The harmonised customs document was jointly developed with UEMOA as a replacement for different forms used by their respective member states. The harmonised customs nomenclature has been adopted by 11 member states, and the protocol on inter-state road transit by five countries. With the exception of Cape Verde, Guinea Bissau and Liberia, 12 member states have nominated national bodies to provide a transit guarantee bond.

Within the framework of the TLS, ECOWAS was supposed to have created a customs union by 2002. However the introduction of common external tariffs has been postponed to 2005 so that the common external tariffs of ECOWAS and UEMOA can be harmonised. UEMOA' CET, which was adopted in 1998 and revised in 2000, is supported by the European Union under the Regional Indicative Programme (RIP).

In line with creating a common market, ECOWAS adopted programmes that allow for the free mobility of its citizens, macroeconomic policy harmonisation and a monetary union. It has also introduced a common passport. With exception of Liberia, citizens of member states do not have to have in their possession entry permit and visa to move across the borders within the community. Under the arrangement, an ECOWAS citizen with a valid travel document and a certificate of international vaccination can enter a member state and stay for a maximum of 90 days.

ECOWAS is also working very hard to create a West African Monetary Zone (WAMZ), with a common currency and a common central bank. Part of the steps it has undertaken to get there includes easing the restriction on foreign exchange requirement for the purchase of such items as air tickets, airport taxes and hotel expenses. Travellers from an ECOWAS state can use local currency in lieu of foreign exchange. With the exception of Liberia and Sierra Leone all the member states have adopted the programme.

The West African Monetary Agency (WAMA), which replaced West African Clearing House (WACH), has been established to promote intra-community trade. With the collaboration of the Committee of Central Bank Governors and the WAMA, the ECOWAS travellers check was introduced in 1998 and went into circulation the following year to facilitate intra-community trade and other business transactions. However, with the relaxation of exchange controls and liberalisation of the economies of member states the use of the ECOWAS travellers' cheque became less important and therefore ceased to exist after a short life.

In 2000, ECOWAS declared to create the West African Monetary Zone by 2003 by establishing a second monetary zone in the in the region. Under the declaration, six non-UEMOA members of the community (Gambia, Ghana, Guinea, Liberia,

Nigeria and Sierra Leone) would form a common currency union by 2003. However the launch date of the common currency for the non-CFA zone has been pushed to 2005. Under the ECOWAS programme of monetary union, the two monetary zones (the CFA and non-CFA zones) would be merged into one monetary union under a common currency and a common central bank – designated as the West African Central Bank (WACB) – at a future date. Part of the process towards the attainment of the WAMZ led to the birth of the West African Monetary Institute (WAMI), which is charged with the responsibility of preparing the groundwork leading to the launch of a single West African monetary union. ECOWAS has also taken steps to coordinate and harmonise macroeconomic policies in the region through its introduction of its convergence indicators.

To support investment and promote financial cooperation in the region ECOWAS has established a number of regional banks. In 1975 it formed the ECOWAS Fund for Cooperation, Compensation and Development (EFCCD). The EFCCD was created to serve as a source of finance for the compensation of revenue loss accompanying regional trade liberalisation. The EFCCD is also responsible for the promotion of balanced regional economic development, providing support to less developed member states of the community. EFCCD has been reconstituted as the ECOWAS Bank for Investment and Development (EBID). The two subsidiaries of EBID are the ECOWAS Regional Development Fund (ERDF) and the ECOWAS Regional Investment Bank (ERIB) with respective focus on public and private sector financing. The ECOWAS Bank Group (Ecobank) has also been established to strengthen regional financial cooperation. Ecobank, a parent holding company, has subsidiaries in 12 countries across West and Central Africa. Ecobank was established to provide commercial banking and other financial services to individuals, private and public sector organisations. The ERDF is the major shareholder of Ecobank. The Ecobank Foundation, a philanthropic arm of the bank, is also involved in supporting scientific, cultural and humanitarian causes across the region. ECOWAS has also undertaken sector programmes that strengthen the economic integration of the region. It has done so by introducing programmes that would develop the infrastructure in the region, particularly the areas of telecommunication, roads and energy. In 1980, ECOWAS introduced a two-phase transport programme. The first phase focussed on road transport facilitation and road construction. The second phase of the ECOWAS transport programme, which was adopted in 1988, focuses on the integration of land-locked member-state roads with the regional highway network.

Under the first phase, the construction of the Trans-West African and the Trans-Sahelian highway systems began. The 4,560 km Trans-West African and the 4,460 km Trans-Sahelian highway projects are near completion. Member countries have also ratified a proposal to form a regional airline (ECOAIR), a private maritime company by private businesses and a study on the development of an interconnected railway system. While the airline and shipping projects are reportedly at an advanced stage, the required financing is being sought for the railway project.

ECOWAS has also taken measures to improve road transport facilitation in the region so as to promote intra-regional movement of goods and people. The measures include the harmonisation of technical specifications of motor vehicles and related infrastructure, customs procedures, cross-border travel and the motor vehicle insurance. The ECOWAS third-party Brown Card motorcar insurance was also introduced to allow for the free flow of goods and persons within the region. Twelve member states of ECOWAS use the Brown Card while their counterparts from the UEMOA use a second motor car insurance, known as *le Conference Inter africaine des Marchés d'Assurance* (CIMA).

Since 1979 ECOWAS has launched two telecommunication programmes: TELECOM I and TELECOM II. It was under TELECOM I that regional telecommunication services were improved and expanded. The West African sub-system of the Pan-African Telecommunication network (PANAFTEL) and the connection of regional capital cities with microwave technology were undertaken under TELECOM I. Mainly the ECOWAS Fund financed the programme, which was implemented over a 10-year period between 1983 and 1992. Under the TELECOM II programme, existing regional telecommunication network are to be modernised, incorporating state-of-the-art features such as wideband and multimedia.

ECOWAS' comprehensive energy plan is yet to be implemented. The plan covers areas of hydro-electricity, thermal and renewable sources, gas pipelines and electricity grid interconnection.

#### 7.4.9. Indian Ocean Commission (IOC)

The Victoria General Agreement on Cooperation established the Indian Ocean Commission (IOC) in 1984. The IOC is composed of four countries, Comoros, Madagascar, Mauritius, and Seychelles and a non-independent French overseas territory, Reunion. All member states of the IOC belong to COMESA and two of them (Mauritius and Seychelles) are also members of SADC. IOC seeks the advancement of a spirit of friendship and solidarity among the governments and peoples of the sub-region and to improve their living standards through cooperation in all areas, particularly the strengthening of economic relationships.

In 1996, IOC took steps towards the liberation of trading in the region by adopting the Integrated Regional Programme for Trade Development or *le Programme Régional Intégré de Développement des Echanges* (PRIDE). The main objective of PRIDE is to promote trade and investment liberalisation policies within the region at the same time increase the level of coordination with COMESA and SADC. A technical committee constituted to oversee the implementation of the trade liberalisation component of PRIDE provided a timetable for a tariff reduction programme that would have transformed the area into a free trade area by 1999. With the exception of the elimination of bilateral tariffs between Mauritius and Madagascar since September 1999, the rest of IOC is a preferential trade area governed by a protocol on the rules of origin. The IOC rules of origin stipulate four conditions similar to those

of COMESA: (1) primary raw materials obtained from the region or goods manufactured from them, (2) manufactured goods with a maximum imported material content of 60 per cent, (3) general manufactured goods with a minimum value added of 45 per cent of the factory price, (4) a minimum value added of 25 per cent to the factory price on goods of special significance to economic development.

IOC has also embarked on comprehensive sector cooperation programmes and projects. These programmes include environmental protection and education, tourism, fruit fly eradication, the establishment of the University of the Indian Ocean. In addition, there is strong cooperation in the region to address issues such as regional oil spill contingency planning, the impact of cyclones regional security, health, and culture and plant protection. The IOC is also very much concerned about the protection of fishery in the sub-region and has therefore formed the Indian Ocean Tuna Commission. The member countries cooperate on the development of new and renewable energy, standardisation and product quality, and the exchange of commercial information (COI-Infonet).

#### *7.4.10. Inter-Governmental Authority on Development (IGAD)*

The Inter-Governmental Authority on Development was established in 1996. It grew out of the Inter-Governmental Authority on Drought and Development (IGADD), which was created in 1986 to tackle the problems associated with severe and recurrent drought confronting the region through mutual cooperation. IGAD is made up of the six founding member states, Djibouti, Ethiopia, Kenya, Somalia, Sudan Uganda and Eritrea, which joined in 1993.

The objectives of IGAD includes: coordination and harmonisation of macroeconomic and sector policies; the creation of a common market with the free movement of trade and factors of production; utilisation of natural resources and the protection of the environment; development of essential infrastructure such as transport, telecommunication and energy; the pursuit and preservation of regional peace and security; the attainment of national and regional food security; the advancement of development-oriented research in science and technology; and the mobilisation of financial resources necessary for the realisation of development programmes. Despite these lofty objectives, the priorities of IGAD focus on cooperation in the areas of peace and security, drought and the environment, development of the infrastructure, and agriculture and food security. It should be pointed out that IGAD lacks financial resources and is heavily dependent on the support of bilateral and multilateral donors.

#### *7.4.11. Mano River Union (MRU)*

The Mano River Union (MRU) was established in 1973 by Liberia and Sierra Leone. Guinea joined later, in 1980. The objective of MRU is to improve the living conditions of the peoples in the sub-region. To attain a higher standard of living, MRU aims at pursuing cooperative and integrated developmental programmes that would

eventually lead to the formation of a customs and economic union with no restrictions on the movement of goods and services. In addition, components of MRU agenda include the pursuit of common policies and programmes in trade, customs, investment, transport, communication, and energy, social and cultural development.

Recent conflicts and instability in Liberia and Sierra Leone has made it impossible for MRU to follow through on its economic integration agenda. In addition, the MRU lack the financial resources to operate its Secretariat let alone to implement its programmes. Despite these constraints, the short-term and medium-term priorities of MRU are on the restoration of durable peace and political stability, the repatriation and re-integration of refugees, the revitalisation and financing of the secretariat, the restoration of political stability and the use of the Mano River as an important channel of transportation. Prior to the regional conflict, MRU had taken measures towards economic integration. In 1997 it adopted a common external tariff with third states and an agreement on liberalised trade among member states. Other programmes of integration undertaken in the community include the opening of two factories in Sierra Leone and Liberia for the production of oil extraction machinery; the construction and rehabilitation of inter-state and local roads; the construction of a bridge over Manor River; a maritime transport pilot project; agricultural resource evaluation; and the establishment of the Guinea Centre for Animal Husbandry.

#### *7.4.12. West African Economic and Monetary Union (UEMOA)*

The West African Economic and Monetary Union (*Union Economique et Monetaire Ouest Africaine*) was established in 1994. The member countries of the organisation are Benin, Burkina Faso, Cote d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo. The goal of UEMOA is to create an enabling environment for the francophone countries in the West Africa, excluding Guinea, to attain full economic and financial integration. To achieve its goal, the treaty establishing UEMOA calls an open and harmonious legal environment; the convergence of member-state economic policies; and the coordination of policies on human resources, transport and communications, environment, agriculture, energy, industry and mines.

In moving towards the creation of a Free Trade Area, UEMOA, in 1996, adopted the Community Preferential Tariff (CPT) agreement. Based on the framework of CPT, internal tariffs have been fully eliminated on agricultural commodities, livestock and traditional handcrafts in the region. Between 1996 and 2000, the region has witnessed tariffs on approved manufactured goods originating from the union drop from 30 per cent to 100 per cent, while those on unapproved manufactured goods were lowered by just 5 per cent. The increase in the approved manufactured goods originating from UEMOA from 840, in 1997, to 948 is attributable to the CPT. In the same period companies have risen from 228 to 244. Table 7.9 summarises the impact of the tariff reduction scheme.

In 1998 UEMOA established the Community Compensation and Solidarity Fund to assist some of the member countries for the loss of customs revenue arising from the reduction of tariffs on intra-community trade. The Fund was financed from a levy

of 1 per cent on imports from third States. In addition to tariff reductions, UEMOA is taking serious steps to remove non-tariff barriers, introducing a single customs forms for the region. In 1998, UEMOA also launched a customs union with the introduction of a common external tariff. Under the CET, goods imported from third states are classified into four coded categories: 0 for a limited list of essential social goods, 1 for primary necessities, basic raw materials, capital equipment and specific inputs, 2 for intermediate products and inputs, and 3 for final consumers goods and other products.

As part of its trade facilitation efforts, UEMOA has adopted the WCO's harmonised system of tariff and statistical nomenclature. Preparations are also underway for the installation of EUROTRACE for the generation, analysis and reporting of external trade statistics.

In terms of the creation of a common market, UEMOA is ahead of most of the RECs in Africa. The free movement of persons and the rights of residence and establishment within UEMOA are fully harmonised with those of ECOWAS, including the introduction of a common passport. Consequently, member countries have abolished entry visa requirements and introduced the CIMA and the Brown Card motor vehicle insurance. Although UEMOA was established in 1994, its roots as a monetary union date as far back as 1974. It has a common currency, CFA and a common central bank, *Banque Centrale des Etats de l'Afrique de l'Ouest* (BCEAO). BCEAO has done extremely well in ensuring macroeconomic convergence in most of the member states. In 1997, UEMOA and BCEAO signed an agreement to transform the Abidjan Bourse to a regional stock exchange. In addition, in 1998, UEMOA agreed to harmonise the regional accounting system through SYSCOA (*Système Comptable Ouest Africain*). These are geared towards the facilitation of the free flow of capital in the region.

The Union has attempted to harmonise its policies in other areas. Within the last 4 years, UEMOA has adopted common policies in the area of agriculture, industry, mining and energy, and handicrafts. In the same period, it has harmonised the consumer price indices, *l'Indice Harmonisé des Prix à la Consommation* (IHPC), and adopted a convergence framework in the spheres of sector and macroeconomic policy coordination and harmonisation, all conducive to a regional common market.

#### 7.4.13. Southern African Development Community (SADC)

The Southern African Development Community was born in 1994. It is born out of the transformation of the former Southern African Development Cooperation Conference (SADCC), which was formed in 1980 as a common front of political and economic liberation from the dominant neighbouring apartheid state, South Africa. The 14 member states of SADC are: Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Seychelles, Swaziland, Tanzania, Zambia and Zimbabwe. The objectives of SADC are: the advancement of sustainable national and regional economic development; the convergence of a common political system and institutions; the achievement and preservation of regional

peace and security; the productive employment of human resources and the sustainable exploitation of natural resources; the development and adoption of policies progressively leading to the free movement of trade, labour and capital; the development and transfer of technology; the coordination and harmonisation of international relations; and the mobilisation of external finance for the implementation of development and integration programmes. The SADC Programme of Action (SPA) – with more than 400 projects – is the cornerstone of its development and integration agenda. Under the framework of the SPA, SADC launched a Trade Protocol in 2000. The protocol aims at the creation of a free trade area amongst the member countries by 2008. The FTA is to be achieved through trade liberalisation, an efficient use of factors of production and a competitive investment environment. The SADC trade Protocol makes no reference to timetables for the establishment of a customs union or a common market.

SADC is in negotiation on a number of issues designed to boost trade in the region. The negotiations which are far advanced include a timetable on tariffs reductions in the member states, rules of origins, removal of non-tariff barriers, preferential market access of selected goods, trade in services and standardisation (quality assurance, accreditation, metrology). Although the harmonisation of customs procedures and documents are part of the negotiation on trade liberalisation, some standard customs forms have been adopted: certificate of origin, declaration by producers, road freight manifest, transport approval certificate and customs transit inspection report.

SADC has also undertaken some initiatives in other sectors. In 1995, the Southern African Power Pool (SAPP) was created. SAPP is a consortium of 12 national electricity companies: SNEL (Democratic Republic of Congo), TANESCO (Tanzania), ZESCO (Zambia), ENE (Angola), NAMPOWER (Namibia), BPC (Botswana), ZESA (Zimbabwe), EDM (Mozambique), SEB (Swaziland), ESKOM (Malawi and South Africa) and LEC (Lesotho). The objective of SAPP is to maintain economical and reliable supply electricity to member states. SAPP hopes to achieve its goal through the efficient use the natural resources in the region at the same time protect the environment.

SADC and COMESA are taking steps to harmonise some of their programmes. Since 2001 the two organisations have reached agreements on the coordination and harmonisation of policies in areas such as: elimination of non-tariff barriers; customs documents and procedures; transport and telecommunication; road safety and motor vehicle insurance; regulatory framework for standards (quality assurance, metrology, accreditations); multilateral trade negotiations; and east-south master plan for infrastructure. In addition, SADC has initiated a tripartite air traffic liberalisation agreement among COMESA, EAC and SADC.

#### *7.4.14. Southern African Customs Union (SACU)*

The South African Customs Union (SACU) has been in existence since the beginning of the twentieth century. However it was not until 1969 that it was formally established

as Customs Union. SACU's main objectives are: the establishment of a customs union in the region and a free trade area, with the free movement of goods and services. The member states of SACU are Botswana, Lesotho, Namibia, South Africa and Swaziland. Whereas SADC is just beginning to make preparations for the formation of a free trade area by 2008, SACU – a sub-region of SADC – has been a free trade area, without tariff and non-tariff barriers, and a customs union with a common external tariff since 1910.

Unlike other regional economic communities, SACU has no protocols governing different areas of cooperation and integration. South Africa is the main economic engine in the area and contributes significantly to the intra-community trade. All customs and excise duties on intra-community trade are pooled into the Southern African National Revenue Fund. The Fund is then shared among the member states according to an agreed formula.

#### 7.5. INTRA-REGIONAL TRADE IN THE RECs

The focus of this section is to assess the impact the establishment of the regional economic communities in Africa has had on the intra-regional trade. For reasons of data availability, the discussion in this section would focus on the trade flows within nine RECs in respect of which statistical data are available in the UNCTAD Statistical Manual (UNCTAD 2004). The overall observation is that intra-African Trade is very low, accounting for about 10 per cent of the value of total exports.

##### *7.5.1. The Situation of Intra-Regional Trade in West Africa (ECOWAS, UEMOA, MRU)*

Intra-regional trade in West Africa is still low, representing, on average, around 10 per cent of total exports (Figure 7.1 and Table 7.1). Intra-community exports within UEMOA accounted for 9.6 per cent of total exports from the area in 1980, 13 per cent in 1990, and 10.3 per cent and 12 per cent in 1995 and 1997, respectively. Intra-community exports within UEMOA witnessed steady growth over the period 1980–2003 at around 12 per cent of total exports from the area. This remarkable performance may be attributed to gains in competitiveness and relative trade creation for businesses as a result of the introduction of the common external tariff.

In Figure 7.2 and Table 7.2, we find that the characteristics of intra-community trade within ECOWAS are similar to those of UEMOA, although there is noticeable stabilisation at around 9.5 per cent of total exports from ECOWAS since 1980. This level is still far above the production of a number of RECs.

Intra-regional trade within the Mano River Union (MRU) area was almost negligible, at less than 1 per cent of total exports from the area. This weak performance may be attributed to chronic instability in the sub-region over the past few years (Figure 7.3 and Table 7.3).

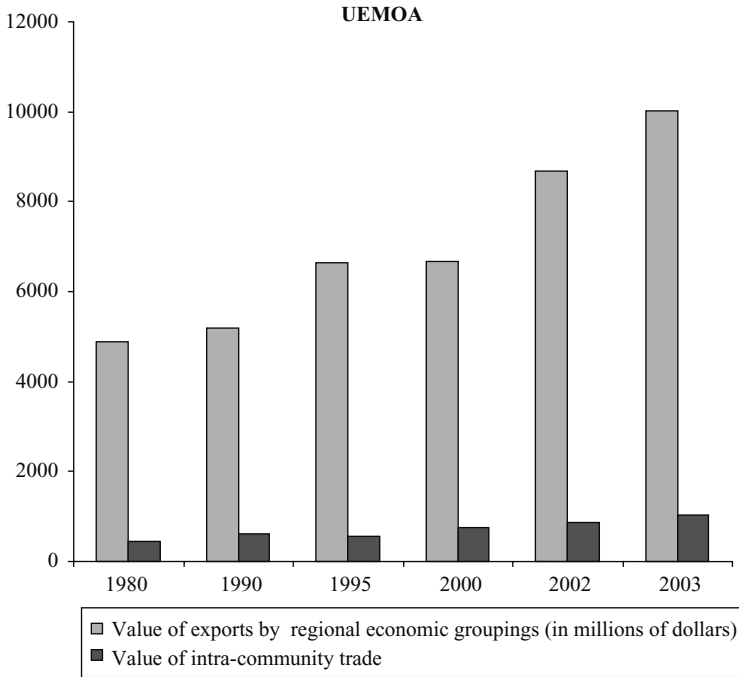


FIGURE 7.1. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

TABLE 7.1. Trend of intra-regional trade (in value and %) in UEMOA

	1980	1990	1995	2000	2002	2003
Value of exports, by economic grouping (in millions of dollars)	4,884	5,202	6,648	6,668	8,672	10,007
Value of intra-community trade	460	621	560	741	857	1,043
Share of internal trade in total exports (%)	9.6	13.0	10.3	13.1	12.1	12.8

Source: Economic Commission for Africa, compiled from UNCTAD data.

### 7.5.2. The Situation of Intra-Regional Trade in The Eastern and Southern African Region (SADC, COMESA)

After a low rate of growth during the period 1980 to 1990, trade within SADC grew steadily from 1995 to 2003 (Figure 7.4 and Table 7.4). The percentage of internal trade involving total exports within SADC increased from 0.4 per cent on average in 1980 to 12 per cent in 2000, but dropped again to 10 per cent in 2003. During

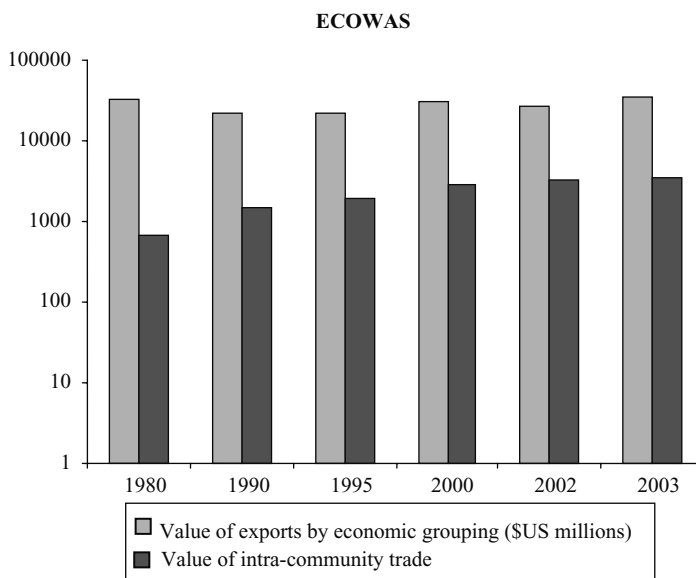


FIGURE 7.2. Share of intra-regional trade in total exports (in value) (Source: Economic commission for Africa, compiled from UNCTAD data)

TABLE 7.2. Trend of intra-regional trade (in value and %) in ECOWAS

	ECOWAS					
	1980	1990	1995	2000	2002	2003
Value of exports, by economic grouping (in millions of US dollars)	33,348	22,743	22,305	30,338	26,829	35,186
Value of intra-community trade	661	1,532	1,875	2,811	3,192	3,541
Share of internal trade in total exports (%)	9.6	8.0	9.0	9.5	11.5	9.8

Source: Economic Commission for Africa, compiled from UNCTAD data.

the same period, average trade within SADC was about 10.5 per cent, placing the region in the second position behind UEMOA. This performance was partly due to the influence of the buoyant South African economy and Mauritius and Zimbabwe, which have strong export base.

With regard to COMESA, Figure 7.5 and Table 7.5 show that COMESA's internal trade grew slightly during the period 1980–2003. The growth rate averaged around 5 per cent during the period under review.

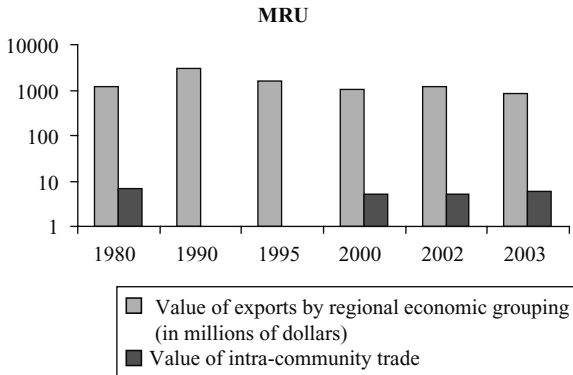


FIGURE 7.3. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

TABLE 7.3. Trend of intra-regional trade (in value and %)

	MRU					
	1980	1990	1995	2000	2002	2003
Value of exports, by economic grouping (in millions of US dollars)	1,225	3,016	1,564	1,008	1,162	839
Value of intra-community trade	7	0	1	5	5	6
Share of internal trade in total exports (%)	0.8	0.0	0.1	0.4	0.2	0.3

Source: Economic Commission for Africa, compiled from UNCTAD data.

TABLE 7.4. Trend of intra-regional trade (in value and %) SADC

	SADC					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic Community (in million of US dollars)	34,884	38,425	43,803	49,573	50,690	60,450
Value of intra-community trade	108	1058	4124	4453	4240	5345
Share of intra-community trade in total exports (%)	0.4	3.1	10.6	12.0	9.3	10.0

Source: Economic Commission for Africa, compiled from UNCTAD data.

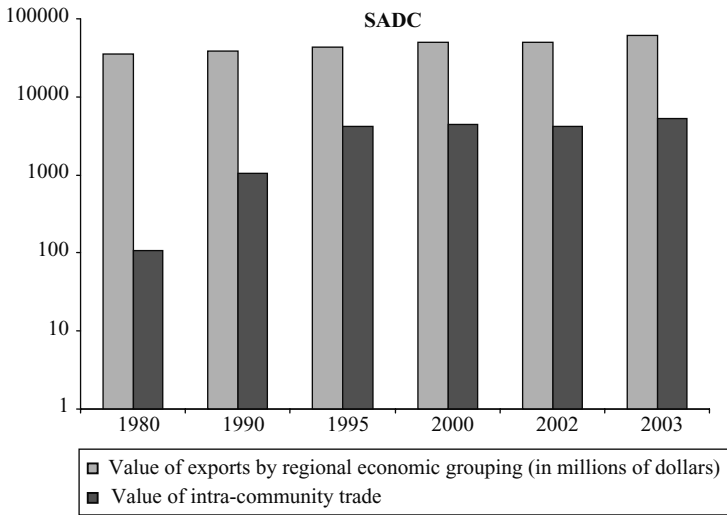


FIGURE 7.4. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

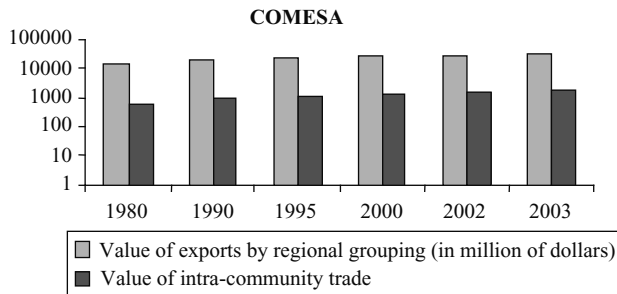


FIGURE 7.5. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

### 7.5.3. Intra-Regional Trade in Central Africa (CEMAC, ECCAS, CEPGL)

The levels of intra-regional trade for CEMAC, CEPGL and ECCAS were low during the period under review, as shown by Tables 7.6, 7.7 and 7.8 below. Internal trade in these RECs accounted for less than 2 per cent of their total exports, a performance surpassed by that of UEMOA, SADC, COMESA and ECOWAS. Figures 7.6, 7.7 and 7.8 clearly illustrate the low share of the internal trade of these economic groupings relative to the value of their total exports.

TABLE 7.5. Trend of intra-regional trade (in value and %) COMESA

	COMESA					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic grouping	14204	19911	20335	25772	26861	30950
Value of intra-community trade	555	890	1027	1281	1465	1812
Share of intra-community trade in total exports (%)	5.7	6.3	6.0	4.9	5.4	5.8

Source: Economic Commission for Africa, compiled from UNCTAD data.

TABLE 7.6. Trend of intra-regional trade (in value and %)

	CEMAC					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic groupings (in millions of dollars)	4668	5558	6016	7926	8823	10296
Value of intra-community trade	75	139	120	101	120	157
Share of intra-community trade in total exports	1.6	2.3	2.1	1.0	1.4	1.4

Source: Economic Commission for Africa, compiled from UNCTAD data.

TABLE 7.7. Trend of intra-regional trade (in value and %)

	ECCAS					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic grouping (in millions of dollars)	9023	11956	11550	16712	17724	20298
Value of intra-community trade	89	163	163	196	193	236
Share of intra-community trade in total exports	1.4	1.4	1.5	1.1	1.1	1.1

Source: Economic Commission for Africa, compiled from UNCTAD data.

TABLE 7.8. Trend of intra-regional trade (in value and %)

	CEPGL					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic groupings (in millions of dollars)	2455	2510	1807	862	1296	1335
Value of intra-community trade (in millions of dollars)	2	7	8	10	12	15
Share of intra-community trade in total exports	0.1	0.5	0.5	0.8	0.7	1.2

Source: Economic Commission for Africa, compiled from UNCTAD data.

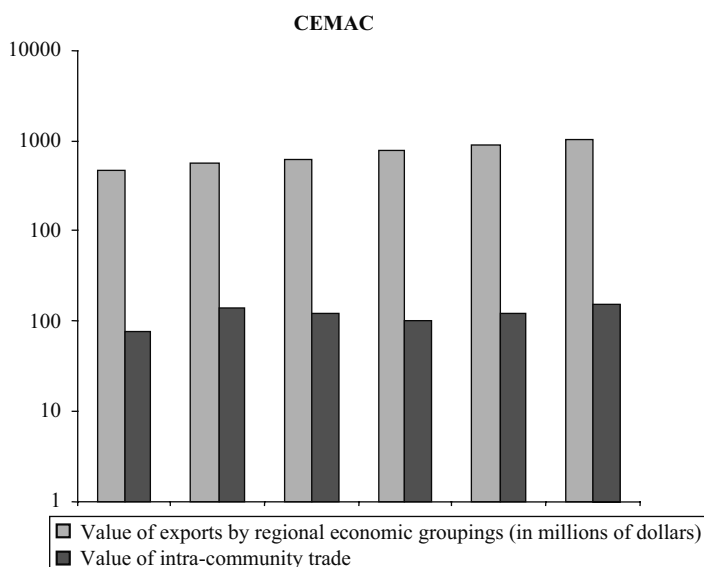


FIGURE 7.6. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

#### 7.5.4. *The Situation of Intra-Regional Trade in North Africa by Reference to Total Exports from the Area*

The trade potential within UMA is partly jeopardised by the similarities between some Maghreb countries, such as Morocco and Tunisia (Figure 7.9 and Table 7.9). This could also be due to the predominance of Morocco and Tunisia in terms of exports to European Union countries, which has in turn resulted in the productive structures of these two countries being basically similar. Other obstacles,

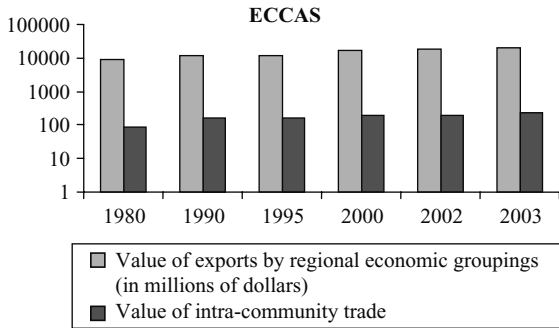


FIGURE 7.7. Share of intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

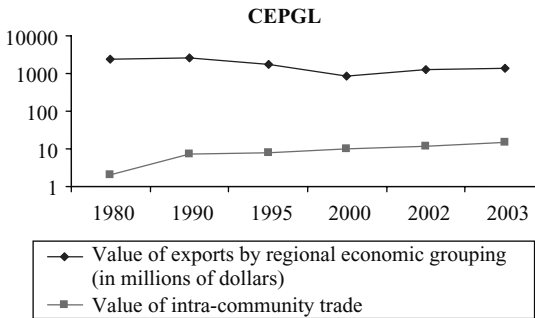


FIGURE 7.8. Intra-regional trade in total exports (in value) (Source: Economic Commission for Africa, compiled from UNCTAD data)

including an inadequate export structure for intra-regional trade and the priority given to the North-South strategy, have also impaired the level of trade within UMA.

#### 7.5.5. Comparative Analysis of The Internal Trade of Selected RECs

Table 7.10 depicts estimates of the intra-regional trade of some of the African RECs. The table highlights the weak impact of the African integration schemes on the growth of intra-regional trade. In sub-Saharan Africa, the performances of UEMOA and SADC stand out. The total intra-regional exports within these regions were in the range of 12 per cent and 10 per cent of their total exports, respectively, during the period 2000–2003.

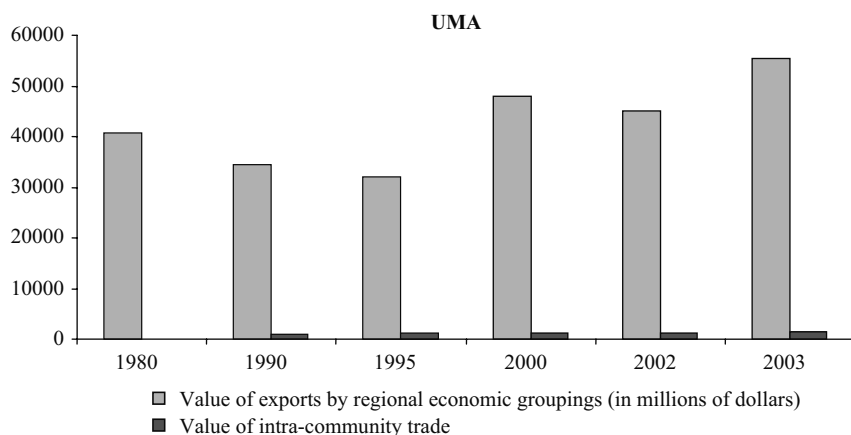


FIGURE 7.9. Share of intra-regional trade in total exports (in value) (*Source*: Economic Commission for Africa, compiled from UNCTAD data)

TABLE 7.9. Trend of intra-regional trade (in value and %)

	UMA					
	1980	1990	1995	2000	2002	2003
Value of exports by regional economic grouping (in million of dollars)	40648	34394	32071	47887	45146	55350
Value of intra-community trade	109	958	1109	1112	1243	1553
Share of intra-community trade in total exports	0.3	2.9	3.8	2.3	2.8	2.7

*Source*: Economic Commission for Africa, compiled from UNCTAD data.

TABLE 7.10. Comparative intra-regional trade profiles

Economic grouping	Share of intra-regional exports in total exports (%)					
	1980	1990	1995	2000	2002	2003
CEPGL	0.1	0.5	0.5	0.8	0.7	1.2
COMESA	5.7	6.3	6.0	4.9	5.4	5.8
ECCAS	1.4	1.4	1.5	1.1	1.1	1.1
ECOWAS	9.6	8.0	9.0	9.5	11.5	9.8
MRU	0.8	0.0	0.1	0.4	0.2	0.3
SADC	0.4	3.1	10.6	12.0	9.3	10.0
CEMAC	1.6	2.3	2.1	1.0	1.4	1.4
UEMOA	9.6	13.0	10.3	13.1	12.1	12.8
UMA	0.3	2.9	3.8	2.3	2.8	2.7

*Source*: UNCTAD Statistical Manual, 2004.

### *7.5.6. Comparative Analysis of The Intra-Regional Trade in Africa versus and Other Economic Groupings*

Data from UNCTAD statistical Manual (2004) shows that trade within the European Union accounted for 60 per cent of world trade on average. The same applies for the countries of the Latin American Free Trade Agreement (ALENA) area, whose intra-regional trade accounted for 55.7 per cent, 56.7 per cent and 56.1 per cent of total exports in 2000, 2002 and 2003. In the case of the Association of South East Asian Nations (ASEAN), their internal trade slightly surpassed the 20 per cent level attained in total exports from the area. Intra-community trade within the Southern (American) Common Market (MERCOSUR) was in the range of 20 per cent of total exports from the area. Compared to these regions, trade within Africa is very low, accounting on average to about 10 per cent of total exports.

### *7.5.7. Factors Responsible Low Intra-African Trade*

Despite the many institutional provisions, such as trade liberalisation programmes, a common external tariff and a common trade policy, adopted by Africa's regional economic communities RECs, the previous sections demonstrate that trade within Africa is very low, particularly compared to other regional groupings.

Several factors are responsible for the observed poor intra-regional trade. First, African countries produce and export the same types of products. With the exception of a few countries, which have reached a significant level of industrial development and are thus able to sell manufactured goods on the sub-regional markets, agricultural and mining products dominate the exports structure of African countries. This situation reflects the lack of coordination and harmonisation of production and marketing policies, as manifested by the insignificant potential for trade between countries of a given sub-region. In addition, the low level of technology leads to quite high production costs, making local goods more expensive than imported goods. Problems also arise in relation to supply-side management and to the lack of competency in the areas of production and marketing.

Second, choices made during the implementation of cooperation agreements have, in many cases, hindered intra-regional trade. The experience of the European Union has shown that production structures must be developed by means of sectoral policies (such as industrial, agricultural, transport and telecommunications policies) while, above all, simultaneously implementing a customs union since there can be no real trade without production. Analysis of the regional integration experience in Africa shows that almost all regional trade agreements have privileged integration using rules aimed at unifying national markets "decommissioning" customs. This approach has, generally speaking, taken precedence over sectoral policies. Thus, even with the greater opening of borders, there has not really been an increase in intra-regional trade. Liberalisation is, of course, important, but it must be based on

an efficient production system (strengthened production capacities, increased supply and an enhanced business culture).

Third, transport and communications infrastructures are powerful catalysts for the economic integration process because they can greatly facilitate the movement of persons, goods and services. However, despite the efforts undertaken in recent years, it is clear that the various African countries have few viable communications channels at either the national or the international level. Intra-African trade is thus hindered by a lack of infrastructure, particularly in the area of transport and communications. The road network consists mainly of unpaved roads and unusable for part of the year, adding to transactions costs.

Fourth, non-tariff barriers are high on the continent. In light of the poor condition of inter-State transport routes, it should be stressed that many African States still apply a number of protectionist measures, which pose obstacles to the promotion of intra-Community trade. These measures include numerous roadblocks and customs posts between countries. The existence of these checkpoints, and harassment at border points, hinder the normal course of transactions and, in particular, the cross-border transport of goods. Restrictions on the free movement of persons and inputs, restrictions on cross-border investments and poor bank and other financial lending also have an impact on trade and productivity. Other barriers are posed by complicated import and export procedures, protectionist measures for local industries, enacted in order to compensate for the loss of customs revenue for all imported products and the lack of measures to support intra-regional trade.

Fifth, problems related to payment and the inter-convertibility of national currencies is among the principal problems faced by African exporters. Unless exporters are assured of being paid promptly for the goods and services that they provide, there can be no real basis for trade within the subregion. The causes of payment problems include the weaknesses of national financial sectors and the absence of export credit facilities and adequate export insurance systems. At the sub-regional level, it is unfortunate that monetary policies are not harmonised and that compensation mechanisms are ineffective. Furthermore, most bank loans are short term and their interest rates are considered high by businesses. Since the withdrawal of so-called "seasonal" credits to farmers following redefinition of the central banks' missions in some countries of the region, it has been difficult to find credit designated specifically for export operations.

Sixth, other institutional weaknesses that impede trade within Africa also include a number of flaws in the legal and regulatory environment for trade promotion, including the form of legislation, the functioning of trade law and administrative and contractual procedures. Furthermore, the social and political tensions in which several sub-regions have been mired for decades have also affected the performance and prospects of the countries concerned and of the economic integration area. These events have resulted in widespread destruction of production facilities, breakdown of national administrations, urban unemployment and capital flight. Social and economic unrest also tends to discourage investment and, generally speaking, creates

an unviable macroeconomic framework by encouraging foreign investors' fear that it will spread to neighbouring countries.

## 7.6. CONCLUSIONS

African regional economic community has made a lot of strides in quest for full integration of the continent. However, substantial gaps remain between their achievements and their mandates. As part of the solutions to addressing their challenges, there is a strong need for coordination and harmonisation of the programs of the RECs so as to bring coherence to the overall integration agenda. Inter-RECs coordinating bodies could be created to ensure that the process takes off. It is very important that the process be aligned with the vision of the African Union and the NEPAD programme. The focus or aim of the coordination and harmonisation process would be to minimise overlapping functions of the RECs and other inter-governmental agencies, leading to the strengthening of the continent's integration agenda as well as encouraging the a targeted use of limited financial resources.

The advancement of Africa's integration agenda requires the strengthening of the capacities of all the partners. There is therefore an urgent need for a strategy of improving the capacities of the RECs to conduct and implement their programmes effectively. The strategy should include a sustainable funding formula that would assist the institutions in their training needs, the hiring and retaining of competent personnel, the provision of the equipments and other relevant materials.

In addition to strengthening the capacities of the RECs in terms of their training and equipments' needs, the strategy of capacity building should also be considered for strengthening competencies of the personnel of the RECs and member countries in other important areas such as *negotiations*. Member States and the RECs are constantly negotiating agreements with parties outside and within Africa on complex and diverse issues. Compared to the capacity of their counterparts, African countries have less skilled negotiators, making it very difficult for the countries to conduct effective negotiations with other countries or parties. Where the problem is pronounced is in matters concerned with international trade negotiations where in many cases member countries do not have adequate capacity to assess the full impact and implication of the international trading rules such as those proposed under the *Doha Round*.

Almost all the RECs have elaborate trade liberalisation schemes. Whereas some RECs like CEMAC, SACU and UEMOA have established custom unions, others are still at different stages of creating FTAs. For the advancement of the integration agenda, a comprehensive strategy is needed to fast track trade liberalisation programmes in member countries of RECs. To achieve this goal, policies in the areas of trade, investment, mobility of factors of production must be harmonised rapidly within and across regional economic communities. An important part of this scheme should include a clear and unified definition of rules of origin.

One of the consequences of regional integration, particularly in terms of trade liberalisation policy is that some countries do loose out on tariff revenue, a vital component for financing a country's budget. It is therefore important that any strategy

of trade liberalisation should include a mechanism for compensating countries that lose tariff revenue.

The promotion of trade within and outside Africa also requires the dismantling of non-tariff barriers. Trade flows on the continent would also be enhanced if efforts were made to harmonise custom procedures; reduce the number of roadblocks; improve the efficiency of maritime ports and to implement other trade facilitation policies. Furthermore, the provision of effective transport, communication and physical infrastructure would also ensure that communities are brought together and the cost of trading is substantially reduced.

The success of regional integration also hinges critically on member countries pursuing convergent macroeconomic policies. Misalignments of tariffs, inflation, exchange rates, debt to GDP ratios, rate of money growth and other vital macroeconomic variables between member countries would be disruptive to the regional integration process. In addition, these misalignments could lead to rent-seeking activities by government and private individuals that could stifle legitimate investment opportunities. This could contribute to the demise of the economy of a member country, weakening the whole integration process. It is therefore imperative that the process of strengthening regional integration includes guidelines for the convergence of macroeconomic and trade policies of the entire regional space so as to strengthen the overall regional integration agenda. Strengthening and deepening of Africa's financial markets and institutions are also essential for the mobilising of financial resources needed to finance integration projects such as infrastructure. These institutions also enhance the payment system and contribute to facilitating trade within and outside the regional communities. In addition to improving the financial markets, efforts must be made to encourage the RECs to establish development banks in their regions to assist member countries in financing infrastructure projects. However, the integration of the financial markets in Africa requires the harmonisation of national policies and procedures governing these markets and institutions across member countries.

#### NOTES

- <sup>1</sup> The five criteria are: (1) fully produced or obtained in a member state, (2) maximum c.i.f. value of imported material input at 60 per cent of total material cost, (3) minimum local value added at 35 per cent of ex-factory cost, (4) products having a special significance for economic development at a minimum local value added of 25 per cent of ex-factory cost, and (5) a level of imported material input transformation requiring reclassification different from the previous import tariff title. COMESA continues to align these rules of origin in step with the changing environment of the World Trade Organisation (WTO) and World Customs Organisation (WCO).
- <sup>2</sup> In 2000 CEMAC eliminated the temporary surtax provision that supplemented the common external tariff. The surtax was designed to lessen the impact of the removal of tariff barriers on domestic manufacturing businesses.
- <sup>3</sup> Mauritania withdrew from ECOWAS in 2000.

## CHAPTER 8

DEVELOPMENTS IN REGIONAL INTEGRATION  
IN WESTERN ASIA AND ARAB REGION8.1. REGIONAL INTEGRATION AND BILATERAL AND MULTILATERAL  
AGREEMENTS: HARMONY OR DISCORD?

In the current era of globalisation and huge regional blocs, it has become imperative for Arab countries to strive for integration in order to confront the challenges posed by new economic developments, such as the rapid opening up of the world economies and the increasing competition faced by developing countries from the products of large industrialised countries. This analysis applies to Arab countries, because, as has been indicated earlier, the Arab world generates a mere 3.5 per cent of global foreign trade. At the regional level, the situation is not much different as the ratio of Arab intra-regional trade to overall Arab trade was no more than 8.8 per cent in 2004, given that the Greater Arab Free Trade Area (GAFTA) came into full implementation in early 2005 exempting products of Arab origin traded in the region from custom fees and similar taxes.

The countries of the ESCWA region and the Arab world face a number of challenges in terms of trade and exchange transactions and the agreements that govern them. The current trend in international trade agreements is towards bilateral, regional or multilateral agreements (Box 8.1).

**Box 8.1. Expert group meeting to assess progress made in Arab regional integration and interregional cooperation, Beirut, 7 and 8 July 2005**

The expert group meeting to assess progress made in Arab regional integration and interregional cooperation was held by the ESCWA secretariat in Beirut on 7 and 8 July 2005, with the League of Arab States, the Council of Arab Economic Unity, the Arab Center for Strategic Studies and the Arab Society for Economic Research. The meeting invited a number of Arab experts to discuss hot topics related to regional integration and to cooperate with LAS, CAEU, CSSR and ASER, with a view to contributing to an understanding of the difficulties of the Arab bloc in keeping pace with globalisation, and to invite international and Arab economic organisations to a round table to discuss the future of regional integration in the light of the bilateral and multilateral agreements concluded between developing and developed nations.

Key participants in the round table discussions were the executive secretaries of the five United Nations regional commissions, namely, the Economic Commission for Europe, the Economic and Social Commission for Asia and the Pacific, the

*(Continued)*

**Box 8.1. (Continued)**

Economic Commission for Africa, the Economic Commission for Latin America and the Caribbean and ESCWA, and the Council of Arab Economic Unity. Other participants included the Secretary General of the Council of Arab Economic Unity, representatives from the Arab Center for Strategic Studies, the Arab Society for Economic Research, and League of Arab States and a number of key experts on regional integration from the Arab world.

The meeting aimed to study regional relations in the light of bilateral, regional and interregional agreements, in addition to the future of Arab intra-regional trade in the context of GAFTA and under bilateral and multilateral trade agreements. A number of regional integration issues were discussed, including the current status of regional integration at the regional and sub-regional levels, the sectoral channel to regional integration, a definition and assessment of developments in integration in some Arab economic sectors and the effects of regional and interregional agreements.

Regional and interregional integration have never been more important. The new international trade system that matured under the auspices of WTO allows for the formation of regional blocs which are granted exceptions from the basic principles of the General Agreement on Tariffs and Trade (GATT), in order to allow it to assimilate such existing large blocs as EU. Article XXIV of GATT not only assimilates existing blocs but encourages the establishment of further regional blocs, in particular between developing countries, while article XXV gives further leeway to collective agreements between countries by granting concessions under GATS. Article V of GATS amends article XXIV of GATT with regard to services. While encouragement was first given in 1979 to regional integration through international agreements within the Tokyo Round by means of the empowerment clause that was aimed at developing countries, and while developing countries have come to view regional integration as acceptable and compatible with the WTO framework, a tendency is emerging on the part of certain economically developed nations, which is possibly politically motivated, to call for the conclusion of bilateral partnerships and free trade agreements between developing and developed nations, such as the EuroMed partnership agreements and the free trade agreements between the United States and certain Arab countries. Care should be taken to ensure that bilateral agreements do not take precedence over efforts aimed at Arab regional integration and the advantages that multilateral agreements provide, and that they do not consolidate and reinforce deficiencies in the practical implementation of multilateral agreements.

Some Arab countries justify bilateral agreements with developed countries on the grounds that WTO has not been able to convince developed countries to make the desired concessions to developing countries, and that similarity in the production systems of the Arab countries will always remain a stumbling block for regional economic integration. Because of its concerted efforts to achieve complete regional

integration between the Arab countries, ESCWA believes that regional agreements are not based on similarity but on complementarity, and that trade is hindered by customs and non-customs barriers and not by a similarity of goods produced. Rather than seeking bilateral agreements, the countries of the Arab world should strive to implement complete customs liberalisation as agreed under GAFTA and to eliminate the non-customs barriers that continue to delay liberalisation of Arab intraregional trade and regional integration. The key areas hindering customs liberalisation are incomplete detailed rules of origin; opaque administrative and customs procedures; immature dispute settlement mechanisms; and high transport costs.

Regional integration is based on production and production costs, and liberalisation of commodities exchange and elimination of all customs and non-customs barriers will therefore advance regional integration. The countries of the Arab world must strive to increase their understanding of international trade and the new global trade system, which will help to increase foreign investment in the Arab region, may stimulate the return of part of the Arab capital currently invested beyond the region, and contribute to developing a regional mechanism for achieving sustainable development in the region. The danger of the recent shift towards bilateral agreements does not only lie in the speed with which such agreements are concluded, but also in the kind of commitments they impose. Developing countries are making commitments most of which exceed the commitments made by those countries in WTO and regional agreements. The cost of such concessions may be far greater than the benefits they may be expected to reap and may divert the course of intraregional trade. ESCWA is greatly concerned that developing countries, the majority of which were cautious in their anticipation of any benefits from WTO membership, are signing bilateral agreements of which the effect on the local economy is unclear. Not only the destiny of the multilateral world trade system but also the destiny of regional and interregional integration is at stake.

## 8.2. REGIONAL INTEGRATION

While some progress was made in Arab economic integration in 2004, in particular in intraregional investment, tourism and labour remittances, that progress remains below the aspirations of the member countries, especially for intraregional trade. Table 8.1 reviews core indicators of Arab economic integration, including intraregional trade, investment, tourism, ODA and labour remittances. Growth rates in those fields vary. There was progress in such sectors as tourism: a large percentage of tourists in Arab countries come from other Arab countries, and in intra-regional investment, with more than 48.2 per cent of FDI being invested by other Arab countries. While there was a reduction in the ratio of intraregional trade to international trade to below 10 per cent, in certain Arab countries, including Jordan and the Syrian Arab Republic, intra-regional trade makes up a considerable proportion of foreign trade. Albeit labour remittances declined, they remain one of the most important sources of foreign currency for such labour-exporting Arab countries as Egypt, Jordan, the Syrian Arab Republic and Yemen.

TABLE 8.1. Selected indicators for regional integration between the Arab countries, 2001–2004

Indicator	2001	2002	2003	2004
Ratio of intra-regional trade to foreign trade	7.5	8.1	7.8	8.8
Ratio of intra-regional investment to overall FDI	34.3	36.0	39.6	48.2
Ratio of intra-regional tourism to overall tourism	40.4	44.6	45.4	—
Ratio of development aid to GDP	1.37	1.67	1.44	—
Ratio of intra-regional labour remittances to GDP	4.4	4.9	5.7	6.1

*Sources:* Inter-Arab Investment Guarantee Corporation, Report on Investment Climate in the Arab Countries 2004, Kuwait, 2005. ESCWA, based on IMF Direction of Trade Statistics Yearbook, 2001, and IMF, Direction of Trade Statistics Quarterly, June 2002, June 2003, June 2004 and June 2005. World Tourism Organisation, Tourism Market Trends, Middle East, 2004 edition. World Development Indicators Database, www.worldbank.org.

### 8.2.1. Arab Intraregional Trade

Table 8.2 shows the increase in value of foreign and intraregional trade in the Arab world over the past 4 years. In 2004, the volume of foreign trade with Arab countries amounted to some \$647.5 billion, an increase of 22.7 per cent over 2003. The value of foreign trade to Arab countries has been rising since 1998, and has registered the highest growth rate over the past 2 years.

That increase can be attributed to the rise in the value of oil exports in 2003. Oil is largely exported beyond the Arab countries and increases the absolute value of foreign trade in the region. In 2004, many agreements were signed between Arab and other countries: Lebanon signed a Free Trade Agreement with EU, and Kuwait, Qatar, the United Arab Emirates and Yemen signed bilateral agreements to develop trade and

TABLE 8.2. Foreign and intra-regional trade in the Arab World, with and without oil, 1997–2004<sup>a</sup>

	1997	1998	1999	2000	2001	2002	2003	2004
Overall foreign trade	312,768	270,715	305,375	400,919	406,120	417,950	527,350	647,521
Intra-regional trade <sup>b</sup>	28,424	26,038	26,937	32,274	30,544	33,925	41,131	57,451
Ratio of intra-regional trade to overall foreign trade	9.1	9.6	8.8	8.1	7.5	8.1	7.8	8.8
Ratio of intra-regional trade to overall foreign trade without oil	14.0	13.3	13.3	14.0	11.5	11.8	13.0	14.0

*Sources:* ESCWA, based on IMF Direction of Trade Statistics Yearbook, 2001; and IMF, Direction of Trade Statistics Quarterly, June 2002, June 2003, June 2004 and June 2005; OAPC, Annual Statistical Report 2004 and 2005.

<sup>a</sup>Excluding the Comoros Islands, Djibouti, Iraq, Somalia and the West Bank and Gaza Strip because of lack of reliable data.

<sup>b</sup>Figures include reimportation.

investment relations with the United States of America. Bahrain, Morocco and Oman signed free trade agreements with the United States of America, while the United Arab Emirates started negotiations for a similar agreement. In addition, free trade agreements were signed between Jordan and Singapore; Egypt and MERCOSUR; and between the GCC States and India.

The value of intra-regional Arab trade has shown marked improvement since 1998, the year following the entry into force of GAFTA in January 1997. The value of intra-regional trade in 2004 was \$57.4 billion, a rise of 39.7 per cent over the previous year. That rise is attributable to several factors, most importantly, the signing of numerous trade agreements between Arab countries, including the Agadir Agreement in February 2004, and an increase in agricultural and food exports to GCC member countries in particular, whose markets constitute an outlet for Arab agricultural products that may not be able to compete on world markets. Albeit planned for 2007, the 100 per cent exemption of Arab goods from all custom duties in the GAFTA area has recently come into effect and should positively affect the future value and rates of intraregional trade.

While intra-regional trade increased, its ratio to overall foreign trade in 2004 was a mere 8.8 per cent, up from 7.8 per cent in 2003. The causes for that modest ratio are set out below:

1. A rise in the value of foreign trade to Arab countries, because of the rise in oil exported mostly to beyond the region, so that it constitutes a small proportion of intra-regional exports.
2. The similarity in production structures of the Arab countries and their heavy dependence on oil and oil derivatives, which limits the need for intra-regional export and import and encourages imports from beyond the region.
3. Remaining non-customs obstacles in GAFTA.

The fact that intra-regional trade increased in 2002 and 2003 while oil revenues also increased is because of an appreciable rise in intra-regional trade and, in particular, agricultural trade between such non-oil producing countries as Egypt, Jordan, Lebanon, the Syrian Arab Republic and Yemen, as Table 8.4 shows. When oil is excluded from foreign trade, the ratio of intraregional trade to overall foreign trade rises considerably, to 13.1 per cent in 1998 and 14 per cent in 2004, a yearly average of 13.3 per cent for the years under consideration, compared to an average 8.4 per cent if oil is included (Figure 8.1). Many measures could be taken by the Arab countries to increase non-oil exports, including the opening of new markets through concluding further agreements and strengthening the competitive capacity of such exports in foreign markets. Many trade agreements were concluded between Arab and other countries for that purpose in 2004. Lebanon signed a Free Trade Agreement with EU, and while Algeria, Lebanon, the Sudan and Yemen remain at the WTO accession negotiations stage, the Libyan Arab Jamahiriya has gained observer status and Saudi Arabia recently acceded to the Organisation.

Arab countries must intensify their efforts to remove all obstacles to Arab intraregional trade liberalisation in order to achieve the greatest benefit from regional

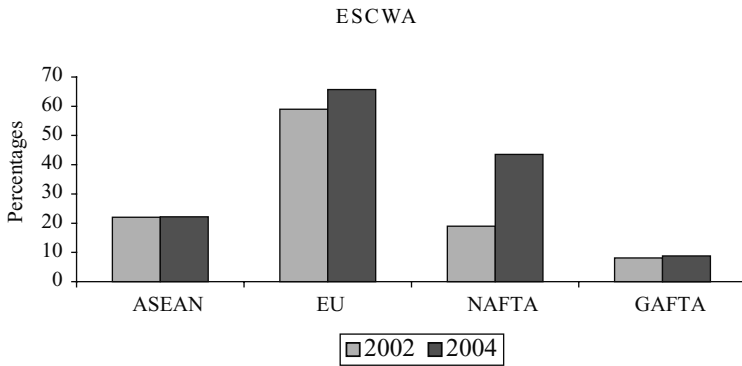


FIGURE 8.1. Ratio of intra-regional trade to international trade in certain regional blocs, 2002 and 2004  
(Source: Based on Table 8.3)

integration and reduce the dependence of Arab economies on the outside world, thereby making them less vulnerable to the effects of external pressures. That may be achieved either by signing further agreements on trade exchange between the Arab countries and activating GAFTA, or by diversifying Arab intraregional and interregional export structures and reducing dependence on oil and oil products.

Table 8.3 and Figure 8.1 show the value of intraregional trade and its ratio to foreign trade in the most important regional blocs in the world for 2002 and 2004.

In 2004, the value of intra-regional trade between ASEAN member countries rose from \$166.1 billion in 2002 to \$238.8 billion; between NAFTA member countries from \$622 billion in 2002 to \$1424.8 billion; and between the member countries of GAFTA from \$30.54 billion in 2002 to \$51.9 billion. The biggest rise was seen in EU: its 2004 enlargement to comprise 25 countries positively reflected on its intra-regional trade volume, which rose from \$2650 billion in 2002 to \$4811.3 billion in 2004. Expressed in percentages, between those 2 years ASEAN witnessed limited growth

TABLE 8.3. Intra-regional trade flows in certain regional bloc, 2002 and 2004

Regional bloc	Value of intra-regional trade		Ratio of intra-regional trade to foreign trade	
	2002	2004	2002	2004
ASEAN	166.1	238.8	22.0	22.2
EU <sup>a</sup>	2650	4811.3	59	65.7
NAFTA	622	1424.8	19	43.5
Arab countries <sup>b</sup>	33.9	57.4	8.1	8.8

Source: IMF, Direction of Trade Statistics Quarterly, June 2005 and June 2003.

<sup>a</sup> Excluding Iraq.

<sup>b</sup> The number of European Union member countries grew from 15 to 25 on 1 May 2004.

TABLE 8.4. Ratio of intra-regional trade to foreign trade for selected Arab countries, 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Bahrain	23.5	15.2	14.5	15.3	14.5	15.6	16.4	17.5
Algeria	2.6	2.2	2.1	1.7	1.5	1.7	2.9	2.8
Egypt	6.8	7.3	7.5	6.6	7.0	7.6	9.0	10.1
Jordan	31.4	26.8	27.7	28.8	11.6	26.5	26.2	33.7
Kuwait	6.0	7.6	6.5	1.3	n/a	7.0	7.5	6.5
Lebanon	10.3	9.7	9.9	12.3	14.6	16.6	16.8	19
Libyan Arab Jamahiriya	7.5	8.1	7.1	6.1	6.5	6.6	6.5	5.6
Mauritania	7.0	4.0	3.0	3.3	2.9	4.5	4.0	4.7
Morocco	8.7	5.0	4.2	4.8	5.0	8.0	8.1	6.9
Oman	19.6	25.1	22.4	20.4	17.3	18.4	14.1	17.8
Qatar	7.5	10	8.8	8.6	7	7.1	4.5	7.0
Saudi Arabia	9.2	9.8	9.5	7.6	7.6	6.9	6.5	7.6
The Sudan	35.4	17.1	18.4	16.3	14.1	14.3	22.8	18.0
Syrian Arab Republic	8.2	16.4	14.3	12.3	11.3	10.8	14.4	17.5
Tunisia	6.1	5.7	5.4	7.8	7.1	7.0	8.7	7.6
United Arab Emirates	6.6	8.3	7.9	7.9	7.0	6.8	7.0	6.5
Yemen	12.2	19.9	14.4	15.8	13.5	16.2	18.5	23

Sources: IMF, Direction of Trade Statistics Yearbook, 2001; IMF, Direction of Trade Statistics Quarterly, June 2002; June 2003; June 2004 and June 2005.

from 22 to 22.2 per cent, while NAFTA showed appreciable growth, given the small number of countries in that bloc, namely, Canada, Mexico and the United States, from 19 to 43.5 per cent. The greatest increase, from 59 to 65.7 per cent, was achieved by EU, and confirms the great success of the European regional integration experience, considered the most successful in the world. Since its expansion, the European market has been able to absorb the exports of its new member countries, mainly in Eastern Europe, which may not have the capacity to compete in the world markets.

Arab countries' ratio of intra-regional trade to foreign trade increased from 8.1 per cent in 2002 to 8.8 per cent in 2004; the value of that trade went up by 69.3 per cent from \$33.9 billion in 2002 to \$57.4 billion in 2004. Such a notable increase can be attributed to the increase in non-oil exports and, in particular, agricultural products from non-oil producing countries to GCC States. The GCC is able to absorb those exports because of its increased purchasing power, the inability of such exports to compete in the world markets in the absence of preferential treatment, and the rise in oil exports from the GCC member countries to non-oil exporting countries. GAFTA has expanded and now comprises 19 countries and the 100 per cent removal of custom duties on Arab products is expected to positively affect the future value and ratio of Arab intra-regional trade. Table 8.4 shows the development of Arab intra-regional trade ratios to foreign trade for the years 1997–2004.

Ratios of intra-regional trade to foreign trade showed marked growth in many Arab countries between 1997 to 2004 (Table 8.4), particularly in such agricultural countries as Egypt, where ratios increased from 6.8 per cent in 1997 to 9 per cent in 2003 and

TABLE 8.5. Ratio of intra-regional trade to GDP in the Arab countries, 1997–2004

	1997	1998	1999	2000	2001	2002	2003	2004
Bahrain	38.5	24.7	22.3	22.4	22.8	22.6	26.2	30.3
Algeria	1.2	0.9	0.9	1	0.9	1	1.6	1.7
Egypt	1.5	1.7	1.6	1.8	2.1	2.2	3.2	5
Jordan	23.4	17	16.7	19.6	7.5	22.2	27.1	36.4
Kuwait	4.5	5.1	4	0.8	n/a	4.8	4.7	4.9
Lebanon	5.6	4.6	4.1	5.2	6.5	7	8.2	10
Libyan Arab Jamahiriya	3	3	2.8	3	3.4	5.1	5.3	5.4
Mauritania	7.1	4.5	3	3.8	3.5	6	5.6	6.9
Morocco	3.7	1.8	2.3	3	3	4.7	4.8	4.2
Oman	15.5	19.7	16.8	16.3	15.5	13.9	11	15
Qatar	5.5	8	6	7.1	6.7	5.9	3.7	6.4
Saudi Arabia	5	5	4.4	4.5	4.5	4.1	4.2	5.2
The Sudan	7.3	4	4	4	3.7	3.1	21.1	6.8
Syrian Arab Republic	5.6	7	6.2	6.7	6.7	6.6	10	12.6
Tunisia	4.7	4	4.7	5.8	6	5	6.1	6.2
United Arab Emirates	7	8.7	9	9	8.4	7.7	7.1	8.7
Yemen	7.7	11.5	8.8	10.6	9.2	11	16.6	18.7
All Arab countries	5	4.7	4.6	4.7	4.6	5	5.5	6.6

Sources: The Unified Arab Economic Report, 2005, first edition; IMF, Direction of Trade Statistics Yearbook, 1999; IMF, Direction of Trade Statistics Quarterly, June 2002; June 2003, June 2004 and June 2005.

10.1 per cent in 2004; Jordan, where rates rose from 26.8 per cent in 1998 to 28.8 per cent in 2000 and 33.7 per cent in 2004; and Lebanon, with rates of 9.7 per cent in 1998 increasing to 19 per cent in 2004. Ratios varied in the GCC member countries given their heavy dependence on oil, which is mostly exported outside the region, and the start of oil price rises in 2003. Kuwait's ratio went down from 7.5 per cent in 2003 to 6.5 per cent in 2004. Jordan, Saudi Arabia and the United Arab Emirates are the top Arab countries in terms of intra-regional trade volume for 2004, amounting to some \$26 billion and representing some 46 per cent of all Arab intra-regional trade for that year. Yemen registered the greatest growth, from 18.5 per cent in 2003 to 23 per cent in 2004. Ratios of intra-regional to foreign trade ratios in the Arab Maghreb countries decreased: in the Libyan Arab Jamahiriya they went down from 6.5 per cent in 2003 to 5.6 per cent in 2004 and in Morocco from 8.1 to 6.9 per cent. Tunisia, where the ratio decreased from 8.7 to 7.6 per cent over the same period, signed a free trade agreement with the EU in 2004.

Table 8.5 presents a core indicator for regional integration between the Arab countries, namely, the ratio of intra-regional trade to GDP which, over the past 4 years, has increased in a number of such Arab countries as Algeria, Egypt, Lebanon, the Libyan Arab Jamahiriya, Morocco and Yemen. Some of the GCC member countries show a decrease in that ratio compared to non-member countries, which is attributable to the rise in the value of GDP in those countries, with the exception of Bahrain, which achieved a ratio of 30.3 per cent in 2004.

The fact that the main two or three trading partners for the GCC member countries are other member countries may be attributed to those countries' geographical proximity and the successful efforts to strengthen cooperation and regional integration between them that has made the Council, one of the most, if not the most, successful regional integration experiences in the Arab region (ESCWA, 2005a: table 13).

In the majority of the Arab Maghreb countries another Maghreb country constituted the main 2004 trading partner, with the exception of in Morocco, where the main trading partner for 2004 was Saudi Arabia.

Saudi Arabia, the United Arab Emirates, Jordan and Egypt retained their first four positions in terms of absolute value in 2003 and 2004, but the fifth position changed from Bahrain to Oman, while the Syrian Arab Republic maintained to seventh place during that period. Morocco moved downwards from eighth to tenth position, and the Sudan, Algeria and Mauritania were in the last three positions in 2004. Qatar moved up to 12th place in 2004 (ESCWA, 2005a: table 14).

Jordan maintained its top position in terms of relative value in both 2003 and 2004, while Yemen moved from third to second position in 2004, replacing the Sudan, which moved into fourth position, and Lebanon, which went into third position. Egypt and Tunisia managed to hold on to their eighth and ninth positions in the years under consideration (Figure 8.2).

It is natural that the oil-producing countries rank lowest, given the dominance of oil exports, which reduce the ratio of intra-regional trade to foreign trade. Both Saudi Arabia and the United Arab Emirates are top of the list of absolute value but are in 10th and 13th place respectively in terms of relative value for 2004.

In conclusion, Arab intra-regional trade showed a marked rise between 2003 and 2004. While there was an increase in oil revenues, the intra-regional trade ratio to foreign trade went up from 7.8 per cent in 2003 to 8.8 per cent in 2004, which can be attributed to a perceptible rise in the intra-regional trade of non-oil countries, which increased the overall percentage for all Arab countries. That rise in the percentage of Arab intra-regional trade remains hostage to the increase in trade with Arab countries with larger economies, such as Saudi Arabia and the United Arab Emirates, whose foreign trade constituted some 54.2 per cent of all the foreign trade of the Arab countries.

### *8.2.2. Progress Made in Implementing GAFTA*

In 2005 GAFTA entered its eighth year. In that year products of Arab origin were exempted from all customs fees and similar taxes, meaning that total liberalisation, due for the end of 2007, was brought forward. It is expected that an Arab customs union will be set up in 2008 in order to enable a common Arab market to be established by 2020. At the end of 2004, GAFTA had 18 member countries, namely, Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, the Libyan Arab Jamahiriya, Mauritania, Morocco, Oman, Palestine, Qatar, Saudi Arabia, Somalia, the Syrian Arab Republic, Tunisia, the United Arab Emirates and Yemen. The agreement with the Sudan came into force at the start of 2005. Three Arab countries, two of which are among the

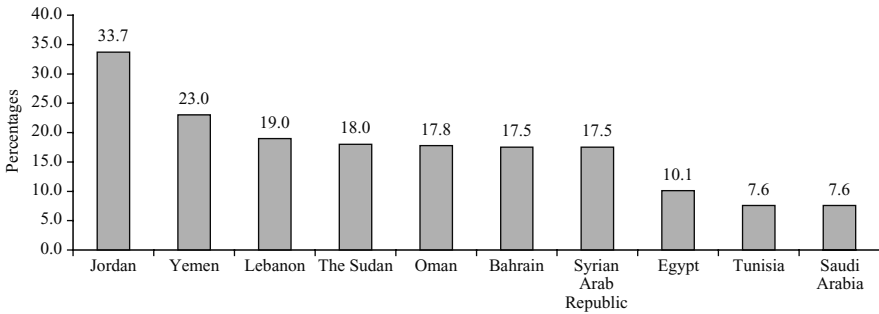


FIGURE 8.2. Top 10 Arab countries in terms of intra-regional trade to foreign trade ratios, 2004  
(Source: Based on tables 4 and 6)

group of least-developed Arab countries, namely, Djibouti and the Comoros Islands, have not joined to date. The Execution Programme of Agreement to Facilitate and Develop GAFTA permits the granting of facilities to those countries to join the Area, and preferential treatment to less developed countries and Palestine.

It is expected that GAFTA will play a role in stimulating Arab intraregional trade and, in particular, non-oil trade, thereby reducing the economic dependence of the Arab countries on exports of oil and oil derivatives and rendering them better able to withstand external impacts. It also aims to provide the necessary finance and such infrastructure facilities as ports and roads to promote that trade, limit public sector control over imports and exports, and create an appropriate environment to attract FDI. Many obstacles continue to hamper the work of GAFTA, most importantly the many quantitative non-customs import barriers; difficulties in the removal of those barriers; and the desire of member countries to protect their small industries from foreign competition. Incomplete rules of origin for Arab products, the remaining work on some exceptions in certain Arab countries, restrictions on the freedom of movement of capital and the increase in transport costs between member countries, despite their geographical proximity, also hinder its effectiveness.

### 8.2.3. Arab Intra-regional Investment

Arab intra-regional investments grew robustly in 2004, realising a percentage growth of over 53 per cent. The volume of such investment increased from \$3.8 billion in 2003 to \$5.9 billion in 2004, resulting in a total Arab intra-regional trade balance of \$35.9 billion for the period of 1985 to 2004, or an annual average growth of \$1.8 billion (IAIGC, 2004: 6).

Such investment is largely directed into the service sector, which absorbed 75 per cent in 2004. The industrial sector ranked second with 23 per cent. The foremost country exporting Arab intra-regional investment was the United Arab Emirates, which exported 33.5 per cent of all intra-regional Arab investment during 2004. The

second country in that respect was Saudi Arabia with 28.1 per cent, and third place went to Kuwait, with 14.2 per cent (IAIGC, 2004: 6–7).

The robust growth in Arab intra-regional investment can be attributed to the efforts of those countries to support FDI in general and Arab intra-regional investment in particular. In 2004, many measures were taken to facilitate the flow of such investment and improve the investment climate in Arab countries. In that year, 41 such measures were taken by 10 Arab countries, and 78 bilateral and multilateral agreements were concluded between Arab countries and other countries, including other Arab countries (IAIGC, 2004: 16). Twelve Arab countries organised some 212 marketing events to support private investment flows, 12 Arab countries participated in 93 such events, and 10 delegations from Arab countries took part in visits to other countries, including Arab countries, to discuss ways of strengthening FDI flows, including Arab intra-regional investment (IAIGC, 2004: 17).

*Countries exporting Arab intra-regional investment* The United Arab Emirates heads the list of Arab countries exporting intra-regional investment in 2004, with investments worth \$1977.9 million, or 33.5 per cent of all Arab intra-regional investment (ESCWA, 2005a: table 15). That investment was divided between 12 Arab countries. Saudi Arabia took the greatest share of 36.4 per cent, followed by Egypt with 36.2 per cent and Lebanon with 11.8 per cent. Saudi Arabia was the second largest exporter, with investments totalling some \$1,654.5 million divided over 11 Arab countries, with the United Arab Emirates taking the lion's share of 30.2 per cent. Kuwait came in third position with investments of some \$838.2 million, 14.2 per cent of all Arab intra-regional investment, divided over nine Arab countries, with Lebanon receiving the biggest portion, 28.2 per cent, followed by Algeria with 25 per cent and Morocco with 12.6 per cent.

The value of Arab intra-regional trade exported by those three countries was about \$4.5 billion, or some 75.7 per cent of all Arab intra-regional trade for that year. Bahrain's share of intraregional investment showed a substantial decrease of some 50 per cent, falling from \$41.3 to \$21.2 million, as did investments from Lebanon, which fell from \$130.8 to \$28.3 million over the same period, an equivalent of 78.4 per cent. Tunisia's investments witnessed a threefold decrease, while Arab intra-regional investment from Algeria, Egypt, Jordan, Kuwait, Morocco, Oman, Saudi Arabia, the Syrian Arab Republic and the United Arab Emirates rose by 132, 76.5, 25.7, 28.7, 29.4, 42.1, 21.9, 1,747.6 and 683 per cent, respectively.

The ratio of Arab intra-regional investment to FDI rose from 36 per cent in 2002 to 38 per cent in 2003. In 2004, it totalled 48.2 per cent meaning that some half of all FDI in the Arab countries is Arab investment. That is a positive state of affairs, and underlines the Arab countries' success in gaining the trust of Arab investors, particularly in view of the estimated \$1.2 trillion value of Arab capital invested outside the Arab region. The return of even a small part of such investment to the region would surely stimulate positive changes in the Arab economies in terms of increased Arab intra-regional investment or development funding. In Jordan the ratio of Arab intra-regional investment to FDI went up from 2.9 per cent in 2003 to 6.6 per cent in

2004; in Egypt it rose from 15.5 per cent in 2002 to 46.6 per cent in 2003 and 88.5 per cent in 2004. The greatest increase occurred in Morocco's ratio, which rose from 2.6 per cent in 2002, to 29 per cent in 2003 and 43.8 per cent in 2004. Morocco has been the main destination for Arab capital investment in tourism over the past few years.

*Countries receiving Arab intra-regional investment* Having held second place in 2003, Saudi Arabia was the foremost recipient of Arab intra-regional investment in 2004 (ESCWA, 2005a: table 16) with investments to a value of \$1,297.3 million or the equivalent of 21.9 per cent of all Arab intra-regional trade, 55.4 per cent of which originated in the United Arab Emirates and 24 per cent in Jordan, followed by Egypt and Lebanon. Egypt received investments worth \$1,109 million, or some 18.8 per cent of all Arab intra-regional trade in 2004, the majority of which, some 64.6 per cent, came from the United Arab Emirates, while Saudi Arabia contributed 23 per cent. Lebanon received investments to a value of \$1,050.7 million, having held first Arab place in 2003; investments in that country largely came from Saudi Arabia, with 38.3 per cent, and the United Arab Emirates, with 22.3 per cent. The combined value of Arab investments in those three countries was some \$3.5 billion, the equivalent of 58.6 per cent of all Arab intra-regional trade in 2004. It is worth mentioning here that a Free Trade Area has been set up between Lebanon and the GCC States.

Compared with 2004, Arab intra-regional investments rose in nine Arab countries, namely, Algeria, Bahrain, Egypt, Jordan, Lebanon, the Libyan Arab Jamahiriya, Saudi Arabia, the Syrian Arab Republic and Tunisia whereas investments in three countries decreased, namely, in Morocco, the United Arab Emirates and Yemen.

There was a marked increase in Arab investment in Algeria, Egypt, Lebanon and Saudi Arabia, while the volume of such investment declined in Morocco, the United Arab Emirates and Yemen. Arab investment in Algeria almost tripled, from \$65.6 million in 2003 to \$260.5 million in 2004, whereas Arab investment in Egypt rose ninefold, from \$110.2 million to \$1109 million during the same period.

In general, the largest proportion of intra-regional investment came from member countries of the GCC, with the exception of the Arab Maghreb, where one of the other Maghreb countries or Egypt were the largest source of investment.

In 2004, Arab intra-regional investment concentrated on the service sector, which absorbed 75.4 per cent of such investment, followed by the industrial sector, which took 23.2 per cent and the agricultural sector, with 12.9 per cent (IAIGC, 2004). While violence in Iraq and tensions in the Palestinian territories continued, Arab intra-regional investment exported by those two countries rose, with Iraq exporting \$4.0 million worth of investment in 2003, rising to \$35.3 million in 2004, or a growth of 787.5 per cent, 67.1 per cent of which went to Morocco and 19.8 per cent to Jordan. Arab intra-regional investment from Palestine went up from \$12.3 million in 2003 to \$47.1 million in 2004, an increase of 283 per cent, with Algeria obtaining the largest share, of 55.6 per cent. The largest share of intra-regional investment, whether from member or non-member countries of the GCC, was invested in GCC

member countries, in addition to Egypt and Lebanon. That may be attributed to the investment-promoting facilities and laws those countries enjoy.

*Efforts made to stimulate Arab intra-regional investment* Continuing efforts to stimulate Arab investment at both the national and regional levels are set out below.

*At the national level.* The Arab countries pursued a policy of encouraging investment, concentrating on four main efforts, namely:

- (i) The development of laws to improve the legal environment by supporting transparency and protecting intellectual property rights.
- (ii) The development and amendment of laws that encourage investment.
- (iii) The adoption of such modern investment marketing techniques as the organisation of marketing events, conferences, seminars and trade fairs; the setting up of 43 free trade zones and special industrial zones in seven Arab countries, namely, Algeria, Egypt, Jordan, Morocco, Tunisia, Saudi Arabia and Yemen; a project for a united Arab Marketing bureau; and the first electronic Arab Investment Map.
- (iv) The establishment of an FDI database in eight Arab countries.

Egypt, Jordan and Yemen concentrated on marketing tourism and industry.

*At the regional level.* New areas in the oil, gas, communications and services sectors in the region were unlocked for FDI. In the period up to 2004, Arab countries had signed some 78 bilateral and multilateral agreements with the United States of America, EU and Asian countries. The most significant of those agreements are set out below:

- (i) The Free Trade Agreement between the EFTA States and the Republic of Tunisia.
- (ii) The Free Trade Agreement between the EFTA States and Lebanon.
- (iii) Free trade agreements between the United States of America and each of Bahrain, Morocco and Oman.
- (iv) Agreements concerning the development of trade and investment relations between the Government of the United States of America and each of Kuwait, Qatar, the United Arab Emirates and Yemen.
- (v) The Free Trade Agreement between Jordan and Singapore.

The most important agreements that remain subject to negotiation are set out below (UNCTAD, 2005: annex table A.II.2):

- (i) An association agreement between the EU and the Syrian Arab Republic.
- (ii) Free trade agreements between Singapore and each of Bahrain, Egypt, Kuwait and Qatar.
- (iii) A free trade area agreement between the United States of America and the United Arab Emirates.
- (iv) A free trade area agreement between the GCC and China.
- (v) A free trade area between Egypt and Turkey.

#### 8.2.4. Arab Intra-regional Tourism

Tourism is a promising sector for Arab regional integration. It has the potential to become a pillar of Arab intra-regional economic integration, given that the largest proportion of tourists in most Arab countries come from other Arab countries. That is because of a number of factors, which are set out below:

- (a) A close similarity in customs and traditions and a common language, which facilitates communication between Arab populations.
- (b) Arab tourism does not require heavy outlay on infrastructure and, in particular, on large hotels. Most Arab tourists travel with their families and prefer accommodation in family housing and furnished flats, in particular those who are visiting areas outside the main cities.
- (c) Family connections and intermarriage between nationals of different Arab countries create “intra-regional extended families”. Furthermore, expatriate families and migrant workers living in other Arab countries visit their homelands in summer.
- (d) The common language makes dealings with airports, hotels and shops easier.
- (e) The diverse geography and history of the region stimulate tourism between the Arab countries. Variety in history, civilisation, climate and temperature give certain countries relative advantages not provided by other economic sectors.
- (f) The growth of so-called “medical tourism” between Arab countries and, in particular, in Jordan, which hosts a number of visitors from Iraq, the Libyan Arab Jamahiriya, the Syrian Arab Republic and Yemen who come for medical reasons.
- (g) Educational tourism: numbers of Arab students studying at Arab universities have increased since 11 September 2001. Thousands of Arab students have returned from American universities to attend Arab universities, in Egypt, Jordan and Lebanon in particular.

A comparison of Arab intra-regional tourism shows that Saudi Arabia receives most tourists, with an average of 4 million Arab visitors per year between 2001 and 2003. The Syrian Arab Republic comes second, with an annual average of some 3 million visitors over the same period. Tunisia is in third place, with an average of 2 million tourists. Egypt’s annual average, estimated at some 1 million tourists, puts it in fourth place (ESCWA; 2005a: table 18).

Ratios indicate that, in many Arab countries, Arab intra-regional tourism constitutes a significant proportion of overall tourism. Arab intra-regional tourism in Jordan grew from 52.8 per cent in 1995 to 66.4 per cent in 2003, indicating that the Jordanian tourism market depends heavily on such tourism and, in particular, from GCC member countries (ESCWA, 2005a: table 19). Ratios are even higher in Syrian Arab Republic, where the available data indicate that Arab intra-regional tourism grew from 72.5 to 77.5 per cent in the same period, indicating that Syrian tourism depends primarily on Arab intra-regional tourism, particularly from the GCC. In Yemen numbers of visitors from Arab countries and, in particular, from Saudi Arabia and the United Arab Emirates, rose from 16.7 per cent of overall tourism in 1995 to over 68 per cent

in 2003. While European and, in particular, German tourists used to dominate the tourist market in Yemen, the political and security situation in the region, resulting in the kidnapping of tourists and other problems in Yemen, have caused a structural change in tourism in the country and Arab intra-regional tourism is now the foremost market.

In Saudi Arabia Arab intra-regional tourism is also significant because of the two holy cities of Mecca and Medina, which draw Arab and Muslim visitors and ensure continued high ratios of Arab intra-regional tourism in the country.

Arab intra-regional tourism represents some 40 per cent of overall tourism in the Arab countries, a very high ratio compared to those of intra-regional trade and investment. Intra-regional tourism can therefore be viewed as a positive and key indicator for Arab regional integration, especially as in some countries Arab tourists make up some two thirds of overall tourism.

Given the right opportunities and services, there are few limits to the expansion of Arab intra-regional tourism. Increased coordination between Arab tourist agencies, the facilitation by Governments of entry and residence procedures for Arab nationals, and cooperation between Arab organisations working in the sector would support the expansion of Arab tourist numbers. The improvement of tourist services and the effective control of the performance of such services within the Arab countries, and the enhancement of such tourist services as transport and communications between the Arab countries would support the rapid growth of Arab intra-regional tourism, turning it into a pillar of future Arab economic integration.

#### *8.2.5. Arab Intra-regional Labour Migration*

While over the past four years there has been a decline in Arab intra-regional labour migration from Egypt, Jordan, Lebanon, Morocco, the Syrian Arab Republic and Yemen to countries with labour shortages, namely, the majority of the GCC countries; compared to the situation in the 1970s and 1980s, intra-regional labour migration remains a core indicator for Arab economic integration. The labour markets of the GCC States have provided and continue to provide work opportunities for hundreds of thousands of workers from other Arab countries with a labour surplus. Were it not for those markets, the problem of unemployment in those countries would be exacerbated and rates of poverty would increase. While migration has not always flowed freely or easily, it has played and continues to play a significant role in Arab intra-regional integration; indeed, given greater freedom of movement, it could become more significant in Arab economic integration than tourism. Arab labour migration is currently better organised than in the early 1970s, being subject to cooperation agreements on labour migration that regulate such conditions of migration as the length of time spent abroad and employer–employee relations. There has also been a structural change in the labour market of the recipient countries. While, in the early 1970s, Governments were the primary economic engines, investing in and implementing huge projects and, in particular, infrastructure projects, it is the private sector that has become the principal investor in the economies of those countries.

Labour migration increases the flow of financial resources from the recipient countries to workers' countries of origin through labour remittances. It also results in workers gaining new experience and skills while abroad, which has a positive impact on those workers and on their job opportunities in their countries of origin; in other words, it develops the capacities of those workers. Labour migration has not been entirely positive. In such countries as Yemen, where most migrant workers are from rural, agricultural areas, migration has in some areas caused a reduction in agricultural labour numbers and, therefore, in agricultural production. As a result, many women have been forced to work in agriculture in order to replace the absent men and there has also been an increase in child labour.

Arab intra-regional labour migration has contributed to a relative reduction in levels of poverty in labour-exporting countries and, in particular, in the rural areas from which most migrant labourers originate. Their remittances constitute an important source of income for their families and for relatives, given the importance of extended family relations between people living in rural areas. Remittances have helped to reduce unemployment in rural areas, where few work opportunities exist outside the agricultural and pastoral sector. Albeit migration has had a negative impact on agricultural production, particularly in Yemen, unemployment and poverty in, and the social and economic impact on, labour-exporting countries might have been far more serious were it not for the opportunities migration provided to those workers. Migrant workers have also contributed to the economic renaissance of the host countries. Such educated migrants as teachers, doctors, engineers and other professionals have had a great impact on the professions in those countries and on the educational and medical development of a number of the host countries. Arab intra-regional labour has also had an impact on Arab economic integration, albeit smaller than that of Arab intra-regional tourism, because while the latter has risen from year to year, Arab migration has declined in recent years compared to the early 1970s. In most labour-exporting Arab countries labour remittances are a primary source of private foreign finance, often ranked before FDI and official aid from other countries. Such remittances have a direct and rapid impact on standards of living because they are sent directly to individuals and are generally invested in small projects by the family of the migrant worker, mostly in real estate or land, with a large part used for consumption. Remittances are also more stable than ODA, which changes from one year to the next; except for a sharp reduction in such remittances in the years after the second Gulf crisis in 1990, levels of remittances have been largely stable.

Remittances also play a crucial role in improving the current accounts of the balance of payments of a country. Volumes of remittances depend on a number of such key factors as numbers of workers living abroad, their skill level, their positions and the length of time they spend abroad. While worker numbers are important, income levels are more important, because they directly influence how much workers are able to remit to their country of origin. The volume of remittances also depends on the banking and financial systems in place and, in particular, the value and performance of the currency of the country of origin. If exchange rates are not economical,

migrant workers will resort to the black market and transfer funds through relatives, resulting in the national balance of payments losing a significant portion of such private remittances.

Both labour migration and labour remittances play an important part in integrating Arab markets with a labour surplus and those with a labour shortage. They also contribute to the promotion of rapid economic integration, in that they promote financial links, in particular of the Arab commercial market.

The GCC States have experienced changes in their labour demand structures and, since the 1970s, unemployment has begun to emerge as a result of the completion of most major infrastructure projects. The Governments of those countries have tried to take a number of steps to limit labour migration and the inflow of workers in search of employment. Restrictions were imposed on work permits in such countries as Saudi Arabia, which tried to solve the problem of unemployment by encouraging the employment of Saudi nationals in a broad range of professions. Kuwait made it obligatory for incoming workers to have insurance. In 2005 Saudi Arabia promulgated a new employment law that requires companies to ensure that 75 per cent of the workers are Saudi nationals (Box 8.2). Given that the majority of foreign workers are employed in the private sector, the Government offered incentives to private sector companies to employ Saudi nationals. Measures included fines for sponsors that “rent out” entry permits for quick gain. Such measures do not solve the problems of the private sector, which faces difficulties in employing Saudi nationals because they may not be qualified or may demand higher wages.

### **Box 8.2. The new employment law in Saudi Arabia**

A number of decisions were taken by Saudi Arabia in order to reduce unemployment by employing larger number of Saudi nationals through the imposition on companies of compulsory quotas. Furthermore, the Government decided not to grant Government contracts to companies that do not pursue the “Saudisation” policy which requires companies to employ a certain percentage of Saudi nationals, and to replace foreign workers with local workers.

In September 2005 the Council of Ministers promulgated a new employment law calling on all firms, whatever their field of work, to employ at least 75 per cent of Saudi nationals. That law further demands that companies which employ more than 25 workers and are active in a field allowing the employment of qualified disabled people should ensure that a minimum of 4 per cent of employees are disabled.

The law also allows Saudi women to work in a variety of fields that are commensurate with women’s nature. The implementation of the law will increase women’s participation in the Saudi economy and reduce dependence on foreign workers.

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*Source: Al-Sharq Al-Awsat, No. 9800, 27 September 2005.*

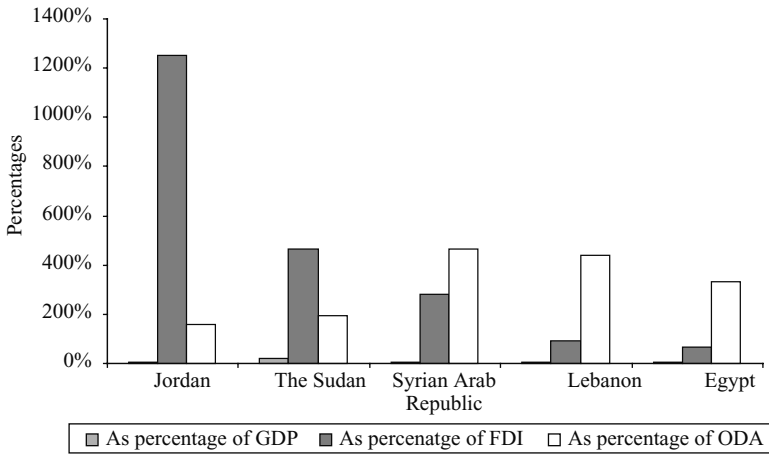


FIGURE 8.3. Ratio of labour remittances to GDP, FDI and ODA, 2003

Labour remittances affect consumption and investment and hence also have an impact on GDP and domestic savings. Remittances cause a rise in the standards of living of migrant workers and their families, and therefore in income in the rural areas where most of them live. Remittances of migrant workers indirectly influence income distribution in labour-exporting countries by improving the income of migrant workers and their families. Such remittances help fund micro-projects and thus create investment opportunities that reduce unemployment rates in the country. Remittances also indirectly reduce urbanisation rates. Those are significant economic impacts, in particular in countries dependent on sources of foreign finance, which is true for a number of the Arab labour-exporting countries. Remittances also play an important role in reducing the severity of poverty. In a 2003 study on the impact of labour remittances on the Moroccan economy, remittances were shown to have contributed to lowering the rate of poverty from 23 to 19 per cent (Gallina, 2004: 14).

The value of labour remittances increased in a number of Arab labour-exporting countries in 2004. In Jordan, remittances rose from \$1881 million in 2003 to \$2613 million in 2004, an increase of some 15 per cent. In the Sudan remittances for 2004 amounted to \$1580 million, an increase of some 30 per cent compared to 2003. Increases were also seen in both Lebanon and the Syrian Arab Republic, where the value of such remittances rose by 26.1 and 4.2 per cent, respectively.

Remittances in Jordan constituted 19.2 per cent of GDP, the highest ratio in the region, compared to 9.8 per cent in Yemen and some 8 per cent in the Sudan (Figure 8.3). The total value of the remittances of Jordan, Egypt, Lebanon, the Sudan, the Syrian Arab Republic and Yemen for 2004 was some \$10 billion, against \$9.2 billion in 2003, an equivalent increase of 8.7 per cent. In 2004 ratios of labour remittances to overall GDP in those countries was some 6 per cent, and ratios to overall imports some 15.2 per cent. That highlights the importance of those remittances in

funding private imports: in Jordan, the ratio was 26.6 per cent, in Lebanon 14.1 per cent and in Yemen labour remittances were some 21.7 per cent of all imports in 2004. Those figures show that labour remittances are more important to the economies of those countries than FDI and ODA and that a steady increase in the value of such remittances will significantly affect investment and consumption and reflect positively on balances of payment. Labour remittances and Arab intra-regional tourism have therefore acted as key indicators for regional economic integration over the past few years. The table furthermore shows that the decline witnessed in volumes of remittances since the second Gulf war in the early 1990s has been halted. It must be remembered that the figures presented only include remittances made through the formal banking sector. Many workers send their remittances through relatives or intermediaries outside the banking sector, particularly in Yemen, where intermediaries play the role of banks, and the actual volume of remittances may therefore be much higher. The remittance figures also do not include in-kind remittances made by workers, whether in the shape of consumables or real estate. The figures in Table 8.6 should therefore be treated as minimum rather than actual levels of remittances.

#### *8.2.6. Arab Intraregional ODA*

Economic aid granted by oil-exporting Arab countries and, in particular, Kuwait, Saudi Arabia and the United Arab Emirates, has played a key role in the economic and social development of other Arab countries and, in particular, Jordan, Lebanon, the Syrian Arab Republic and Yemen. Such aid is granted either by Governments as ODA, or by such development organisations as the development funds of those countries. The key characteristic of economic aid granted by Arab countries to other Arab countries is that it is non-conditional or “soft”, meaning that recipient countries are not obliged to import materials for development projects from developing countries, which generally is the case with official aid granted by developed countries. That makes Arab ODA more flexible and thus more useful. The majority of such aid is not given to the recipient countries: donor countries directly implement such projects as hospitals, schools and universities and infrastructure projects.

Reference should be made to the fact that economic development aid granted by Arab countries is a result of temporary surpluses caused by a rise in oil revenues in those countries, and that those surpluses will be needed by their own economies in the long term. Aid from developed countries, in contrast, is a result of stable economic performance and not temporary, as is that of the Arab donor countries. In years of big rises in oil revenues that their economies cannot absorb, those Arab countries increase their economic development aid in order to permit other Arab countries to share those revenues.

The volume of development aid granted by the major oil-exporting Arab countries is directly related to volumes of oil revenue. Soft aid amounted to some \$10.9 billion in 1980, when oil prices reached their highest level to date. Aid decreased to a mere \$307 million in 1998 as a result of a decrease in oil prices and revenues which had

TABLE 8.6. Labour remittances (*Millions of dollars and percentages*)

		1995	2001	2002	2003	2004
Jordan	Value of remittances	1244	1921	1921	1981	2163
	As percentage of GDP	18.5	20.3	20.3	19.9	19.3
	As percentage of FDI	9569.2	3002.3	3002.3	467.2	348.9
	As percentage of ODA	230.4	396.6	369.6	160.5	—
	As percentage of imports	33.6	37	37	28.3	26.6
The Sudan	Value of remittances	346	970	970	1218	1580
	As percentage of GDP	7.1	5.9	5.9	6.4	7.2
	As percentage of FDI	—	136.0	136.0	90.3	104.6
	As percentage of ODA	142.9	276.5	276.5	196.1	—
	As percentage of imports	28.3	50.6	50.6	60	147
Syrian Arab Republic	Value of remittances	—	—	—	743	775
	As percentage of GDP	—	—	—	3.5	3.3
	As percentage of FDI	—	—	—	68.5	64.3
	As percentage of ODA	—	—	—	463.4	—
	As percentage of imports	—	—	—	8.7	7.3
Lebanon	Value of remittances	836	888	888	1003	1265
	As percentage of GDP	7.5	5.1	5.1	5.5	6.4
	As percentage of FDI	2388.6	345.4	345.4	280.2	439.3
	As percentage of ODA	446.7	196.1	196.1	439.3	—
	As percentage of imports	8	13.7	13.7	14	14.1
Egypt	Value of remittances	3226	2893	2893	2961	2856
	As percentage of GDP	5.4	3.4	3.4	3.6	3.7
	As percentage of FDI	539.5	447.2	447.2	1249.3	228.0
	As percentage of ODA	160.0	233.6	233.6	331.3	—
	As percentage of imports	27.4	16.1	16.1	13.6	10.2
Yemen	Value of remittances	1080	1294	1294	1270	1261
	As percentage of GDP	21.1	12.6	12.6	11.3	9.8
	As percentage of FDI	(495.6)	1268.6	1268.6	21165.0	(6004.9)
	As percentage of ODA	638.9	221.7	221.7	522.4	—
	As percentage of imports	68.2	35.8	35.8	31.2	21.7
Totals	Value of remittances	6732	7966	7966	9176	9900
	As percentage of GDP	6.4	5.0	5.0	5.7	6.0
	As percentage of FDI	1275.1	283.2	283.2	265.4	203.9
	As percentage of ODA	191.6	246.9	246.9	271.4	—
	As percentage of imports	23.5	26.6	26.6	18.2	15.2

Source: World Development Indicators Database; IMF, *Direction of Trade Statistics Yearbook*, 1999; IMF, *Direction of Trade Statistics Quarterly*, June 2005; June 2004; September 2003 and June 2002.

Parentheses ( ) indicate that a figure is negative.

Remark: ESCWA estimates that most workers from the above countries work in other Arab countries and thus most of their remittances are from Arab countries. Algeria, the Comoros Islands, Djibouti, the Libyan Arab Jamahiriya, Mauritania, Morocco and Tunisia have not been included in this table because a large percentage of workers from those countries work outside the Arab world.

begun in 1986, while in 2003 aid went up to some \$3.4 billion. The main Arab countries granted such aid were, first and foremost, Jordan, which received \$740 million in 2003, followed by Palestine, where Arab intra-regional aid increased from some \$300 million in 1995 to \$583 million in 2003, or 17 per cent of GDP. Egypt takes third place with total Arab aid for 2003 being some \$536 million, less than 1 per cent of GDP (Table 8.7). Aid to Egypt has decreased over the past few years from over \$1 billion in 1995 to \$743 million in 2002 and \$536 million in 2003. The Sudan comes fourth, with a share of \$373 million of Arab intra-regional aid, or an equivalent of 2 per cent of GDP. Table 8.6 shows that Arab intra-regional aid to the Sudan doubled between 1995 and 2001–2003 from \$145 million to \$373 million, which may be attributed to the return of peace to the south of the country and stability to the country overall. Yemen received aid to the value of \$146 million in 2003, or 1.3 per cent of GDP, compared to \$101.5 million in 1995. Total Arab intra-regional aid increased from \$3.1 billion in 1995 to some \$3.4 billion in 2003.

Over the past few years intra-regional ODA to those countries has exceeded FDI flows, meaning that the role of aid exceeds the impact of FDI on their economies. That may be attributed to the fact that aid is generally given as a result of political decisions taken by Arab donor Governments.

Aid is given to Palestine as the outcome of commitments made during various Arab summit conferences to assist the Palestinian people living under occupation. That is also true for such least developed countries as Mauritania, Somalia, the Sudan and Yemen.

### 8.3. THE SECTORAL APPROACH TOWARDS ARAB INTEGRATION

#### *8.3.1. Progress in Negotiations on Regional Integration in the Transport Sector*

*Adoption of the memorandum of understanding on maritime transport cooperation in the Arab mashreq* The Memorandum of Understanding on Maritime Transport Cooperation in the Arab Mashreq was adopted at the 23rd ESCWA session, held in Damascus from 9 to 12 May 2005, and is the first of its kind in the Arab world. It is the third such initiative taken by ESCWA in the field of transport and complements the Integrated Transport System in the Arab Mashreq, which now includes land, rail and maritime transport. The Memorandum is commensurate with the resolution adopted at the Summit of the League of Arab States held in Algeria in March 2005, on the need for Arab cooperation in the field of transport, and was initialled and signed by eight member countries, namely, Egypt, Jordan, Lebanon, Palestine, Qatar, Saudi Arabia, the Syrian Arab Republic and Yemen, at the official signing ceremony attended by the Legal Counsel of the United Nations on behalf of the Secretary-General.

ESCWA, in coordination with the League of Arab States, prepared a Memorandum of Understanding for presentation to the Council of Arab Ministers of Transportation for adoption by the League of Arab States. When presented at the 28th session of the Council, held on 23 and 24 November 2005, the session recommended that the

TABLE 8.7. Arab intra-regional ODA, 2001 and 1995–2003 (*Millions of dollars*)

		1995	2001	2002	2003
Jordan	Arab intra-regional aid	324.0	259.5	311.9	740.6
	As percentage of GDP	4.82	2.9	3.3	7.45
Tunisia	Arab intra-regional aid	45.1	226.6	158.9	183.3
	As percentage of GDP	0.25	1.13	0.69	0.68
Comoros Islands	Arab intra-regional aid	25.1	16.5	19.5	14.7
	As percentage of GDP	10.8	7.53	7.89	4.55
Djibouti	Arab intra-regional aid	63.1	34.6	46.7	46.7
	As percentage of GDP	12.67	6.03	7.88	7.47
The Sudan	Arab intra-regional aid	145.4	111.2	210.5	372.8
	As percentage of GDP	2.02	0.82	1.37	2.09
Syrian Arab Republic	Arab intraregional aid	215.5	93.2	48.6	96.2
	As percentage of GDP	1.3	0.47	0.24	0.45
Palestine	Arab intra-regional aid	299.2	521.7	969.9	582.9
	As percentage of GDP	8.33	12.93	28.56	16.88
Lebanon	Arab intra-regional aid	112.3	145.7	271.6	137.0
	As percentage of GDP	1.01	0.87	1.56	0.76
Egypt	Arab intra-regional aid	1209.7	754.0	743.2	536.4
	As percentage of GDP	2.01	0.84	0.87	0.66
Morocco	Arab intra-regional aid	297.1	311.1	292.2	313.7
	As percentage of GDP	0.9	0.92	0.81	0.72
Mauritania	Arab intra-regional aid	138.2	160.5	207.2	145.6
	As percentage of GDP	13.09	16.69	20.97	12.51
Yemen	Arab intra-regional aid	101.5	276.6	350.2	145.8
	As percentage of GDP	1.98	2.86	3.4	1.29
Totals	Arab intra-regional aid	3089.6	3001.1	3746.7	3420.6
	As percentage of GDP	1.92	1.37	1.67	1.44

Source: World Development Indicators Database, <http://www.worldbank.org>; Unified Arab Economic Report.

ESCWA estimates that some 60 per cent of all aid received by Arab countries is granted by other Arab countries or Arab organisations. This table is therefore based on the assumption that 60 per cent of aid granted to Arab countries is intra-regional aid.

scope of the Memorandum of Understanding should be expanded to include all Arab countries, and that countries which had not yet signed the Memorandum should be invited to study it with a view to acceding thereto.

Palestine subsequently appended to the Memorandum a final signature which does not require approval. Yemen presented the Memorandum of Understanding to the 24th session of its Ministerial Council on 14 June 2005, which issued Decree 196 of 2005 approving the accession of Yemen to the Memorandum of Understanding and calling on the ministers concerned to take the necessary steps to complete legal measures and implement the provisions arising from the Memorandum. It called on

the Prime Minister to study the outcomes of the Memorandum and any difficulties that may occur during the process of implementation.

Iraq, Lebanon, Oman, Qatar, Saudi Arabia and the Syrian Arab Republic have presented the Memorandum of Understanding to the official organs concerned, namely, councils of ministers, consultative councils, assemblies and parliaments, in order to enable them to take the legal measures required for ratification of the Memorandum.

During the preparation of the Memorandum of Understanding, coordination took place with the member countries with a view to identifying all regional seaports, harbours and shipping routes in the Arab Mashreq, to be appended to the Memorandum of Understanding for reference purposes, albeit it does not form part of that Memorandum, as is shown in its articles.

The shipping routes which connect those seaports and harbours were drawn up as illustrated below:

Route AM 10: the Mediterranean: Syrian coast Lattakia – Tartous – Baniyas; Lebanese coast Tripoli – Beirut – Sidon – Tyre; Palestinian coast – Gaza; and Egyptian coast Al Arish – Port Said – Damietta – Alexandria.

Route AM 20: the Gulf of Suez: Egyptian coast Suez – Ayn Sukhna – the entrance of the Red Sea.

Route AM 30: the Gulf of Aqaba: Jordanian coast – Aqaba; and the Egyptian coast Nuweaiba – Sharm al – Sheikh.

Route AM 40: the Red Sea: Saudi coast Daba – Yanbu – Jeddah; Yemeni coast – Salif – Hodeidah.

Route AM 50: Gulf of Aden and Arabian Gulf: Yemeni coast Aden – Mukalla to Omani coast – Salalah – Daqam to the entrance of the Gulf.

Route AM 60: the Gulf of Oman: Omani coast – Sultan Qabus – Sahar – Shanas to the coast of the United Arab Emirates – Fujeirah – Khor Fakkan – entrance of the Gulf.

Route AM 70: Arabian Gulf: Omani coast from the entrance of the Gulf at Khasab; the United Arab Emirates coast through Port Khaled, Dubai, Zayed; the Qatari coast through Doha Ports; the Bahraini coast through Port Salman; the Saudi Arabian coast through King Abd al – Aziz Port in Dammam and al – Jubail; the Kuwaiti coast through al – Shuaiba Port and al Shuwaikh Port; and the Iraqi coast through Umm Qasr Port.

Route AM 80: The Shatt al-Arab: Iraqi coast – Al Fau – Basra (Maqal).

Route AM 01: The Nile: Damietta – Rosetta – the Sudan.

Route AM 02: The Tigris: Tigris – Basra – al-Qarna – Al-Kut Dam.

Route AM 03: The Euphrates: Basra – al-Qarna – Nasariya – Samawa.

When the Memorandum of Understanding comes into force pursuant to Article 17, ESCWA expects all or some of its articles to be included in the national laws of member countries. It also expects its implementation to lead to increased cooperation between member countries in respect of maritime transport and supporting services. For the first time in their history, member countries will have at their disposal a document and the legal authority that will enable the relevant bodies in the public

sector, national public and private maritime companies and support service companies and institutions to cooperate within the framework of the Memorandum.

That is expected to result in the development and improvement of maritime transport and the potential of seaports and harbours. It is also expected to result in an increase in maritime activity in the region and an expansion of the volume of trade transported by sea between member countries, thus positively affecting intraregional trade in the region. It may, in addition, lead to further cooperation in such areas as maritime environmental protection, maritime safety and security of vessels both at sea and in the ports and harbours in the region.

*Regional dimension of developments in maritime transport* The Technical Committee for Maritime Transport of the League of Arab States has conducted a study on the development and modernisation of Arab seaports and harbours, which was financed by ESCWA. ESCWA takes part in all meetings of the League of Arab States concerning maritime transport, has observer status in the Arab Sea Ports Federation and is a member of the Technical Committee for Maritime Transport of the League of Arab States.

Through that Committee, and in cooperation with ESCWA, the League of Arab States has also completed a study on activation of the agreements on the establishment of an Arab institute for ship classification within the League of Arab States, in coordination with the Arab Federation of Shipping and Arab maritime companies. The project aims to promote cooperation on maritime transport and Arab control over Arab ships in terms of their building, repair, inspection and classification; the issuing and verification of permits of seaworthiness; and the harmonisation of technical specifications for vessels. The Ministry of Transport of the Syrian Arab Republic is implementing a plan to develop the port and maritime transport sector, including maritime commercial law and maritime management, as part of the ministerial investment map for the ports of Tartous and Lattakia. The project includes a plan to develop and reform Syrian ports in order to enable them to absorb the marked increase in volumes of transit commodities, which rose by 20 per cent in 2004, and to benefit from the strategic eastern Mediterranean position of the Syrian ports for transit commodities coming from Europe, North and South America and North Africa and going to Iraq, Iran, Jordan, Saudi Arabia and the United Arab Emirates. The plan includes the building of fully equipped, modern container platforms and stations, the development and modernisation of processes in and movements through the Syrian seaports, in addition to the automation of the ports and their operations and customs procedures and new maritime training programmes for employees of the Syrian General Directorates of Ports. A study will be conducted on the expansion of existing or the building of new ports to handle bulk environmental pollutants and the construction of multipurpose platforms. ESCWA is assisting in studies to develop and modernise the Syrian seaports and the development of Lattakia into a model seaport.

There have been many developments in the region in maritime transport, seaports and harbours aimed at facilitating the movement of maritime import and export of goods. In cooperation with the ESCWA Maritime Task Force, Yemen designed a national strategy for the development of Yemeni seaports by 2025. It aims to increase

the efficiency and effectiveness of port services; modernise organisational structures and management and financial systems, including the use of computers; and to modernise tariff calculation procedures and port employee training programmes. Yemen will carry out a study on the expansion and development of existing ports and the development of new ports with a view to meeting the appreciable increase in Yemeni exports and imports, and in transit trade and shipment through the port of Aden, which enjoys a strategic position in the ESCWA region, being located between North and South America, on one hand, and the Arabian Gulf and South-East Asia on the other. Investments for the projects are estimated at more than \$100 billion Yemeni rial, or some \$520 million. The Government of Yemen will provide funding through its third Five Year Plan for 2006 to 2010. In 2003, the port of Dubai was the sixth largest port in the world in terms of containerisation, handling the equivalent of 23 per cent of world totals (ESCWA, 2005a: table 22). The port of Aden ranked second in global terms in 2003, with 60 per cent of world totals, followed by the port of Fujairah, which ranked fourth, with 29 per cent of total world containerisation. In terms of ranking by country, the United Arab Emirates took 13th place in global containerisation levels for both 2002 and 2003. Saudi Arabia ranked 24th and Egypt 35th in the same years.

While overall numbers of vessels went up by 1.9 per cent on the global level, in the ESCWA and Arab regions a decline of 18.9 and 11.4 per cent, respectively may be noted. Deadweight tonnage (DWT) in the ESCWA and Arab regions similarly decreased, by 10.4 and 9.9 per cent, respectively, while global DWT rose by 10.3 per cent (ESCWA, 2005a: figure 12). The decrease in the number of vessels and DWT in the ESCWA and Arab region and their limited increase on the world level may be explained by the increase in the number of smaller vessels, which are disposed of through sale or scrapping, and the building of smaller numbers of large DWT vessels for modern purposes. The respective 5.4 and 3.2 per cent decrease in containerisation in the ESCWA and Arab regions is unusual, and research should be undertaken into the reasons for that decrease, given that global levels of containerisation have continued to grow from year to year, as is shown by the global increase of 35.9 per cent for 2003.

### *8.3.2. Regional Integration with Respect to Road Safety*

Unfortunately, there has been little cooperation and integration between the ESCWA member countries in regard to road safety over the past few decades. While there are a large number of traffic accidents in most of those countries, resulting in economic losses caused by increased fatalities, the permanent disability of or severe injuries to many road users, or and which further entail financial cost in loss of vehicles or damage to roads, efforts made by the member countries have mostly been individual: they have not come together to find joint solutions or exchange experiences with a view to improving the road safety situation. While individual efforts and reluctance to exert regional efforts can be attributed to the belief in many countries that road safety is a national rather than a regional concern, vehicles travelling from one country to another, especially in transit, have caused many traffic accidents because

of insufficient maintenance, or have caused the collapse of road structures because their cargo exceeded local weight restrictions. A number of accidents have also taken place involving trucks carrying such hazardous materials as flammable chemicals or petrochemicals. Such accidents may have contributed to the increasing awareness that road safety is an issue that transcends national borders and affects all countries in equal measure, and may have helped to increase efforts between countries, and the desire to solve the problem at the regional level.

*The concerted efforts represented by the United Nations General Assembly resolutions (ESCWA, 2005b)* Resolution 309/57 was the first resolution on road safety adopted by the United Nations General Assembly, at its 57th session, which was held in 2003. Many countries participated in the drafting of that resolution, including ten countries from the ESCWA region, namely, Bahrain, Jordan, Kuwait, Lebanon, Oman, Qatar, Saudi Arabia, the Syrian Arab Republic, the United Arab Emirates and Yemen. The resolution welcomed the dedication by WHO of International Health Day 2004, to be celebrated on 7 April of that year, to the issue of "Safe roads." The Resolution urged all Governments to promulgate new traffic laws and requested a report to be written on the global road safety crisis.

The United Nations report on the road safety crisis highlights the great danger of injuries resulting from road accidents. While such injuries ranked as the ninth most common injury in 1990, they are expected to be the third most common global injury by 2020 (United Nations, 2003). That emphasises the need for efforts to eradicate the toll that "dangerous disease" takes on human life. General Assembly resolution 9/58 of 2003 on the issue was the second resolution of the Assembly to be adopted without a vote. Oman played a crucial and tactful role in ensuring continued United Nations efforts on road safety, which culminated in the adoption by the General Assembly of a third resolution, namely, 289/58, which calls upon the WHO to lead and coordinate road safety issues within the United Nations system, in close cooperation with the regional commissions. Upon presentation of his Report to the sixtieth session of the General Assembly, and pursuant to resolution 289/58, the Secretary-General called on countries to benefit from the experience of the regional commissions of the United Nations, WHO and the World Bank, and emphasised the ongoing need to strengthen international cooperation on road safety and to give special consideration to the needs of developing countries.

*Cooperation on road safety between the GCC States* Cooperation on road safety between the GCC States started many years ago with the launching of the United Gulf Traffic Week. The first such Week, in 1984, had as its theme use of the safety belt. Traffic weeks have been held every year since then, with a different focus each year. They involve intensive cooperation and exchange of expertise between the GCC member countries and are a joint and integrated effort to achieve the slogan for each week. Efforts are also being made to harmonise traffic laws in those countries and a standard model traffic law or system for the GCC countries has been issued.

The GCC States have, furthermore, cooperated since 1986 in unifying and integrating their traffic education programmes through a strategy of using books that were

standardised and developed for GCC members by the Arab Bureau of Education for the Gulf States and the Gulf Arab States Education Research Centre. The programmes start in the first grade of primary school. Science classes include special lessons on how to use the road, including illustrations which facilitate familiarisation with safe and unsafe practices in getting in and out of cars, crossing the street and using the bus. In higher grades various road safety issues are further elaborated.

A range of traffic seminars, attended by many officials concerned with traffic, have recently been held in Arab countries and, in particular, in countries in the ESCWA region. The Arab Road Safety Organisation has held a variety of seminars on road safety, and the Jordan Traffic Institute has also organised various seminars, most recently on plans for traffic awareness campaigns in which officials of more than ten Arab countries participated. In order to ensure the integration and success of efforts in road safety, it has recently begun to establish networks and channels of communication to tackle traffic problems (Box 8.3).

### **Box 8.3. The role played by ESCWA in road safety**

A series of resolutions on road safety adopted by the United Nations General Assembly draw attention to the need to intensify efforts in that field, in particular those of the regional commissions, including ESCWA, and for those commissions to play a key role in concentrating member countries' efforts on road safety. ESCWA participated in two consultative meetings, which were held in Geneva in 2004 and 2005, and attended by more than 40 international and consultative bodies, in order to draft a report to be presented to the sixtieth session of the General Assembly and to formulate an international strategy to tackle the global road safety crisis that endangers so many lives.

The first efforts undertaken by ESCWA in respect of road safety resulted in the successful adoption of the Agreement on International Roads in the Arab Mashreq on 10 May 2001 and its entry into force on 19 October 2003. That Agreement will contribute in an effective manner to the upgrading of engineering standards that affect road safety. In addition, application of the Agreement will result in the installation of road signs and symbols that meet international specifications, and such road fixtures as speed barriers, lighting, glare reduction devices, road perimeter indicators, emergency communication systems and other such assistive measures as pedestrian and animal crossings, all of which will have a positive impact on road safety.

In 2005, ESCWA conducted a study of road safety in certain ESCWA member countries. With a view to urging countries to devote increasing efforts and resources to road safety, at its twenty-third session on 17 April 2005, ESCWA adopted resolution 256(XXIII) on regional cooperation on road safety. It called on member countries to integrate road safety into their development programmes, to increase road safety awareness through visual, auditory and written media and educational curricula aimed in particular at children and young people, to

*(Continued)*

**Box 8.3. (Continued)**

cooperate with relevant regional and international organisations and to make available the budgets required to meet the demands of road safety. It further called on member countries to contribute to the Commission's activities on road safety, either through participating in specialist studies, the Regional Workshop on the Implementation of Good Practices in Road Traffic Safety or in preparation for the Global Road Safety Week planned for 2007. It is hoped that, where possible, member countries will provide financial and other support to the Secretariat in order to enable it to implement activities that support national efforts to achieve road safety. The resolution called on member countries to take an active part in the discussions of the General Assembly on that matter in September 2005. At the end of November 2005, ESCWA will hold a regional workshop on the implementation of good practices for road traffic safety. Discussions between member countries on those practices and ways to implement them will represent an important move towards cooperation and integration between the countries of the region.

Much remains to be done in order to achieve a certain level of integration and cooperation on road safety between the countries of the region, in particular in terms of standardising laws, road safety data collection, the drafting of agreements to govern the transport of hazardous materials and the volume and weight of trucks.

*8.3.3. Energy Sector*

The Arab countries, including the ESCWA member countries, face common challenges in expanding their electricity systems to meet the increasing demand for electrical energy. The availability of oil and natural gas resources in many of the member countries is a regional wealth that can be used by all the countries through electricity grid networks or the construction of natural gas transport networks. The expansion of the electrical energy grid and the optimum use of natural gas reserves are a strategic investment which can help to achieve economic integration between those countries and facilitate their inclusion into world markets and, in particular, the European market, by linking the grids between the Syrian Arab Republic and Turkey, and Spain and Morocco, and natural gas transport networks to Europe.

Once the electricity and natural gas grids of the GCC member countries are linked with those of the countries of the Arab Mashreq and Maghreb, the benefits from such a grid will be multiplied.

To that end, the Arab countries have begun a range of projects for cooperation and integration in the energy sector, including projects to link electricity grids and build pipelines for the transportation of oil and natural gas. There are also a number of bilateral agreements for the development of renewable energy sources and rationalisation of energy use, for the purpose of which ESCWA's Regional Mechanism to Develop Energy Uses for Sustainable Development was created.

Several such regional organisations as the Council of Arab Ministers for Electricity, the Organisation of Arab Petroleum Exporting Countries and the Arabian Union of the Producers, Transporters and Distributors of Electricity, support and develop cooperation and integration between the Arab States.

*Electricity grid projects* The Arab electricity grid projects have achieved considerable success, gaining them the continued interest and support of the Arab leadership, which was expressed in an appeal to draft a plan to expedite the reinforcement and completion of the grid, and an appeal to Arab and international donor organisations to provide the necessary funding for electrical grid projects. The Council of Arab Ministers for Electricity, in cooperation with the Arab Fund for Economic and Social Development, is responsible for the creation of a mechanism to help the least developed countries complete their electrical systems, with a view to linking them to those of the other Arab countries (Algiers Summit, March 2005).<sup>1</sup> At its sixth session, held in April 2005, the Council<sup>2</sup> issued various key resolutions in support of electrical networking. Some of its recommendations are set out below.

- (a) A study should be conducted which includes a 20 year vision of work on electricity grid projects between the Arab countries and with other countries; the potential for using oil and natural gas for the export of electrical energy; and the required institutional and legal changes in the Arab countries.
- (b) A meeting should be convened between the seven-country interconnection countries and the Maghreb grid countries to study issues involved in the implementation of the resolution issued at the Arab Summit held in Algiers in March 2005 on the expediting of the establishment of a coordination and control centre for the Arab countries that are already connected.

On 14 April 2005 a seminar on the electrical grid<sup>3</sup> was held in Cairo. It was attended by a large number of experts representing 17 Arab countries. The seminar focused on the future development of the electricity grid systems in the Arab region, and experience of operating them. The key concluding recommendations of the seminar are set out below.

- (a) High-capacity joint projects for the generation of electricity should be set up close to the sources of natural or fossil energy, and the necessary electricity grids should be established between them in order to meet the rising local demand for electrical energy and to export the surplus.
- (b) Electrical sectors in Arab countries should be restructured and laws and regulations promulgated in order to organise relations between countries in furtherance of the establishment of an Arab electricity market.
- (c) Regional centres and a main control centre for the Arab electricity grid should be set up.
- (d) New sources of Arab finance should be created and laws and regulations modernised in order to help attract investment in support of electricity grid projects.

Set out below is an overview of the progress achieved in electricity grid projects in the Arab countries.

*The seven-country interconnection (Egypt, Iraq, Jordan, Lebanon, Libyan Arab Jamahiriya, Syrian Arab Republic, Turkey)*

*The first stage* In 1993 a general trade agreement was signed for an electricity grid between Egypt, Iraq, Jordan, the Syrian Arab Republic and Turkey. It aimed to implement a project to link the electrical grids of those countries. Lebanon joined the agreement in 2000 and the Libyan Arab Jamahiriya in 2003. In the period following the 2004 *Annual Review* the following achievements have been made:

*Egypt and Jordan.* A contract was signed by Jordan and Egypt with respect to the supply of electrical energy for the period from 2003 to 2005 and agreement was reached on the tariffs for the exchange of electrical energy during that period, to be reviewed annually. Up to 2004, 681 GW hour were exported from Egypt to Jordan and 210 gega hour watt from Jordan to Egypt.

*Syrian Arab Republic–Turkey.* Work on the 400 KW voltage connections of the Syrian–Turkish grid was completed. The operation of the line is subject to Turkey obtaining the approval of the Union for the Coordination of Electrical Transmission (UCET).

*Syrian Arab Republic–Iraq.* The Syrian–Iraqi grid began with work on the Syrian side on the construction of a 500k 400KW line from the central Syrian Arab Republic to the Iraqi–Syrian borders.<sup>4</sup> It is expected that the grid will be completed by the end of 2006.

*Syrian Arab Republic–Lebanon.* The Syrian–Lebanese grid started with a 400 MW grid between the Syrian Arab Republic and Lebanon. The Syrian Arab Republic has expanded its power station at Dimas and built the 22 km grid line located inside its territory. Work on the Lebanese side has yet to be implemented. The grid is expected to be completed in the last quarter of 2005.

*Egypt–Libyan Arab Jamahiriya.* The Egyptian–Libyan 220 MW grid has been completed and was put into service on 28 May 1998.<sup>5</sup> Operating experience has confirmed the great benefit of that project: some 785 GW was exchanged between the two countries up to 31 December 2004. It was agreed to further reinforce the Egyptian side of the grid with 500 MW and the Libyan grid with 400 KW. Studies on the reinforcement of the electrical grid between Egypt and the countries of the Arab Maghreb which were funded by the Arab Fund for Economic and Social Development have been carried out.

*The second phase.* The second phase of the project aims to double electrical exchange capacity and, in principle, to add a third circuit of 400 KW to the Jordanian-Syrian grid, extending the Jordanian circuit by 365 km from the Aqaba power station to that in North Amman, and adding a second 150 km 400 KW voltage circuit from the north of Amman to the Deir Ali power station in the Syrian Arab Republic. A joint Syrian-Jordanian-Egyptian Technical Committee has been set up to conduct technical studies in order to show the flow of electricity to the three countries in the period between 2003 and 2010, with a view to activating and strengthening the electrical grid between those countries. The Committee has completed the first phase of the studies, concerned with renewing exchange of electricity, bottlenecks and peaks. On 22 June 2005 the electricity companies of Egypt, Jordan and the Syrian Arab Republic signed an agreement to expand the electricity grid which links them, in order to increase electrical exchange capacity.

*Electrical linkage of GCC State grids to countries of the Arabian Gulf.* The leadership of the GCC has agreed to begin implementation procedures for a project to link the electrical grids of the GCC States, to be implemented in three phases. The first phase will link the electrical grids of Bahrain, Kuwait, Qatar and Saudi Arabia, while the second phase will link those of Oman and the United Arab Emirates. Once the first and second phase are completed the third phase will link those two groups. The overall cost of that project is estimated at \$1626 million. The GCC States have agreed to fund the project as follows: Saudi Arabia 31.6 per cent, Kuwait 26.8 per cent, the United Arab Emirates 15 per cent, Qatar 11.8 per cent, Bahrain 9 per cent and Oman 5.8 per cent.<sup>6</sup> The cost of the first stage is estimated at \$1189 million, the second phase at \$300 million and the third phase at \$137 million.

Tender documents for the first phase have been completed and include the following:

- (i) Construction of a double circuit, 400 KW line over a distance of 800 km.
- (ii) Construction of six mixed voltage power stations and an oscillation power station.
- (iii) Construction of a main control station to coordinate the operation and management of the grid network.
- (iv) Installation of a marine cable between Saudi Arabia and Bahrain.

The contract has been opened for tender. The winning company will be determined in August 2005, in order to ensure that work can be completed in the first quarter of 2008.

*Electrical grid network between Yemen and Saudi Arabia.* The Arab Fund for Economic and Social Development has agreed to fund a feasibility study on linking the Yemeni electricity grid to that of Saudi Arabia, and a contract has been signed with a consultant.

*The electrical grid between the countries of the Arab Maghreb.* The electrical grids of the countries of the Arab Maghreb, namely, Algeria, Morocco and Tunisia, are already linked. Electrical power has been exchanged between Morocco and Spain since 1997. A grid network linking the Libyan Arab Jamahiriya to Tunisia has been implemented and is expected to start operation during 2005 following UCET approval.

*Comprehensive Arab electricity linkage.* Several alternatives have been proposed to link the electricity grid of Saudi Arabia to that of Egypt, either through a marine cable across the Gulf of Aqaba or through the Red Sea from the Saudi city of Yanbu, and for the linking of the Iraqi grid with that of the GCC member countries via Kuwait. Research has also been carried out into the possibility of Djibouti, Mauritania, Palestine and the Sudan joining the Arab electricity grid.

*The European-Arab electricity linkage project.* It would be possible to link the electrical grids of the Arab Mashreq and Maghreb with those of the European states at a voltage of 400 KW via the following routes:

- (i) In the east: via Turkey, after the completion of the Syrian-Turkish grid.
- (ii) In the west: from Morocco via Spain through the 400 MW marine cable that has been in effective operation since August 1997. The two countries have also signed an agreement to reinforce the grid by means of a second marine cable, which is expected to be completed by the end of 2005 and will help to double the current electricity transport capacity between Morocco and Spain from 700 to 1400 MW. Algeria has signed agreements with both Italy and Spain on conducting technical and economic feasibility studies on electricity linkage via a direct current (DC) cable. It is in the process of building 200 MW power stations, largely aimed at export to Europe.
- (iii) In the centre: a preliminary study has been conducted on linking Italy to one of the Arab countries in North Africa.

Studies are being carried out by a consultant, in partnership with certain Arab countries and funded by EU, under the heading of MEDRING, to assess the performance of the Euro-Mediterranean electricity network which was established as a result of the implementation of current grid projects and those which are planned up to 2010. The study is expected to be finished shortly.

*Natural gas grid networks between the Arab countries* While natural gas reserves in the Arab countries constituted some 31 per cent of world reserves in 2004 and natural gas reserves in the ESCWA countries represent more than 88.4 per cent of all Arab country reserves ratios of production to global production were a mere 11.4 per cent and ratios of consumption to global rates were a mere 6.73 per cent. The total quantity of natural gas exported to world markets in 2003 was some 97.5 billion cubic metres. Algeria was the largest exporter, with some 62.6 per cent of global exports, followed by Qatar with 19.7 per cent, Oman with 9.6 per cent and the United Arab Emirates with 7.3 per cent. Natural gas reserves in the Arab countries have grown more than

5.75 times over the last three decades, from 9.2 trillion cubic metres in 1971 to 53 trillion cubic metres in 2004. Natural gas is mainly found in Algeria, Egypt, Iraq, the Libyan Arab Jamahiriya, Qatar and Saudi Arabia.<sup>7</sup>

Given its economic and environmental importance, demand for natural gas has grown in the Arab countries and rapid progress has been made in building pipeline networks to transport natural gas from the sources of production to the site of consumption, in particular in Arab countries that suffer from a lack of energy resources. Set out below is the progress achieved in projects concerning natural gas pipelines between the Arab countries.

*Projects for natural gas pipelines between the northern ESCWA member countries (Arab Gas Pipeline)*

- (i) Work is continuing on the implementation within the deadline of the second phase of the project, which consists of a 370 km pipeline in Jordanian territory. The pipeline is expected to be completed by the 2006 deadline.
- (ii) An announcement was made on the implementation of the first part of the next phase of the project, which includes the building of a 310 km pipeline to transport natural gas from the Jordanian-Syrian border to the area of Rayyan, close to Homs in the central Syrian Arab Republic. Contractual procedures are expected to be completed before the end of 2005 in order to ensure that the pipeline can be completed by the end of 2007.
- (iii) The second part of the third phase of the project has also been completed. It includes the building of a pipeline from Rayyan near Homs in the Syrian Arab Republic to the power station of Dayr Ammar in Lebanon. An agreement is being sought for the supply of gas between the Syrian Arab Republic and Lebanon.

*Gas pipeline projects between the GCC and Arabian Gulf countries*

- (i) The Dolphin Energy Project between Qatar and the United Arab Emirates is considered one of the most significant sub-regional natural gas projects in the Arab region. The project entails the building of a 370 km, 48 inch diameter marine pipeline with an 82 million c/m/d capacity to transport gas from Qatar to the United Arab Emirates. The Dolphin Energy Limited Company, based in Abu Dhabi, was set up in order to implement the project.

The Company has completed several administrative and legal steps and signed the necessary contracts to implement the project, including the following:

- (a) An engineering-supply building contract for a natural gas station in Al Tawila.
- (b) The construction of and provision of pressure units for a natural gas processing station in Ras Laffan.
- (c) A contract for the construction of two off-shore construction platforms.
- (d) An engineering and supply contract for two marine pipelines to transport raw gas from Qatar to the treatment plant.

It is planned to complete implementation and for gas to start being delivered to the United Arab Emirates by the deadline of 2006.

- (ii) In January 2004 Dolphin began to pump Omani gas to the Emirate of Fujairah in the United Arab Emirates to supply its electrical generator station, and desalinated water through an overland pipeline constructed between al Ain and al-Fujairah for future replacement with Dolphin gas from Qatar.<sup>8</sup>

*Regional Mechanism on the Development of Energy Uses for Sustainable Development*

- (a) The Regional Mechanism on the Development of Energy Uses for Sustainable Development has continued its activities aimed at developing cooperation between ESCWA member countries on uses of energy for sustainable development by employing their individual and joint capacities. The achievements of the Mechanism are set out below:
- (i) A regional report on renewable energy was issued which provided quantitative and qualitative information about the available sources, programmes and potential of renewable energy in the member countries.
  - (ii) A regional capacity building project on renewable energy and the energy system was implemented between 2002 and 2004. Four workshops were held, in which 85 trainees from 13 Arab countries took part.
  - (iii) A regional project to spread renewable energy applications for reducing poverty was initiated.
- (b) National focal points held their fifth meeting in September 2005 at a wind farm in Zaafarana in Egypt. The meeting recommended that the plan of action for 2006/2007 include a number of studies and activities of joint interest, in particular the use of solar water heating panels in the ESCWA member countries and those countries' approaches to the use of energy efficiency data.

#### 8.4. CONCLUSION AND RECOMMENDATIONS

##### *8.4.1. Conclusion*

The most important conclusions of this chapter are set out below.

1. Negligible progress has been made in terms of the Arab economic contribution to the world economy. Figures indicate that overall Arab GDP grew by some 2.1 per cent in 2004 compared to 1.6 per cent in 2003. That increase is below requirements, given that the Arab world takes up some 10 per cent of the world surface and that its population constitutes some 5 per cent of the world population.
2. The oil sector is still the most significant Arab contribution to the world economy. Oil production ratios in the Arab world increased to 31.2 per cent of world averages in 2004, compared to some 26.3 per cent in 2003. Oil reserves decreased to 55.5 per cent of world reserves compared to 56.7 per cent in 2003. In 2004 natural gas production constituted some 12 per cent of global production compared to 16.9 per cent in 2003.

3. 2004 saw a marked 25 per cent increase in FDI flows, greatly exceeding the world average of 2.5 per cent. Notwithstanding the significant growth registered in 2004, and the many efforts made by member countries to improve their investment climates and promulgate the necessary laws and measures to increase FDI flows, the ratio of such flows in Arab countries to those in the world was a mere 1.9 per cent in 2004. That is a very low ratio and Arab countries must double their efforts to increase that flow.
4. There are risks associated with the new approach with a new trend towards concluding bilateral agreements, at the local economy level, the level of the multilateral world trading system, and regional and inter-regional integration, in particular, between developing countries.
5. Ratios of Arab intra-regional trade to foreign trade in the Arab world went up from 7.8 per cent in 2003 to 8.8 per cent in 2004. If oil is excluded, that ratio increases to 14 per cent in 2004, a marked improvement. In 2005 Arab goods will become exempted from all customs fees under GAFTA, which now comprises 19 countries.
6. Arab intra-regional investments realised a marked growth from \$3.8 billion in 2003 to \$5.9 billion in 2004, the equivalent of 55 per cent, and investment ratios to GDP rose to 48.2 per cent in 2004, meaning that they almost doubled. That shows the beginning of Arab investor interest in the Arab countries, and, in particular, in the services sector.
7. The tourism sector is considered a key sector for Arab intra-regional integration. Most tourists visiting Arab countries are Arab tourists, and their ratio to overall tourists in the Arab world was 40 per cent in 2003. The sector grew appreciably in 2004 in a number of countries, including Egypt, Jordan, Lebanon and the Syrian Arab Republic.
8. Arab intra-regional labour migration from countries with a labour surplus to those with a labour shortage is a core indicator for Arab intra-regional integration. While migration has declined over the past four years, the ratio of labour remittances to GDP is estimated at 6.6 per cent, which highlights the importance of such remittances in solving such economic problems as unemployment and poverty and in financing development. While ODA, in particular from the oil-exporting countries towards the least developed countries, plays a similar role, its ratio to GDP was a mere 1.44 per cent in 2003.
9. A Memorandum of Understanding on Maritime Transport in the Arab Mashreq was signed at the 23rd ministerial session of ESCWA, which was held in Damascus from 9 to 12 May 2005. It is the first of its kind in the Arab world. The Memorandum is the third ESCWA initiative in the field of transport, and completes the Integrated Transport System for the ESCWA Region, which now includes road, rail and maritime transport. The Memorandum was signed at the official signing ceremony by eight member countries, namely, Egypt, Jordan, Lebanon, Palestine, Qatar, Saudi Arabia, the Syrian Arab Republic and Yemen.

10. The Agreement on International Roads in the Arab Mashreq was the first international agreement adopted by ESCWA. It was adopted on 10 May 2001, entered into force on 19 October 2003, and to date has been ratified by seven member countries, namely, Egypt, Jordan, Lebanon, Qatar, the Syrian Arab Republic, Saudi Arabia and Yemen.
11. The interest of many ESCWA member countries in developing and modernising their railways has increased since the adoption of the Agreement on International Railways in the Arab Mashreq on 14 April 2003, particularly after it entered into force on 23 May 2005 and was ratified by four member countries, namely, Egypt, Jordan, Lebanon and the Syrian Arab Republic.
12. All of the above may have contributed to an increase in awareness that road safety problems transcend national borders and affect all nations, which has stimulated interest in member countries in exerting increased efforts to solve the problem at the regional level.
13. The expansion of the electrical grid network and the optimal use of natural gas reserves as a strategic investment has helped to advance regional integration between the Arab countries and their integration into world markets and, in particular, to the European market, through linking the Syrian-Turkish and the Moroccan-Spanish electricity grids and natural gas networks to those of Europe. The benefits of those grids will multiply when the electrical and natural gas grid networks of the GCC countries are connected to those of the Arab Mashreq and Maghreb countries.

#### *8.4.2. Recommendations*

The age of globalisation and the formation of regional economic blocs demands that the countries of the ESCWA region and the Arab countries take measures to obtain maximum benefits from and limit the negative effects of globalisation.

Recommendations which decision makers in the region could take into consideration for that purpose are set out below:

1. GAFTA should, as a priority, be encouraged and its participation in WTO negotiations intensified. Careful consideration should be given to bilateral agreements in order to ensure integration into the world economy. Arab countries should also ratify the General Agreement on Trade in Services.
2. Ensure the participation of the Arab private sector in integration projects between Arab countries, and work to facilitate the movement of Arab investors.
3. Countries should be aware of the stricter commitments required under regional trade agreements, that considerably exceed the commitments required under WTO.
4. Sectoral integration between Arab countries, particularly in the fields of transport, tourism, electricity and technology, should be encouraged in order to expedite Arab economic integration. A mechanism to compensate sectors that may be harmed by integration in the short term should be created.

5. Arab countries should clearly define priorities in WTO agreements and coordinate to defend their joint trade interests, in cooperation with other developing countries that share those interests.
6. Cooperation in financial services should be strengthened by facilitating banking procedures and all financial and currency services between Arab countries.
7. In order to facilitate integration, Arab economic, financial and trade laws should be harmonised, and a regional development bank similar to EDB should be established solely in order to deal with integration projects.

#### NOTES

- <sup>1</sup> Final Declaration of the Arab Summit of the Council of the League of Arab States, 17th regular session, Algeria 2005.
- <sup>2</sup> Sixth Session of the Council of Arab Ministers for Electricity, held at the Office of the League of Arab States General Secretariat, 13 April 2005, report and resolutions.
- <sup>3</sup> Report and recommendations, Seminar on the Electrical Grid, Cairo, 14 April 2005.
- <sup>4</sup> *Al-Watan*, The Electricity Grid Project between Syria and Iraq, press release, 27 May 2005.
- <sup>5</sup> Fathi Muhammad Abu Qarad and others, Egyptian-Libyan electricity grid, difficulties in exploitation and benefits gained, paper presented during the Seminar on the Electrical Grid, Cairo, 14 April 2005.
- <sup>6</sup> Gulf Unified Electrical Grid Project, press release, 18 April 2005.
- <sup>7</sup> OAPEC, *Secretary-General's 31st Annual Report*.
- <sup>8</sup> Dolphin Energy Limited, Public Relations Department press release, 2 March 2005.

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## CHAPTER 9

TRADE AND INTEGRATION IN (SOUTH) EAST EUROPE,  
CAUCASUS, AND CENTRAL ASIA

## 9.1. INTRODUCTION

Eastern Europe, Caucasus, and Central Asia (EECCA)<sup>1</sup> and South East Europe (SEE)<sup>2</sup> were among the world's fastest growing regions in recent years. Yet, their presence on the international markets is as yet underdeveloped and their combined share of world exports was only 4.1 per cent in 2004.

The first part of this chapter focuses on economic growth and per capita income trends. It also discusses poverty and its various dimensions, such as health protection, education and participation in the job market. It seeks to answer two questions: What have been the social repercussions of the last 15 years of far-reaching economic and political transition? Did recent robust growth have the expected outcome on poverty and jobs?

The second part of the chapter describes the growth and product composition of external trade flows, and identifies the major commercial partners for each country and region. This provides the background for the analysis of the countries' trade and integration policies, covered in the third part. This analysis looks primarily at customs tariffs, non-tariff barriers to trade, WTO accession, and regional and interregional trade agreements. In this part we seek to review the steps the countries of the region have undertaken to better integrate into regional and global markets.

Cooperation within each of the two sub-regions has not been limited to trade. The last part of the chapter therefore summarises some other UNECE-related projects that were launched in different sectors, and in particular in the field of transport. The facts that are presented in the main parts of the study are critically considered in the conclusions which also set out the policy actions that have been proposed in order to tackle the most pressing challenges that these two sub-regions face.

In the preparation of the study, a comprehensive data set was established. It includes, as regards socio-economic trends, the World Bank "World Development Indicators Database," complemented by the UNECE Statistical database, the UNDP Human Development Indicators database and the ILO LABORSTA Database. As regards recent trade trends, the main reference was the UN COMTRADE database, complemented by the IMF "Statistics on the Direction of World Trade" and the WTO Statistical database. As regards tariff barriers to trade, the study refers to the TRAINS statistical database of UNCTAD.

## 9.2. SOCIO-ECONOMIC TRENDS AND INDICATORS FOR THE REGION

## 9.2.1. Economic Growth and Poverty in SEE and EECCA

The recent history of SEE and EECCA was marked by inter-ethnic divisions, wars and civil strife. At the same time, the countries of the region are in different stages of a profound transformation from centrally planned into free market economies. The severity of the prolonged economic contraction that accompanied the early stages of the reforms<sup>3</sup> and the disruptions caused by conflicts deeply affect socio-economic realities to this day. Most of the countries of the SEE and EECCA are in the lower middle income group,<sup>4</sup> with the exception of Turkey and Croatia in SEE and of the Russian Federation in EECCA.<sup>5</sup> At the other end of the spectrum are the low-income countries of EECCA – Tajikistan, Kyrgyzstan and Uzbekistan, with per capita Gross National Income (GNI) of US\$ 280, US\$ 400 and US\$ 460, respectively. For comparison, average GNI per capita in least developed countries is US\$ 340 (Figure 9.1).

In recent years, the ongoing economic and political reforms and the high oil and commodity prices attracted increasing foreign direct investment and renewed consumer confidence. Growth rates in the region were among the highest in the world: between 2000 and 2005 GDP grew by 5.2 and 6.7 per cent per annum in SEE and in EECCA, respectively (Figure 9.2a). In 2005, annual GDP growth averaged 7.8 per cent.<sup>6</sup>

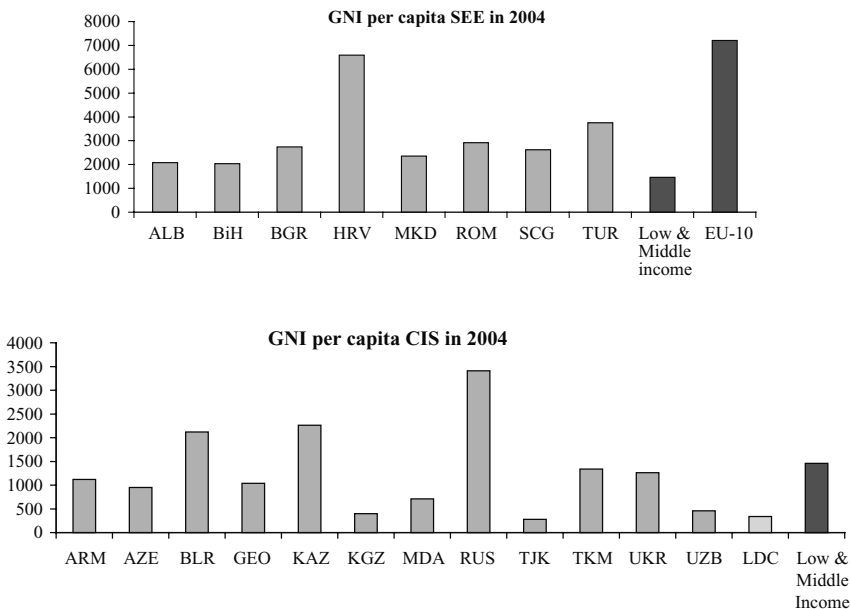


FIGURE 9.1. GNI per capita CIS in 2004

(Source: World Bank, World Development Indicators Database).

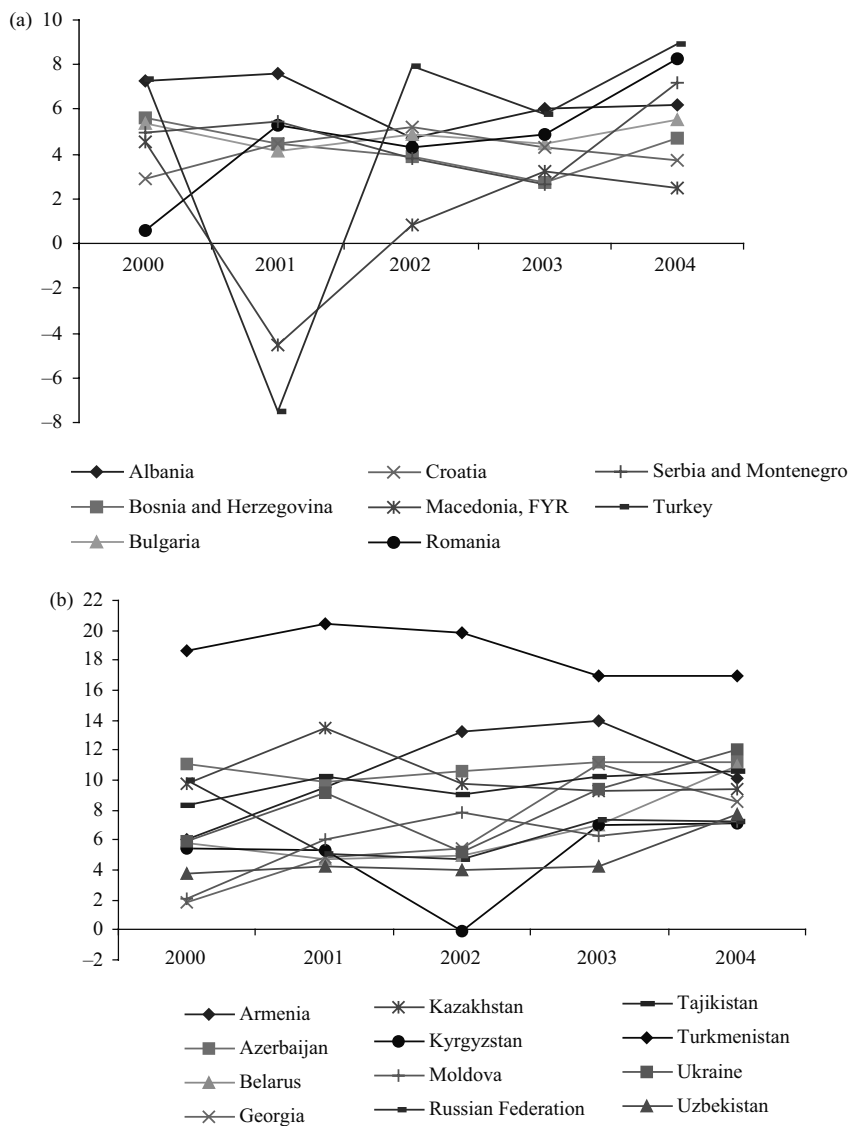


FIGURE 9.2. (a) GDP Growth (annual %) in SEE. (b) GDP Growth (annual %) in EECCA  
(Source: World Bank, World Development Indicators Database).

Looking in more detail at the seven countries of SEE (see Figure 9.2b), Turkey and the Former Yugoslav Republic of Macedonia (FYRM), both experienced a sharp decline in 2001,<sup>7</sup> while the other countries grew at or above 3 per cent per annum consistently between 2000 and 2004.

In EECCA countries, GDP growth was impressive and consistently positive between 2000 and 2004. Armenia, Azerbaijan, Kazakhstan, Tajikistan and Turkmenistan in particular grew by more than 10 per cent per annum. Kyrgyzstan was the only country to experience a mild recession in 2002.<sup>8</sup>

In spite of recent robust growth, the region faces important challenges and, in particular, reducing the number of people living in poverty. The region's poor, which had increased from 4.5 to 19.0 per cent of the total population between 1990 and 2001, declined in recent years to 12 per cent.<sup>9</sup> This decline was mainly concentrated in urban areas, while the young and residents in rural areas remain the most vulnerable.

Measuring poverty and comparing measures of poverty across the countries of the sub-region poses a major challenge. One aspect that differentiates this region from others pertains to the high costs that the poor have to bear for heating and warm clothing, a necessity given the region's cold climate. The threshold of poverty for this region is therefore set at US\$ 2.15 per day rather than US\$ 1 per day. Even this higher threshold does not protect people from extreme vulnerability to economic shocks, and for this purpose a US\$ 4.30 cut-off point may be more appropriate. At the same time, and irrespective of the choice of the threshold, existing purchasing power parity estimates appear insufficiently reliable, so in Table 9.1 and 9.2 below, countries that are at very similar levels of development appear to have very different headcount rates. For this reason, the share of people below the poverty line – which is defined in a different way by each of the countries – is shown alongside the other indicators to provide the authority's perception of the poverty trends in their own countries. By international measures, countries in the SEE countries have moderate poverty, generally below 20 per cent. Some countries have been more successful in reducing levels of poverty: for example, in Bulgaria, recent growth and the country's extensive social protection system contributed to a substantial reduction in poverty between 2000 and 2004 (World Bank, 2006).

TABLE 9.1. Selected social indicators in SEE

		Share of population below \$2.15 per day at PPP (%)	Share of population below \$4.30 per day at PPP(%)		Share of population below national poverty line (%)
	Survey year			Survey year	
ALB	2002	24	71	2002	25.4
BiH	2004	4	35	2002	19.5
BGR	2003	4	33	2001	12.8
HRV		–	–		–
MKD	2003	4	24		–
ROM	2003	12	58		–
SCG	2002	6	42	2003	10.5
TUR	2002	20	58	2003	1.3

Source: World Bank, Human Development Indicators (UNDP).

TABLE 9.2. Selected social indicators in EECCA

		Share of population below \$2.15 per day at PPP (%)	Share of population below \$4.30 per day at PPP (%)		Share of population below national poverty line (%)
	Survey year			Survey year	
ARM	2003	50	93	2000	24.0
AZE	2003	4	70	2003	9.6
BLR	2002	2	21	2004	18.0
GEO	2003	52	85	2003	16.6
KAZ	2003	21	66	2001	11.3
KGZ	2003	70	96	2001	13.5
MDA	2003	43	85	2002	33
RUS	2002	9	41	2004	17.8
TJK	2003	74	96		–
TKM		–	–		–
UKR	2003	1	22	2002	13.7
UZB	2003	47	86	2003	26.2

Source: World Bank (2005), UNECE Statistical Database.

In EECCA, the low-income countries record very high poverty headcount rates, comparable to those of least developed countries from other regions. The situation is less severe in the middle-income countries of the sub-region – Belarus, Kazakhstan, Russia and Ukraine – which were able to move a number of people out of poverty when economic growth restarted after 1998.<sup>10</sup>

### 9.2.2. Other Socio-Economic Indicators: Health, Education and Employment

Poverty's two most important non-income dimensions – health and education – are captured to a degree by the two indicators shown in Table 9.3 and 9.4 below.

Life expectancy at birth dropped throughout the region in the early stages of the transition. In SEE, this trend reversed starting from 1997 and it is now at pre-transition levels (on average 71.5 years). The EECCA average, instead, is still below its level of 1990 at 65.7 years. It is surprising that in Armenia and Georgia life expectancy is higher (75 and 73 years, respectively) than in Kazakhstan and the Russian Federation (61 and 66, respectively), although the latter countries are comparatively richer. These differences reflect several factors including high child mortality (especially in Central Asia and the Caucasus), as well as the increasing spread of the HIV virus. A major concomitant factor, which also explains the gap between life expectation for males and females, are lifestyle behaviours that lead to accidents, injuries and cardio-vascular diseases (World Bank, 2005a: 67).

The education index – calculated by UNDP on the basis of gross enrolment data and adult literacy rates – is very high (over 90 per cent) throughout the two regions, with the exception of Turkey and Moldova. This reflects a tradition of equal access

TABLE 9.3. Selected social indicators in SEE

	Life expectancy at birth (years)		Education index
	2003		2003
	Male	Female	
ARM	68	74.7	0.9
AZE	63.2	70.5	0.89
BLR	62.4	74	0.95
GEO	66.6	74.3	0.9
KAZ	57.8	69	0.94
KGZ	62.7	71.1	0.93
MDA	63.9	71.3	0.85
RUS	59	72.1	0.96
TJK	61	66.3	0.91
TKM	58.3	66.8	0.91
UKR	60.1	72.5	0.95
UZB	63.4	69.8	0.91

Source: Human Development Indicators (UNDP).

TABLE 9.4. Selected social indicators in EECA

	Life expectancy at birth (years)		Education index
	2003		2003
	Male	Female	
ALB	71	76.7	0.89
BiH	71.4	76.8	0.86
BGR	68.9	75.6	0.91
HRV	71.4	78.4	0.9
MKD	76.3	71.3	0.87
ROM	67.8	75	0.89
SCG	–	–	–
TUR	66.5	71.1	0.82

to education and high quality in schooling: however, there is evidence that – even though enrolment in classes is still strong – the quality of education has suffered a decline.

Correlation between poverty and unemployment is looser in EECA than in other developing regions. Unemployment is relatively low – with the exception of the Russian Federation and Armenia (Figure 9.3a) – while the majority of the poor live in households where at least one family member is employed. One can infer that many people in poverty hold low wage/low productivity jobs (World Bank, 2005b: 129).

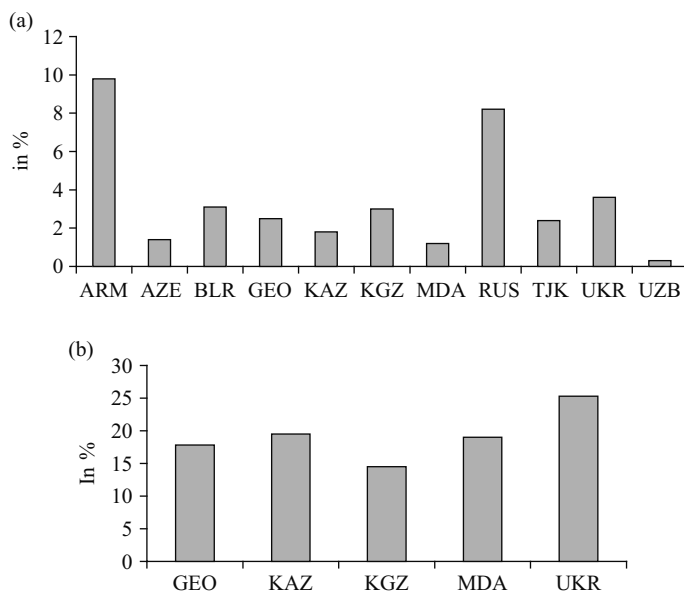


FIGURE 9.3. (a) Unemployment rate (EECCA 2003). (b) Share of professionals, associate professionals and technicians in total employment (EECCA 2003).

The prevalence of low skills employments is reflected by the low share of professionals, associate professionals and technicians in total employment<sup>11</sup> (Figure 9.3b). Although statistics are available for only a few of the countries, it appears that this share is very low (below 20 per cent) in the countries of the EECCA region, and especially in the low-income countries. In Kyrgyzstan, for example, high skilled jobs were 14.5 per cent of total against a EU average of 27.5 per cent. Ukraine is an outlier with a share of professionals of 25.3 per cent. SEE countries – on the other hand – register very high unemployment rates with peaks of 45.3 per cent in the FYRM and 44 per cent in Bosnia and Herzegovina. The share of professionals in total employment is close to that of the EU in Bulgaria, Croatia, the FYRM and Serbia and Montenegro, ranging from 23 to 25 per cent. Conversely, Romania and Turkey have much lower unemployment rates (6.8 and 10.5 per cent, respectively) but a very low share of professionals in total employment is (17.4 and 11 per cent, respectively) (Figure 9.4a and 9.4b).

In both SEE and EECCA, output growth did not yield the expected reductions in unemployment nor the creation of a sufficient number of skilled job opportunities. The issues that characterise the job market are to a large extent determined by structural rather than cyclical factors. The challenge of stimulating job-rich growth in the two sub-regions will require a number of policy actions, which are discussed in the Conclusions to this document.

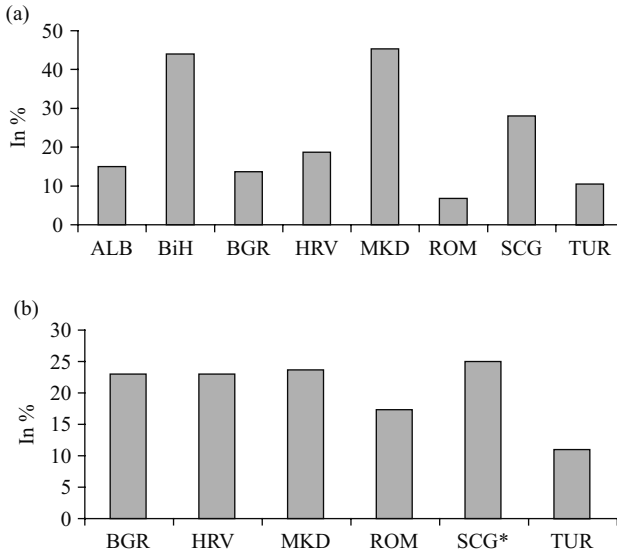


FIGURE 9.4. (a) Unemployment rate (SEE 2003). (b) share of professionals, associate professionals and technicians in total employment (SEE 2004)

Source: UNECE Database and ILO LABORSTA Database.

### 9.3. RECENT TRENDS IN INTERNATIONAL TRADE FOR EECCA AND SEE

#### 9.3.1. Growth and Export Composition of EECCA and SEE International Trade

Over the 10 years from 1994 to 2004, the average annual growth rate for exports (in US dollars) of EECCA and SEE countries to the world was – respectively – 11.3 and 12.7 per cent (Figures 9.5a and 9.5b). World export growth was 7.8 per cent per annum over the same period, so the shares of EECCA and SEE increased from 2.0 to 2.9 per cent and from 0.7 to 1.2 per cent of total world exports respectively.<sup>12</sup> While growing in volume, the product composition of exports of both EECCA and the SEE changed during the transition. In EECCA, the countries that have large reserves of mineral resources shifted their export mix even more towards these commodities in recent years (see Table 9.5). For example, between 1997 and 2004, the combined share of oil and gas in total exports increased from 58 to 82 per cent for Azerbaijan, from 28 to 60 per cent for Kazakhstan and from 71 to 82 per cent for Turkmenistan. Energy products also represent a high and stable share of the Russian Federations' exports. Other commodities also feature prominently in the regions' exports basket, including: aluminium (55 per cent of Tajikistan's total exports in 2004),<sup>13</sup> cotton (19.8 per cent of Uzbek's exports in 2003)<sup>14</sup> and gold (11 per cent of Kyrgyzstan's exports in 2004). Although these data need to be interpreted with caution, because the price of oil and other commodities increased significantly over the period we are reviewing, they

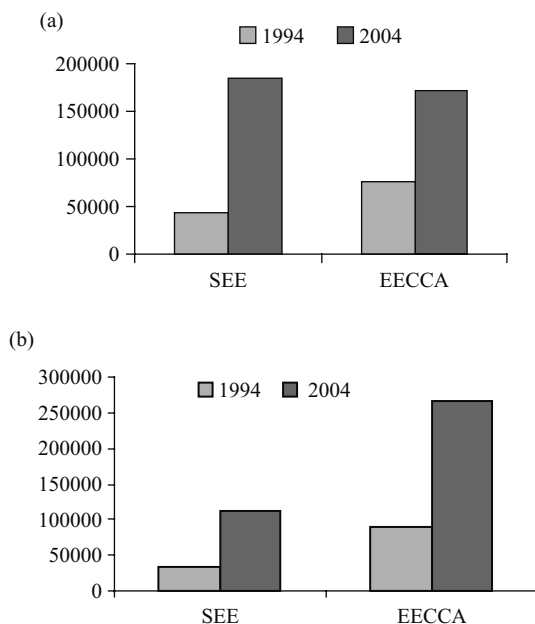


FIGURE 9.5. (a) Total imports. (b) Total exports *Source:* WTO, Statistical database, <http://stat.wto.org/>

document these countries' difficulty in integrating into international value chains, and their persistent reliance on inter-industrial as opposed to intra-industrial international trade flows.

For countries that are not rich in mineral resources, the developments in the export mix were more varied. In Armenia the development of the diamond-cutting industry based on imported raw diamonds cushioned the decline in the more traditional food, apparel and machinery industries. Moldova and Georgia relied increasingly on their agro-industrial sector and, in particular, on exports of beverages, while Belarus and Ukraine maintained their specialisation in heavy industrial products (chemicals and iron and steel).

As regards SEE, the export structure of the seven countries appears remarkably similar, with a high percentage of labour-intensive exports such as clothing, leather, footwear and furniture. These exports depend in large part on outsourcing orders from EU firms and FDI for which there has been a strong competition among the countries of the region (Table 9.6).<sup>15</sup> These specialisations "may not be sustainable in the medium term, since these sectors are greatly exposed to the rapidly increasing competition from the lower-cost, labour-abundant Asian countries. Thus it is essential that the SEE countries upgrade their production and export base and foster human resource development in order to gain new comparative advantages in higher skill and advanced technology sectors" (Gaucaité Wittich, 2005: 19).

TABLE 9.5. Composition of EECCA countries' exports

	Major exports and share in total (2004) <sup>a</sup>	Share (percent) of top three exports in total export	Major exports and share in total (1997) <sup>b</sup>	Share (percent) of top three exports in total export
Armenia	Non-metallic mineral manufactures (35), Metalliferous ores and metal scrap (13), Iron and steel (10)	58	Metalliferous ores and metal scrap (25), Non-metallic mineral manufactures (24), Beverages (9)	58
Azerbaijan	Petroleum and its products (82), Transport equipment (4), Chemical elements and compounds (2)	88	Petroleum and its products (58), Textile fibres (15), Non-electrical machinery (4)	77
Belarus	Petroleum and its products (26), Transport equipment (9), Non-electrical machinery (7)	42	Transport equipment (13), non electric machinery (10), Petroleum and its products (8)	31
Georgia	Metalliferous ores and metal scrap (24), Beverages (16), Transport equipment (16)	56	Iron and steel (17), Beverages (15), Petroleum and its products (12)	44
Kazakhstan	Petroleum and its products (60), Non-ferrous metals (9), Iron and steel (8)	77	Petroleum and its products (28), Non-ferrous metals (17), Iron and steel (14)	59
Kyrgyzstan	Petroleum and its products (14), Non-metallic mineral manufactures (11), Textile fibres (11)	36	Tobacco (17), Textile fibres (9), electrical machinery (8), electric energy (8)	42
Moldova	Beverages (28), Clothing (16), Fruit and vegetables (11)	55	Fruit and vegetables (19), Meat and meat preparations (13), Sugar and honey (12)	44
Russia	Petroleum and its products (49), Iron and steel (10), Gas (8)	67	Petroleum and its products (31), Gas (21), Non-ferrous metals (10), Iron and steel (10)	72
Tajikistan	Non-ferrous metals (56), Electric energy (14), Textile fibres (13)	83	Gas (36), Petroleum and its products (35), Textile fibres (12)	83
Turkmenistan	Gas (51), Petroleum and its products (31), Textile fibres (10)	92	Iron and steel (36), Non-electric machinery (7), Metalliferous ores and metal scrap (7)	50
Ukraine	Iron and steel (31), Non-electrical machinery (7), Petroleum and its products (7)	45		

Source: UN COMTRADE Database.

<sup>a</sup> Data for Tajikistan is for the year 2000, and data for Ukraine is for the year 2002.

<sup>b</sup> Data for Belarus and Kyrgyzstan is for the year 1998.

Uzbekistan does not appear as a reporter in COMTRADE in recent years.

TABLE 9.6. Composition of SEE countries' exports

	Major exports and share in total (2004)	Share (percent) of top three exports in total export	Major exports and share in total (1997)	Share (percent) of top three exports in total export
Albania	Clothing (33), Leather (23), Footwear (6)	62	Clothing (24), Leathers (19), Crude animal and vegetable material (9)	52
Bulgaria	Clothing (19), Non-ferrous metals (10), Iron and steel (10)	39	Iron and steel (11), Non-ferrous metals (9), Petroleum and its products (8)	28
Bosnia and Herzegovina	Wood, lumber and cork (11), Non-electrical machinery (11), Non-ferrous metals (11)	33		
Croatia	Transport equipment (15), Electrical machinery (10), Petroleum and its products (8)	33	Clothing (15), Petroleum and its products (9), Electrical machinery (8)	32
Macedonia	Clothing (29), Iron and steel (24), Petroleum and its products (5)	58	Clothing (20), Iron and steel (15), Tobacco and tobacco manufactures (9)	44
Romania	Clothing (20), Electrical machinery (11), Iron and steel (9)	40	Clothing (21), Iron and steel (13), Non-electrical machinery (6), Petroleum and its products (6)	46
Turkey	Clothing (18), Transport equipment (15), Textile fabrics (10), Iron and steel (10)	53	Petroleum and its products (12), Fruit and vegetables (9), Iron and steel (9)	56

Source: UN COMTRADE Database.

### 9.3.2. Geographical Composition of Trade

Intra-regional trade represents an important component of total trade for EECCA. The main reason for this was the way in which manufacturing production was organised under central planning. At the time, there were incomplete production chains in different parts of the Soviet Union, leading to the necessity of flows of both parts and finished products. The need to dispose of local sub-standard goods and produce and the negligible trade relations with countries outside the Council for Mutual Economic Assistance (CMEA) also played a role (Michalopoulos and Tarr, 1999).

It was therefore to be expected that following the transition, the share of intra-regional trade would decline. Trade relations among the EECCA countries remain significant, however, and represent 17.4 per cent of total exports and 35.5 per cent of total imports. In SEE, regional trade is at much lower levels: 9.1 per cent of exports and 5.9 per cent of imports in 2004.<sup>16</sup> This can be explained by several factors, including the similarity in the export structure of the SEE countries; the disruptions in regional trade caused by the armed conflicts of the 1990s and, finally, the focus of the region's commercial policy, which is clearly a rapid integration with the European Union. Between 1999 and 2004, however, there was an increase in intra-regional trade within the sub-region as Figures 9.6a and 9.6b above show.

Looking more broadly at the countries' main trading partners (Figures 9.7 and 9.8), the region's two main trading "poles" are the European Union and the Russian Federation. The main destination and origin market for imports of and exports from the SEE is

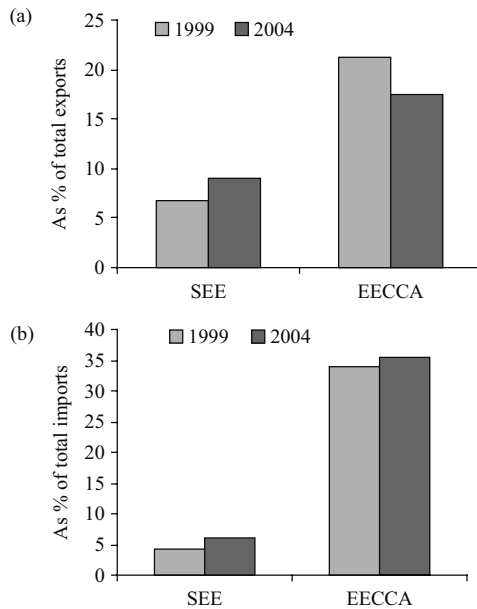


FIGURE 9.6. (a) Intra-regional exports (1999–2004). (b) Intra-regional imports (1999–2004)

Source: IMF, Direction of Trade Statistics. Yearbook 2005.

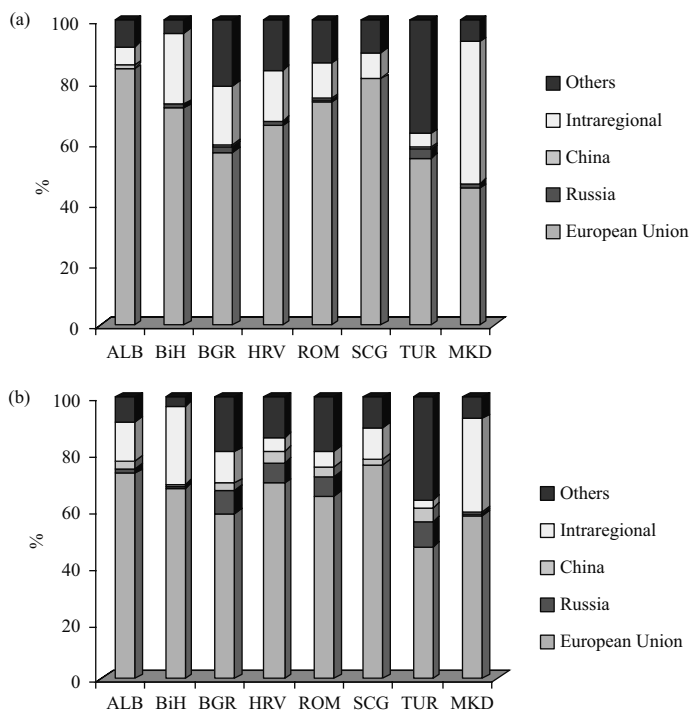


FIGURE 9.7. (a) Geographic destination of SEE exports in 2004. (b) Geographic origin of SEE imports in 2004.

the European Union and in particular, Italy and Germany. Greece plays an important role as well for Albania, Bulgaria and the FYRM, especially on the import side. Turkey imports a large volume of goods from South Africa. Albania and Serbia and Montenegro are the two countries that import and export the largest percentage of their goods from and to the European Union (84 per cent of exports and 73 per cent of imports for Albania; 80 per cent of exports and 76 per cent of imports for Serbia and Montenegro).

As regards EECCA, on the export side, more than 50 per cent of Belarus, Republic of Moldova and Uzbekistan's exports are directed to the Russian Federation. Turkmenistan's intra-regional exports are instead mainly directed to Ukraine. Other important partners for this country are Islamic Republic of Iran and the United Arab Emirates. Kyrgyzstan also directs large exports to the United Arab Emirates (US\$ 198.29 million). The European Union represents an important export partner for Azerbaijan, the Russian Federation and Tajikistan, with Italy, Germany and the Netherlands featuring more prominently.

As mentioned above, for EECCA, imports are mainly sourced from within the region. For Turkmenistan, intra-regional imports are 70 per cent of total imports with

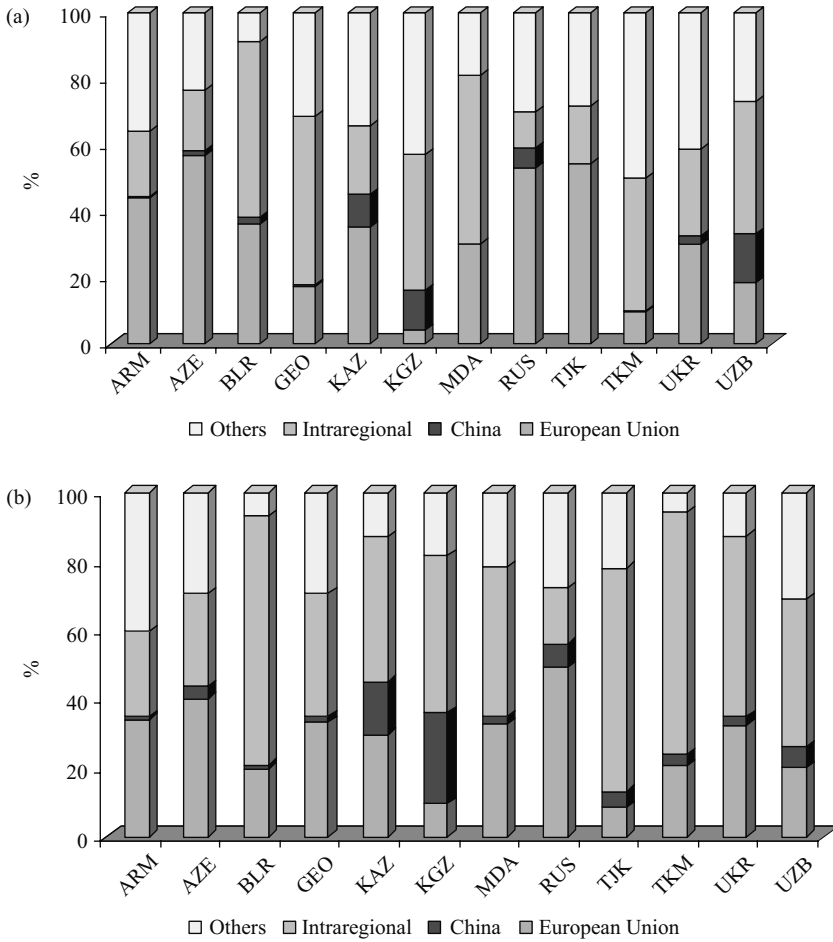


FIGURE 9.8. (a) Geographic destination of EECCA exports in 2004. (b) Geographic origin of EECCA imports in 2004. (Source: IMF, Direction of Trade Statistics. Yearbook 2005).

the Russian Federation, Ukraine and Georgia as principal partners. The Russian Federation accounts for 94 per cent of Belarus’ imports from the region while Tajikistan’s main partners – in addition to the Russian Federation – are Uzbekistan and Kazakhstan.

*9.3.3. Integration in The International Trading System: The WTO, Inter-Regional and Regional Trade Agreements*

*General framework of trade policy* The simple mean of applied customs tariffs ranges from 3 per cent (Armenia) to 16.5 per cent (Romania) (see Figure 9.9). Countries that have joined the WTO in recent years have generally lower tariffs than

regional partners that joined previously or that are not yet members. It should be noted that the tariffs shown in the figure are those applied to most-favored nations (i.e. WTO partners): a substantial amount of trade however takes places at preferential or zero customs tariffs within the framework of the bilateral and regional preferential trade agreements discussed below.

A recent study estimates that, on average, NTBs add an additional 70 per cent to the level of trade restrictiveness imposed by tariffs (Kee et al., 2005).<sup>17</sup> In close to a quarter of countries reviewed, the contribution of NTBs to the overall level of restrictiveness of trade policy is higher than the contribution of tariffs themselves (Figure 9.10). Without attempting a comprehensive review, this paragraph offers a few examples from SEE and EECCA countries.

Burdensome customs procedures and customs fees cause delays for transit and delivery, raise the costs of traded goods and have a considerable impact on competitiveness. In many countries, in spite of recent reforms, clearing customs still requires a number of different documents and authorisations, while the lack of a unified procedure, and of a single document explaining all the necessary steps and payments required, compounds the difficulties and increases the potential for the extortion of unofficial payments. Table 9.7 presents some examples.

Visa policy and practice may also affect trade in various ways. For example by creating an impediment for business visitors, hindering transport of purchased

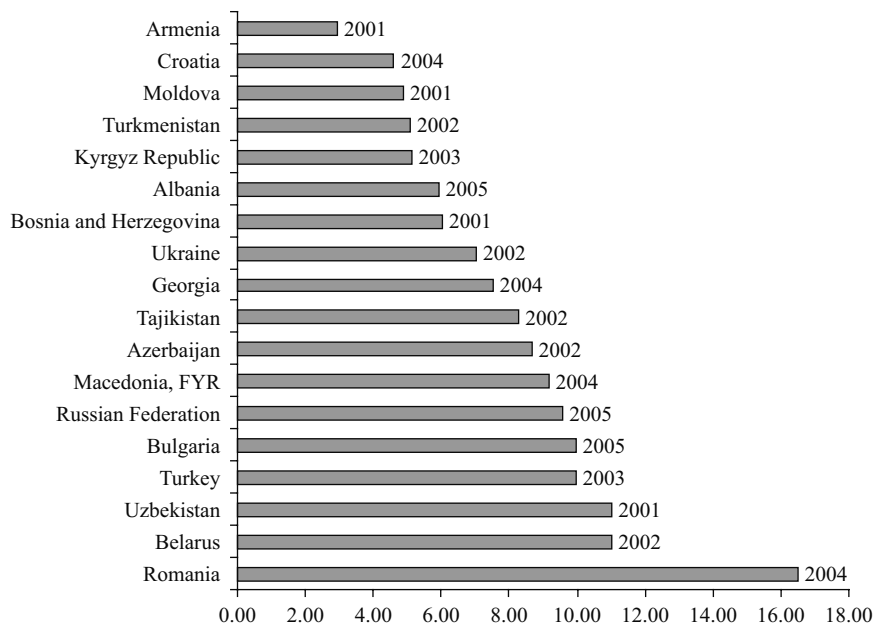


FIGURE 9.9. Simple average of customs tariffs (*Source*: UNCTAD, TRAINS Database). The number next to the bar indicates the year for which the customs tariff average was calculated.

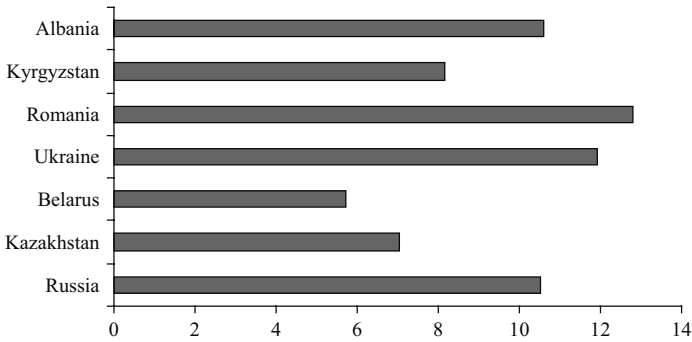


FIGURE 9.10. Non-tariff barriers in per cent (*Note:* Simple average of ad-valorem equivalents of core NTBs)

*Source:* Kee et al. (2005)).

TABLE 9.7. Customs procedures

South East Europe	EECCA Countries
<ul style="list-style-type: none"> <li>• Border crossing into Serbia and Montenegro is complicated by the increasingly divergent customs regulations and procedures of the two entities.</li> <li>• The Former Yugoslav Republic of Macedonia imposes a €100 payment for each tariff line inserted in the certificate of import for all imports of agricultural goods that benefit from tariff preferences. This fee counteracts the tariff preferences that are granted.</li> <li>• Local authorities in Romania have discretion to impose additional taxes, for example, for environmental reasons. Such taxes are highly variable and non-transparent.</li> </ul>	<ul style="list-style-type: none"> <li>• In Uzbekistan, ten different documents, issued by various departments and ministries, are required for customs clearance, prolonging custom procedures for up to 2–3 months.</li> <li>• In the Republic of Moldova, several government agencies are present at the border, each of them representing a different ministry and collecting fees.</li> <li>• In Uzbekistan, as of August 2002, imports of non-food consumer goods are subject to an extra fee of 30 per cent of the customs value in hard currency, if imported by firms, or to an additional customs duty of 90 per cent (which replaces VAT and customs duty) if imported by individuals.</li> <li>• It can take up to 100 hours to cross the border between Turkmenistan and Uzbekistan.</li> </ul>

*Source:* Cottier et al. (2005), Trade Working Group (2005), ADB (2003: 28), WTO (2004a) and UN-ESCAP (2003).

goods or preventing the respond dispatch service personnel. Table 9.8 presents some examples.

An additional problem relates to the insufficient customs and transport infrastructure, which is pervasive in both regions as a result of wartime destruction, inadequate and degraded road systems, lack of competition in a road transport and insufficient rail systems (Navaretti, 2003). These problems are exacerbated by economic and financial problems. Countries are apparently trying to generate funds through taxes

TABLE 9.8. Visa policy

South East Europe	EECCA Countries
<ul style="list-style-type: none"> <li>• Unlike tourists, truck operators cannot obtain a visa for Bulgaria at the border.</li> <li>• Strict visa requirements for business visitors including transport operators can cause significant delays for exports to Serbia.</li> <li>• In Romania, procedures for issuing visas to professional drivers are slow and expensive, and the validity of visas is too short.</li> <li>• There are difficulties in securing visas for commercial visits to Albania.</li> </ul>	<ul style="list-style-type: none"> <li>• In general, visa policy does not seem to be a barrier to trade among EECCA countries. EECCA nationals can travel freely in the region. Professional drivers travelling with their cargo outside the region do face a number of constraints.</li> </ul>

Source: Cottier et al. (2005) and Trade Working Group (2005).

and fees on vehicles in transport and this results in an additional restriction to trade (Table 9.9).

Overall, in most of the countries of the two sub-regions, trade policies are still overly restrictive. A case study shows that while Georgia can produce high-quality apple juice concentrate at a competitive price, the cost of transporting one “twenty foot equivalent unit” (TEU) to a European port from Georgia can be as high as US\$ 3000. The cost of transporting the same TEU from China is just US\$ 1500 and transport arrangements are much more dependable. In this – and many other cases – transport and transit costs are effectively wiping out a potential competitive advantage (Molnar and Ojala, 2003).

*South Eastern Europe and EECCA in the WTO framework* Since the establishment of the WTO in January 1995 ten countries of the region acceded the organisation, four from EECCA: Kyrgyzstan (December 1998), Georgia (June 2000), the Republic of Moldova (July 2001) and Armenia (February 2003), and six from South East Europe: Romania (January 1995), Turkey (March 1995), Bulgaria (December 1996), Albania (September 2000), Croatia (December 2000) and the Former Yugoslav Republic of Macedonia (April 2003).

Other countries are in different stages of the accession process (Table 9.7). In EECCA, Turkmenistan is the only country that has not yet submitted an application for membership in the WTO. Negotiations with Azerbaijan, Tajikistan and Uzbekistan are at a relatively early stage: Tajikistan has not yet started bilateral negotiations on market access, while Azerbaijan and Uzbekistan, started in May and September 2005, respectively. On the other hand, the accession negotiations of the Russian Federation and Ukraine are well advanced. As regards South east Europe, the most important recent development was the decision by Serbia and Montenegro to submit separate applications for membership in the WTO, when it was confirmed that both Republics possess full autonomy in the conduct of their external commercial relations. The Republic of Serbia has not yet started bilateral negotiations on market access.

TABLE 9.9. Customs and Transport Infrastructure, Taxes and Fees

South East Europe	EECCA
<ul style="list-style-type: none"> <li>● Insufficient information technology equipment combined with inadequate training of custom staff delays customs clearance and traffic, throughout the region but especially in the Republic of Montenegro, Albania, Bosnia and Herzegovina.</li> <li>● Authorities responsible for veterinary, sanitary and phytosanitary testing and certification are not properly technically equipped: testing causes delays for clearance of goods and raises concerns about reliability, throughout the region and specifically in Bosnia and Herzegovina, Croatia and Former Yugoslav Republic of Macedonia).</li> <li>● Poor road systems, lack of motorways, different railways systems across countries make transport difficult and costly throughout the region.</li> <li>● Road tolls charged in the Republic of Serbia to foreigners are reported to be three times as high as the rate for domestic transport undertakings.</li> </ul>	<ul style="list-style-type: none"> <li>● While computerised customs management systems – Electronic Data Interchange (EDI) among different customs offices – have been set up by some of EECCA countries (and in particular by the Russian Federation, Belarus, Ukraine, Azerbaijan), EDI between traders and customs and electronic declarations is very rare and is still not foreseen by national law in most EECCA countries.<sup>18</sup></li> <li>● Condition of road infrastructure, comprising the Transport Corridor Europe-Caucasus-Asia (TRACECA) highway is, at present, generally poor, with the surface displaying considerable cracking in many places.</li> <li>● Fees are applied for the transit of Kyrgyzstan cargo road vehicles and buses along the territory of Uzbekistan.</li> <li>● Georgia levies a “road tax” on all “vehicles registered outside of Georgia (including special vehicles), as well as owners of vehicles registered in Georgia which are loaded or are to be loaded within the territory of Georgia for delivering the cargo of a foreign country to a foreign country.”<sup>19</sup></li> </ul>

Source: Cottier et al. (2005), WTO (2004b), WTO (1998) and Polyakov (2000).

There is growing awareness among applicants about the complexity and inherent costs of WTO accession. The process of accession has become lengthier<sup>20</sup> and more demanding: the percentage of individual tariff lines that are bound upon accession is larger, while the level of the tariff bindings is deeper for countries that have joined recently (WTO, 2003a). For some of the transition economies, with low GDP per capita, a special challenge is that they do not qualify for special and differential treatment on the same terms as some developing countries.

A recent EBRD paper estimates that ‘trade between two WTO members is, other things being equal, around 25 per cent higher than trade between non-members’ (Babetskii et al., 2003). Besides market access, other important benefits that may be expected include institution-building during the accession talks and beyond as well as access to a contractually binding dispute settlement mechanism (UNECE, 1999).

*Interregionalism: Agreements with the European Union* The European Union has developed bilateral relations with EECCA countries through Partnership and Co-operation Agreements (PCAs), and with its partners in South East Europe through Stabilisation and Association Agreements (SAAs).

TABLE 9.10. Status of the accession talks as of December 2005

	Working party	Memorandum circulation	Working party meetings	Total #	Market access negotiation	Factual summary	Draft working party report	Services offer	
								Dates	Goods offer
Azerbaijan	July 1997	April 1999	June 2002/ Oct. 2005	3	May 2005	May 2005	—	—	—
Belarus	Oct. 1993	Jan. 1996	June 1997/ May 2005	7	Mar.1998/ May 2004	Feb 2000/ Nov. 2004	April 2005	—	—
Kazakhstan	Feb. 1996	Sep. 1996	Mar 1997/ June 2005	8	June 1997/ May 2004	Sep.1997/ June 2004	Sep.2004	May 2005	—
Russian Federation	June 1993	Mar. 1994	July 1995/ Oct. 2005	29	Feb. 1998/ Feb.2001	Oct 1999/ June 2002	—	March 2002 Oct. 2004	—
Tajikistan	July 2001	Feb. 2003	Mar. 2004/ Apr. 2005	2	Feb.2004/ Apr. 2005	Feb.2004/ Apr. 2005	Apr. 2005	—	—
Ukraine	Dec. 1993	July. 1994	Feb. 1995/ Nov. 2005	15	May1999/ May2002	Feb 1997/ June 2004	June 1998	March 2004 Sept. 2004 Aug. 2005	—
Uzbekistan	Dec. 1994	Oct. 1998	July 2002/ Oct. 2005	3	Sep. 2005	Sep. 2005	—	—	—
Bosnia and Herzegovina	July 1999	Oct. 2002	Nov. 2003/ Dec. 2004	2	Oct. 2004/ June 2005	Oct.2004/ June 2005	—	—	—
Republic of Montenegro	Feb. 2005	Mar. 2005	Oct. 2005	1	—	July 2005	—	—	—
Republic of Serbia	Feb. 2005	Mar. 2005	Oct. 2005	1	Not yet started	—	—	—	—

Source: Compiled by UNECE staff on the basis of information from the WTO database.

PCAs are legal frameworks, based on the respect of democratic principles and human rights, setting out political, economic and trade relationships between the parties.<sup>21</sup> They commit the parties to applying most-favoured nation (MFN) status to one another with respect to tariffs. EECCA countries are also beneficiaries of the EU Generalised System of Preferences, so implicitly they have access to the EU market on a preferential basis. The PCA agreements – which have been renewed and extended to the enlarged EU – also contain provisions on the elimination of quantitative restrictions and address other trade-related issues such as competition and state aids. In compliance with these agreements, the EU eliminated quantitative restrictions with most of EECCA countries.

In addition, bilateral steel agreements were concluded with Russia, Ukraine and Kazakhstan and entered into force in the late 1990s. Subsequently, the new steel agreements have increased the quantitative limits and introduced provisions for revision in case of WTO accession. All the PCA agreements were supplemented by special protocols on textile products, a particularly important product for Ukraine. Under a recent agreement, which went into effect in March 2005, the last remaining restrictions to trade in textiles and clothing products (in particular import and export licensing requirements) between the EU and this country were lifted.

As regards SEE, the EU granted the countries of this region – excluding Turkey which has a customs union with the EU since 1995 – autonomous trade concessions resulting in 95 per cent of their exports entering the EU free of duties and of any quantitative limits. The EU currently maintains tariff quotas only on imports of wine, veal and certain fishery products. The EU is also progressively negotiating and implementing SAAs with these countries, with the aim of progressively establishing a free-trade area between the two regions, based on asymmetrical reciprocity.

The SAA agreements with the Former Yugoslav Republic of Macedonia and with Croatia have already entered into force. The SAA Albania was initialled in February 2006, while negotiations with Serbia and Montenegro and Bosnia and Herzegovina started at the end of 2005. The SAAs cover a large number of issues, including not only trade liberalisation, but also political dialogue and legal approximation.

*Regional cooperation and integration: Southeastern Europe* Under the auspices of the Stability Pact for South East Europe, Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Former Yugoslav Republic of Macedonia, the Republic of Moldova, Romania and Serbia and Montenegro agreed to reduce and eliminate customs tariff and non-tariff barriers to trade and implement measures to facilitate intra-regional trade.<sup>22</sup>

In June 2001, the countries signed a Memorandum of Understanding (MOU) on Trade Liberalisation and Facilitation which resulted in the establishment of 31 bilateral free trade agreements (see Table 9.8).<sup>23</sup> By the terms of these agreements, at least 90 per cent of mutual trade has been liberalised, both in terms of tariffs and trade, while regulations need to be gradually harmonised with EU legislation (Table 9.11).

While there have been instances of safeguard measures temporarily applied by some of the countries that are parties to these agreements,<sup>24</sup> overall the arrangement

TABLE 9.11. Free Trade Agreements in SEE as of 15 February 2006

	Albania	Bosnia-Herzegovina	Bulgaria	Croatia	FYR of Macedonia	Republic of Moldova <sup>a</sup>	Romania	Serbia and Montenegro <sup>b</sup>	UNMIK/ Kosovo <sup>c</sup>
Albania		Applied 01/12/04	Applied 01/09/03	Applied 01/06/03	Applied 15/07/02	Applied 01/11/04	Applied 01/01/04	Applied 01/08/04	Applied 01/10/03
Bosnia-Herzegovina	Applied 01/12/04		Applied 01/12/04	Applied 01/01/05	Applied 01/07/04	Applied 01/05/04	Applied 01/12/04	Applied 01/06/02	Initialled 15/02/06
Bulgaria	Applied 01/09/03	Applied 01/12/04		CEFTA 01/03/03	Applied 01/01/00	Applied 01/11/04	CEFTA 01/07/97	Applied 01/06/04	Under examination
Croatia	Applied 01/06/03	Official Application Form 01/01/05	CEFTA 01/03/03		Applied 11/07/02	Applied 01/10/04	CEFTA 01/03/03	Applied 01/07/04	Under consideration
FYR of Macedonia	Applied 15/07/02	Applied 01/07/04	CEFTA Feb. 06	CEFTA Feb. 06		Applied 01/01/05	CEFTA Feb. 06	Signed 21/10/05	Applied 02/02/06
Republic of Moldova	Applied 01/11/04	Applied 01/05/04	Applied 01/11/04	Applied 01/10/04	Applied 01/01/05		Applied 17/11/94	Ratified by SCG 02/12/05	Applied 01/09/04
Romania	Applied 01/01/04	Applied 01/12/04	CEFTA 01/07/97	CEFTA 01/03/03	Applied 01/01/04	Applied 17/11/94		Applied 01/07/04	
Serbia and Montenegro	Applied 01/08/04	Applied 01/06/02	Applied 01/06/04	Applied 01/07/04	Signed 21/10/05	Applied 01/09/04	Applied 01/07/04		
UNMIK/ Kosovo	Applied 01/10/03	Initialled 15/02/06		Under consideration	Applied 02/02/06				

Source: [www.stabilitypact.org/trade/](http://www.stabilitypact.org/trade/).

<sup>a</sup> The Republic of Moldova is associate to the process with an extended timeline.

<sup>b</sup> Serbia and Montenegro started the negotiation process when it was known as the Former Republic of Yugoslavia, therefore both names may appear on the agreement.

<sup>c</sup> All agreements are in line with United Nations Security Council Resolution No. 1244.

has improved trade relations among the countries of the region. The main has been that “the sheer number of agreements has resulted in a bureaucratic jungle for business people who want to trade and invest in this region and for government agencies such as customs who seek to facilitate trade but who must try to conform with 31 sets of rules.”<sup>25</sup>

Integration can now only move forward when the bilateral agreements are replaced by a single free trade agreement for the region. Over the last few years, two options were explored: the launch of a new agreement or the enlargement of the Central Europe Free Trade Agreement (CEFTA) to which Bulgaria, Croatia, the FYRM<sup>26</sup> and Romania are already members. Several partners were initially concerned about the requirements for membership of CEFTA<sup>27</sup> and the bureaucratic and time-consuming procedures for accession. These issues were recently resolved in cooperation with CEFTA, and a simultaneous modernisation of the CEFTA Agreement (to include some new trade issues) and enlargement (to include the remaining SEE countries and territories) of the organisation is envisaged in the course of 2006. The negotiations for the CEFTA enlargement were officially launched in Bucharest on 6 April 2006.

When fully implemented, the CEFTA arrangements are expected to create a free-trade area encompassing 55 million inhabitants and hence boost intra-regional trade, efficiency and investments. The potential economic effects of the CEFTA enlargement would be limited by the low volume of trade between the country pairs and by their remarkably similar export specialisation. At the same time, once enlarged to the SEE, CEFTA could negotiate with the European Union for an extension of the pan-European system of diagonal cumulation of origin to the region.<sup>28</sup> This would allow SEE to function as a unified production pole and overcome the limits of strict rules of origin requirements. Particular benefits could then be realised in the textile and clothing sector, where strict rules of origin could otherwise frustrate the full utilisation of the EU trade preferences.

Another important dimension of the work of the Stability Pact – complementary to that of the elimination of tariff barriers – is the facilitation of trade among the countries of the region. The work of the Stability Pact’s Trade Task Force is complemented by several partners, including:

- SECIPRO (the Association of National Pro Committees in South East Europe) brings together the representatives of the business community – in particular the Chambers of Commerce and the transport and freight forwarding associations – with the representatives of the numerous public sector agencies present at border crossing. SECIPRO also organises bilateral and trilateral border meetings among the national authorities of the region to discuss procedural and infrastructure problems impeding the movement of goods. The SECIPRO network and its organisations have been focused on implementing UNECE’s recommendations, standards and tools for trade and transport facilitation for many years. Additionally, SECIPRO has been training more than 2000 professionals since 2001.<sup>29</sup>
- The Trade and Transport Facilitation in Southeast Europe Programme (TTFSE) results from a collaborative effort between the World Bank – which manages

the Program – and the national governments in the region. It aims at reducing non-tariff costs to trade and transport, reduce smuggling and corruption at border crossings, and strengthen the customs administrations and other border control agencies. A second phase of the TTFSE is now under preparation to increase the trade competitiveness of SEE by ensuring effective collaboration between all agencies active at border crossings (customs, road administration, border police, phyto-sanitary and veterinary controls) and all modes of transport in the region (road, rail, inland waterway and multimodal transport).<sup>30</sup>

*Regional integration in EECCA* Efforts towards regional integration among the countries of the former Soviet Union began at the very moment the Federation disintegrated with the foundation of the Commonwealth of Independent States (Voitovich, 2003). At the same time, each of the newly independent Republics concluded a number of bilateral free trade agreements – with corresponding lists of exceptions – with their most significant trading partners. In 1994, 11 of the CIS countries signed a free trade agreement that envisaged the abolition of all customs duties, taxes and levies with equivalent effect, as well as quantitative restrictions. However, the door was left open to exceptions, which were to be drafted in the form of a general schedule binding all the parties. In 1999, upon their failure to reach an agreement on the general schedule of exceptions, the 11 countries signed a Protocol on “amendments and supplements” to the 1994 Agreement, which stipulated that the exceptions to the free trade regime, being of a temporary nature, could be applied on the basis of bilateral documents (WTO, 1999). This protocol made bilateral agreements a lasting and important piece of the architecture of the former Soviet Republics’ trade regimes.

Most of the bilateral FTAs are still in force and result in a web of preferential market access agreements, which can be summarised as follows:

- Armenia’s imports from Georgia, the Russian Federation, Ukraine, Kyrgyzstan and Turkmenistan, and the Russian Federation are free from duties and quotas (WTO, 2002a).
- Belarus and the Russian Federation have set up a Customs Union and consequently have eliminated customs checkpoints on their common border (1996).<sup>31</sup>
- Azerbaijan does not apply customs duties on goods originating in Georgia, Kazakhstan and Ukraine.<sup>32</sup>
- Georgia grants free market access without any exceptions to goods originating in Armenia, Azerbaijan, Kazakhstan, Ukraine and Turkmenistan (WTO, 2002b). Exceptions to free trade with the Russian Federation are very limited.<sup>33</sup>
- The Russian Federation’s trade regime with Armenia (WTO, 1996) and Georgia<sup>34</sup> is one of free trade with very limited exceptions.
- Kazakhstan and the Republic of Moldova have an FTA with the exception of a few products.<sup>35</sup>
- Kyrgyzstan “does not maintain exceptions to any of the bilateral FTAs” that it has signed with Ukraine, Uzbekistan, Kazakhstan and Armenia (WTO, 2001).

At the same time as integration based upon bilateral FTAs was under way, several sub-regional agreements were signed among groups of countries willing to go further in the liberalisation of their trade relationship. The most important of these sub-regional agreements is the Eurasian Economic Community,<sup>36</sup> which aims at establishing a fully-fledged customs union. Currently participant countries have established free trade among themselves but maintain different external tariffs.

Other regional trade arrangements have been formed among EECCA countries (Table 9.12), but these have not yet had an impact on the tariffs applied to imports from partner countries.<sup>37</sup>

In October 2005, the heads of states of the CACO<sup>38</sup> countries decided to merge the organisation with EurAsEC. This decision was motivated by the desire to avoid a duplication of activities between two organisations had increasingly similar goals (ADB, 2005). As a result, Uzbekistan – which was not previously a member of EurAsEC – has joined the organisation.

#### 9.4. SELECTED SECTORAL ANALYSES

##### 9.4.1. Initiatives in South East Europe

Since the mid-90s, several international and regional organisations have recognised the need to promote cooperation among countries in SEE to support the development of regional infrastructure. The Infrastructure Steering Group (ISG) was set up in 2001 within the context of the above-mentioned Stability Pact to coordinate the work of

TABLE 9.12. Plurilateral Agreements, in EECCA as of March 2006

Organisation	Membership
Commonwealth of Independent States (CIS)	Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan
Eurasian Economic Community (EurAsEC)	Belarus, Kazakhstan, Kyrgyzstan, Russian Federation, Tajikistan, Uzbekistan <sup>a</sup>
Economic Cooperation Organisation (ECO)	Afghanistan, Azerbaijan, Islamic Republic of Iran, Kazakhstan, Kyrgyzstan, Pakistan, Tajikistan, Turkmenistan, Uzbekistan, Turkey
GUAM <sup>b</sup>	Azerbaijan, Georgia, Republic of Moldova, Ukraine
Single Economic Space (SES)	Belarus, Kazakhstan, Russian Federation and Ukraine
Shanghai Cooperation Organisation	China, Russian Federation, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan
Black Sea Economic Cooperation Organisation	Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Republic of Moldova, Romania, Russian Federation, Serbia and Montenegro, Turkey, Ukraine

<sup>a</sup> Uzbekistan entered (EurAsEC) in Jan. 2006. Being the largest central Asian nation in terms of population, the entrance of Uzbekistan could boost integration in the union and expand its market.

<sup>b</sup> Until May 2005, the Organisation was named GUUAM as Uzbekistan was a member as well.

TABLE 9.13. Ongoing Regional Infrastructure Projects (as of May 2003)

Sector	No. of projects	Cost (M€)	(%)
Transport	35	2,561.60	67.12
Roads	24	1,603.40	42.01
Railways	4	442.00	11.58
Ports and Waterways	3	100.00	2.88
Airports	4	406.20	10.64
Energy	5	773.00	20.26
Electricity	5	773.00	20.26
Gas, oil and district heating	0	0.00	0.00
Water and environment	5	330.54	8.66
Water supply	0	0.00	0.00
Water waste	4	230.14	6.03
River basin management	0	0.00	0.00
Environment	1	100.40	2.63
Cross border/Trade facilitation	6	151.14	3.96
Total	51	3816.28	100

Source: Office for South Europe, "Developing Regional Infrastructure: Strategic approach and implementation of projects," May 2003.

the different donors.<sup>39</sup> It focuses on three sectors, seen as key areas for economic growth: transport, energy and the environment. Table 9.13 gives an overview of ongoing projects in the three sectors. In more detail, the most important developments in these three areas were as follows:

– *Transport sector:* Transport – essential for realising the full potential of any region – is considerably underdeveloped in South East Europe, which has the lowest density of good quality roads and railways of any other region in Europe. Since 2001, the ISG has been working towards a multimodal transport infrastructure network to revive intra- and interregional trade, and restore the direct and indirect war damages. The network covers main road and rail routes, inland waterways and river ports, seaports, airports and terminals. In June 2004, a Memorandum of Understanding (MoU) on the "Development of the South East Europe Core Regional Transport Network" was signed,<sup>40</sup> leading to establishment of the South East Europe Transport Observatory (SEETO) and the development of a 5-year Plan for the SEE Core Transport Network. The Plan identifies priority areas of assistance and was adopted in April 2006. It includes a number of key investment projects for road, rail, air, maritime and river transport as well as a wide range of suggested actions for governments and management. Projects that are underway include the construction of a passenger terminal in the Port of Dubrovnik, in Croatia, the Reconstruction and Modernisation of the Sarajevo International Airport, in Bosnia-Herzegovina, and the modernisation of the motorway between Belgrade and Novi-Sad (the second largest city in Serbia).

– *Energy sector:* South East Europe lacks modern and efficient energy infrastructure networks in the fields of electricity, oil and gas. In 2001, the countries of

SEE recognised that market-oriented reforms were needed to improve overall energy conservation and efficiency; reduce the excessively high energy intensity of SEE's production; strengthen national institutional capacities and adapt legislation and regulations to EU norms and practices (European Commission, 2001). In October 2005, SEE countries signed an International Treaty establishing an Energy Community for SEE to encourage competition and investments in the energy sector and in particular in power generation (Office for South-East Europe, 2005).

In the electricity sector, a Memorandum of Understanding on creating a Regional Electricity Market in South East Europe and its integration into the Internal Electricity Market by 2005 was signed at a ministerial meeting in Athens in 2002. A Strategy Paper listing all measures to be taken in that regard was approved at this occasion (Office for South-East Europe, 2003). The objective of the MoU is to create a functioning electricity market in SEE through structural reforms, market rules and the attraction of private/public investments.

As regards oil and gas, the SEE countries are highly dependent upon imports of these resources. The distribution network is not well developed; hence the construction of new pipeline and a better integration of gas markets in the region are priorities (European Commission, 2001). However, no regional agreements have been signed yet and no infrastructure projects have yet been financed.

– *Environment.* SEE lacks effective environmental management and adequate facilities for environmental protection and sustainable development. Establishing and maintaining these facilities also requires support for capacity and institution building. SEE countries have committed to respect and apply EU environmental laws, standards and policies within the context of their future integration in the European Union.<sup>41</sup> In addition, interventions in this field have repercussions outside national borders, hence the importance of a coherent regional approach.

In line with this principle, several regional initiatives have been established in order to enhance cooperation between countries, including:

- the Regional Environmental Reconstruction Program for South East Europe (REReP) to support the countries of the region in meeting obligation on regional cooperation within the Stabilisation and Association process,
- the DABLAS for the effective implementation of the MoU on Common Strategic Goals between the International Commission for the Protection of the Danube River (ICPDR) and the Black Sea Commission,
- the Sava River Basin Program to secure the sustainable development, utilisation, preservation and management of the Sava basin water and related resources,
- the Tisza River Basin Sustainable Development Program to provide capacity building to local and regional initiatives and ensure sustainable use of natural resources,
- the Mediterranean Action Plan to protect the marine and coastal environment and achieve sustainable development.

#### 9.4.2. *The SPECA Programme*

The United Nations Special Programme for Economies of Central Asia (SPECA) is a programme supported by the Economic Commission for Europe (UNECE) and the Economic and Social Commission for Asia and the Pacific (UNESCAP).

The Programme covers Afghanistan, Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan. The overall programme objective is to contribute to Central Asia's development needs, notably by strengthening links with Asia and Europe and addressing trade and trade-facilitation issues in order to promote sub-regional integration. According to the 2005–2007 SPECA Work Plan, activities will be developed in the areas of transport, water, energy and environment, trade development, statistical capacity building and ICT for development.

Trade development is very important for the social and economic growth of the region; hence the countries have signed several agreements on trade facilitation. The countries of SPECA are working on reducing non-tariff barriers and aligning trade documentation and procedures with international standards. SPECA is now planning to build a network of public-private partnerships to reduce customs delays and promote trade-related cooperation among the countries.

As regards transport, the development of international transit transport infrastructure is considered as a priority to facilitate the integration of the region into the world economy.<sup>42</sup> In this area, the countries of SPECA are committed to the initiatives undertaken in this field by EurAsEC and ECO and intend to fully develop and benefit from technical assistance programmes, including TRACECA<sup>43</sup> and the Trade and Transport Facilitation in Central Asia (TTFCA)<sup>44</sup> initiative of World Bank.

#### 9.5. CONCLUSIONS

In order to ensure a significant reduction in poverty and unemployment, there is a need for basing growth on a wider and more sustainable basis, throughout the region. For the resource-rich EECCA economies the recent economic boom was largely sustained by an expansion of their extractive industries coupled with a surge in world commodity prices. This leaves the countries exposed to fluctuations in the volatile global commodity markets. Moreover, mineral extraction is a capital-intensive activity generating little employment and is likely to result in geographically unbalanced development and greater income inequality. For the SEE countries, export-led growth critically depends on outsourcing orders from EU firms of labour-intensive products such as clothing, leather and footwear. Competition from the lower-cost, labour-abundant Asian countries may pose a threat to this specialisation pattern, although EU preferences for the Balkan countries currently protect their export industries.

Reviving and broadening the scope of the manufacturing sector will require a number of policy actions, at the national and regional levels to better integrate firms in international and regional supply chains and improve their positioning in the fast

developing knowledge-intensive sectors. In the following, some of the reforms that are perceived as most important are highlighted.<sup>45</sup>

In several countries of the two sub-regions, public institutions for a market economy are still underdeveloped: the protection of property rights, including law and contract enforcement, is weak; the public administration is widely perceived as inefficient and lacking in transparency; and corruption is widespread. Reform in the judiciary and the public administration are fundamental requirements for economic development and economic integration and should be an area of priority for the international community of donors.

Firms throughout the two sub-regions lament administrative and fiscal barriers that hamper business growth. Improved access to finance as well as comprehensive reforms in labour market institutions are seen as key in fostering a business environment conducive to economic development. In particular, foreseeing specific assistance for workers searching for a job, incentive for on-the-job training and improved arrangements for part-time work contracts are measures that may prove effective in increasing the participation in the work force and reducing unemployment. Foreign direct investment (FDI) can also play a significant role in increasing economic efficiency and promoting the integration of domestic firms into global networks. As widely reported in the literature on FDI, costly and cumbersome administrative procedures, including the fragmentation of decision-making on FDI issues, are obvious deterrents. Policies that improve the business climate will have a positive impact on both foreign and domestic investors.

To improve the countries' positioning in the knowledge economy, investments are also needed in research and development, higher education and lifelong on-the-job training. For this purpose, governments may target the limited funds at their disposal towards education, or provide fiscal incentives to encourage individuals and private businesses to invest in human capital development.

These policy actions may also need to be adapted to the specific needs of small and medium enterprises, which are often important actors in the transition to a market economy and provide a strong potential for economic growth. Specific business training programmes to improve the skills of these firms in marketing, or in adapting their business strategies to new markets and new niches may also be relevant for this group of firms.

The data presented in this chapter show that many of the countries of the region still apply a number of tariff and non-tariff-barriers to imports from their regional partners. Transit across the region is also severely hampered, and in the EECCA region one recent estimate put the cost of exporting towards world markets at 50 per cent of the value of the commodities traded. Arrangements for free transit regional trade integration is therefore of crucial importance, in particular for the landlocked countries of the sub-region. For this reason, projects for deepening cooperation in the field of trade and trade facilitation, such as those reviewed above in the context of SPECA and the Stability Pact are of major importance. In particular, harmonising customs documentation and improving cooperation among the customs authorities would yield immediate benefits (UNECE, 2005).

Another area of priority action at a regional level concerns regulatory cooperation and harmonisation. In penetrating mature markets – such as those of the European Union – success or failure often hinges on how familiar exporters are with regulations and standards. This affects trade in agricultural and food products as well as machinery and appliances. For this reason, one key priority for the countries of the two sub-regions is increasing participation in the development of international standards for trade within the UNECE and other standard-setting organisations as well as obtaining increased technical assistance and capacity building for their implementation.<sup>46</sup>

## NOTES

- <sup>1</sup> EECCA includes the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.
- <sup>2</sup> SEE includes the following countries: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, FYR, Romania, Serbia and Montenegro, Turkey.
- <sup>3</sup> Between 1989 and 1993 aggregate GDP decreased by 23 per cent in eastern Europe, while in EECCA, the transformational recession was even longer and deeper: between 1989 and 1998 aggregate GDP fell by a cumulative 46 per cent (UNECE, 2006).
- <sup>4</sup> The World Bank classification divides countries into four groups: low income, with per capita GNI of less than 825 USD; lower middle income, with per capita GNI between US\$ 826 and US\$ 3,255; upper middle income with per capita GNI between US\$ 3,256 and US\$ 10,065; and high income, with per capita GNI greater than 10066 USD.
- <sup>5</sup> With a GNI per capita of US\$ 6,590, US\$ 3,750, US\$ 3,410, respectively, Croatia, Turkey and the Russian Federation are upper middle income countries according to the World Bank classification. World Bank, World Development Indicators Database.
- <sup>6</sup> UNECE Statistical Database.
- <sup>7</sup> In February 2001, the Turkish exchange rate system collapsed and the Central Bank allowed the lira to float freely. The crisis that ensued led to the adoption of a new economic programme, which contributed to the country's subsequent fast growth (Özatay and Sak, 2002; World Bank, 2003). Always in 2001, the FYRM was drawn into the ethnic Albanian armed insurgency. The country has underperformed regional partners in recent years, reflecting continuing instability.
- <sup>8</sup> In 2002, an accident in a gold mine caused a 26 per cent drop in gold production and coincided with a downturn in electricity generation.
- <sup>9</sup> Data on poverty quoted in this document are drawn from World Bank (2005a,b) as well as the UNDP Human Development Indicators database.
- <sup>10</sup> The poverty reduction was particularly impressive in Belarus, where, according to national measures of poverty the headcount ratio has fallen from 39 per cent of population in 1996 to 27 per cent in 2002, and further to 18 per cent in 2004, implying that about 2 million people moved out of poverty over this period. See: World Bank (2006: 53).
- <sup>11</sup> ISCO 1988 groups 2 and 3.
- <sup>12</sup> The average annual growth rate for imports (in US dollars) of EECCA and SEE countries from the world was 8.6 and 15.4 per cent, respectively. World imports grew at an average annual rate equal to 7.9 per cent over the same period and, as a result, EECCA and SEE's shares of world imports grew respectively from 1.7 to 1.8 per cent and from 1 to 1.9 per cent.
- <sup>13</sup> A recent World Bank study indicates that this sector represented 17 per cent of total exports in 1994. See Freinkman et al. (2004: 62).
- <sup>14</sup> Uzbekistan National Statistical Department.
- <sup>15</sup> For an in-depth discussion of these trends see Gaucaité Wittich (2005).
- <sup>16</sup> If Turkey is excluded, intra-regional trade accounts for 10 per cent of imports and 15 per cent of exports.
- <sup>17</sup> The study reviews 90 countries from all regions of the world.

- <sup>18</sup> For some of the countries, concrete assistance could be sought in the context of the Automated System of Custom Data programme (ASYCUDA), which has been developed by UNCTAD and implemented in over 80 countries. So far, only two of the 12 EECCA countries (namely Armenia and Georgia) have benefited from the program.
- <sup>19</sup> Article 7 of the Law “On Road Fund” No. 802, 22 September 1995: There is evidence that the tax can be quite substantial, amounting to 880 Georgian Lari (or about US\$ 480) for trucks of over 40 tons. Additionally, transit cargoes are charged clearance fees of 100–300 Georgian Lari (roughly US\$ 54–164).
- <sup>20</sup> For a more detailed discussion of the difficulties inherent in the accession process for developing countries see UNCTAD (2001).
- <sup>21</sup> The PCA with the Russian Federation has been in force since 1997; the PCAs with Moldova and Ukraine since 1998 and those with Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan and Uzbekistan since 1999. The PCAs with Belarus, Turkmenistan and Tajikistan – signed respectively in 1995, 1998 and 2003 are not yet in force.
- <sup>22</sup> Stability Pact for South Eastern Europe, <http://www.stabilitypact.org>.
- <sup>23</sup> These activities are coordinated by the Working Group on Trade Liberalisation and Facilitation (the Trade Working Group) of the Stability Pact, which consists of senior trade officials appointed by the countries of the region and by international organisations as well as officials from supporting countries.
- <sup>24</sup> One example was the introduction of tariffs on imports of wheat flour from Croatia and from Serbia by the Republic of Bosnia. Radio Free Europe/Radio Liberty, 9 (47), Part II, 11 March 2005.
- <sup>25</sup> <http://www.stabilitypact.org/pages/events/detail.asp?y=2006&p=282>.
- <sup>26</sup> The FYRM joined CEFTA in February 2006.
- <sup>27</sup> To qualify for CEFTA membership countries need to be members of WTO and have Stabilisation and Association Agreements with the EU. See: [www.cefta.org](http://www.cefta.org).
- <sup>28</sup> For more information on rules of origin requirements see European Commission (2004).
- <sup>29</sup> <http://www.secipro.net/>
- <sup>30</sup> <http://www.seecon.org/tfse/>
- <sup>31</sup> Subsequently, they signed a “Treaty on the Formation of a Union State” (December 1999), and are taking steps towards establishing a joint monetary system.
- <sup>32</sup> Azerbaijan maintains limited exceptions as regards the FTA with Kazakhstan, such as alcohol and tobacco. The share of the goods excluded from the free trade regime made up 0.14 per cent of the commodity turnover between Azerbaijan and Kazakhstan in 1999.
- <sup>33</sup> Exceptions amounted to less than 1 per cent of imports from the Russian Federation in 2001, see WTO (2003b).
- <sup>34</sup> Exceptions amount to 5 per cent of Georgia’s exports to the Russian Federation, and concern sugar and ethyl alcohol, see WTO (2003b).
- <sup>35</sup> The exceptions, on the part of Kazakhstan are: grains and oil products, sheep and lambs. From the part of the Republic of Moldova the exceptions are alcohol and vitamins.
- <sup>36</sup> The Eurasian Economic Community is a successor agreement to the Customs Union of the EECCA – signed in January 1995 by the Russian Federation, Belarus and Kazakhstan, and later joined by Kyrgyzstan (1996) and Tajikistan (1998). The arrangement was transformed into the Eurasian Economic Community and at the same time given the status of the subject of international law in 2000.
- <sup>37</sup> For more details about these agreements and arrangements – which have led to cooperation in a number of fields – see: <http://ecetrade.typepad.com>
- <sup>38</sup> The members of the Central Asian Cooperation Organisation (CACO) were: Kazakhstan, Kyrgyzstan, Russian Federation, Tajikistan and Uzbekistan.
- <sup>39</sup> The work of the Infrastructure Steering Group is supported by the ‘Office for South East Europe’, jointly established by the World Bank and the European Commission in 1999. The office coordinates the activities of various donors including – on top of individual governments – the European Investment Bank, the European Bank for Reconstruction and Development and the Council of Europe Development Bank. For more information: <http://www.seecon.org/infrastructure/>

- 40 Signatory parties: Albania, Bosnia and Herzegovina, Croatia, FYRM, Serbia and Montenegro UNMIK/Kosovo, European Commission.
- 41 <http://www.seerecon.org/infrastructure/sectors/environment/>
- 42 UNECE, UNESCAP, 2005–2007 Work Plan.
- 43 A European Union funded programme to develop a corridor on an east-west axis from Europe, across the Black Sea, through the Caucasus and the Caspian Sea to Central Asia <http://www.traceca-org.org/default.php>
- 44 TTFCA aims at reducing the physical costs of transportation, improve transit logistics as well as the efficiency of operations at the border and inland terminals in the region.
- 45 Ideas for this paragraph were liberally adapted by the author from UNECE (2006).
- 46 See, 2004 Executive Forum on “Competing in a changing Europe. Opportunities and Challenges for Trade and Enterprise Development”, ECE, Geneva, 11–12 May.

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## CHAPTER 10

REGIONAL INTEGRATION IN THE EUROPEAN UNION:  
ENLARGEMENT WITHOUT CONSTITUTION

## 10.1. INTRODUCTION

Much of the debate on regional integration in the European Union (EU) has for a long time focused on the “deepening” and “widening” of the integration project, and the balance between these two movements. The process as such was usually not questioned; the debates evolved around issues of speed, sequencing, balancing, etc. However, it seems that we now entered a (transition?) phase in which several European actors and sectors of the public opinion are putting forward a number of fundamental questions about the regional integration process in the EU.

On the one hand, the further deepening of the process and the strengthening of the regional governance level is being questioned. The proposal for a European Constitution and the ratification process have certainly acted as a catalyst in this respect. After the negative results of the French and Dutch referenda, the European Council itself called for a period of reflection and discussion in June 2005. In the same period, and symptomatically, the Bolkestein services Directive met with fierce opposition and had to be re-drafted (see below).

On the other hand, several sectors have questioned the further widening of the EU and have called for a delimitation of the borders of Europe. After five rounds of enlargement, the EU has expanded from a six-member entity into the world’s largest trading block with 25 Member States on 1 May 2004 and producing more than 30 per cent of world GDP. On that date, Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia became full members of the EU. Bulgaria and Romania are acceding countries scheduled to join the European Union on 1 January 2007.<sup>2</sup> Turkey, Croatia and the Former Yugoslav Republic of Macedonia constitute a group of candidate countries negotiating accession terms with the EU, while Bosnia and Herzegovina, Albania, Serbia and Montenegro form a group of “potential candidate countries”. The final outcome of these processes is however far from clear. This relative internal paralysis has also its repercussion on the external role and policies of the EU. The unclear signals from within make it difficult for the EU, as a regional actor, to further develop its role on the world governance scene in different policy areas (economic, security, etc.) and to contribute to an effective multilateralism carried by stronger regions.

All this is happening against (and related to) a background of slow economic growth and persistent unemployment levels in the region, coupled with a serious preoccupation with the future energy supply, the challenging growth rates in China and India, the continued immigration pressures, and the unclear security situation in the Middle East. After a brief review of a selection of socio-economic and trade

indicators of relevance for the European regional integration process in the next section, we will have a closer look at the different issues and challenges facing the EU, thereby focusing on events in 2005. These include: the internal market, the implications of enlargement for the labour markets, the financial perspectives of the Union, competitiveness and sustainability, the European Constitution the stakes of the EU at the WTO Doha Development Round, and EU's interregional relations.

## 10.2. SOCIO-ECONOMIC TRENDS AND INDICATORS FOR THE REGION

### 10.2.1. Growth and Employment

For several years now, the EU area has been facing slow economic growth and relatively high unemployment levels. In 2005, the average GDP growth rate fell again below 2 per cent, as in the 2001–2003 period (Table 10.1). Unemployment levels oscillate around 9 per cent. Although these concerns are older than today, this situation calls for policy responses and structural measures both at the national and regional levels.

Following the mid-term review of the Lisbon strategy (see below), a package of Integrated Guidelines have been adopted in July 2005, aiming at spurring growth and creating jobs in a socially cohesive and environmentally responsible Union. The Integrated Guidelines group together the Broad Economic Policy Guidelines and the Employment Guidelines. Within this framework, Member States prepare tailor-made

TABLE 10.1. EU's main economic indicators

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
<i>EU's share of world GDP</i>										
EU-25	30.65	28.97	30.20	29.08	26.18	26.61	27.91	30.21	31.01	30.65
EU-15	29.55	27.87	29.00	27.94	25.09	25.41	26.62	28.85	29.58	29.55
<i>Real GDP growth rate<sup>a</sup></i>										
EU-25	1.8	2.7	3.0	3.0	3.9	1.9	1.2	1.2	2.4	1.6
EU-15	1.6	2.6	2.9	3.0	3.9	1.9	1.1	1.0	2.3	1.4
<i>Total employment growth<sup>b</sup></i>										
EU-25	0.6	1.1	1.6	1.3	1.5	1.4	0.5	0.3	0.6	
EU-15	0.6	1.0	1.8	1.9	2.2	1.5	0.7	0.3	0.7	
<i>Harmonised unemployment rate, yearly averages<sup>c</sup></i>										
EU-25			9.4	9.1	8.6	8.4	8.8	9.0	9.1	8.7
<i>Inflation rate<sup>d</sup></i>										
EU-25	:	2.6	2.1	1.6	2.4	2.5	2.1	1.9	2.1	2.2
EU-15	:	1.7	1.3	1.2	1.9	2.2	2.1	2.0	2.0	2.1

Source: Eurostat and World Development Indicators for GDP figures.

<sup>a</sup> Growth rate of GDP volume – percentage change on previous year

<sup>b</sup> Annual percentage change in total employed population

<sup>c</sup> Percentage share of the unemployed in the number of economically active persons. Quarterly results of Labour Force Survey and monthly figures on registered unemployment are used.

<sup>d</sup> Annual average rate of change in Harmonised Indices of Consumer Prices (HICPs)

National Reform Programs that involve regional and local government, and civil society.

### 10.2.2. Investment and Trade

As far as FDI is concerned, the main development consisted in large investment outflows from the old EU members to the ten new Member States. According to the European Commission figures, 7.1 per cent of all EU FDI flowed into the new EU members, while only 2 per cent went to China and India together. Since the old EU still holds the bulk of FDI, high FDI flows into the Central and Eastern European countries are expected to continue.

Intra-EU trade, as illustrated in Figure 10.1, increased significantly over the period 1996–2004. This can be interpreted as a first evidence of complementarity of trade and FDI. Fears of trade substitution by FDI do not appear to be grounded, since high trade flows coexisted with high FDI flows. Mainly manufactured goods are traded (Table 10.2).

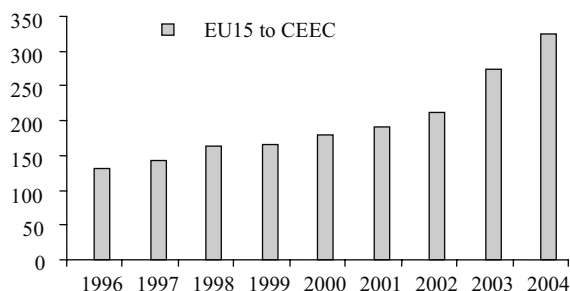


FIGURE 10.1. Intra-EU trade, 1996–2004(billion USD) (Source: COMTRADE Database)

TABLE 10.2. Intra-EU trade composition, 1996–2004 (%)

Product	1996	1997	1998	1999	2000	2001	2002	2003	2004
Food & live animals (%)	5.45	4.86	4.23	3.81	3.53	3.67	3.63	3.51	3.93
Beverages and tobacco (%)	0.67	0.57	0.48	0.52	0.49	0.42	0.41	0.39	0.44
Crude mater.ex food/fuel (%)	3.68	3.53	3.11	3.01	2.99	2.81	2.81	2.73	2.60
Mineral fuel/lubricants (%)	4.32	3.86	2.78	2.70	3.17	3.06	2.94	2.41	3.26
Animal/veg oil/fat/wax (%)	0.26	0.25	0.25	0.19	0.15	0.16	0.18	0.18	0.19
Chemicals/products n.e.s (%)	9.43	9.38	8.77	8.74	8.73	8.87	9.02	8.75	8.71
Manufactured goods (%)	22.07	21.36	21.00	20.38	20.06	19.89	19.55	19.34	18.92
Machinery/transp equipmt (%)	36.96	39.49	43.09	44.56	46.11	46.35	46.60	47.63	48.43
Miscellaneous manuf arts (%)	16.30	15.40	14.81	14.69	13.49	13.55	13.58	12.96	11.77
Commodities nes (%)	0.86	1.30	1.49	1.38	1.27	1.23	1.26	2.09	1.76

Source: COMTRADE.

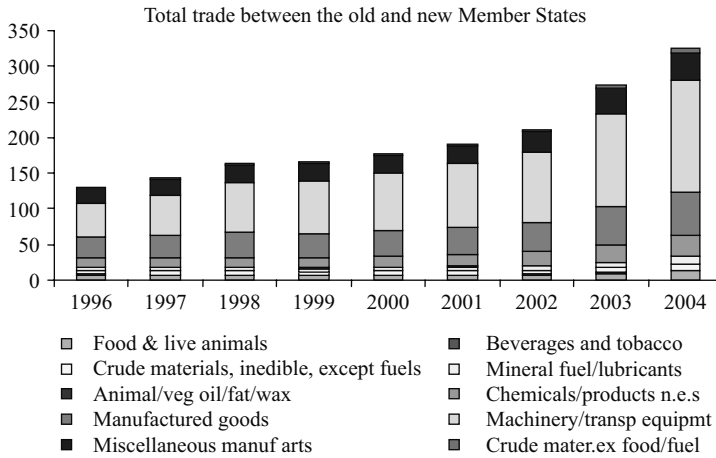


FIGURE 10.2. Composition of trade between old and new EU members, 1996–2004 (billion USD)  
(Source: COMTRADE).

Extra-EU 15 trade points to important rising deficits with China and South-East Asia. However, these are compensated by surpluses with other regions, most importantly with the US and the ten new EU Member States (Figure 10.2). The European Commission considers that EU exports are still well positioned in the world markets, especially due to high-quality industrial products. Those account for about half of European exports and a third of world demand. The next challenge for the EU would be to keep its leading position and to better approach the newly emerging markets at the world level.

### 10.2.3. The EU Budget

The European Budget is divided into different headings, the most important in value terms being the Common Agriculture Policy (around 40 per cent) and the second the Structural Funds expenditures (around 36 per cent) (Figure 10.3).

The Common Agriculture Policy was created with the Treaty of Rome in 1957 with the aim to help the agriculture sector to develop and grow while at the same time assuring food security, fair prices and quality to consumers. The CAP has changed dramatically with the years as it confronted the un-sustainability of price support and the change in size of its sector. Several attempts to reform it were done. If at the beginning it counted more than 70 per cent of the total EU budget, today it is around 40 per cent. Nevertheless, the transfer to the CAP is still the major expense of the EU and the issue of reform is very sensitive for the Member States. It is important not only for them, but for the rest of the world too. In fact, while some Member States defend it and other push for its reform and reduction, several EU trading partners accuse it of distorting international trade. The Structural Funds were created to help those regions within the EU whose development is lagging behind. Structural funds aim at reducing the difference

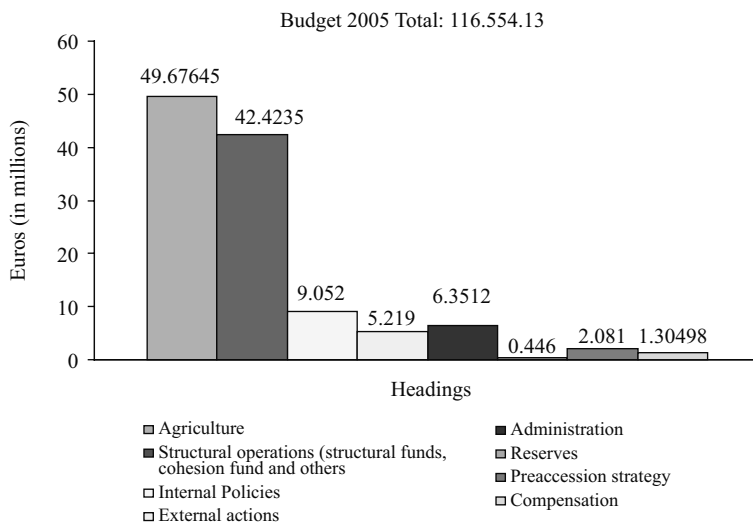


FIGURE 10.3. Configuration of the Budget 2005 (Source: European Commission [http://ec.europa.eu/budget/library/publications/budget\\_in\\_fig/syntchif\\_2005\\_en.pdf](http://ec.europa.eu/budget/library/publications/budget_in_fig/syntchif_2005_en.pdf))

in GDP per capita of EU regions. The accession of ten new member states in May 2004 has been an impressive historical achievement but also led to greater disparities within the EU since GDP per capita difference between new and old members states are still substantial. The situation could be even more accentuated after Romania and Bulgaria joined in January 2007. To face these challenges the Commission's proposed framework for the cohesion policy has been redesigned, and three objectives have been put forward: convergence, regional competitiveness and employment. The main sources for financing these actions are the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF). The ERDF aims to reduce disparities between the levels of development of the various regions and the backwardness of the least advanced/developed regions, the ESF will provide support for achieving full employment and to promote social inclusion and cohesion. The Cohesion Fund assists member states to catch up with Europe's healthier regions and was established in 1993 to complement the Structural Funds. Finally, the CF was intended to help the EU's poorer countries to prepare for economic and monetary union, at that time, the four Member States whose GNP per capita was less than 90 per cent of the EU average. Today, the Cohesion Fund covers projects in all new member states. In order to identify the regions in need of structural aid, these funds are allocated according to three main objectives. Objective one absorbs the majority of the fund and it is aimed at helping regions that lag behind others in development. Objective two supports economic, social and industrial convergence in areas facing structural problems and Objective three covers all the rest of the sensitive areas, especially employment.

10.3. REGIONAL COOPERATION AND INTEGRATION IN THE EU:  
SITUATION AND PROSPECTS

*10.3.1. Internal Market*

In parallel with the enlargement process, in the European Community there has been a continuous commitment for deepening. Within this framework, the single market is one of the main achievements, but also field for further work. Since 1 January 1993, the European Community has enjoyed a frontier-free single market. No other region in the world is so advanced in the free movement of goods, services, capital and workers. While the movement of goods, based on harmonisation or mutual recognition, is mostly free, there is still more room for advancement in services, capital and workers' free movement. The Internal Market Strategy 2003–2006 identifies the current achievements but also the remaining obstacles and the ways to overpass them, in line with the objectives of the Lisbon Strategy.

The 2005 *Internal Market Scoreboard* pointed to a downward trend in the transposition deficit of EU legislation. This refers to the proportion of EU laws which should have been written into national law but have not. “The average deficit per Member State is down to 3.6 per cent, from 7.1 per cent at enlargement. Three new Member States, Lithuania, Hungary and Poland, are among the top twelve performers – which we have called the “first division” for convenience. All the new Member States have reduced their deficits since accession. Spain has maintained its good performance and the Netherlands has improved significantly”.

In services, the controversial directive proposal aiming at facilitating cross-border trade and establishment has been intensively debated in 2005. The Bolkestein directive, named after the former Internal Market Commissioner who initiated it at the beginning of 2004, has been initially considered to be too liberal by several Member States. According to an early draft, a service provider registered in a Member State would have been allowed to temporarily perform its activity in another Member State by only conforming to the legislation of the country of origin. This has generated fears that lower regulated service providers coming from the New Member States would cause social dumping in the old over-regulated Member States' economies.

A watered down version, replacing the “rule of origin principle” with the milder “cross-border facilitation”, has been agreed upon during the inter-institutional decision making process in 2006. In the same line, several categories of services were excluded from the scope of the directive: non-economic services of general interest, healthcare and social services, both private and public, audiovisual, legal, gambling and lotteries services. Professions and activities linked to the exercise of public authority and tax services as well as services making the object of sector-specific regulation (financial, transport, electronic communications) were also excluded.

Regarding the Financial Services Action Plan, 40 out of 42 measures have been agreed upon. In terms of consumer policy, action was also needed. Only one in

five consumers, according to a survey, had confidence in cross-border shopping. Thus, important measures to promote consumer interests were adopted, such as the directives on Unfair Commercial Practices and on General Product Safety, or the regulation on Consumer Protection Cooperation. Three directives adopted in the company tax field were also meant to cut costs for cross-border activities. A VAT directive on indirect taxes applied to electronic services was another progress.

Besides these achievements, some stagnation is observed in several other fields. Prices across the EU are not converging at the expected pace. For instance, price convergence in the energy markets became a main concern for the fostering of a common energy market.

Trade in manufacturing between the Member States has not increased since 2000, meaning also less competitive pressure on prices.

The services directive, the initiative of cutting down red tape barriers, and progress in the financial services action plan were the main topics on the 2005 agenda. The year 2006 announces itself as an interesting year, as a common energy policy might be shaped, further progress on cross-border takeovers might be achieved and development in services in general and in financial services in particular is expected.

### *10.3.2. Enlargement in The European Year of Workers' Mobility*

With the accession of the ten new member states, the population of the EU has grown by approximately 75 million into an economic area of 455 million people and thus became the world's largest single market. However, the increase in population (20 per cent) and area (23 per cent) resulting from the enlargement of 2004 is not greater than previous enlargements. For example, the enlargement in 1973 to include Britain, Denmark and Ireland was proportionately larger in terms of population, and the enlargement in 1995 to include Austria, Sweden and Finland was larger in terms of land area. From an economic perspective, the new member states have an average GDP per capita of approximately 40 per cent of the existing members (at purchasing power parity). Spain and Portugal had an average per capita GDP of about 70 per cent of the existing EU when they joined in 1986 (Kok, 2003). Another difference between the most recent enlargement and the previous ones is that most of the new members are completing the transition from planned economies to a market-based system and have been undergoing difficult economic reforms independently of their efforts to join the EU. Nine of the ten new members are small or tiny countries and their combined economic weight added only 5 per cent to the EU's GDP. Nevertheless the EU enlargement is a long process with results that will only become clear once the new member states are fully integrated into the single market and EU structures. The enlargement of the EU fulfils the hope that the successful model of the EU with its values of democracy, rule of law, protection of human rights can be transferred to the countries of Central and Eastern Europe.

Despite the hopes that the latest enlargement round will enhance stability and security in these countries, fears aroused that workers from new member states might

have a negative impact on the EU-15 states' labour markets. Therefore the EU-15 states were granted the possibility of imposing temporary restrictions on the flow of workforce from EU-10 (excluding Cyprus and Malta, EU-8) to EU-15, and vice versa. Although it has not been the first time that an enlargement round is accompanied by transitional arrangements,<sup>3</sup> it was the first time that the decision on the introduction of restrictions was left to national governments. Possible reasons for introducing these restrictions are twofold. Countries sharing borders with CEECs were afraid of huge migration waves disturbing their national labour markets.<sup>4</sup> Thus, they decided very early to maintain strict migration policies for workers. This led other countries also to introduce transitional arrangements, even if they initially decided not to do so, because they were afraid that migration might divert to their labour markets, with the expectation of similar negative effects (Boeri, 2005). For instance, Denmark, Ireland, the Netherlands, Sweden and the United Kingdom initially stated that they do not plan to restrict access to their labour markets. But after the governments of Germany and Austria announced their transitional arrangements, these countries changed their policies and introduced transitional arrangements as well.

The transitional arrangements itself have to follow the so-called 2 + 3 + 2 formula. During the first 2 years after enlargement, until 30 April 2006, national restrictions of access to the labour market could be introduced (also via bilateral agreements). These restrictions, however, could not be narrower than those existing when the accession treaty was signed (2003). After these 2 years, national governments have to report to the Commission whether they plan to extend the transitional agreements for another 3 years or choose to implement Community rules. After 5 years (2009), Community rules should be introduced in all member states. Only if a member state can provide evidence that its labour market is disturbed, it may extend the transitional arrangements for two more years (2011). After that, Community rules have to be applied.<sup>5</sup>

Table 10.3 shows that most EU-15 member states have, to a different extent, introduced transitional arrangements to restrict access to their labour markets and welfare systems. Only Sweden is fully applying Community rules and therefore the freedom of movement as it is expressed in the *Acquis Communautaire*.<sup>6</sup> The overall percentage of EU-10 citizens working in EU-15 countries remained relatively stable during the period 2003–2005, as Table 10.4 illustrates; whether this is due to the different restrictions to migration of labour force or not is not evident yet; studies taking other effects (growth rates, unemployment rates, etc.) into account are not available yet. One possible reason is the decreasing unemployment rate in the EU-10 countries, declining from 14.5 in 2003 Q1 to 13.3 in 2005 Q3, thus removing pressure to find employment in EU-15 countries.

It has to be noted that in the case of Austria and Germany the figures are including seasonal workers not contributing to the social insurance system. If only migrant workers with work permits longer than 3 months are counted, which means they are contributing to the social insurance funds, figures drop from 0.9 to 0.2 per cent.

The Commission's report on the functioning of the transitional arrangements expresses that in general the free movement of workers had generally positive effects

TABLE 10.3. National transitional arrangements, 2004–2006

No further rights than non-EEA countries	Belgium Finland Germany Greece France Luxembourg Spain
Equal rights but quotas for new member states	Austria Italy The Netherlands Portugal
General admittance, but limited access to welfare system; work and resident permits only granted if certain criteria are met	Denmark Ireland United Kingdom
Community rules apply	Sweden

Source: Based on Traser (2005).

Notes: For a detailed view of the different national restrictions consult the EURES website: <http://europa.eu.int/eures/index/jsp>.

TABLE 10.4. Foreign resident working age population by nationality – 2003–2005 – cell percentages

Country of destination	Nationality					
	EU-15			EU-10		
	2003	2004	2005	2003	2004	2005
Belgium	5.4	5.8	5.8	0.2	0.2	0.2
Denmark	1	1.1	1.1	n/a	n/a	n/a
Germany	2.7	2.6	2.8	n/a	n/a	0.7
Greece	0.2	0.4	0.3	0.3	0.4	0.4
Spain	1.1	1.2	1.2	0.2	0.2	0.2
France	1.9	2.1	1.9	0.1	0.1	0.1
Ireland	3.4	3.3	3	n/a	n/a	2
Luxembourg	37.2	37.6	37.6	0.3	0.3	0.3
Netherlands	1.5	1.5	1.4	0.1	0.1	0.1
Austria	1.7	1.8	1.9	0.7	0.8	1.4
Portugal	0.3	0.4	0.4	n/a	n/a	n/a
Finland	0.3	0.3	0.4	0.3	0.3	0.3
Sweden	2.2	2.2	2.3	0.2	0.2	0.2
United Kingdom	1.8	1.8	1.7	0.2	0.3	0.4
EU-15	2	2.1	2.1	0.2	0.2	0.4
EU-10	n/a	0.2	0.2	n/a	0.1	0.2
EU-25	1.9	1.7	1.7	0.1	0.1	0.3

Source: Eurostat, LFS, 2003–2005 Q1, as in Commission:2006l, p. 11.

n/a: Data not available. Italy is excluded, because no aggregation of data by nationality is available yet.

on the labour markets, by easing labour shortages and opening new job positions that otherwise would not have been created (European Commission, 2006l).

The major conclusions of the report are that:

- the mobility flows between EU-10 and EU-15 are very limited, and the volume cannot be directly linked to the existence or absence of transitional arrangements,
- the total number of migrant workers have remained stable before and after enlargement,
- EU-10 nationals working in EU-15 countries positively contribute to the performance of the respective national economies.

Therefore the Commission suggests that the EU-15 states which have imposed restrictions to the migration of workers should review their policies and also take into account that the freedom of movement is a fundamental principle of the European Union.

By 30 April 2006, EU member states had to report their experiences with the migration of workers during the last 2 years and whether they will continue or introduce transitional arrangements. Germany and Austria are the only two countries that will not lift or ease the restrictions of access to the labour markets. Portugal and Greece will lift the restrictions implemented in the first phase (2004–2006), Finland intends to follow, France will lift restrictions gradually. Belgium, Denmark and Luxembourg will not lift the restrictions, but stated that they want to make the procedure more flexible in certain sectors/occupations. Italy is expected to raise the quota of workers from EU-8, while the Netherlands have postponed the decision on restrictions for the period 2006–2009 (European Commission, 2006m).

### *10.3.3. The Financial Perspective's Debate: Compromising The Cohesion Policy*

The EU Financial Perspective defines the framework of the Community's budget over a period of several years, in other words it sets the ceiling for EU expenditure. The seven-yearly budget rounds in the European Union are always dramatic events. The spring summit in 2005 was no exception; the Heads of State and Government were not able to reach an agreement until December 2005. Ironically, the budget of the EU is rather small; it accounts for only 1 per cent of the combined Gross National Income of the Members States. Still, it is a ground for political struggle among member states and is sometimes used as a scapegoat in front of national electorates.

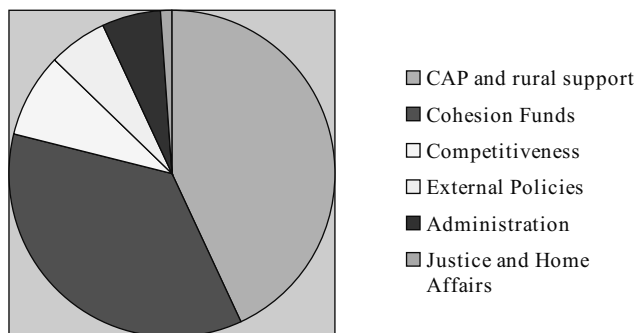
The first Council meeting in spring 2005, under the Dutch Presidency, ended up in a fiasco. The European Commission wanted to raise the expenditure, in order to put more funds in cohesion policies for new member states and in research. The budget proposal implied an increase in the EU budget by 31 per cent by 2013 compared to the budget in 2006. Some of the member states were opposed to that. The UK was under pressure to give up part of its rebate<sup>7</sup> and the French refused to discuss a possible reform of the CAP. Moreover, the Dutch were unhappy about the large contribution to the EU budget and the new members states were eager to get the funds they expected after the enlargement process was over. After tough negotiations, at the 2 days' summit

on 15–16 December (under the UK Presidency) a deal was reached. Prime Minister Tony Blair insisted that his country would be willing to give up the rebate only on the condition of a reform of the CAP. Nevertheless, following political pressures from the majority of the Member States and especially from Germany, the UK agreed to give up around one fifth of its budget rebate, attributable to the cost of the eastern enlargement. The French stood firm to leave the CAP unchanged until 2012, but accepted to review the budget in 2008. The budget deal raised the 2007/2013 budget to 862.3 billion euros, 1.045 per cent of Gross National Income, that is, 1.1 per cent annual growth over the period 2007–2013. It was a compromise between the UK proposal (1.03 per cent) and the commission proposal (1.14 per cent). In conclusion, the budget was lower than what the Commission proposed, it was higher than the UK would have wished and left the CAP untouched, and no major shift was made in the internal composition of the expenditure. The deal was reached thanks to the efforts done by the new German Chancellor, Mrs. Angela Merkel who managed to convince Poland to accept an inferior budget than expected, by promising a 100 million extra of aid earmarked for Eastern Germany.

Poor in outcomes, the real positive aspect of such an agreement was the ability of the Members States to overcome the stall emerged during spring. This helped in tossing away partially the negative atmosphere haunting Europe since the failures of the Dutch and French referenda on the Constitution. The December agreement on the long-term budget was not the final one but it set the main breakdowns for the EU's next years expenditures (Figure 10.4).

#### 10.3.4. Competitiveness and Sustainability

In 2005, the EU has undertaken two important reviews aiming to accelerate competitiveness and sustainability: the mid-term review of the Lisbon Strategy and the review of the Sustainable Development Strategy (SDS).



Source: The Economist

FIGURE 10.4. Composition of EU expenditures, 2007–2013 (%) (Source: The Economist).

The Lisbon Agenda is the EU major strategy adopted in 2000 aimed to face the challenges of globalisation, ageing population and the rapidly growing information society through the adoption of the new strategic goal of making the European region “the most dynamic and competitive knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion, and respect for the environment by 2010” (European Council, 2001:1). Though launched with great enthusiasm, the Lisbon strategy has failed to show substantial progress in the achievement of these extremely ambitious goals until 2005. The November 2004 report drawn by the high-level expert group led by the former Dutch Prime Minister Wim Kok, entrusted with the mission of assessing the instruments and methods and proposing recommendations for improvement, pointed out the “disappointing delivery due to an overloaded agenda, poor coordination and conflicting priorities” underlining as a key issue “the lack of determined political action” (Kok, 2000:6).

The new Barroso Commission, which took up its mandate on 22 November 2004 set as its first political objective the mid-term revision of the Lisbon Strategy<sup>8</sup> and, taking into consideration the recommendations of the Kok report as well as its own detailed assessment the results achieved so far (European Commission, 2005a). At the Spring European Council, it presented concrete proposals for “A new Start of the Lisbon Strategy” (European Commission, 2005b). Placing the focus on two main tasks – the delivery of stronger, lasting growth and the creation of more and better jobs – the Commission proposed a “*Partnership for Growth and Jobs*”, aiming to make Europe a more attractive place to invest and work through deepening of the internal market, the development of knowledge and innovation for growth, and the increased ownership by social partners. Considering that “Delivery is the Achilles heel of the Lisbon strategy”, the Commission proposed that these goals supported by initiatives at EU level should be backed up by detailed national Lisbon action plans in each of the member states.

Following the agreement on the mid-term review of the Lisbon strategy reached at the European Council on 22–23 March 2005, the Commission issued in April 2005 the first “integrated guidelines” (European Commission, 2005c) that aimed to launch a “new cycle of governance” and to serve as a basis for drawing up national action plans (national reform programmes) that were to be designed by Member States by the end of 2005 (European Commission, 2005d:3). In July, a *Community Lisbon Programme* presented policy measures in three fields aiming to have a clear value added because of action being taken or coordinated at the Community level: knowledge and innovation for growth; making Europe a more attractive place to invest and work; creating more and better jobs (European Commission, 2005e). Finally, by December 2005, the 25 national action plans were submitted to the European Commission.

The mid-term review of the Lisbon Agenda has tried to reshape the strategy by sharpening its objectives and to increase the efficiency of implementation by broadening its ownership. It is still too early for assessing the first results of this “new cycle of governance”, but it is likely that a number of structural weaknesses will continue to affect the effectiveness of the new strategy (Soete, 2006).

Next to the efforts to improve the competitiveness of the European economy, the EU has also taken measure in 2005 in order to accelerate its Sustainable Development Strategy launched at the Gothenburg European Council in 2001 (European Commission, 2001). Considering that “not enough progress has been seen, unsustainable trends have yet to start to reverse and the international stakes remain high” (European Commission, 2005f), the European Commission proposed in February 2005 a number of orientations for the review of the Sustainable Development Strategy. Following their approval at the June 2005 European Council in the form of a “Declaration on the Guiding Principles for Sustainable Development” (European Council, 2005:28–30), the Commission’s orientations took a more concrete shape through the publication of a platform for action in December 2005 (European Commission, 2005g). The platform identifies a number of key issues, where a stronger impetus is needed in the coming years: climate change and clean energy; public health threats; social exclusion; demography and migration; management of natural resources; sustainable transport and global poverty and development. In order to improve the monitoring of the implementation of the Strategy, a progress report should be submitted from the Commission every two years drawing on a set of sustainable development indicators, designed with the assistance of national experts in February 2005. Also, the review required greater coherence between Member State and EU strategies and called on all stakeholders (citizens, businesses, academia, regional and local authorities, social partners) to join forces behind the strategy and bring about real change.

The review highlights the need for the EU to make efforts both bilaterally and multilaterally in an integrated way in order to achieve its commitments to global sustainable development. Concrete actions are proposed including: the increase in the volume of aid of the EU and its Member States to 0.7 per cent of Gross National Income (GDI) in 2015 achieving an intermediate target of 0.56 per cent in 2010, the increase in effectiveness of aid policies in the period 2005–2010 by greater coordination between Member States, the development of a Common EU Programming framework, the improvement of international environmental governance through the creation of a UN Environmental Organisation and strengthening multilateral environmental agreements. Although the reviews of both the Lisbon Strategy and the SDS aimed to tackle the challenges facing the EU on the road to competitiveness and sustainability, the question still remains how integrated and coordinated these strategies are. Sustainable development has been integrated in the EU Treaty as a cross-cutting principle to be taken into account in all policies, and is stated amongst the objectives of the Lisbon Strategy, while the SDS refers to the drawing up of an action plan to promote sustainable production and consumption. But the coordination between these “twin brothers” of competitiveness and sustainability seems both difficult to assess in practice. Quite often, analysts tend to consider that the increased emphasis on competitiveness concerns tends to sideline the sustainability ones (EPC, 2005; Spangenberg, 2006). These questions remain open, with the search for better coordination in the future being increasingly imposed by the rise of concrete challenges to both economic and environmental policies, and of the important concerns over the security of energy supplies that the EU started to face at the end of 2005.

### 10.3.5. *The European Constitution*

Since the conclusion of the Treaty of Nice, in 2001, the EU has struggled to achieve consensus over the contents and adoption of a Constitutional Treaty, the first of its kind in the history of regional organisations. This text, which soon came to be known as “European Constitution”, aimed to answer the challenges of widening and deepening integration in a context of accelerated globalisation, by strengthening the internal institutional and legal structure and by giving the Union the necessary tools to make its voice better heard on the global scene.

The unique character of this endeavour has required a new treaty drafting method: the regular Intergovernmental Conference (IGC) usually convened for EU Treaty changes was this time preceded by a Convention gathering representatives from Member states and candidate countries, EU institutions, civil society and the main European interest groups. Starting its work in February 2002, the Convention reached a consensus over the Draft EU Constitutional Treaty to serve as a basis for negotiations during the IGC convened in October 2003.<sup>9</sup> Following the failure of the December 2003 IGC Summit, the Heads of State and Government have reached agreement over the Constitutional Treaty at the June 2004 European Council.<sup>10</sup> The final document was signed in Rome on 29 October 2004 by 25 member states and two candidate countries, where the six original EC Member States signed the Treaty establishing the European Community in 1957.

Made of a preamble, four parts, and annexes containing different protocols, the “Treaty establishing a Constitution for Europe”<sup>11</sup> aimed to replace with a single text the previous EC and EU Treaties<sup>12</sup> revised at various occasions. After referring to the common cultural heritage of Europe, the Preamble states that “while remaining proud of their own national identities and history, the peoples of Europe are determined to transcend their former divisions and, united ever more closely, to forge a common destiny” following the credo “*United in diversity*”. The Treaty defines the objectives of the Union and the values on which it is based, integrating in its second part the Charter of Fundamental Rights adopted by the EU in 2000 and making it a legally binding act. The text also clarifies the Union’s competencies and its relation with member states. Important changes include: the introduction of a EU legal personality, the merger of the three “pillar” structure while still maintaining special role for foreign, security and defence policy, the simplification of legal instruments and procedures (with the introduction of new concepts such as European laws and European framework-laws and the extension of the co-decision procedure), the clarification of the role and functions of the EU institutions and the introduction of the right for any Member State to withdraw from the Union.

Next to the introduction of the legal personality, several important institutional changes aim to ensure more coherence and weight in the EU’s performance on the international scene. While still maintaining the 6-month rotating Presidency of the Council of Ministers, the Treaty creates a Union Minister of Foreign Affairs, who will conduct the Union’s common foreign and security policy presiding over the Foreign Affairs Council while acting also as a full member and Vice-President of the European Commission. In fulfilling his or her mandate, the Union Minister

for Foreign Affairs shall be assisted by a European External Action Service, made of officials from relevant departments of the General Secretariat of the Council and of the Commission as well as staff seconded from national diplomatic services of the Member States. Also, the European Council will become a fully fledged institution with a President appointed for 2.5 years. The possibility of closer structured cooperation in the field of defence policy is newly introduced.

The symbolic ceremony marking the signature of the Treaty in October 2004 did not entail, nevertheless, the end of the constitutional process: after signing the text, Member States had 2 years to ratify it either through a parliamentary procedure, or through the organising of a referendum. By mid-May 2005, 11 countries counting for 220 millions citizens had ratified the Constitution with a positive result in the first consultative referendum held in Spain on 20 February. But the rejection of the Treaty in the French and Dutch referenda organised on 29 May and 1 June, by 55.6 and 61.8 per cent of votes respectively, has thrown the ratification process in a major deadlock. The same text approved in January 2005 by the European Parliament with an overwhelming majority<sup>13</sup> was now rejected by the citizens of two founding members of the EC, bringing again to the front of the European political debate the notion of “democratic deficit”. As a result, the European Council, has decided in June 2005, that the date of 1 November 2006, initially set up for the ratification of the Treaty, was untenable, and asked for a period of reflection and discussion in all Member States. The results of this process were to be assessed under the Austrian Presidency in the first half of 2006. Although any further referenda were put on hold, the ratification process went on in the countries going for the parliamentary method. At the end of 2005, 14 members had ratified the document (see Figure 10.5) but in order to enter into force, the Treaty needs to be ratified in all 25 countries.<sup>14</sup> The discussion of the various reasons underpinning the opposition to the process of ratification in some EU countries is beyond the purpose of this chapter (Table 10.5). What deserves, however, to be pointed out is that, once implemented, the provisions of the Constitutional Treaty have the potential to bring major transformations to the current functioning of the EU’s foreign policies. In the words of the HR for CFSP Javier Solana, “what the Maastricht Treaty did for the euro, the Constitution could do for Europe’s role in the world”.<sup>16</sup> From this perspective, the EU could show that the contours of a “third generation” (Van Langenhove and Costea, 2005) of regionalism which recognises that, next to economic and internal political integration, integration in external policy with impact on global governance is also possible. Although this type of regionalism is still a largely normative idea, the entering into force of the Constitutional treaty will have important repercussions over the future developments of regionalism in the world.

#### 10.4. EXTERNAL RELATIONS OF THE EU

The EU’s relations with the rest of the world are based on a wide range of policies – the main ones being External trade; Development Cooperation and Humanitarian Aid; External Relations and Neighborhood Policy (ENP)<sup>17</sup> and the Common Foreign and Security Policy (CFSP).<sup>18</sup> The Commission is responsible for the majority of these

TABLE 10.5. Ratification method and public support to Constitution

Member state	Procedure	Dates	Support/Opposition to Constitution (%)
Austria	Parliamentary ( <i>Nationalrat</i> and <i>Bundesrat</i> )	Approval by the <i>Nationalrat</i> (11/05/2005) Approval by <i>Bundesrat</i> (25/05/2005) Approval by the Senate (28/04/2005) Approval by the Chamber (19/05/2005) Approval by the Brussels regional parliament (17/06/2005) Approval by the Chamber (19/05/2005) Approval by the German Community Parliament of Belgium (20/06/2005) Approval by the Walloon regional Parliament: (29/06/2005) Approval by the French Community Parliament: (19/07/2005) Approval by the Flemish regional Parliament: (08/02/2006) Approval by the House (30/06/2005) Referendum postponed to end of 2006-beginning of 2007	FOR: 49
Belgium	Parliamentary (Chamber and Senate + Assemblies of Communities and Regions) Indicative referendum ruled out		
Cyprus	Parliamentary	Previously scheduled on 27/09/2005	FOR: 72
Czech Republic	Referendum probable But no final decision so far	Referendum postponed to end of 2006-beginning of 2007	FOR: 50
Denmark	Referendum	Now postponed (no new date)	FOR: 45
Estonia	Parliamentary	Ratification on 09/05/2006	FOR: 49
Finland	Parliamentary	First reading of the Bill on 08/02/2006 Presentation by the Government of a report to the parliament on 25/11/2005	FOR: 49
France	Referendum	Ratification on 5/12/2006 Referendum 29/05/2005 negative	NO: 54,68 Turn out: 69,34 67 in favor in Eurobarometer 12/2005
Germany	Parliamentary ( <i>Bundestag</i> and <i>Bundesrat</i> )	Approval by <i>Bundestag</i> (12/05/2005) Adoption by <i>Bundesrat</i> (27/05/2005)	FOR: 74
Greece	Parliamentary But the Left parties submitted a proposal for a referendum	Approval by Parliament (19/04/2005)	FOR: 68
Hungary	Parliamentary	Approval by Parliament (20/12/2004)	FOR: 76
Ireland	Parliamentary + Referendum	Referendum postponed A White paper has been presented to the parliament on 13/10/2005	FOR: 58

Italy	Parliamentary (Chamber and Senate)	Approval by the Chamber (25/01/2005)	FOR: 70
Latvia	Parliamentary	Approval by the Senate (06/04/2005)	FOR: 57
Lithuania	Parliamentary	Approval by the chamber (02/06/2005)	No data available
Luxembourg	Parliamentary (two votes) + consultative referendum	Approval by Parliament (11/11/04) Approval by the Chamber first reading (28/06/2005) Referendum on 10/07/2005 positive Final approval by the Chamber (25/10/2005)	Turn out: voting compulsory 69 in favor in Eurobarometer 12/2005
Malta	Parliamentary	Approval by Parliament (06/07/2005)	FOR: 60
Netherlands	Parliamentary (First and second Chambers) + consultative referendum	Referendum 1/06/2005 negative	NO: 61,7, Turn out: 63 62 in favor in Eurobarometer 12/2005
Poland	No decision so far	The Parliament failed on 5 July to vote on the ratification procedure The decision should be taken by the next parliament	
Portugal	Referendum	Referendum previously scheduled for October 2005 along with the local elections	FOR: 63
Slovakia	Parliamentary	Government wishes to postpone the process (no date fixed)	FOR: 64
Slovenia	Parliamentary	Approval by Parliament (11/05/2005)	FOR: 74
Spain	Parliamentary (Congress and Senate) + consultative referendum	Approval by Parliament (01/02/2005) Referendum on 20/02/2005 positive Approval of the Congress (28/05/2005)	FOR: 76,7 Turnout: 42,3 62 in favor in Eurobarometer 12/2005
Sweden	Parliamentary	Approval of the Senate (18/05/2005)	FOR: 44
United Kingdom	No referendum envisaged at this stage Parliamentary (House of Commons and House of Lords) + referendum	Presentation of the Ratification Bill previously scheduled in Summer for approval in December 2005 has been postponed Parliamentary ratification process suspended as announced by UK government on 06/06/2005	FOR: 46

Source: European Commission [http://europa.eu.int/constitution/ratification\\_en.htm](http://europa.eu.int/constitution/ratification_en.htm).



FIGURE 10.5. Ratification of the Treaty establishing a Constitution for Europe: state of play beginning 2006 (Source: European Commission, available at: [http://europa.eu.int/constitution/ratification\\_en.htm](http://europa.eu.int/constitution/ratification_en.htm))

policies, including trade, humanitarian and development assistance, rehabilitation and reconstruction and sanctions' regulations. The CFSP, which was established by the Maastricht Treaty as the second Pillar of the European Union is based primarily on inter-governmental arrangements.

In the following paragraphs we will focus only on the EU commercial policy, and in particular on the EU position at the Doha Development Round of WTO trade negotiations and on the development of interregional trade arrangements. This is due to space constraints and is in line with the focus on economic and trade issues in this Report.

#### 10.4.1. *The EU and The WTO*

The EU is a member of the World Trade Organisation (WTO) since its creation in 1995. The European Community is one of the key players in the WTO, its Common Commercial Policy entitles the Commission to negotiate on behalf of the 25 member States.

The main decisions in the WTO are taken by consensus in the form of agreements negotiated during the Ministerial Conferences, reunited at least once every 2 years. The present round of negotiations was launched in Doha (Qatar) in November 2001 following the so-called “Doha Development Agenda” with the aim to help developing countries liberalise their trade while sustaining their efforts in adopting WTO requirements. Moreover, the Round tries to find a solution for the delicate issues of the TRIPS (Trade Related Aspects of Intellectual Property Rights) in order to set a balance between the legitimacy of property rights and the necessity of accessing health care assistance in poor countries. The Doha Conference brought new hopes on the future of the WTO after the fiasco in Seattle in 1999, and as the Prime Minister Tony Blair stated: “its aim is to create the conditions in which millions of people will have a chance to escape poverty”.

Despite these noble targets, 5 years later negotiations are standing still and a settlement is far from being reached. The Cancun Meeting in 2003 ended in a failure and was a new ground for battle between developing and developed countries and within the two groups as well. While the US and the EU have trading disputes on issues such as Genetically Modified Organisms (GMOs) and agricultural subsidies, there were also diverging views between emerging developing countries such as Brazil and India and other developing countries.

*Sensitive issues at the Hong Kong Meeting* The EU is one of the major trading actors and has a very heavy impact on positions adopted in the WTO itself, therefore it has great negotiating power. The EU Common Agriculture Policy has been in the spotlight for a long time. Strong pressure for its reform is exerted by the developing and developed countries within the WTO, where the system of direct payment to farmers is seen as a protectionist toll, impeding the free trade of agriculture products from third countries and thus, the development of some regions in the world. Indeed, even though agriculture accounts for less than 10 per cent of global trade, it is one of the most distorted trade sectors in the world. The World Bank estimated that more than 60 per cent of the gains promised in Doha would come from cutting tariffs on agriculture goods (Anderson and Martin, 2005).

As a response to these pressures, the EU set conditions for lifting the export subsidies and reducing the agricultural exports. The CAP could be revised only if other countries would eliminate their export subsidies, mainly in the areas of services. The Ministerial Meeting in Hong Kong that took place from 13 to 18 December 2005 was another attempt to find some agreements after the collapse of the Cancun meeting. In the aftermath of the meeting, on 28 October, Peter Mandelson, Europe’s Commissioner for Trade, made a new offer. He proposed to cut the top farm tariff by 60 per cent, put a ceiling of 100 per cent and reduce the average tariff by 46 per cent. However, the proposal was not at the level of tariff cut that big developing countries and the G20 were demanding (75 per cent of the top farm tariff to be cut). The offer was criticised because of the discrepancy between the modesty of its concessions and the ambitious demands for reduction of developing countries’ tariffs on industrial goods.

On the discussion table, most of the attention was concentrated on farm trade but disputes were raised also on industrial tariffs and trade in services.

The discussion on industrial goods did not bring any grand results either. In this case the ardent defenders of these tariffs were the big developing countries such as Brazil and India, which used them as a bargaining chip for reduction of agriculture tariffs. Services as well were on a stall.

In conclusion, almost no progress was made in Hong Kong. As for the discussion on the financial perspective of the EU (that took place during the same period), the WTO meeting achieved the goal of allowing a rebirth of negotiations and a better climate among the delegates. Nevertheless, concrete results were not attained and the main achievement was to agree on a date, 2013, for the elimination of export subsidies on farm goods.

#### *10.4.2. InterRegional Negotiations*

Apart from the WTO framework, the EU conducts trade negotiations with single states and with other regional groups. Inter-regional negotiations represent the most distinctive features of the EU external trade policy. In the course 2005 the EU has attempted to strengthen existing inter-regional arrangements (association, cooperation and partnership agreements) and to further advance negotiations. Progress has been made in many regions but no final agreement has been signed.

*Central America and Andean Community* The EU has maintained regular relations with both Central America (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama) and the Andean Community of Nations (Bolivia, Colombia, Ecuador, Peru and Venezuela). With both regions the EU has established in 1993 “third generation” cooperation agreements, which provided for economic and trade cooperation and development cooperation and included a most-favoured-nation clause. During the Guadalajara summit in 2004, the EU and both regions took a further step in the objective of concluding Association Agreements, by launching two separate but parallel joint assessments to examine the level of regional economic integration achieved.<sup>19</sup> In 2005 three meetings were held in parallel for each region by the Joint Working Groups.

*MERCOSUR* Negotiations for an inter-regional Association Agreement between the EU and Mercosur (Argentina, Brazil, Paraguay and Uruguay) began in April 2000. The agreement under negotiation consists of three parts: a chapter on political dialogue, a chapter on trade and economic issues (creating a biregional free trade area) and a chapter on cooperation.

In September 2005, during the EU-MERCOSUR trade negotiators meeting at ministerial level, ministers met to discuss the further conduct of EU-Mercosur Association Agreement. Ministers acknowledged the progress made towards the conclusion of such Association Agreement and fixed a roadmap: two technical meetings (November 2005 and February 2006) at coordinators level. They also agreed upon a series of

accompanying measures and actions. However, to date no final agreement has been reached.

*MEDA* The relationship between the EU and the neighbouring Mediterranean countries (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia and Turkey) operates under the complementary bilateral and regional cooperation frameworks developed under the Euro-Mediterranean Partnership (1995). In addition to the bilateral Association Agreements, the Agadir Agreement foresees the creation of an integrated regional market between Egypt, Jordan, Morocco and Tunisia.

In November 2005 two important decisions have been taken by the EU Member States: to open negotiations to further open up trade in fresh and processed agricultural and fisheries products and to authorise the European Commission to open negotiations on the liberalisation of services and investment with the Mediterranean partners. The Barcelona Summit (27 and 28 November 2005) commemorated the tenth Anniversary of the Barcelona Euro-Mediterranean Conference. A new phase in Euro-Mediterranean relations was launched to meet the demands created by major changes on the international scene and within the European Union itself following the enlargement.

*Gulf Cooperation Council* A Cooperation Agreement between the EU and the GCC was signed on 15 June 1988. It came into force on 1 January 1990. Since then, the Union has been linked with the six countries of the GCC (Saudi Arabia, Kuwait, Bahrain, Qatar, United Arab Emirates, Oman) in a non-preferential agreement, which establishes cooperation in a wide range of fields: economy and trade, agriculture and fisheries, industry, energy, science and technology, investment and environment.

The Joint EU-GCC Council that took place on 5 April 2005 reiterated the political will to further relations and cooperation in all areas besides trade and economic issues. Concerning the FTA, Ministers committed to conclude the negotiations at the earliest possible stage. However, no agreement was reached by the end of 2005.

*ASEAN* The EU is a longstanding dialogue Partner of ASEAN. Cooperation between the EU and ASEAN is based on a Cooperation Agreement (1980) between the EC and member countries of ASEAN: Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam. Protocols for the accession of Laos and Cambodia to the Agreement were signed in July 2000. No agreement has been negotiated with Burma/Myanmar because of the scarce improvements in democracy and human rights conditions in the country. The 15th ASEAN-EU Ministerial Meeting was held in Jakarta, Indonesia on 10 March 2005. The Meeting took several decisions: increased support for ASEAN integration; start of bilateral negotiations with Singapore and Thailand; concrete joint cooperation in the fight against terrorism; substantial progress under the TREATI (trade) initiative; launch of tri-lateral cooperation; the endorsement of the Commission's READI (dialogue instrument for non-trade issues) principle; approval of the Indicative Programme 2005–06 and agreement on meetings of both

Informal Coordinating Mechanism (ICM) and Senior Officials (SOM) in the course of the year to step up contacts and prepare the ground for further progress in the relations.

In May the European Commission also launched a study on the feasibility of an EU-ASEAN FTA.

*ACP* The Economic Partnership Agreements (EPAs) negotiations between the European Community and the Africa, Caribbean and Pacific countries (ACPs) started in June 2002. In the first phase negotiations were conducted at all ACP countries level. In 2003–2004 formal negotiations started with each one of the six sub-regions identified by the EU: West Africa (October 2003); Central Africa (October 2003); Eastern and Southern Africa (February 2004); the Caribbean (April 2004); Southern Africa/SADC (July 2004) and the Pacific (September 2004).

Several meetings took place during 2005 at both parliamentary (bi-annual Joint Parliamentary Assembly) and ministerial level in order to further advance with the negotiations. Technical talks took place in March in each one of the regions concerned. In December the ACP-EU Technical Monitoring Committee in Brussels agreed on: (1) the need for meetings between Regional Preparatory Task Forces and other donors in the first quarter of 2006, and (2) the need to promote rapid delivery of trade-related technical assistance linked to the EPA process.

*Western Balkans* In addition to the regional agreements mentioned above, the EU is progressively negotiating and implementing Stabilisation and Association Agreements (SAA) with five South-East European countries (Albania, Bosnia-Herzegovina, Croatia, the former Yugoslav Republic of Macedonia and Serbia and Montenegro). The Stabilisation and Association Agreements cover a large number of issues (apart from trade also political dialogue and other areas of cooperation such as environment and energy).

In June 2005, Trade Ministers from the region agreed to work towards the transformation of the network of bilateral FTAs into one regional arrangement. In November 2005 trade preferences for the countries in the region have been renewed for a further 5 years period (until December 2006).

#### 10.5. CONCLUSIONS

Against a background of slow economic growth, rigid unemployment levels, an insufficiently delivering Lisbon strategy, an aging population, growing immigration pressures, concerns about the future energy supply and about the security situation in the Middle East, there does not seem to be a consensus on the role the macroregional policy level in the EU area should play, both internally and externally, to address the challenges that the EU is facing in different policy areas. Contradictory signals are perceived from different angles, simultaneously calling for a “lighter” and a “heavier” European policy level.

Several of the issues mentioned above do, however, show a clear regional dimension and logically call for regional answers. The need for EU-scale action will

have to be made compatible with the continuing national and sub-national reflexes, aspirations and proposals.

The challenges for the European policy community include: further deepening of the internal market, shaping of a common energy policy, addressing the structural weaknesses for the development of the knowledge-based society and the enhancement of Europe's competitiveness, reaching a new consensus on Europe's finances, creating the institutions and conditions for a stronger role of the EU on the world scene, and addressing demographic and migration issues. Quite some issues are thus on the agenda of the EU policy makers.

#### NOTES

- 1 This document is co-authored by: Ana-Cristina Costea, Philippe De Lombaerde, Birger Fühne, Aurora Mordonu, Giulia Pietrangeli, Isabella Torta and Malgorzata Wesolovska. The views expressed are those of the authors only. They thank Rodrigo Tavares for comments on a previous version.
- 2 The EC position was updated in May 2006. See: the recent EC position stated in the May package, [http://ec.europa.eu/comm/enlargement/report\\_2006/index.htm](http://ec.europa.eu/comm/enlargement/report_2006/index.htm).
- 3 For example, when Greece (6 years transitional arrangements) or Portugal and Spain (initially 7 years TA, lowered to 6 years) joined the EU.
- 4 Germany and Austria absorbed 2/3 of all migration from the EU-10 countries in 2002 (Boeri, 2001).
- 5 Even when Community rules are once applied, a state may use the safeguard clause and introduce transitional arrangements; though only with consent of the Commission (Paragraph 7, Accession Treaty).
- 6 Although the Swedish Government tried to introduce transitional arrangements, it ultimately failed to convince the parliament.
- 7 Rebate is the UK's contribution to the Budget that is paid back to the UK government by the EU.
- 8 Speech by José Manuel Barroso, President of the European Commission, "Presentation of the five year strategy and 2005 legislative and work programme", European Parliament, plenary session, SPEECH/05/43, Brussels, 26 January 2005.
- 9 Thessaloniki European Council, Presidency Conclusions, 19 and 20 June 2003, 11638/03, POLGEN 55, [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressData/en/ec/76279.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/76279.pdf).
- 10 Brussels European Council, Presidency Conclusions, 17 and 18 June 2004, 10679/2/04 REV 2, and Conference of the Representatives of the Governments of the Member States Brussels, 18 June 2004 CIG 85/04 IGC 2003 PRESID 27, Brussels, 17/18 June 2004, <http://ue.eu.int/igcpdf/en/04/cg00/cg00085.en04.pdf>.
- 11 Full text of the Constitution: <http://europa.eu.int/constitution/>.
- 12 With the exception of the Euratom Treaty which is still a separate legal entity while sharing the same institutions with the EU.
- 13 For: 500, Against: 137, Abstentions: 40, with 677 of the total number of 732 MEPs voting.
- 14 Estonia ratified the Constitution on 9 March 2006 and Finland on 5 December 2006.
- 15 Next to the referenda outcome, the data concerning public support/opposition to the Constitution were extracted from the European Commission Standard Eurobarometer 64, December 2005, [http://europa.eu.int/comm/public\\_opinion/archives/eb/eb64/eb64\\_first\\_en.pdf](http://europa.eu.int/comm/public_opinion/archives/eb/eb64/eb64_first_en.pdf).
- 16 Javier Solana, "The Future of the European Union as an International Actor", 23 March 2005, [http://ue.eu.int/ueDocs/cms\\_Data/docs/pressdata/EN/articles/84349.pdf](http://ue.eu.int/ueDocs/cms_Data/docs/pressdata/EN/articles/84349.pdf).
- 17 The ENP was developed in the context of the EU 2004 enlargement, with the objective of avoiding the emergence of new dividing lines between the enlarged EU and our neighbours. Currently, the ENP applies to the following countries: Algeria, Belarus, Egypt, Israel, Jordan, Lebanon, Libya, Moldova, Morocco, the Palestinian Authority, Syria, Tunisia; Ukraine; Armenia, Azerbaijan and Georgia.
- 18 Next to them we could add the external dimension of the internal policies (such as agriculture).

- <sup>19</sup> See COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the Commission's objectives, in the framework of the relations between the European Union and Latin America, in view of the third Summit of Heads of State and Government of the European Union and Latin America and the Caribbean to be held in Guadalajara (Mexico) on 28 May 2004 (COM 2004 220 final). See, for example, Adiwasio et al. (2005).

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## ANNEX

Annex – Selected data on Regional Arrangements\*, as of 1 January 2006

Regional arrangements	Year of establishment	Official website(s)	Combined population of member states as % of world population (2005) <sup>1</sup>	Combined GDP of member states as % of world GDP (2004) <sup>2</sup>	Intra-regional trade as % of total trade (2003) <sup>3</sup>
African Union	2002	<a href="http://www.africa-union.org">http://www.africa-union.org</a>	12.84	2.06	8.3
African, Caribbean and Pacific Group of States	1975	<a href="http://www.acp.int">http://www.acp.int</a>	11.56	1.64	9.46
Andean community	1969	<a href="http://www.comunidadandina.org/endex.htm">http://www.comunidadandina.org/endex.htm</a>	1.84	0.64	11.15
Arab Maghreb Union	1989	<a href="http://www.maghrebarabe.org/">http://www.maghrebarabe.org/</a>	1.3	0.57	1.78
Asia-Pacific Economic Cooperation	1989	<a href="http://www.apec.org/">http://www.apec.org/</a>	39.17	53.58	70.38
Association of Caribbean States	1994	<a href="http://www.acs-aec.org/index.htm">http://www.acs-aec.org/index.htm</a>	3.84	2.03	6.05
Association of South Eastern Asian Nations	1967	<a href="http://www.aseansec.org/index.asp">http://www.aseansec.org/index.asp</a>	8.16	2.09	22.06
Baltic Sea States Subregional Cooperation	1993	<a href="http://www.bsssc.com/">http://www.bsssc.com/</a>	2.36	11.4	22.46
Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation	1997	<a href="http://www.bimstec.org/index.htm">http://www.bimstec.org/index.htm</a>	20.75	2.97	4.2
Belarus-Russia Union	1997	N/a	2.4	1.6	5.86
Black Sea Economic Cooperation	1992	<a href="http://www.bsec-organization.org/">http://www.bsec-organization.org/</a>	3.4	1.6	12.27
Caribbean Community	1973	<a href="http://www.caricom.org">http://www.caricom.org</a>	(excludes Moldova)	(excludes Moldova)	6.27
Central African Customs and Economic Union	1964	N/A	2.8	0.1	-/
			0.53	0.13	

(Continued)

## Annex (Continued)

Regional arrangements	Year of establishment	Official website(s)	Combined population of member states as % of world population (2005) <sup>1</sup>	Combined GDP of member states as % of world GDP (2004) <sup>2</sup>	Intra-regional trade as % of total trade (2003) <sup>3</sup>
Central American Integration System	1991	<a href="http://www.sgsica.org/">http://www.sgsica.org/</a>	0.49	0.17	9.52
Central Asian Cooperation Organization	1991	<a href="http://www.eurasianhome.org/">http://www.eurasianhome.org/</a> . click databases	2.4	1.7	6.11
Central European Free Trade Agreement	1992	<a href="http://www.cefta.org">http://www.cefta.org</a> or <a href="http://www.stabilitypact.org">http://www.stabilitypact.org</a>	0.5	0.1 (excludes Kosovo, Macedonia, Moldova)	4.87
Common Market for Eastern and Southern Africa	1994	<a href="http://www.comesa.int">http://www.comesa.int</a>	5.32	0.58	5.12
Common Market of the South	1991	<a href="http://www.mercosur.org.uy">http://www.mercosur.org.uy</a>	3.65	2.66	12.82
Commonwealth of Independent States	1991	<a href="http://www.cisstat.com/eng/index.htm">http://www.cisstat.com/eng/index.htm</a>	4.4	1.9 (excludes Moldova)	22.70
Community of Sahel-Saharan States	1998	<a href="http://www.uneca.org/cen-sad/">http://www.uneca.org/cen-sad/</a>	5.93	0.89	5.27
Council of Arab Economic Unity	1957	<a href="http://www.caeu.org/English/Intro">http://www.caeu.org/English/Intro</a>			-/-
Council of Europe	1949	<a href="http://www.coe.int">http://www.coe.int</a>	9.94	32.99	73.76
Council of the Baltic States	1992	<a href="http://www.cbss.st">http://www.cbss.st</a>	2.37	11.43	22.14
Cross Border Initiative	1992	<a href="http://www.imf.org/external/np/cross">http://www.imf.org/external/np/cross</a>	2.99	0.22	10.68
East African Community	1999	<a href="http://www.eac.int">http://www.eac.int</a>	1.52	0.09	-/-
Economic Co-operation Organisation	1977	<a href="http://www.ecosecretariat.org">http://www.ecosecretariat.org</a>	6.16	1.78	5.11
Economic Community of Central African States	1983	<a href="http://www.ceeac-eccas.org">http://www.ceeac-eccas.org</a>	1.97	0.2	-/-
Economic Community of the Great Lakes Countries	1976	N/A	1.3	0.09	-/-
Economic Community of West African States	1975	<a href="http://www.ecowas.int">http://www.ecowas.int</a>	3.61	0.36	8.51

Eurasian Economic Community	2000	<a href="http://www.eurasianhome.org/">http://www.eurasianhome.org/</a> . click databases	3.3	1.7	15.74
European Economic Area	1992	<a href="http://europa.eu.int/comm/external_relations/ee a/">http://europa.eu.int/comm/external_relations/ee a/</a>	5.84	28.63	56.9
European Free Trade Association	1960	<a href="http://www.efta.int">http://www.efta.int</a>	0.19	1.45	0.64
European Union	1992	<a href="http://www.europa.eu.int">http://www.europa.eu.int</a>	7.08	29.7	68.92
Georgia, Ukraine, Azerbaijan, Moldova (GUAM)	1997	<a href="http://www.guam.org.ua/en.phtml">http://www.guam.org.ua/en.phtml</a>	1.0 (excludes Moldova)	1.7 (excludes Moldova)	9.47
Group of Three	1995	N/A	2.71	1.65	1.79
Gulf Cooperation Council	1981	<a href="http://www.gcc-sg.org">http://www.gcc-sg.org</a>	0.56	0.93	2.45
Indian Ocean Commission	1984	<a href="http://www.coi-info.org">http://www.coi-info.org</a>	1.25	-/-	0.4
Indian Ocean Rim Association for Regional Cooperation	1997	<a href="http://www.iornet.com">http://www.iornet.com</a>	28.63	-/-	21.46
Intergovernmental Authority on Development	1996	<a href="http://www.igad.org">http://www.igad.org</a>	2.92	0.2	8.35
Intergovernmental Group of 24 on International Monetary Affairs	1971	<a href="http://www.g24.org">http://www.g24.org</a>	33.95	-/-	9.28
Latin America Integration Association	1980	<a href="http://www.aladi.org">http://www.aladi.org</a>	7.56	-/-	13.52
Latin American Economic System	1975	<a href="http://www.sela.org">http://www.sela.org</a>	8.51	-/-	15.18
League of Arab States	1945	<a href="http://www.arableagueonline.org/">http://www.arableagueonline.org/</a> (note to self: update RIIS)	5	2.02	5.22
Mano River Union	1973	<a href="http://www.mbendi.co.za/orgs/cfbt.htm">http://www.mbendi.co.za/orgs/cfbt.htm</a>	0.28	0.02	-/-
Mekong River Commission	1995	<a href="http://www.mremekong.org">http://www.mremekong.org</a>	2.6	0.58	2.73
Nordic Council and The Nordic Council of Ministers	1952	<a href="http://www.norden.org">http://www.norden.org</a>	0.38	2.71	20.89
North American Free Trade Agreement	1994	<a href="http://nafta-sec-alena.org">http://nafta-sec-alena.org</a>	6.74	31.55	47.28
Organisation for Economic Cooperation and Development	1960	<a href="http://www.oecd.org">http://www.oecd.org</a>	18.04	76.45	79.2
Organisation of African Unity	1963 - 2002	<a href="http://www.africa-union.org/">http://www.africa-union.org/</a> successor's website	12.03	2.08	8.77
Organisation of Arab Petroleum Exporting Countries	1968	<a href="http://www.oapcc.org">http://www.oapcc.org</a>	5.15	0.58	4.93

(Continued)

## Annex (Continued)

Regional arrangements	Year of establishment	Official website(s)	Combined population of member states as % of world population (2005) <sup>1</sup>	Combined GDP of member states as % of world GDP (2004) <sup>2</sup>	Intra-regional trade as % of total trade (2003) <sup>3</sup>
Organisation of Eastern Caribbean States	1981	<a href="http://www.oecs.org/">http://www.oecs.org/</a>	0.01	0.01	-/-
Organisation of Islamic Conference	1969	<a href="http://www.oic-oci.org/main-body.htm">http://www.oic-oci.org/main-body.htm</a>	22	-/-	9.51
Organisation pour l'harmonisation du droit des affaires	1993	<a href="http://www.ohada.org">http://www.ohada.org</a>	2.67	0.28	7.72
Organization of American States	1948	<a href="http://www.oas.org/main/english/">http://www.oas.org/main/english/</a>	13.61	35.45	51.97
Permanent Interstate Committee for Drought Control in the Sahel	1973	<a href="http://www.cilssnet.org">http://www.cilssnet.org</a>	0.98	0.1	-/-
Permanent Mechanism of Political Consultation and Coordination	1986	<a href="http://www.mre.gov.br/cdbrasil/itamaryaty/web/ingles/relex/mre/ogreg/gruporio/">http://www.mre.gov.br/cdbrasil/itamaryaty/web/ingles/relex/mre/ogreg/gruporio/</a>	8.95	-/-	13.91
Shanghai Co-operation Organization	2001	<a href="http://www.sectsc.org/home.asp?LanguageID=2">http://www.sectsc.org/home.asp?LanguageID=2</a>	24.1	6.1	6.84
Single Economic Space	2003	<a href="http://www.eurasianhome.org/">http://www.eurasianhome.org/</a>	3.4	1.7	20.44
South Asian Association for Regional Cooperation	1985	<a href="http://www.saarcc-sec.org/">http://www.saarcc-sec.org/</a>	22.28	2.74	6.02
Southern African Customs Union	1969	<a href="http://www.dfa.gov.za/foreign/Multilateral/afri-ca/sacu.htm">http://www.dfa.gov.za/foreign/Multilateral/afri-ca/sacu.htm</a>	0.79	0.52	-/-
Southern African Development Community	1980	<a href="http://www.sadc.int/">http://www.sadc.int/</a>	2.52	0.68	7.69
Stability Pact for South Eastern Europe	1999	<a href="http://www.stabilitypact.org">http://www.stabilitypact.org</a>	16.04	75.3	75.8
West African Economic and Monetary Union	1994	<a href="http://www.uemoa.int/index.htm">http://www.uemoa.int/index.htm</a>	2.79	0.3	6.71
Western European Union	1954	<a href="http://www.w.eu.int">http://www.w.eu.int</a>	5.43	25.67	54.8

<sup>1</sup> Based on U.S. Census Bureau, International Data Base (<http://www.census.gov/ipc/www/itdbacc.html>).

<sup>2</sup> Based on UN Statistics Division: GDP at market prices, 1990 prices, US\$ (UN estimates).

<sup>3</sup> Based on COMTRADE data, SITC Rev. 1.

\* "Regional Arrangements" include regional organizations and other (looser) forms of regional cooperation. The selection of the arrangements does not imply any pronouncement by UN, UNU, UNU-CRIS or any other official body on the status of the arrangements. The data contained in the table are presented for purely informative purposes. Comments on the selection of the arrangements should be directed to: [director@cris.unu.edu](mailto:director@cris.unu.edu).

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African Union	Algeria
	Angola
	Benin
	Botswana
	Burkina Faso
	Burundi
	Cameroon
	Cape Verde
	Central African Republic
	Chad
	Comoros
	Congo
	Cote d'Ivoire
	Democratic Republic of the Congo
	Djibouti
	Egypt
	Equatorial Guinea
	Eritrea
	Ethiopia
	Gabon
	Gambia
	Ghana
	Guinea
	Guinea-Bissau
	Kenya
	Lesotho
	Liberia
	Libya
	Madagascar
	Malawi
	Mali
	Mauritania
	Mauritius
	Mozambique
	Namibia
	Niger
	Nigeria
	Rwanda
	Sao Tome and Principe
	Senegal
	Seychelles
	Sierra Leone
	Somalia
	South Africa
	Sudan
	Swaziland
	Tanzania
	Togo
	Tunisia

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*(Continued)*

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African, Caribbean and Pacific Group of States	Uganda
	Zambia
	Angola
	Antigua and Barbuda
	Bahamas
	Barbados
	Belize
	Benin
	Botswana
	Burkina Faso
	Burundi
	Cameroon
	Cape Verde
	Central African Republic
	Chad
	Comoros
	Congo
	Cook Islands
	Cote d'Ivoire
	Cuba
	Democratic Republic of the Congo
	Djibouti
	Dominica
	Dominican Republic
	East Timor
	Equatorial Guinea
	Eritrea
	Ethiopia
	Fiji
	Gabon
	Gambia
	Ghana
	Grenada
Guinea	
Guinea-Bissau	
Guyana	
Haiti	
Jamaica	
Kenya	
Kiribati	
Lesotho	
Liberia	
Madagascar	
Malawi	
Mali	
Marshall Islands	
Mauritania	
Mauritius	
Micronesia	
Mozambique	

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	Namibia
	Nauru
	Niger
	Nigeria
	Niue
	Palau
	Papua New Guinea
	Rwanda
	Saint Kitts and Nevis
	Saint Lucia
	Saint Vincent and the Grenadines
	Sao Tome and Principe
	Senegal
	Seychelles
	Sierra Leone
	Solomon Islands
	Somalia South Africa Sudan
	Suriname Swaziland
	Tanzania
	Togo
	Tonga
	Trinidad and Tobago
	Tuvalu
	Uganda
	Vanuatu
	Zambia
Andean community	Bolivia
	Colombia
	Ecuador
	Peru
	Venezuela (until 2006)
Arab Maghreb Union	Algeria
	Libya
	Mauritania
	Morocco
	Tunisia
Asia-Pacific Economic Co-operation	Australia
	Brunei
	Canada
	Chile
	China
	Hong Kong
	Indonesia
	Japan
	Korea, North
	Korea, South
	Malaysia
	Mexico
	New Zealand

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*(Continued)*

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	Papua New Guinea
	Peru
	Philippines
	Russian Federation
	Singapore
	Thailand
	United States
	Vietnam
Association of Caribbean States	Antigua and Barbuda
	Bahamas
	Barbados
	Belize
	Colombia
	Costa Rica
	Cuba
	Dominica
	Dominican Republic
	El Salvador
	Grenada
	Guatemala
	Guyana
	Haiti
	Honduras
	Jamaica
	Mexico
	Nicaragua
	Panama
	Saint Kitts and Nevis
	Saint Lucia
	Saint Vincent and the Grenadines
	Suriname
	Trinidad and Tobago
	Venezuela
Association of South Eastern Asian Nations	Brunei
	Cambodia
	Indonesia
	Laos
	Malaysia
	Myanmar
	Philippines
	Singapore
	Thailand
	Vietnam
Baltic Sea States Subregional Co-operation	Denmark
	Estonia
	Finland
	Germany
	Latvia
	Lithuania
	Norway

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	Poland
	Russian Federation
	Sweden
Bay of Bengal Initiative for Multi-sectoral Technical and Economic Co-operation	Bangladesh
	Bhutan
	India
	Nepal
	Sri Lanka
	Thailand
Black Sea Economic Co-operation	Albania
	Armenia
	Azerbaijan
	Bulgaria
	Georgia
	Greece
	Moldova
	Romania
	Russian Federation
	Turkey
	Ukraine
Caribbean Community	Antigua and Barbuda
	Bahamas
	Barbados
	Belize
	Dominica
	Grenada
	Guyana
	Haiti
	Honduras
	Jamaica
	Montserrat
	Saint Kitts and Nevis
	Saint Lucia
	Saint Vincent and the Grenadines
	Suriname
	Trinidad and Tobago
Central African Customs and Economic Union	Cameroon
	Central African Republic
	Chad
	Democratic Republic of the Congo
	Equatorial Guinea
	Gabon
	Gambia
Central American Integration System	Belize
	Costa Rica
	El Salvador
	Guatemala
	Nicaragua
	Panama

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*(Continued)*

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Central Asian Cooperation Organization	Kazakhstan Kyrgyzstan Russia Tajikistan Uzbekistan
Central European Free Trade Agreement	Croatia Republic of Macedonia Albania Bosnia and Herzegovina, Moldova, Montenegro, Serbia UNMIK on behalf of Kosovo
Common Market for Eastern and Southern Africa	Angola Burundi Comoros Democratic Republic of the Congo Djibouti Egypt Eritrea Ethiopia Kenya Madagascar Malawi Namibia Rwanda Seychelles Sudan Swaziland Uganda Zambia Zimbabwe
Common Market of the South	Argentina Brazil Paraguay Uruguay
Commonwealth of Independent States	Armenia Azerbaijan Belarus Georgia Kazakhstan Kyrgyzstan Moldova Russia Tajikistan Turkmenistan Ukraine Uzbekistan
Community of Sahel-Saharan States	Burkina Faso Central African Republic Chad

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	Djibouti
	Egypt
	Eritrea
	Libya
	Mali
	Morocco
	Niger
	Nigeria
	Senegal
	Somalia
	Sudan
	Tunisia
	Zambia
Council of Arab Economic Unity	Egypt
	Iraq
	Jordan
	Kuwait
	Libya
	Mauritania
	Somalia
	Sudan
	Syria
	Yemen
	Palestine Liberation Organization
Council of Europe	Albania
	Andorra
	Armenia
	Austria
	Azerbaijan
	Belgium
	Bosnia and Herzegovina
	Bulgaria
	Croatia
	Cyprus
	Czech Republic
	Denmark
	Estonia
	Finland
	France
	Georgia
	Germany
	Greece
	Hungary
	Iceland
	Ireland
	Italy
	Latvia
	Liechtenstein
	Lithuania

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*(Continued)*

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	Luxembourg
	Macedonia, Former Yugoslav Republic of
	Malta
	Moldova
	Netherlands
	Norway
	Poland
	Portugal
	Romania
	Russian Federation
	San Marino
	Slovakia
	Slovenia
	Spain
	Switzerland
	Turkey
	Ukraine
	United Kingdom
Council of the Baltic States	Denmark
	Estonia
	Finland
	Germany
	Iceland
	Latvia
	Lithuania
	Norway
	Poland
	Russian Federation
	Sweden
Cross Border Initiative	Burundi
	Comoros
	Kenya
	Madagascar
	Malawi
	Mauritius
	Mozambique
	Namibia
	Rwanda
	Seychelles
	Swaziland
	Tanzania
	Uganda
	Zambia
	Zimbabwe
East African Community	Kenya
	Tanzania
	Uganda
Economic Co-operation Organisation	Afghanistan
	Azerbaijan
	Iran

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	Kazakhstan
	Kyrgyzstan
	Pakistan
	Tajikistan
	Turkey
	Turkmenistan
	Uzbekistan
Economic Community of Central African States	Angola
	Burundi
	Cameroon
	Central African Republic
	Chad
	Congo
	Democratic Republic of the Congo
	Equatorial Guinea
	Gabon
	Gambia
	Rwanda
	Sao Tome and Principe
Economic Community of the Great Lakes Countries	Burundi
	Congo
	Oman
	Rwanda
Economic Community of West African States	Benin
	Burkina Faso
	Cape Verde
	Cote d'Ivoire
	Ghana
	Guinea
	Guinea-Bissau
	Liberia
	Mali
	Niger
	Nigeria
	Senegal
	Sierra Leone
	Togo
Euroasian Economic Community	Belarus
	Kazakhstan
	Kyrgyzstan
	Russia
	Tajikistan
European Economic Area	Austria
	Denmark
	Finland
	France
	Germany
	Greece
	Iceland

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*(Continued)*

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	Ireland
	Italy
	Liechtenstein
	Luxembourg
	Netherlands
	Norway
	Portugal
	Spain
	Sweden
	United Kingdom
European Free Trade Association	Iceland
	Liechtenstein
	Norway
	Switzerland
European Union	Austria
	Belgium
	Cyprus
	Czech Republic
	Denmark
	Estonia
	Finland
	France
	Germany
	Greece
	Hungary
	Ireland
	Italy
	Latvia
	Lithuania
	Luxembourg
	Malta
	Netherlands
	Poland
	Portugal
	Slovakia
	Slovenia
	Spain
	Sweden
Georgia, Ukraine, Azerbaijan and Moldova (GUAM)	Georgia
	Ukraine
	Azerbaijan
	Moldova
Group of Three	Colombia
	Mexico
	Venezuela
Gulf Cooperation Council	Bahrain
	Kuwait
	Oman
	Qatar

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	Saudi Arabia
	United Arab Emirates
Indian Ocean Commission	Comoros
	France
	Madagascar
	Mauritius
	Seychelles
Indian Ocean Rim Association for Regional Cooperation	Australia
	Bangladesh
	India
	Indonesia
	Iran
	Kenya
	Madagascar
	Malaysia
	Mauritius
	Mozambique
	Oman
	Singapore
	South Africa
	Sri Lanka
	Tanzania
	Thailand
	United Arab Emirates
	Yemen
Intergovernmental Authority on Development	Djibouti
	Eritrea
	Ethiopia
	Kenya
	Somalia
	Sudan
	Uganda
Intergovernmental Group of on International Monetary Affairs	Algeria
	Argentina
	Brazil
	Colombia
	Cote d'Ivoire
	Democratic Republic of the Congo
	Egypt
	Gabon
	Gambia
	Ghana
	Guatemala
	India
	Iran
	Lebanon
	Mexico
	Nigeria

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(Continued)

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	Pakistan
	Peru
	Philippines
	South Africa
	Sri Lanka
	Syria
	Trinidad and Tobago
	Venezuela
Latin America Integration Association	Argentina
	Bolivia
	Brazil
	Chile
	Colombia
	Cuba
	Ecuador
	Mexico
	Paraguay
	Peru
	Uruguay
	Venezuela
Latin American Economic System	Argentina
	Bahamas
	Barbados
	Belize
	Bolivia
	Brazil
	Chile
	Colombia
	Costa Rica
	Cuba
	Dominican Republic
	Ecuador
	El Salvador
	Grenada
	Guatemala
	Guyana
	Haiti
	Honduras
	Jamaica
	Mexico
	Nicaragua
	Panama
	Paraguay
	Peru
	Suriname
	Trinidad and Tobago
	Uruguay
	Venezuela
League of Arab States	Algeria
	Bahrain

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	Comoros
	Djibouti
	Egypt
	Iraq
	Jordan
	Kuwait
	Lebanon
	Libya
	Mauritania
	Morocco
	Oman
	Qatar
	Saudi Arabia
	Somalia
	Sudan
	Syria
	Tunisia
	United Arab Emirates
	Yemen
Mano River Union	Guinea
	Liberia
	Sierra Leone
Mekong River Commission	Cambodia
	Laos
	Thailand
	Vietnam
Nordic Council and The Nordic Council of Ministers	Denmark
	Finland
	Greenland
	Iceland
	Norway
	Sweden
North American Free Trade Agreement	Canada
	Mexico
	United States
Organization for Economic Cooperation and Development	Australia
	Austria
	Belgium
	Canada
	Czech Republic
	Denmark
	Finland
	France
	Germany
	Greece
	Hungary
	Iceland
	Ireland

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*(Continued)*

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	Italy
	Japan
	Korea, South
	Luxembourg
	Mexico
	Netherlands
	New Zealand
	Norway
	Poland
	Portugal
	Slovakia
	Spain
	Sweden
	Switzerland
	Turkey
	United Kingdom
	United States
Organization of African Unity	Algeria
	Angola
	Benin
	Botswana
	Burkina Faso
	Burundi
	Cameroon
	Cape Verde
	Central African Republic
	Chad
	Comoros
	Cote d'Ivoire
	Democratic Republic of the Congo
	Djibouti
	Egypt
	Equatorial Guinea
	Eritrea
	Ethiopia
	Gabon
	Gambia
	Ghana
	Guinea
	Guinea-Bissau
	Kenya
	Lesotho
	Liberia
	Libya
	Madagascar
	Malawi
	Mali
	Mauritania
	Mauritius
	Mozambique

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	Namibia
	Niger
	Nigeria
	Rwanda
	Sao Tome and Principe
	Senegal
	Seychelles
	Sierra Leone
	Somalia
	South Africa
	Sudan
	Swaziland
	Tanzania
	Togo
	Tunisia
	Uganda
	Zambia
	Zimbabwe
Organization of Arab Petroleum	Angola
Exporting Countries	Burundi
	Comoros
	Democratic Republic of the Congo
	Djibouti
	Egypt
	Eritrea
	Ethiopia
	Kenya
	Madagascar
	Malawi
	Mauritius
	Namibia
	Rwanda
	Seychelles
	Sudan
	Swaziland
	Uganda
	Zambia
Organization of Eastern Caribbean States	Anguilla
	Antigua and Barbuda
	British Virgin Islands
	Dominica
	Grenada
	Montserrat
	Saint Kitts and Nevis
	Saint Lucia
	Saint Vincent and the Grenadines
Organization of Islamic Conference	Afghanistan
	Albania
	Algeria

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*(Continued)*

Azerbaijan  
Bahrain  
Bangladesh  
Benin  
Brunei  
Burkina Faso  
Cameroon  
Chad  
Comoros  
Cote d'Ivoire  
Djibouti  
Egypt  
Gabon  
Gambia  
Guinea  
Guinea-Bissau  
Guyana  
Indonesia  
Iran  
Iraq  
Jordan  
Kazakhstan  
Kuwait  
Kyrgyzstan  
Lebanon  
Libya  
Malaysia  
Maldives  
Mali  
Mauritania  
Morocco  
Mozambique  
Niger  
Nigeria  
Oman  
Pakistan  
Qatar  
Saudi Arabia  
Senegal  
Sierra Leone  
Somalia  
Sudan  
Suriname  
Syria  
Tajikistan  
Togo  
Tunisia  
Turkey  
Turkmenistan  
Uganda

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	United Arab Emirates
	Uzbekistan
	Yemen
Organisation pour l'harmonisation du droit des affaires	Benin
	Burkina Faso
	Cameroon
	Central African Republic
	Chad
	Comoros
	Congo
	Cote d'Ivoire
	Equatorial Guinea
	Gabon
	Gambia
	Guinea
	Guinea-Bissau
	Mali
	Niger
	Senegal
	Togo
Organization of American States	Antigua and Barbuda
	Argentina
	Bahamas
	Barbados
	Belize
	Bolivia
	Brazil
	Canada
	Chile
	Colombia
	Costa Rica
	Cuba
	Dominica
	Dominican Republic
	Ecuador
	El Salvador
	Grenada
	Guatemala
	Guyana
	Haiti
	Honduras
	Jamaica
	Mexico
	Nicaragua
	Panama
	Paraguay
	Peru
	Saint Kitts and Nevis
	Saint Lucia

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*(Continued)*

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	Saint Vincent and the Grenadines
	Suriname
	Trinidad and Tobago
	United States
	Uruguay
	Venezuela
Permanent Interstate Committee for Drought Control in the Sahel	Burkina Faso
	Cape Verde
	Chad
	Guinea-Bissau
	Mali
	Mauritania
	Niger
	Senegal
Permanent Mechanism of Political Consultation and Coordination	Argentina
	Bolivia
	Brazil
	Chile
	Colombia
	Costa Rica
	Dominican Republic
	Ecuador
	El Salvador
	Ethiopia
	Mexico
	Nicaragua
	Panama
	Paraguay
	Peru
	Uruguay
	Venezuela
Russia Belarus Union	Russia
	Belarus
Shanghai Co-operation Organization	China
	Russia
	Kazakhstan
	Kyrgyzstan
	Tajikistan
	Uzbekistan
Single Economic Space	Belarus
	Kazakhstan
	Russia
	Ukraine
South Asian Association for Regional Co-operation	Bangladesh
	Bhutan
	India
	Maldives
	Nepal
	Pakistan
	Sri Lanka

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Southern African Customs Union	Botswana Lesotho Namibia South Africa Swaziland
Southern African Development Community	Angola Botswana Democratic Republic of the Congo Lesotho Madagascar Malawi Mauritius Mozambique Namibia Seychelles South Africa Swaziland Tanzania Zambia

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