

F. Conclusions

An over-arching conclusion of this report is that regional and multilateral approaches to trade cooperation need not be incompatible, but neither can they be seen simply as substitutes (i.e. arrangements that serve the same purposes or satisfy the same needs). Support for an increasingly outward-looking and inclusive global trading order has been strong in the period since the end of the Second World War, and this growing trend towards openness has manifested itself through unilateral, bilateral, regional and multilateral approaches.

It is perhaps not surprising that the creation of the multilateral trading system has not diminished the allure of bilateral and regional trade agreements. After all, bilateral trade agreements long pre-dated the multilateral trading system. The appeal of preferential trade agreements (PTAs) has grown in recent decades. This trend has not only been apparent among traditionally active PTA participants but also new players who have eschewed preferential trade agreements in the past. The recent wave of regional agreements has been remarkable for the sheer number of PTAs, their geographical spread, the mix of developed and developing countries involved, and their sectoral coverage.

Many of these agreements go beyond tariff commitments and include provisions on a wide range of behind-the-border or regulatory policy areas. Increasingly, PTAs involve deep rather than shallow integration. Many factors explain the interest in deeper integration, and perhaps why the demand for it has frequently found expression in PTAs. Trade and investment links among countries have been growing to a degree where existing multilateral rules do not go far enough to manage those tighter bonds. The steady reduction of tariff barriers has generated pressure on countries to align divergent national non-tariff policies.

Countries in close geographical proximity to one another are more likely to be affected by one another's trade policy actions, calling for rules tailored to their regional circumstances. Small developing countries may want to import best-practice rules and an institutional framework that has been pre-tested. Large developed countries may want to export their regulatory regimes through PTAs. Countries may use trade cooperation as part of a broader political agenda of shared interests going beyond purely economic considerations.

This report has focused particularly on international production networks as a core explanation for deep integration. This is not to downplay the possible importance of the other, often more complex explanations that elude precise analysis in the absence of adequate data. International production networks function by parcelling out various stages of manufacturing processes to different countries, each of whom has a cost advantage that contributes to the success of the whole. In a world where tariffs are already low, the success of such networks requires that participating countries have the necessary infrastructure, institutional framework and enabling regulations.

Market access can still be a reason for signing PTAs. Even if preferential tariffs are very low, other border measures can be used for protection. While acknowledging this point, the report provides support for the hypothesis that deep PTAs respond in no small measure to the exigencies of international production

networks. This analysis is based on the magnitude of preferential tariff rates, the coverage and contents of the agreements themselves, econometric estimation, and case studies of specific PTAs.

Small margins of preference provide evidence that tariffs are no longer the primary motivation of PTAs. Preference margins (i.e. the difference between the preferential tariff and the most-favoured nation – MFN – rate applied to other trading partners) measured to take account of the presence of other preferential suppliers are no greater than 2 per cent in absolute value for more than 87 per cent of all merchandise trade. This is not surprising in light of the extent to which MFN tariffs have been reduced worldwide. However, in sectors where MFN tariffs are higher than the average, PTAs have for the most part failed to do a better job of reducing them.

Moreover, the proliferation of PTAs implies that the benefit from entering into an agreement need not be substantial given the preferential access enjoyed by other suppliers. As a result of all of this, the value of trade that receives preferential treatment is no more than 16 per cent of global merchandise trade if trade within the EU is excluded from the total, and 30 per cent if intra-EU trade is included. This number is an upper limit, since it does not take account of the extent to which the utilization of those preferential tariffs is hampered by rules of origin and other administrative requirements.

In addition to policy areas already covered by WTO agreements, many recent PTAs include commitments in areas such as competition policy, investment, and movement of capital. For the most part, PTA commitments in these sectors are substantive and legally enforceable. This is certainly true for those policy areas – primarily services, investment, technical barriers to trade and competition policy – which are essential for production networks. The report provides new econometric evidence showing that such provisions increase the degree of production networking among partner countries. Furthermore, a closer examination of the integration experience of some PTAs in Asia and Latin America provides evidence of the role of international production networks in their establishment.

The spread of deep PTAs and the weightier role of non-tariff commitments have important implications for how to evaluate the role of PTAs and how they interact with the multilateral trading system. Viner's (1950) standard analysis of the trade creation and trade diversion effects of preferential tariffs focuses attention on the discriminatory market access effects of PTAs. However, since preferential tariffs are not the main focus of PTAs today, this framework serves less well in identifying the causes and consequences of deep agreements. In the same vein, the building-block/stumbling-block imagery does not

adequately characterize the relationship between PTAs and the multilateral trading system. Trade specialists will need to fashion an improved analytical framework to explain better the evolution of deep PTAs.

The sheer number of PTAs and continuing momentum towards establishing more of them suggest that they are here to stay. They respond to a range of economic and political motivations. Governments will need to find a coherent way of fashioning trade policy at the regional and multilateral level. This means that PTAs and the multilateral trading system can complement each other while ensuring that multilateral disciplines minimize any negative effects from PTAs. If PTAs are about tariffs, a coherent trade policy requires disciplines that reduce trade diversion. If, instead, PTAs are primarily about reducing trade costs and removing regulatory barriers, something different is required to achieve coherence between PTAs and the multilateral trading system. The report has identified a number of ideas relevant to achieving a coherent trade policy in a world of deep PTAs. One such idea is that of subsidiarity, whereby some policy areas may be best addressed at the regional or bilateral level, whereas others will require multilateral attention.

Other ideas advanced for promoting a coherent trade policy are the acceleration of multilateral trade opening, addressing deficiencies in WTO agreements, initiatives to complement the existing legal framework (i.e. soft-law approach), and multilateralizing regionalism (i.e. extension of existing preferential arrangements in a non-discriminatory manner to additional parties). One constraint to bear in mind is the political feasibility of various options. As the report makes clear, GATT contracting parties and WTO members have been tolerant of PTAs and markedly non-litigious on this subject. This suggests that some options may be promoted more readily than others.

We conclude with a non-exhaustive list of possible questions that WTO members may see fit to address as they deal with the problem of creating greater coherence between PTAs and the WTO.

- If some policy areas are to be subject to multilateral review and rule-making while others are left to the regional level, what are the criteria for determining the boundaries?
- Many non-tariff policy commitments in PTAs are largely non-discriminatory, at least in intent, and pose no threat to the multilateral trading system. However, are there other risks (e.g. regulatory lock-in) associated with these policy areas that are not readily apparent but deserve attention?
- Are the various families of deep PTAs which the report has been able to identify compatible? Or are they competing systems that make the task of creating coherence between PTAs and the multilateral trading system more difficult?
- Given the large number of PTAs between developed and developing countries (North-South agreements), what role do differences in power between these partners play in shaping the design and content of PTAs? Is there a role for the WTO in considering the impact of such differences?
- Will the co-existence of different dispute settlement systems lead to conflicts between PTAs and the WTO? To what extent can potential conflict be addressed either at the level of PTAs or at the WTO?

These are not questions that have easy answers, but the sooner WTO members reflect upon them, the greater the prospects for achieving coherence between PTAs and the WTO.