Chapter 2

International and Regional Agreements Affecting Trade

THE GATT AND WTO

The General Agreement on Tariffs and Trade (GATT) was established in 1945 as a provisional agreement pending the creation of an International Trade Organization (ITO). The ITO draft charter, which was the result of trade negotiations at the Havana Conference of 1948, never came into being due to the failure of the U.S. Congress to approve it. Other countries also declined to proceed with the ITO without the participation of the United States. Thus, the GATT continued to fill the vacuum as a de facto trade organization, with codes of conduct for international trade but with almost no basic constitution designed to regulate its international activities and procedures. The GATT, in theory, was not an “organization,” and participating nations were called “contracting parties” and not members (Jackson, 1992; Hoekman and Kostecki, 1995).

Since its inception, the GATT has used certain policies to reduce trade barriers between contracting parties (CPs):

- *Nondiscrimination:* All CPs must be treated in the same way with respect to import-export duties and charges. According to the most favored nation treatment, each CP must grant to every other CP the most-favorable tariff treatment that it grants to any country with respect to imports and exports of products. Certain exceptions, however, are allowed, such as free trade areas, customs unions, or other preferential arrangements in favor of developing nations. Once imports have cleared customs, a CP is required to treat foreign imports the same way as it treats similar domestic products (the national treatment standard).

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- *Trade liberalization:* The GATT has been an important forum for trade negotiations. It has sponsored periodic conferences among CPs to reduce trade barriers (see International Perspective 2.1). The Uruguay Round (1986-1993) gave rise to the establishment of a permanent trade organization (World Trade Organization or WTO). The most recent round (the Doha Round) hopes to reach agreement on other trade distortions, such as agricultural subsidies and trade barriers imposed by developing countries on imports of manufactured goods.
- *Settlement of trade disputes:* The GATT/WTO has played an important role in resolving trade disputes between CPs. In certain cases where a party did not follow GATT's recommendations, it ruled for trade retaliation that is proportional to the loss or damage sustained. It is fair to state that the existence of the GATT/WTO has been a deterrent to damaging trade wars between nations.
- *Trade in goods:* The GATT rules apply to all products both imported and exported, although most of the rules are relevant to imports. It was designed primarily to regulate tariffs and related barriers to imports such as quotas, internal taxes, discriminatory regulations, subsidies, dumping, discriminatory customs procedures, and other nontariff barriers. The Uruguay Round (1994) resulted in a new general agreement on trade in services, trade-related aspects of intellectual property (TRIPs) and trade-related investment measures (TRIMs). Thus, CPs have moved beyond the original purpose of the GATT to achieve unrestricted trade in goods, to reduce barriers to trade in services, investment, and to protect intellectual property (Collins and Bosworth, 1995).

The Uruguay Round and WTO

In 1982, the United States initiated a proposal to launch a new round of GATT talks. The major reasons behind the U.S. initiative were (1) to counter domestic pressures for protectionism precipitated by the strong dollar and rising trade deficit, (2) to improve market access for U.S. products by reducing existing tariff and nontariff barriers to trade, (3) to reverse the erosion of confidence in the multilateral trading system, (4) to extend GATT coverage to important areas such as services, intellectual property, and investment, and (5) to bring developing nations more effectively into the international trading system.

Despite the initial reluctance of many developing nations, the effort culminated in the conclusion of a successful trade negotiation (the Uruguay Round) in 1994. The results of the Uruguay Round are summarized in the following sections.

INTERNATIONAL PERSPECTIVE 2.1.
GATT Negotiations (1947-2006)

GATT Round	Explanation
Geneva (1947)	Twenty-three countries participated in establishing the GATT in 1947. Average tariff cut of 35 percent on trade estimated at $10 billion.
Annecy, France (1949)	Thirty-three countries participated in tariff reductions.
Torquay, UK (1951)	Thirty-four countries participated in tariff reductions.
Geneva (1956)	Twenty-two countries participated in tariff reductions on trade estimated at $2.5 billion.
Dillon (1960-1961)	Forty-four countries participated in tariff reductions on trade estimated at $5 billion.
Kennedy (1962-1967)	Forty-eight countries participated in tariff reductions on trade estimated at $40 billion.
Tokyo (1973-1979)	Ninety-nine countries participated in reductions of tariff and non-tariff barriers on trade valued at $155 billion.
Uruguay (1986-1994)	Broadening of the GATT to include services, intellectual property, and investment. It also resulted in the establishment of WTO. One hundred and twenty-four countries participated on reductions of tariff and non-tariff barriers on trade valued at $300 billion.
Doha (2001)	Reduction of agricultural subsidies and other trade barriers on agricultural exports, broadening of international rules in services, lowering trade barriers by developing nations. More than 124 countries participate in this round.

Trade Liberalization

Significant progress was made toward reducing trade barriers in the areas of agriculture and textiles that had long been resistant to reform. Tariff reductions of about 40 percent were achieved. The agreement also opened access to a broad range of government contracts (Government Procurement Agreement). It also provided for the liberalization of the textiles and apparel sector by the end of 2004. Textiles quotas have been removed except for occasional safeguards used to protect a sudden increase in imports.

Trade Rules

The Uruguay Round added new rules relating to unfair trade practices (dumping, subsidies) and the use of import safeguards.

New Issues

The agreement broadened the coverage of the GATT to include areas such as trade in services, TRIPs, and TRIMs. The GATT establishes rules to liberalize trade in services, which in 2002 was estimated to be almost $1.6 trillion (Wild, Wild, and Han, 2006). The TRIPs agreement establishes new trade disciplines with regard to the protection and enforcement of intellectual property rights. TRIMs provides for the elimination of trade distorting investment requirements such as local content, limitation of ownership, or exports of certain shares of domestic production.

Institutional Reforms

In the area of institutional reform, the Uruguay Round strengthened the multilateral dispute settlement mechanism and established a new and permanent international institution, the World Trade Organization, responsible for governing the conduct of trade relations among its members. The new dispute settlement procedure instituted an appeals procedure, expedited decision making, and encouraged compliance with GATT decisions. Members of WTO are required to comply with the GATT rules as well as various agreements (rounds) negotiated under GATT auspices.

REGIONAL INTEGRATION AGREEMENTS (RIAs)

WTO members are permitted to enter into RIAs under specific conditions. Regional integration agreements must be consistent with the WTO rules, which require that the parties to the agreement (1) establish free trade on most goods in the regional area within ten years and (2) refrain from raising their tariffs against countries outside the agreement.

The number of RIAs and their share in global trade has been steadily rising over the past decade (see Tables 2.1 and 2.2). Since January 1995, approximately 196 RIAs have been notified to the WTO with 112 currently in

TABLE 2.1. Notifications of RIAs in Force to GATT/WTO (June 15, 2006)

	Accessions	New RIAs	Total
Free trade areas	4	122	126
Customs union	5	6	11
Enabling clause[a]	1	21	22
Free trade in services	2	36	38
Total	12	185	197

[a]Agreements between developing countries.

Source: Adapted from WTO, 2006.

TABLE 2.2. Merchandise Exports, 1993, 2002 (Billion U.S.$)

Source	Destination	1993	2002
U.S. exports to	Canada	100	161
	Mexico	42	97
Canadian exports to	USA	117	220
	Mexico	0.64	1.54
Mexican exports to	USA	42	143
	Canada	1.57	2.81
Total intra-NAFTA trade		303.82	625.8
NAFTA trade with rest of world		535.68	761.51

Source: Adapted from UNCTAD, 2002.

effect. During the period 2004-2005 alone, about forty-three RIAs were notified to the WTO (WTO, 2006). A large percentage of these agreements (over 80 percent) are mostly bilateral free trade deals intended for market access and do not require a high degree of policy coordination between participating countries. Less than 10 percent of the agreements provide for high levels of integration as well as harmonization of trade policies (customs union; see International Perspective 2.2).

Small countries enter into RIAs not only for market access but also to deal more effectively with larger economies in multilateral trade talks and other areas. Although RIAs are not often considered a potential threat to multilateralism, some scholars believe that (1) they lead to large volumes of

INTERNATIONAL PERSPECTIVE 2.2.
Stages of Economic Integration

Preferential Trade Arrangements: Agreement among participating nations to lower trade barriers. *Example:* British Commonwealth preference scheme, 1934.

Free Trade Area: All barriers are removed on trade among members but each nation retains its own barriers on trade with nonmembers. *Example:* The European Free Trade Area (EFTA) formed in 1960 by Austria, Denmark, Norway, Portugal, the U.K., Sweden, and Switzerland.

Customs Union: In addition to an agreement to lower or remove trade barriers, members establish a common system of tariffs against nonmembers (common external tariff). *Example:* The Andean Common Market, MERCOSUR.

Common Market: A common market includes all the elements of a customs union and allows free movement of labor and capital among member nations. *Example:* The European common market achieved common market status in 1970.

Economic Union: Economic union goes beyond a common market and requires members to harmonize and/or unify monetary and fiscal policies of member states. *Example:* Benelux, which includes Belgium, The Netherlands, and Luxembourg, formed in the 1920s and also forms part of the EU; the European Union.

trade diversion often leading to substantial welfare losses, (2) they create lobbies and interest groups against multilateral trade liberalization, and (3) their differing regulatory regimes including rules of origin pose a challenge to the multilateral trading system (Das, 2004).

The major drivers of RIAs are stated as follows:

- Consolidation of peace, regional security, and free market reforms in many countries
- Promotion of deeper levels of economic integration than what is available under the WTO (issues pertaining to competition, investment, labor, and the environment)
- Market access and a means of attracting foreign direct investment (FDI). Discriminatory liberalization in favor of partner countries is likely to provide firms (from these countries) with competitive advantages
- Sluggish progress in multilateral trade talks

THE NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

The North American Free Trade Agreement (NAFTA) established a free trade area among Canada, the United States, and Mexico. The agreement came into effect on January 1, 1994, after a difficult ratification by the U.S. Congress and approval by the Canadian and Mexican legislatures. The North American Free Trade Agreement gave rise to the second largest free trade zone (in terms of population) in the world after the European Union—439 million people and a joint gross domestic product exceeding $14 trillion—and constitutes one of the most comprehensive free trade pacts ever negotiated among regional trading partners. It is also the first reciprocal free trade pact between a developing nation and industrial countries (Hufbauer and Schott, 1994). Canada and the United States agreed to suspend the operation of the Canada–U.S. Free Trade Agreement so long as both countries are parties to NAFTA and to establish certain transitional arrangements.

Negotiating Objectives

The United States

Since World War II, the United States has advocated trade liberalization and the elimination, on a reciprocal and nondiscriminatory basis, of measures that restrict commercial transactions across national boundaries. To achieve this, it had relied on the GATT, now the WTO, and had demonstrated its commitment through its active participation in the successive rounds of trade negotiations under the GATT framework. However, the GATT process has been slow and ineffective in liberalizing trade in general, particularly in certain sectors such as agriculture. The regional approach was thus considered an attractive alternative to the multilateral framework for achieving rapid progress in trade liberalization. Second, the proliferation of regional common markets and the continued expansion of the European Union are considered to be important factors in influencing the United States to enter into a regional free trade agreement, as a response to the prevailing trend in international economic relations. Third, it was logical to embark on a free trade arrangement with Canada and Mexico, not only due to their geographical proximity but also because they are the most important trading partners to the United States. The United States is the destination for over 80 percent of Canadian and Mexican exports. Both countries also import about one-third of U.S. exports. The United States is also the largest investor in both countries. It was in the interest of the United States to maintain and expand existing trade and investment opportunities through a regional trade arrangement.

Canada

The North American Free Trade Agreement permits Canadian firms to achieve economies of scale by operating larger and more specialized plants. It also provides a secure access to a large consumer market. Even though tariff rates between United States and Canada have declined over time, there had been an increase in protectionist sentiment and use of aggressive trade remedies to protect domestic industries in the United States. These measures created uncertainty for producers with respect to investment in new facilities. The North American Free Trade Agreement reduces this uncertainty since it provides rules and procedures for the application of trade remedies and the resolution of disputes.

Mexico

The North American Free Trade Agreement provides secure access to the U.S. and Canadian markets for Mexican goods and services. Its low labor costs and access to the U.S. market attracts FDI to Mexico (Echeverri-Carroll, 1995; Lederman, Maloney, and Serven, 2005). In view of the adverse impact of its import substitution policy in the 1980s and the debt crisis, trade liberalization was considered to be an effective means of fostering domestic reform and achieving sustainable growth. Ostry briefly describes Mexico's objectives:

> So NAFTA is a means of consolidating an export-led growth path both by improving secure access to the U.S. market and encouraging a return of flight capital as well as new investment. (Quoted in Randall, Konrad, and Silverman, 1992, pp. 27-28)

Overview of NAFTA

Market Access for Goods

The North American Free Trade Agreement incorporates the basic national treatment obligation of the GATT. This means that goods imported from any member country will not be subject to discrimination in favor of domestic products. It provides for a gradual elimination over fifteen years of tariffs for trade between Mexico and Canada, as well as between Mexico and the United States, except for certain agricultural products. Under the Canada–U.S. Free Trade Agreement, tariffs between the two countries were eliminated in January 1998.

By January of 1998, tariffs had been phased out on about 65 percent of all U.S. exports to Mexico. For certain import-sensitive sectors in which quotas are imposed, the agreement provides for a replacement with a sliding tariff quota over ten or fifteen years. The North American Free Trade Agreement also provides for a gradual elimination of nontariff barriers such as customs user fees, import licenses, export taxes, and duty drawbacks on NAFTA-made goods. Since NAFTA would gradually phase out tariffs within the free trade area, such drawbacks will no longer be necessary. To qualify for preferential market access, however, goods must be wholly or substantially made or produced within the member countries. For example, farm goods wholly grown or substantially processed within the NAFTA region would qualify for NAFTA treatment.

Services

The agreement governs financial, telecommunications, trucking, and rail services. With respect to financial services, NAFTA commits each party to treat service providers such as banks and insurance companies from other NAFTA parties no less favorably than its own service providers in like circumstances. It also commits members to gradually phase out, during the transition period, limits on equity ownership by foreign individuals or corporations and on market share by foreign financial institutions. Mexico was allowed to set temporary capital limits for banks, securities firms, and insurance companies during the transition period. The agreement allows members to take prudential measures to protect the integrity of the financial system or consumers of financial services. It includes a freeze on restrictions governing cross-border trade in financial services and also provides for consultations and a dispute settlement mechanism.

The North American Free Trade Agreement commits members to impose no conditions (i.e., reasonable and nondiscriminatory terms) on access to, or use of, public telecommunication networks unless they are necessary to safeguard the public service responsibilities of the network operators or the technical integrity of the networks. It also imposes an obligation to prevent anticompetitive conduct by monopolies in basic services.

The agreement (1) removes most limitations on cross-border trucking and rail, and liberalizes Mexican investment restrictions in these sectors, and (2) preserves existing cabotage laws, that is, laws that allow a truck to carry goods to and from a given destination but not to make additional stops unless the vehicle and cargo are registered in the country.

Investment

Investment includes majority-controlled or minority interests, portfolio investments, and investments in real property from member countries. All three countries agree to (1) provide national treatment to investors from member countries, a treatment that is not less favorable than that given to an investor from a non-NAFTA country; (2) prohibit the imposition and enforcement of certain performance requirements in connection with the conduct or operation of investments, such as export requirements or domestic content; and (3) severely restrict or prohibit investment in their most strategic industries, such as energy (Mexico), cultural industries (Canada), nuclear energy, and broadcasting (all three countries). Both Canada and Mexico reserve the right to screen potential investors in certain cases. The parties also agree to subject disputes raised by foreign investors to international arbitration.

Intellectual Property

The North American Free Trade Agreement mandates minimum standards for the protection of intellectual property rights (IPRs) in member countries and requires each country to extend national treatment to IPRs owned by nationals of other countries. The scope of IPR protection includes patents, trademarks, trade secrets, copyright, and industrial designs. It also extends to semiconductors, sound recordings, and satellite broadcast signals. Patents are to be provided for products or processes that are new, useful, and nonobvious. They are valid for twenty years from the date of filing, or seventeen years from the date of grant. The agreement permits the use of compulsory licensing (i.e., a requirement to grant licenses to local companies or individuals if the patent is not used in the country) in limited circumstances. The North American Free Trade Agreement protects registered trademarks for a term of no less than seven years, renewable indefinitely. It harmonizes members' laws on trademark protection and enforcement. The agreement prohibits "trademark-linking" requirements in which foreign owners of trademarks are to use their mark in conjunction with a mark owned by a national of that country. The North American Free Trade Agreement requires adequate protection for trade secrets and does not limit the duration of protection. Copyright protection is extended to computer software and provides owners of computer programs and sound recordings with "rental rights" (i.e., the right to authorize or prohibit the rental of programs or recordings). It ensures protection of copyright for a minimum period of fifty years and gives effect to the 1971 Berne Convention on artistic and literary works.

Government Procurement

Purchase of goods and services by government entities in member countries is estimated at over one trillion dollars. The North American Free Trade Agreement extends the national treatment standard (equal treatment to all member country providers) for all goods and services procured by federal government entities unless specifically exempted. Procurement contracts must, however, meet certain minimum value thresholds: $50,000 for contract of goods, and/or services and $6.5 million for construction contracts procured by federal government entities. For government enterprises, the threshold is $250,000 for contract of goods and/or services and $8 million for construction services. For U.S. and Canadian entities, the Canada–U.S. Free Trade Agreement maintains the threshold at $25,000 for goods contracts. It provides tendering procedures and bid-challenging mechanisms to seek a review of any aspect of the procurement process by an independent authority.

Safeguards

If a surge in imports causes serious injury to domestic producers, a member country is allowed to take emergency action temporarily, for up to four years, to protect the industry. A request for emergency action is usually initiated by a domestic industry. A number of factors are considered by the investigating tribunal in arriving at a decision on injury: the level of increase in imports, market share of the imports, changes in sales, production, profits, employment, and other pertinent variables.

Technical and Other Standards

The North American Free Trade Agreement requires a member to provide sixty days notice before adopting new standards to allow for comments before implementation. It prohibits members from using standards as a disguised restriction to trade. Working groups are established to adopt or harmonize technical and other standards pertaining to specific sectors.

Other Areas

The agreement (1) requires members to create and maintain rules against anticompetitive business practices, (2) allows for temporary entry of businesspersons and certain professionals who are citizens of another member country—NAFTA does not create a common market for the movement of labor, (3) establishes institutions such as the Free Trade Commission (FTC) to supervise the implementation of the agreement and resolve disputes, and (4) creates a secretariat, composed of national offices in each country, to support the commission. The agreement also allows any country or group of countries to join NAFTA, subject to approval by each member country and on such terms as agreed upon by the FTC.

Dispute Settlement

Disputes arising over the implementation of the agreement may be resolved through (1) consultations; (2) mediation, conciliation, or other means of dispute resolution that might facilitate an amicable resolution; or (3) a panel of nongovernmental experts. If the decision is made by a binding panel (binding dispute settlement), the parties are required to comply within thirty days or else compensation/retaliation may result. If the decision is reached by a nonbinding panel, parties shall comply or agree on another solution within thirty days or else compensation/retaliation may result. Panel reports are not automatically enforceable in domestic law.

Separate dispute settlement mechanisms are in place for certain specialized areas, such as financial services, investment, environment, standards, and private commercial disputes, as well as dumping and subsidies.

Preliminary Assessment of NAFTA

The full impact of NAFTA can only be determined in the long term after the necessary economic adjustments have taken place. Although a short-term assessment of such a comprehensive agreement is often inadequate and sometimes misleading, a cursory discussion will be made on economic conditions since NAFTA.

Overall Increase in Trade between Members

There has been a marked increase in trade among the three member countries since the agreement went into effect in January 1994 (U.S. Census, 1993-2003). Intra-NAFTA trade jumped from $304 billion in 1993 to $626 billion in 2002 compared to NAFTA's trade with the rest of the world, which increased by only 42 percent (from $536 billion to $762 billion) during the same period. An increasing portion of Canadian and Mexican trade is conducted with the United States. The United States accounted for 86 percent of Canadian exports (76 percent of its imports) and 89 percent of Mexican exports (62 percent of its imports) in 2005. During the same year, the two countries accounted for about 36 percent of U.S. exports (23 percent for Canada and 13 percent for Mexico; see Table 2.3).

TABLE 2.3. Gross Inward FDI Flows 1994, 2001 (Billion U.S. $)

Country	1994	% of world FDI flows	2001	% of world FDI flows
Canada	8.2	3.2	27.46	3.7
Mexico	10.64	4.2	25.33	3.4
USA	45.1	17.6	124.44	16.9

Source: Adapted from UNCTAD (2002)

Increase in the U.S. Trade Deficit

The U.S. merchandise trade deficit with Canada and Mexico quadrupled since NAFTA. By 2005, U.S. exports to Canada and Mexico had grown to $330 billion. However, this was not sufficient to offset the growing trade deficit with both countries. The U.S. trade deficit with Canada and Mexico stands at $76.4 and 50 billion (U.S.), respectively in 2005.

NAFTA's Impact on Jobs is Uncertain

There is no conclusive evidence on the effect of NAFTA on jobs. There are certain indications, however, that NAFTA may have had a negative effect on jobs. Between 1994 and 2002, the U.S. Department of Labor certified 525,000 workers for income support and training due to loss of jobs arising from shifts in production to Mexico or Canada. In view of its narrow eligibility criteria, the program covers a small number of workers who lost their jobs due to NAFTA. Most of the job dislocations appear to be concentrated in apparel and electronic industries. This may be attributed to the growing trade deficit with both countries, which often leads to declines in production and employment. There are also some studies that show the negative effects of NAFTA on agricultural employment and real wages in manufacturing in Mexico. The Canadian Center for Policy Alternatives states that the Canadian government reduced social spending (such as qualification for unemployment insurance) to enhance competitiveness (Campbell, 2006).

Substantial Increase in Foreign Investment in all Countries

Since NAFTA, there has been a substantial growth in inward FDI flows in member countries (Weintraub, 2004; see Table 2.4).

TABLE 2.4. NAFTA and EU: Major Differences

NAFTA	EU
NAFTA does not provide for a common external tariff	EU has a common external tariff
NAFTA has no provision for economic assistance or economic/monetary union	EU provides for economic assistance to members and economic/monetary union
NAFTA does not provide for free movement of labor	EU allows for free movement of labor

THE EUROPEAN UNION

The European Union (EU) is the oldest and most significant economic integration scheme, involving twenty-seven Western and Eastern European countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom. One of the most important developments is the recent EU enlargement from fifteen to twenty-five countries in May 2004, with the admission of Cyprus, Malta, and eight East European countries. In January 2007, Bulgaria and Romania also joined the EU, increasing the number to twenty-seven countries. Turkey and other East European countries will be considered for admission in the coming years based on certain criteria such as stable democratic institutions, free markets, and ability to assume EU treaty obligations (Van Oudenaren, 2002; Poole, 2003).

Even though the European economic integration dates back to the Treaty of Rome in 1957, the European Union is the outcome of the Maastricht treaty in 1992. The European Union has an aggregate population of about 456 million and a total economic output (GDP) of $12 trillion (U.S.) (2005), and involves the largest transfer of national sovereignty to a common institution. In certain designated areas, for example, international agreements can only be made by the European Union on behalf of member states (Wild, Wild, and Han, 2006).

The pursuit of such integration was partly influenced by the need to create a lasting peace in Europe as well as to establish a stronger Europe that could compete economically against the United States and Japan (see Table 2.5). Since the countries were not large enough to compete in global markets, they had to unite in order to exploit economies of large-scale production.

TABLE 2.5. Other Major Regional Trade Agreements

The European Free Trade (EFTA, 1960)	*Members:* Iceland, Liechtenstein, Norway, Switzerland *Objectives:* Removal of customs barriers and differing technical standards. Free trade with EU strictly limited to commercial matters
The Preferential Area for Eastern and Southern American Common Market (MERCOSUR, 1991)	*Members:* Argentina, Brazil, Paraguay, Uruguay, Venezuela. Chile and Bolivia joined as associate members *Objectives:* Free trade and industrial cooperation
The Central American Common Market (CACM, 1960)	*Members:* Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua *Objectives:* Free trade and a common external tariff
The Andean Pact, 1969	*Members:* Bolivia, Colombia, Ecuador, Peru, Venezuela *Objectives:* Free trade and industrial development
The Association of Southeast Asian Nations (ASEAN, 1967)	*Members:* Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam *Objectives:* Reduction of trade barriers, industrial cooperation
The Caribbean Common Market (CARICOM, 1973)	*Members:* Antigua and Barbuda, The Bahamas, Barbados, Belize, Dominica, Grenada, Haiti, Guyana, Jamaica, Montserrat, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago, Suriname *Objectives:* Political unity, economic cooperation
The Southern African Customs Union (SACU, 1969)	*Members:* Botswana, Lesotho, Namibia, South Africa, Swaziland *Objectives:* Free movement of goods, common external tariff
The Economic Community of West African States (ECOWAS, 1974)	*Members:* Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, the Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo *Objectives:* Economic and monetary union
Asia Pacific Economic Cooperation (APEC, 1989)	*Members:* Australia, Brunei, Canada, Chile, China, Japan, S. Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, the Phillippines, Peru, Russia, Singapore, Taiwan, Thailand, USA, Vietnam *Objectives:* Strengthen the multilateral trading system, simplify and liberalize trade and investment procedures among members

The objectives of European integration as stated in the Treaty of Rome (1957) are as follows:

- To create free trade among member states and provide uniform customs duties for goods imported from outside the EU (common external tariff).
- To abolish restrictions on the free movement of all factors of production, that is, labor, services, and capital. Member states are required to extend the national treatment standard to goods, services, capital, etc., from other member countries with respect to taxation and other matters (nondiscrimination).
- To establish a common transport, agricultural, and competition policy.

A number of the objectives set out in the Treaty of Rome were successfully accomplished. The Common Agricultural Policy (CAP) was established in 1962 to maintain common prices for agricultural products throughout the community and to stabilize farm incomes. Tariffs between member nations were eliminated and a common external tariff established in 1968. However, efforts to achieve the other objectives, such as a single internal market (elimination of nontariff barriers), free movement of services or capital, and so forth, had been slow and difficult. Coordinated or common policies in certain areas such as transport simply did not exist (Archer and Butler, 1992).

The European Commission (for other EU institutions, see International Perspective 2.3) presented a proposal in 1985 to remove existing barriers to the establishment of a genuine common market. The proposal, which was adopted and entitled The Single European Act (SEA), constitutes a major revision to the Treaty of Rome. The SEA set the following objectives for its members:

- To complete the single market by removing all the remaining barriers to trade such as customs controls at borders, harmonization of technical standards, liberalization of public procurement, provision of services, removal of obstacles to the free movement of workers, and so on. In short, efforts involved the removal of physical, technical, and fiscal (different excise and value added taxes) barriers to trade.
- To encourage monetary cooperation leading to a single European currency. The Maastricht Treaty of 1992 further reinforced this and defined plans for achieving economic and monetary union.
- To establish cooperation on research and development (R & D) and create a common standard on environmental policy.
- To harmonize working conditions across the community and improve the dialogue between management and labor.

INTERNATIONAL PERSPECTIVE 2.3.
Institutions of the European Union

The European Council: Composed of representatives (ministers) of member states, the council sets out general direction of the union. The council approves legislation and international agreements, acting on a proposal from the commission and after consulting with the European Parliament.

The European Commission: Members of the commission are chosen by the mutual agreement of national governments and serve four-year terms. Larger nations appoint two while smaller nations appoint one commissioner. They neither represent nor take orders from member states. The commission initiates policies and ensures members' compliance with the treaty.

The European Parliament: Composed of 732 representatives directly elected, the European Parliament supervises the commission, adopts the community budget, and influences the legislative process. Any agreement concerning international cooperation must be reviewed and accepted by Parliament before it is concluded. The parliament, however, does not have express legislative powers.

The Court of Justice: Settles disputes arising from the treaty (i.e., interprets and applies the EU treaty). The judges are appointed by mutual agreement of member states and serve six-year terms. The court ensures uniform interpretation and application of community law, evaluates legality of legislation adopted by the council and the commission, and provides rulings on community law when requested by national courts in member states.

The Single European Act established a concrete plan and timetable to complete the internal market by 1992. It is fair to state that most of the objectives set out under the SEA were accomplished: border checks are largely eliminated, free movement of workers has been achieved through mutual recognition of qualifications from any accredited institution within the EU, free movement of capital (banks, insurance, and investment services) has been made possible with certain limitations, and the single currency (the Euro) was introduced in 1999. The Euro has helped reduce transaction costs by eliminating the need to convert currencies and made prices between markets more transparent. There still exist a number of challenges in completing and sustaining the single market, expanding EU policy responsibilities in certain controversial areas such as energy policy, and undertaking appropriate structural reforms to take advantage of the economic and monetary union.

CHAPTER SUMMARY

The GATT/WTO

Principal objectives of the GATT: Nondiscrimination, trade liberalization, and settlement of trade disputes between members.

The Uruguay Round of the GATT and the Birth of WTO

Important results of the Uruguay Round trade negotiations (1986-1994): Reductions in tariffs, adoption of new trade rules on unfair trade practices, GATT coverage extended to trade in services, intellectual property, and trade-related investment measures, and the birth of WTO.

The North American Free Trade Agreement (NAFTA)

Scope of coverage: Market access for goods, services, investment, protection of intellectual property, government procurement, safeguards, standards, and dispute settlement.

NAFTA: Preliminary Assessment

Increases in overall trade between members, increase in the U.S. trade deficit on merchandise trade with members, and a rise in foreign investment.

The European Union (EU)

Major objectives of the EU: To create free trade and a common external tariff between members, to abolish restrictions on the free movement of all factors of production, to establish common policies in the area transport, agriculture, competition, etc.

Institutions of the EU: The European Council, the European Commission, the European Parliament, the Court of Justice.

Other Regional Trade Agreements

The European Free Trade Area (EFTA), MERCOSUR, The Central American Common Market (CACM), The Andean Pact, The Association of Southeast Asian Nations (ASEAN), The Caribbean Common Market (CARICOM), The Southern African Customs Union (SACU), The Economic Community of West African States (ECOWAS).

REVIEW QUESTIONS

1. What were the major achievements of the Uruguay Round of the GATT/WTO?
2. Distinguish between the most-favored nation and national treatment standard in international trade.
3. Discuss the major drivers of regional trade agreements.
4. Compare and contrast the negotiating objectives of Canada and Mexico behind NAFTA.
5. Discuss NAFTA pertaining to services and investment. Has it increased trade between the member countries?
6. What are the various stages of economic integration?
7. What are the objectives of European integration? Which countries joined the EU in 2004?
8. Discuss the major differences between NAFTA and the EU.
9. What were the major achievements of the Single European Act?
10. What is the role of the EU commission?

CASE 2.1. THE BENEFITS AND COSTS OF FREE TRADE

Since 1980, the orthodox recipe for economic growth has been the reduction of barriers to the free flow of commerce and capital. International institutions such as the IMF and the World Bank have contended that the free market approach to development will create faster levels of economic growth and alleviate poverty. The integration of markets has been largely achieved through regional free trade agreements and unilateral liberalization. It has also been facilitated by deregulation, the shrinking costs of communications and transportation, and the IT revolution.

Some developing countries benefited from trade liberalization. China's ratio of trade to GDP doubled. Brazil, Mexico, and other middle-income countries registered large increases in their volume of trade. They managed to export a range of manufactured goods often as part of global production networks. In China, the number of poor people (earning less than $0.70 a day) decreased from 250 million in 1978 to 34 million in 1999. Similarly in India, the number decreased from 330 million in 1977 to 259 million in 1999.

In the case of many other nations, however, the laissez-faire approach appears to have worsened growth rates and income distribution. In 1980, for example, the medium income in the richest 10 percent of countries was seventy-seven times greater than in the poorest 10 percent. By 1999, this gap had grown to 122 times (see Table 2.6). Many studies show that trade

TABLE 2.6. Distribution of World Income[a]

	1980	1990	1999
By Countries			
Ratio of average incomes	86.20	125.90	148.80
Ratio of medium incomes	76.8	119.6	121.8
By Population			
Ratio of average incomes	78.9	119.7	117.7
Ratio of medium incomes	69.6	121.5	100.8
By Population, Excluding China			
Ratio of average incomes	90.3	135.5	154.4
Ratio of medium incomes	81.1	131.2	153.2

Source: Adapted from IMF, 2000.

[a]Ratio of income of the richest 10 percent of countries/population to that of the poorest 10 percent of countries/population.

liberalization in Latin America, for example, led to widening wage gaps, falling real wages for unskilled workers, and rising unemployment. In many countries, trade liberalization and deregulated markets have induced rapid structural changes often leading to declining wages, working conditions, and living standards. The challenge today is to make trade liberalization work for the poor. This requires a wide-ranging reform in national institutions and policies.

Questions

1. How can trade liberalization be made to work for the poor?
2. Select a country or region and evaluate its performance (GDP per capita, distribution of income, etc.) before and after trade liberalization.