Economics Division Working Papers

Development Issues

The Political Economy of Regionalism and Developing Countries

David Robertson

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Research School of Pacific Studies ANU

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David Robertson is well known both in Australia and overseas for his writing on international trade relations. David, formerly Deputy Director of the Office of National Assessments, now works at the National Centre for Development Studies.

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abstract

The revival of interest in regionalism at a time when the Uruguay Round negotiations are in difficulty indicates the uncertainties of the GATT system. It is the Organization for Economic Cooperation and Development (OECD) countries that are forming and extending regional trade agreements, this time with strong US participation, and this suggests that regionalism will strengthen and not fade as it did in the 1960s.

Some developing countries are also renewing regional links, despite their lack of success with customs unions and free trade areas in the 1960s. But fragmentation of the multilateral trading system is not in the interests of developing countries. Programs of economic reform and trade liberalization that are spreading among middle-income countries depend for success on an open trading system. Low-income developing countries could become more rather than less dependent in regional agreements with industrial countries. Or worse, they could be left out altogether.

Free trade areas and customs unions attract support for political and economic reasons, and from protectionists as well as free traders. So the motives for the new regionalism need careful scrutiny. As part of the theory of second best, free trade areas do not offer strong conclusions about their effects. Empirical research suggests that welfare benefits are small. They tend, however, to be distributed towards participants and away from third countries.

Despite claims that regionalism will promote economic growth and trade, and help reduce trade barriers, there must be concern that OECD countries are turning inward and protectionist as competition from Japan and the newly industrializing economies (in East Asia and Latin America) causes adjustment problems in their economies. Domestic political pressures in the European Community and the United States are demanding reciprocity and actions against `unfair' trade from competitive developing countries.

Is regionalism essentially protectionist? Or can it be seen as a force for trade liberalization and global economic integration? Is it a reflection of the protectionist trends that make the Uruguay Round so difficult to conclude? By emphasizing reciprocity and preferences is it adding to the expanding use of administered protection and aggressive bilateralism? What does the new regionalism mean for developing countries' economic opportunities?

Glossary

OECD	Organization for Economic Cooperation and Development
GATT	General Agreement on Tariffs and Trade
SEM	Single European Market Act (1986)
EC	European Community
NAFTA	North America Free Trade Agreement
EAI	Enterprise for the Americas
CU	Customs Union
EFTA	European Free Trade Association
ASEAN	Association of South East Asian Nations
ACP	African, Caribbean and Pacific Countries
LAFTA	Latin America Free Trade Area
CACM	Central American Common Market
EAEC	East African Economic Community
GSP	Generalized system of preferences
CAP	Common agricultural policy
LAIA	Latin American Integration Association
UDEAC	Central African Customs and Economic Union
ECOWAS	Economic Community of the West African States
EEA	European Economic Area
CEAO	West African Economic Community
CEPGL	Economic Community of the Great Lakes Countries
ANZCERTA	Australia New Zealand Closer Economic Relations Trade Agreement
PTAESA	Preferential Trade Area for Eastern and Southeast Africa
MRU	Mauo River Union
CARICOM	Caribbean Common Market
MERCOSUR	Common Market of the Southern Cone
APEC	Asia-Pacific Economic Cooperation

The political economy of regionalism and developing countries

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In the 1980s, regional trade agreements once again became fashionable in international economic relations. Officials and governments argue that they are a movement towards multilateral free trade. Slow progress in the Uruguay Round of GATT negotiations, with the goals of the Punte del Este Declaration receding and deadlines frequently breaking down or being extended, encourages trade negotiators to insinuate that new and extended regional arrangements should be viewed as supportive of the GATT system. Hence, the Single European Market Act (1986) (SEM), the Australia-New Zealand Closer Economic Relations agreement (1983) and the United-States-Canada free trade agreement (1987), and other proposed regional agreements, are presented as instruments that allow the most progressive countries to implement agreements in areas where the GATT negotiations are blocked by less liberal-minded negotiators (Frisch 1989). In practice, however, the establishment of regional agreements has had more to do with political clout than with the resolution of difficult issues in the Uruguay Round negotiations; differences over agricultural policies which remain the principal obstacle to agreement are unaffected by these new regional arrangements.

Historically, customs unions and free trade areas have attracted support from protectionists as well as free traders. So there are reasons to suspect whether the renewed interests in regionalism genuinely represent liberal motives. After all, while tariffs have been steadily reduced by GATT negotiating rounds, non-tariff measures involving discrimination and quantitative restraints on trade using escape clauses in the General Agreement or by resort to instruments not covered in its articles (so-called 'grey area' measures), have increased (Robertson 1992a: Ch.1). Many of the most difficult negotiations in the Uruguay Round concern

'administered protection' (Finger, Hall and Nelson 1982) - anti-dumping, subsidies and countervailing, 'safeguard' actions (including voluntary export restraints), technical standards, etc. If the new regionalism is a shift towards trade liberalization, it must be demonstrated that this trend in protectionism will be reversed.

Many developing countries will be affected by the spread of regionalism.[1] First, many rapidly growing, middle-income developing countries have embarked on economic reforms, including unilateral trade liberalization, which depend on an open, liberal, multilateral trading system (Chile, Mexico, Thailand, Korea, Indonesia). Fragmentation into trading blocks could seriously undermine these reform programs. Second, some developing countries are being persuaded to join regional trade arrangements, either with other developing countries or with industrial countries (notably negotiations between Mexico, the United States and Canada (NAFTA) and the wider Enterprise for the Americas initiative (EAI)). The formal arrangements will increase discrimination and promote preferential trading. The record of integration among developing countries shows remarkably little success.[2] Associations between countries with widely disparate levels of trade protection and industrial development will pose particular problems, because of the wide margins of preference they create for some members, and against third countries. Export opportunities for non-members, industrial and developing countries, will depend on the extent of discrimination and the tariff and non-tariff barriers against third countries.

This paper examines the alleged advantages of regional trade agreements in the context of developing countries' interests. Section 1 contains a brief review of the economics of regionalism and the role of GATT provisions (Article XXIV). Section 2 examines the history of regional trade agreements among developing countries. Section 3 reviews the reasons behind the renewed interest in regionalism and what this means for developing countries. Section 4 assesses whether increased regionalism can be used to strengthen the multilateral trading system.

[1]The analysis in this paper is concerned with developing countries as conventionally defined. It does not refer to the formerly centrally planned economies of central Europe or the countries of the former Soviet Union, most of whom have similar economic problems to developing countries and many of whom are seeking preferential trade agreements with the European Community.

[2]See Annexes I and II.

1 Economics of regionalism

Regional trade agreements are now being seen as building blocks of multilateral trade liberalization, with emphasis on accelerated growth in output, economies of scale and efficiency gains in wider markets, and beneficial spillovers to third countries (Lawrence 1991). Concerns about discrimination and trade diversion, which were major issues in the earlier round of regional integration arrangements in the 1950s and 1960s, are relegated to secondary importance. With most tariffs on manufactures imports into OECD countries reduced to very low levels after the Tokyo Round, this lack of emphasis on discrimination appears reasonable. But non-tariff protection has increased in OECD countries since the 1970s, especially against developing countries (World Bank 1992). Although liberalization is under way in some developing countries, in most protection remains high. Trade diversion is not only related to existing protection applied by members of a regional trade agreement, but also to any new external trade policies implemented by its members, as experience with the European Community's 'pyramid of preference' has shown (Robertson 1992b). And when the new regional groups bring together industrial and developing countries, as proposed for NAFTA and the wider EAI, tariff disparities among members against third countries become important sources of discrimination.[3]

'Regionalism' is a collective term for a range of economic arrangements, with different intensities of integration and coverage, between countries. Four main types of arrangements are usually distinguished. They involve different trade effects for third countries.

i A free trade area eliminates trade barriers (and sometimes other restrictions) among the member countries, thereby granting members preferential access to each other's markets while retaining their own trade policy against third countries.

ii A customs union (CU) goes one step further and adopts a common external trade policy against third countries.

iii A common market extends the integration process to allow free movement of factors of production (labour, capital) among the member countries.

iv Economic union implies harmonization of members' economic policies, including fiscal and monetary policies. This requires political and social unification to decide and administer the common policies.

[3]Mexico reduced average industrial tariffs from 27 per cent in 1982 to 13 per cent in 1990, but that is much higher than US tariffs which average around 5 per cent. According to the OECD Secretariat, average tariffs in developing countries are over 30 per cent, still much higher than industrial countries' tariffs were in 1947; non-tariff measures are also widely used by developing countries.

According to GATT article XXIV, which allows free trade areas and customs unions as exceptions to non-discrimination in trade among GATT contracting parties (article I), such arrangements should eliminate barriers to substantially all trade between members in a reasonable time period and should not raise barriers to trade with other contracting parties. (In a customs union, this means that the common external tariff should not on the whole be higher or more restrictive than the general incidence of members' trade policies prior to the formation of the union.) In practice, however, certain interim or partial arrangements have been allowed which cover limited ranges of products or specific sectors.[4] Moreover, substantial sectors have been excluded from some regional agreements. The exclusions of agriculture under the Treaty of Rome (1956) (EC) and the Stockholm Convention (1960 European Free Trade Association (EFTA) are the most notorious.

This paper concentrates on free trade areas. They have become the focus of attention in the revival of regionalism, especially in the United States and among developing countries, because participants retain much of their independence in trade policies relating to third countries. Existing most-favoured-nation tariff levels are preserved, whereas harmonization to a common external tariff requires rebalancing of tariff concessions previously negotiated in the GATT.[5]

All regional trade arrangements cause trade-creating and trade-diverting effects (Viner 1950; Meade 1955). Trade creation is a shift away from high-cost domestically produced goods and services to lower-cost imports from partner countries. Trade diversion is a shift away from consumption of low-cost imports from third countries to higher-cost imports from partner countries that enjoy tariff preferences. If on balance incomes rise in member countries, imports from third countries will increase according to the income elasticity of demands for imports. This 'external' trade creation could offset any losses to non-members from trade diversion.

Initially, trade creation and trade diversion were conceived as production effects arising from changes in relative costs resulting from tariff preferences. In terms of national welfare, production efficiency and resource allocations were improved by trade creation, but worsened by trade diversion - under small

[4]The Canada-United States Automotive Products Agreement (1965) eliminated tariffs between the two countries on new automobiles and parts.

[5]This became a point of conflict in US-EC relations in the mid-1980s when the European Community was enlarged to 12 countries by the accession of Spain, Portugal and Greece. The US authorities sought compensation for reduced access to Spain for its agricultural exports when Spain adopted the common agricultural policy, and for displacement of citrus exports to European Community markets by Spain after accession (Yannopoulos 1987).

country assumptions which allowed no changes in the terms of trade. Hence, net trade-creating agreements were viewed as beneficial, while trade-diverting ones were regarded as welfare reducing.

Once allowance is made for the effects of relative price changes on consumption as well as production, the static short-term effects of regional trade preferences become more problematical (Johnson 1965). Switching towards partner supplies of a product reduces its price to consumers (raising real incomes) which is beneficial. But government revenues are reduced by the loss of tariff collections on imports from within the free trade area. So public expenditures must contract (reducing real incomes) or new taxes must be levied. The net effect is likely to be a redistribution of income in the country concerned, although the partner country will increase its national output. So the members are still likely to benefit, although third countries would lose in as much as export contraction from trade diversion is not offset by 'external' trade creation (Lipsey 1960). Because any regional trade agreement is a problem in the theory of second best (Lipsey and Lancaster 1956) - multilateral free trade being the optimal solution - each case requires an analysis of the particular circumstances to establish whether anyone benefits, and how any benefits are distributed among the member countries and third countries.

Once long-run effects are brought into consideration, the consequences of a free trade area become more farreaching. By expanding the markets of producers in partner countries, opportunities arise for economies of scale, improvements in technology and increases productivity, which promote economic growth (Corden 1972). Even without policy harmonization comprised in higher forms of integration, these effects will increase the competitiveness of industries. Combined with trade creation and trade diversion these 'dynamic' effects will affect the terms of trade between the members and outsiders. In addition to trade creation among members, rising incomes and improved competitiveness will augment 'external' trade creation. Any major improvement in competitiveness of members' industries will tend to cause a deterioration in their terms of trade; on the other hand, a trade diverting free trade area would improve the terms of trade, disadvantaging third countries (Mundell 1964).

The dynamic benefits are receiving prominence in the latest arguments for regionalism. But all forms of regional trade agreements remain second best in economic terms when compared with multilateral liberalization. Trade diversion imposes higher resource costs than would be involved in imports from third

countries. Improved competitiveness from economies of scale, etc. lead to transition (adjustment) costs that are politically unpopular in some industries and regions, and these are likely to create pressures for protectionist policies.[6]

Ultimately, the trade effects of a regional trade agreement depend on the levels of protection in place prior to its establishment and the levels of protection remaining against third countries when it is completed. (The latter is not strictly relevant to a free trade area where national trade policies should remain in place.) Cooper and Massell (1965) present the question of second-best alternatives arising from regional trade agreements in terms of initial tariffs. Since a non-preferential tariff reduction is necessarily superior to a discriminatory reduction as a liberalizing step, they argue that efficient resource allocation could not be the reason for it. Hence, the reason must relate to trade diversion and the opportunities this provides to improve economic efficiency and growth. The welfare effect on participating countries can then be divided into a pure tariff reduction component and a trade diversion component. This emphasizes the importance of the dynamic effects of free trade areas. Cooper and Massell presented this analysis for developing countries seeking import-competing industrialization, and which wanted to retain protection against third countries and so could not follow first-best, multilateral liberalization.

Bhagwati (1990) has demonstrated theoretically that any group of countries could form a customs union that would leave non-members' welfare unchanged while improving the welfare of the member countries (that is, not a free trade area where national trade policies are maintained). In practice, however, establishing such conditions would be very difficult and some redistribution of incomes would be bound to occur through the dynamic effects mentioned earlier. The important question is: how does a trade block affect the welfare of the separate countries forming it, and the outside world? Since the purpose of any preferential trade agreement is to redistribute income in favour of the member countries, the theoretical possibilities of arrangements that do not disturb global welfare have little relevance, although they serve to demonstrate that in a customs union or higher form of integration, tariff preferences can be manipulated to achieve desirable trade or welfare changes.

Globalization of production (evident in increasing intra-industry and intra-firm trade) and complex cross-hauling of foreign direct investment, facilitated by

[6]This consequence of improved resource allocations arising from the SEM was made by Dornbusch (1989:352-5).

deregulation of financial systems, have made assessment of the effects of free trade areas more difficult. Trade policies are still formulated by national governments and defined according to national origins, but global/regional production and marketing decisions by firms mean that trade diversion and trade creation effects extend to foreign firms operating within that region. These changes will influence investment decisions (Bhagwati and Brecher 1980). For example, trade diversion may encourage firms from third countries to invest in the region; in a free trade area with different national trade policies, foreign investments may gravitate towards the member countries with low tariffs and liberal attitudes to foreign investment, whereas trade deflection through low tariff members into other member countries are prevented by rules of origin.[7] In general, anticipation of accelerated economic growth and improved competitiveness will encourage foreign investment inflows and relocation of production to the region. In large trade blocks, where outsiders anticipate that access for their exports may be adversely affected, 'tariff factories' are likely to be established. This investment will benefit the members, by raising growth rates and competitiveness, but it also represents investment diversion which parallels trade diversion; for example, foreign investment in automobile and electronics industries in the European Community that has been stimulated by the European Community 1992 program (Hufbauer 1990:23-32). Investment diversion is likely to reduce investment in third countries and the redistribution towards countries in a regional agreement may disadvantage developing country members.

This brief review of the economics of regionalism demonstrates that whether or not a particular regional trade agreement brings benefits to its members depends on the particular circumstances surrounding that arrangement. It is theoretically possible to devise a regional trade agreement that will benefit members, but in the short-run (static) context this will be at the expense of third countries. Dynamic effects and globalization of world production make the outcome of regionalism more uncertain. Non-discriminatory liberalization of trade according to GATT principles remains the 'first best' economic solution for trade liberalization.

[7]To ensure that only members of an regional trade agreement benefit from the elimination of mutual trade barriers, it is necessary to adopt rules of origin to prevent trade deflection (that is, goods entering the area through the lowest tariff member and then being freely traded among the members). Because of multi-processing of products rules of origin usually require that at least 50 per cent of value added of traded goods should take place within members of the regional trade agreement; some processes may be exempted where the competitors exist among the members. See Treaty of Rome article 115; Stockholm Convention article 5; Canada-US free trade area, Chapter 3.

GATT consistency

When the GATT was founded in 1947, the exception provided in article XXIV for free trade areas, customs unions and interim agreements leading to such regional arrangements was viewed as a movement towards liberal trade. Viner (1950) and Meade (1955) analysed the second-best character of such agreements *ex post facto*.

GATT article XXIV sets out some rigorous conditions for the creation of free trade areas and customs unions. The contracting parties have, however, failed to enforce these conditions when agreements are notified to GATT. Over 70 regional trade agreements have been notified since 1949; only five were approved, although none has been rejected (Schott 1989).

US acceptance of article XXIV, which allowed 100 per cent preferences among a group of countries, was surprising in view of US negotiators rejection of existing British Commonwealth preferences when the GATT was negotiated (Bhagwati and Irwin 1987). It appears to have been the first example of conflicts between economic and political motives surrounding trade preferences. The US authorities wanted to promote European integration and stability after World War II, but, as has happened so often since, these political motives were captured by protectionists to subvert the multilateral trading system.[8] The same elements are evident in the present acceptance of regionalism by US authorities. While the claim is made that NAFTA represents a movement towards multilateral free trade, by allowing like-minded groups of countries to liberalize faster than the totality of GATT contracting parties, key areas in the NAFTA negotiations are being dominated by protectionists.[9]

Many commentators believe that article XXIV has played a major part in the breakdown of GATT's legal discipline (Dam 1970:290; Jackson 1990:141). Other exceptions to the principle of non-discrimination - countervailing and anti-dumping duties (article VI), and since 1967 special and differential treatment for developing countries (Part IV and article XVIII) - have also undermined GATT fundamental principles. Difficulties over the interpretation of article XXIV have provided scope for many kinds of preferences.

The review of article XXIV in the Uruguay Round has proposed amendments which are set out in the Draft Final Act (GATT 1991). These serve only to clarify the existing clauses of the article. They do not mention non-tariff measures.

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[8]Jackson (1969:159-60) has suggested that acceptance of the Treaty of Rome by contracting parties did lasting damage to the GATT's authority.

[9]Textiles, motor vehicles and agriculture are industries where negotiating difficulties are occurring because of US industry pressures, including support from labour unions against low-wage imports. Environmental groups have also played a strong role in congressional debates (Low 1992).

Measuring the effects of regional trade agreements

Attempts to measure the effects of regional trade agreements on member economies and third countries divide into two groups: (i) studies of the potential welfare gains or losses expected (Britain's prevarication about joining the European Community in the 1960s generated a plethora of different exercises from pro and anti-Common Market groups); and (ii) retrospective estimates of the welfare effects of membership of such a grouping. Most of the empirical research related to the European Community or EFTA in the period up to 1972, when Britain finally acceded to the European Community (along with Denmark and Ireland).[10] Since 1986 another rash of empirical estimates has occurred in connection with the creation of a Single European Market, the US-Canada Free Trade Area, and its extension to Mexico in the proposed NAFTA.

The surprising feature of the early studies was the small welfare gains or losses identified, when related to GNP of the subject countries (Williamson and Bottrill 1971; Miller 1971; Balassa 1967). Most of this research related to the static trade effects of eliminating mutual trade barriers and little attention was given to the 'dynamic' effects of economies of scale, improved efficiency, greater competition, etc. Retrospective estimates revealed additional difficulties because defining the alternative position required major adjustments to historical data to allow for multilateral trade liberalization and new trade restrictions, such as the long-term cotton textiles agreement. While trade volumes increased substantially according to most of these studies, and most of the increases were attributed to trade creation, with trade diversion more than offset by external trade creation resulting from accelerated economic growth in the European blocks, the estimation of 'welfare triangles' produced insignificant results.

The revival of interest in regionalism in the 1980s, especially among OECD countries, has put more emphasis on the 'dynamic' effects of policy harmonization, partly because trade in manufactures is now either tariff-free or subject to low tariffs. Other restrictions have limited effects on trade among OECD countries, with the important exception of Japan which has been a major target for US and European Community non-tariff protection. Studies of the effect of European Community 1992 that concentrate on the 'static' effects still show comparatively small effects from unification (Cecchini *et al.* 1988, Emerson *et al.* 1988), while estimates that incorporate dynamic effects from increased investment, competition and efficiency give suspiciously strong effects (Baldwin

[10]The European Community was further enlarged to 12 members by the accession of Spain, Portugal and Greece in 1985.

1989). The conclusions are that the effects of faster economic growth within the new regional trade agreements (SEM and NAFTA) will result in external trade creation that will outweigh any trade diversion, which will be small anyway because tariffs on manufactured goods among OECD countries are low.

Empirical studies of regional agreements among developing countries have been even less satisfactory because few of the proposed arrangements have reached levels of trade liberalization that have influenced production and consumption in the participating countries (Annex I). Most of the agreements among developing countries fell far short of the conditions set down in article XXIV. In Latin America and Africa, regional trade agreements established in the 1960s were about allocating specialization among member (Kiyoshi Kojima 1972). This 'agreed specialization' created new tensions among participants in regional agreements and this added to political instabilities and caused agreements to break down (for example, the Central American Common Market) (CACM). The Association of South East Asian Nations (ASEAN) attempted integration projects of this kind, which failed. The latest attempts to achieve a free trade area over 15 years has also received a cool response.[11]

The small welfare gains indicated by empirical studies of regional trade agreements attest the importance of non-economic (political) underpinnings for their success. The optimistic claims of external trade creation from new regional agreements are based on the continuation of multilateral trade liberalization and minimal trade diversion (Baldwin 1989; Lawrence 1991). These studies have given little attention to the spread of new protectionism among OECD countries and the proliferation of discriminatory measures against outsiders. In particular, regional trade agreements that bring together industrial and developing countries, like NAFTA and the EAI, will have disparate tariff and protection regimes that will tend to increase trade diversion effects on developing country participants and disadvantage non-member developing countries. Integration of countries at different levels of development requires more adjustment and raises problems about the distribution of costs and benefits arising from discriminatory trade liberalization (Balassa and Stoutjesdijk 1975:41-2).

[11]The fourth ASEAN Summit held in Singapore, January 1992, agreed to establish the ASEAN Free Trade Area (AFTA) within 15 years. Earlier preferential arrangements in 1977 agreed to 25-50 per cent tariff cuts, but this has applied to only 5 per cent of ASEAN trade owing to exclusion of sensitive products.

2 Regionalism and developing countries

Many regional trade agreements have been attempted by developing countries (beginning in 1960) but the benefits expected from closer economic links have not materialized. Several arrangements did not proceed beyond the planning stage and none has brought about genuine economic integration. The major agreements among developing countries are described and evaluated briefly in Annex I. Many regional trade agreements have disbanded, fallen into abeyance or continued in name only, in spite of repeated affirmations of intent by participating governments. It appears that the loosest associations with conservative goals have shown most durability, although they have recorded little economic success (for example, the Latin American Free Trade Area (LAFTA)). The Andean Pact and CACM showed early successes but failed later.

Political problems impeded many regional trade agreements. Political instability or revolutions disrupted agreements (e.g. CACM, East African Economic Community (EAEC)), or national rivalries caused agreements to be neglected. In addition, governments failed to live up to commitments on trade liberalization or financing. Ambitious programs of integration were not be implemented when it came to agreeing collective schedules for trade liberalization. National priorities took precedence, especially in newly independent states or where domestic economic adjustments caused difficulties. Disputes arose over the distribution of benefits and costs where integration showed results, especially among countries at different levels of development. Nationalism, political pay-offs and domestic lobbying also impeded integration processes.

Poor economic performance also contributed to the many failures. Macroeconomic imbalances (inflation, government debt and external deficits), aggravated by external shocks (oil price changes and swings in commodity prices), upset plans for regional integration. Losses of customs revenues imposed burdens on budgets in countries with narrow taxation systems. In instances where initial trade among countries was low, the scope for gains from specialization and trade creation depended on a major investment and structural adjustment, which are by definition difficult in developing countries; immobility of productive factors within the region was a serious impediment to production growth. Several regional trade agreements recorded some increases in intra-regional trade (for example, CACM) but usually at the expense of larger reductions in trade with third countries. Where these countries were dependent on this third country trade, incomes declined (Appendix Table 1). Moreover, where regional agreements were accompanied by import-substitution strategies

(for example, LAFTA), any specialization that resulted tended to be in capital-intensive industries where in multilateral terms they were at a comparative disadvantage (Balassa and Stoutjesdijk 1975).

Various attempts have been made to establish economic criteria for successful regional integration (Krauss 1972; Lipsey 1960).

- Members should be geographically close to reduce inefficiencies and additional costs arising from transportation and cultural differences.
- Large overlaps in production structures increase prospects for trade creation in the free trade area, especially if initial tariffs (and other barriers) are high[12].
- Low tariffs against third countries (before and after integration) will minimize trade diversion.
- The larger the integrated market, the greater will be the opportunities for 'dynamic' gains (economies of scale, competition, improved efficiency and technology development).

Above all, experience has shown that political commitments to regional goals must be strong and undertakings must be given about the distribution of economic costs and benefits from integration, and compensation for the structural adjustments that will be necessary. These burdens are smaller among countries at similar levels of development and frictions between members are correspondingly reduced.

If existing and proposed regional trade agreements among developing countries are to be effective in promoting economic development, specialization and trade, major changes will be necessary. Political enthusiasm has often evaporated as difficulties appeared. One step would be to ensure that a full and realistic program of integration should be set down, including domestic reforms, so that commitments are understood and schedules can be maintained. These programs should contain effective mechanisms to distribute costs and benefits among participants in an acceptable fashion, including compensation for imbalances created. Policy reforms being introduced in Latin America to establish macroeconomic stability will facilitate regional liberalization, as well as encourage economic development (IMF 1991:18; Bradford 1992).

The most recent initiatives Common Market for the Southern Cone (MERCOSUR and the Chile-Mexico free trade area)[13], and amendments to existing agreements (LAFTA became Latin American Integration Association

[12]Of course, if most-favoured-nation tariffs are high, even larger economic gains will be available from multilateral liberalization of trade policies.

[13]In June 1992, the US announced that discussions with Chile about a free trade area with the United States would commence as soon as the NAFTA negotiations were completed.

(LAIA)), appear to be defensive measures against discrimination expected from the new regionalism. Latin American countries are sensitive to US initiatives. Collective negotiations with neighbours appears to be one way to strengthen positions in any discussions that may begin within the EAI.

The record of regional trade agreements among developing countries shows that they have not promoted economic development for their participants. Trade among developing countries has increased, including shares of their trade undertaken with regional neighbours (Appendix Tables 1, 2 and 3), but regional trade agreements have made little contribution. East Asia (mostly newly industrializing economies and near newly industrializing economies) doubled its share of OECD imports in the 20 years to 1990. All other developing countries lost shares in the OECD markets (Appendix Table 3). Middle-income developing countries in Latin America lost share in OECD imports because they lacked export-competitiveness and preferential access to markets. On the other hand, low-income developing countries of Africa lost share in spite of preferences (Appendix Table 3). Do these figures suggest that regional trade agreements between OECD countries and developing countries would give better results?

3 Mixed regional trade agreements

One argument for drawing middle-income developing countries into arrangements with OECD countries (like NAFTA and EAI proposals) is that they will be locked into permanent trade liberalization. Mexico has reduced its tariffs by 50 per cent since it acceded to the GATT in 1986. A free trade area with the United States will lock in those lower tariffs against third countries in the treaty. This step is favoured by commentators concerned about reducing trade protection in developing countries, and by governments using international approval to silence opponents of domestic reforms. Special and differential treatment of developing countries in the GATT since the Kennedy Round has allowed 'free-riding' in tariff negotiations (Hudec 1987: Chs 4, 8). This would no longer be the case with commitments in regional agreements.

On the other hand, if these reduced tariffs and other trade barriers are locked into regional agreements, suppliers to that protected market from partner countries have a vested interest in maintaining their preferential margin over third countries. Pressures not to reduce tariffs against non-members in multilateral negotiations will increase and opposition to allowing other countries to join the free trade area will increase also. Wonnacott (1990) has argued that discrimination would be intensified by 'hub and spoke' bilateral free trade areas; for example, if the United States signed separate free trade areas with Mexico and

Chile, with the United States as 'the hub' benefiting most, vested interests to oppose moves towards multilateral trade liberalization would intensify. It is likely, therefore, that mercantilist motives will make multilateral liberalization through the GATT more difficult as value is attached to regional preferences.

Most notifications under article XXIV of GATT have concerned preferential arrangements between the European Community and other countries. (Schott 1989 Annex I, contains 26 separate agreements by the European Community with other countries, not counting the bilateral arrangements between the European Community and individual EFTA countries negotiated in 1973, or European Community agreements with East European countries.) The European Community maintains a multi-layer system of trade preferences (GATT 1991b:61-7). The most significant arrangements are the Lomé Conventions that establish European Community preferential trade and financial assistance for 69 African, Caribbean and Pacific countries (ACP).[14] Somewhat less generous agreements exist between the European Community and Mediterranean countries. Less generous again are the European Community's generalized system of preferences (GSP) which applies to other developing countries. Only non-European OECD countries and some newly industrializing economies (Taiwan and Korea) are subject to European Community most-favoured-nation tariffs; certain pariah and non-GATT regimes (South Africa, China, Indo-China) also do not enjoy preferences in European Community markets.

The record of developing countries associated with the European Community under this variety of preferential agreements does not indicate significant benefits (Langhammer and Sapir 1987). Partly this is because the European Community has been careful to restrict access for ACP, Mediterranean and GSP exports that became competitive; safeguards clauses in these agreements allow the European Community to suspend any concession unilaterally. Most agricultural exports to the European Community are restricted to sustain the common agricultural policy (CAP) (GATT 1991b). The most generous European Community preferences apply to developing countries with limited export capacity.

Intensification of European Community integration according to the SEM and agreement to establish the European Economic Area (EEA) have spawned many applications for new associations with the European Community from developing countries in the Mediterranean region, as well as advances from central and eastern European countries. All these applications are being considered

[14]Lomé IV was signed with 69 ACP countries to cover the 10-year period to February 2000. The European Community's first cooperation agreement on development was signed at Yaoundé in 1963 with 18 developing countries. Lomé I (1975) applied to 46 ACP countries. The ACP group contains some very small, underdeveloped countries. Lomé provides better treatment than the European Community's Mediterranean association agreements or its generalized system of preferences.

bilaterally by the European Community. Different conditions will be attached to each new association, and it appears that relations between each pair of associated states will have to be sorted out between them. That is, the existing EC-12 will be the 'hub' with 'spokes' extending out to each associated state, which will be expected to provide trade reciprocity in return. In particular, the European Community members will continue to discriminate against competitive exporters in agriculture, textiles and clothing, etc. In turn, countries that achieve associate status with the European Community will receive preferred treatment over the ACP countries and other developing countries covered by the GSP or other preferential agreements. Trade diversion arising from further discrimination in the European Community pyramid of preferences will adversely affect trading opportunities. And as it expands and intensifies its integration 'the European Community is likely to become more rather than less protectionist' (Hughes-Hallett 1992:15).

The 1990 Enterprise for the Americas (EAI) has attracted widespread interest in Latin America and the US Administration has concluded framework agreements for free trade area negotiations with half a dozen countries. Separate free trade agreements will be drawn up bilaterally with the United States, leading to a 'hub and spoke' structure. The negotiations with Mexico have shown that these agreements are likely to be limited in scope, with the US authorities retaining powers to apply 'trade remedies' and maintaining many non-tariff measures in sensitive industries (textiles, motor vehicles etc.), or applying extended time tables for removal of special protection. At the same time US lobby groups will ensure that tough conditions are imposed on investment, the environment and labour laws (Hufbauer and Schott 1992). In consequence, the benefits resulting from these free trade agreements are uncertain for the 'spoke' countries.

The two main benefits claimed by applicants for EAI agreements are access to the large US market, which is expected to achieve faster growth from these new regional agreements, and locking in their own economic reforms and trade liberalization. But if US 'trade remedies' and non-tariff measures are not dismantled, access for competitive exports from Latin America will be limited. In fact, as each new 'spoke' is connected to the US 'hub', vested interests in existing preferences in the US market are likely to increase resistance to new free trade agreements, as well as provoking more resistance from US industries. Such 'exclusiveness' in agreements will lock in trade patterns and increase trade diversion at the expense of third countries. Regional trade arrangements among Latin American countries will provide a 'rim' that will reduce discrimination

among the 'spokes'. But each free trade area with the United States will remain separate, which will create problems over rules of origin and local content (value added) measures with the EAI.[15]

The threat of losses from trade diversion in these new 'hub-and-spoke' free trade agreements may be outweighed by losses from investment diversion. In the NAFTA negotiations, the United States pursued tough conditions for local content on textiles and motor vehicles (Hufbauer and Schott 1992: Ch.8). Local-content rules for motor vehicle parts (62.5 per cent has been agreed in the NAFTA draft) will encourage investment in component manufacture in Mexico, based on the low labour costs. Similarly, high requirements for NAFTA value added in textiles and clothing will advantage Mexican producers and third country investors in Mexico, although it will raise their input costs. The consequent investment diversion effect would harm development prospects for other developing countries whose exports compete with Mexico (and eventually other signatories of EAI agreements). In world welfare terms, this trade and investment diversion arising from US protectionism and the new regionalism will have negative effects on non-member developing countries.

Similar re-direction of trade and investment is also likely to arise in Europe. Foreign direct investment inflows into the European Community increased sharply in the period 1986-90 following the commencement of the EC-92 program (Hufbauer 1990:23). If new preferential arrangements are extended to central European countries and Mediterranean countries, investment flows will be diverted from other developing countries towards these preferred sources.

Most of this trade and investment diversion will be at the expense of the newly industrializing countries in Southeast Asia (the 'four tigers' and ASEAN). These countries are highly dependent on manufactures exports to North America (Table 4), and exports to the European Community have increased recently. Investment from the United States has also been important. Yet the widening and deepening of the European Community and the creation of the NAFTA-EAI framework will discriminate against these countries. The EC Commission has targeted its new protection at the East Asian economies in the 1980s (Hindley 1988; Messerlin 1990). US claims of 'unfair' competition against Japan and the East Asian newly industrializing economies are well known. The 'hub and spoke' approach to regionalism in the EAI provides opportunities to discriminate against such countries.

[15]It is not clear how Canada will react to the EAI. Will the Canada-United States free trade area form the 'hub', or will Canada simply be one of the spokes?

Attacks on the dynamic East Asian economies and Japan are being reinforced by glib statements about the creation of a 'yen' trading block (Frankel 1991). Such attempts to promote NAFTA as a reaction to Asian regionalism has no substance in fact. In the 1980s, trade within East Asia (including Japan) has grown at the same rate as this region's trade with the rest of the world (GATT 1990:27), notwithstanding the faster economic growth of the region compared with the OECD countries. Any inward-looking trade agreements would be counter-productive for countries that depend so significantly on exports to the rest of the world (Appendix Table 4). Cool responses to recent proposals for closer integration are in keeping with that strategy.[16] In addition, political resistance to any Japanese dominated arrangement would prevent any broad trade block being formed. Moreover, these countries commitment to multilateralism has been demonstrated by the character of APEC (Elek 1992).

4 Regionalism and the world trading system

Regional trade agreements among developing countries have a poor record. The new enthusiasm for regionalism in Latin America, with several new agreements already in place, derives from the economic reforms being pursued by countries in that continent, after the economic crises of the 1980s, and the desire to achieve secure access to the US market. Their declining trade with the European Community and the threat of growing discrimination in that market makes the United States appear to offer opportunities through the EAI. The new opportunities perceived to exist in free trade arrangements comprising industrial and developing countries have yet to be tested. The NAFTA draft represents the first specific test. European Community association agreements with Greece and Turkey provided little evidence one way or another because of heavy political overtones. Other European Community preferential arrangements with developing countries were different because few production overlaps existed between participants, and specific safeguards were widely used.

Mixed regional trade agreements will require economic adjustment as members dismantle mutual trade barriers. Developing countries are likely to have higher tariff protection than industrial country members, so the adjustment would fall mostly on them. Moreover, by retaining high tariffs against non-members, these weaker economies are also providing bigger preferences to industrial partners than they receive; that is, trade diversion costs will fall more heavily on weaker members. In 'hub and spoke' agreements, the entry price (to

[16]The East Asian Economic Caucus (EAEC) proposed by Dr Mahathir (1991) was politely declined; the ASEAN free trade agreement (1992) has limited scope and will take 15 years to implement.

persuade existing members to allow in new members) is likely to be high. The 'hub' country will seek to protect its own interests and may well retain existing non-tariff measures for that purpose. Given the generally low level of tariffs in most OECD countries after seven rounds of GATT negotiations, non-tariff measures are the main barriers to trade. Yet the US Congress considers free trade areas should cover tariff dismantling, leaving other trade measures to be dealt with under the trade remedies legislation. The 'hub and spoke' system leaves most of the bargaining power with the industrial country at the 'hub'. This may lead to non-trade issues, such as environmental standards, investment policies and workers rights, being brought into the negotiations, as has occurred in the NAFTA negotiations.

Against these uncertainties the 'spoke' countries have to weigh expected benefits. International treaties 'lock in' domestic reforms and promote trade liberalization. Import-substitution strategies, which played an important role in regional integration among developing countries in the 1960s, have no place in mixed regional trade agreements. Economic and industrial efficiency are essential to be able to compete. Above all, guaranteed access to a major world market (United States or European Community) offers security against harassment of trade using 'contingent' protection or new discriminatory trade arrangements. Free trade with such countries should also attract foreign investment from third countries wishing to produce within the region. Unfortunately, both the European Community and the United States are unprepared to give up their freedom of action to restrict trade from competitive suppliers where disruption might be caused to domestic industry, even under free trade agreements. Rules of origin and local content requirements are being employed to manage trade even within free trade agreements.

These various benefits are expected for members of regional trade agreements. Their distribution will depend on the extent of free trade among the members, the levels of protection against third countries and the competitive structure of industry among the members. Third countries will suffer losses from trade and investment diversion arising from the regional trade agreement, which may be offset by any gains from external trade creation caused by income gains by members. The distribution of such gains will depend on income and price elasticities of exports to the member countries. On the whole, other developing countries who are discriminated against by the regional agreement will become worse off.

Small countries have looked upon the GATT 'rules-based' system as providing support for their trade interests. The present fashion for regionalism is founded on two dubious arguments.

i The GATT system is weakening, and the failure to reach agreement in the Uruguay Round is presented as evidence of that. But the absence of agreement in the Uruguay Round arises from the intransigence by the major countries (European Community and United States) in key areas like agriculture and contingency protection rules. The new major regional agreements (SEM and NAFTA) show no progress in these areas either. Moreover, both the European Community and the US authorities continue to apply new discriminatory protection. It is the countries holding up the GATT negotiations who are adopting regionalism.

ii It is claimed that 'regionalism is shaping the post-Cold War order'. Examination of international trade and investment data does not support this argument. Trade between the major regions (European Community, United States and East Asia) is growing faster than intra-regional trade (Tables 4 and 5). Moreover, foreign investment flows grew much faster in the 1980s than international trade. Globalization of production (Ostry 1990) means that regional agreements have little affect on industry, because firms invest inside regional trade agreements to protect their market interests. Capital movements are a substitute for trade flows. Politicians approve of regionalism because it means signing treaties, which is regarded as political activity.

The reality is that regionalism is an exercise in political economy. Middle-income developing countries in Latin America and around the Mediterranean (and the former centrally planned economies of central Europe) are seeking to lock-in their economic reforms and trade liberalization and to link their industries to major industrial markets. In doing so they hope to obtain some economic stimulus while minimizing the likelihood of trade harassment from new forms of protection. Since GATT rules are seen to be providing little restraint on European Community and US uses of contingent protection, bilateral trade agreements are sought to reduce uncertainties. A review of the economics of discriminatory trade arrangements shows that the welfare effects of free trade agreements are uncertain and difficult to estimate. Political economy seems to be the driving force behind the new regionalism.

As regionalism increases, trade disputes will become more common. Most disputes brought to the GATT involve the European Community, United States and Japan. Some form of international agency will be needed to resolve them. The GATT is in existence and its role seems likely to increase, even under the most pessimistic expectations about the Uruguay Round. The causes for the poor progress in the Uruguay Round are the same as those behind the new emphasis on for regionalism; slow and reluctant economic adjustment to macro and micro-economic disequilibria, leading to more frequent use of non-tariff measures

against competitive producers; emphasis on mercantilist principles, and particularly reciprocity receiving priority over non-discrimination. Rather than being complementary to multilateral trade liberalization, regionalism seems likely to increase protectionism and to weaken the GATT system.

One of the major changes in the Uruguay Round compared with earlier GATT rounds has been the energetic participation of many developing countries in the negotiations. This recognition of their interest in the multilateral system is under threat from the new regionalism.

Appendix Table 1 Regional trade among developing countries - indicators

	GNP per capita		Export share in GNP	Trade growth (1980-89 % p.a.)		Trade with developing countries (% exports)			Intra-group trade (% imports)		
	Value (US$) 1989	Growth (% p.a.) 1980-89	(%) 1989	Exports	Imports	1970	1980	1989	1970	1980	1989
Africa											
ECOWAS	368	-2.0	22.2	-2.2	-3.1	8.6	6.2	16.9	2.1	3.9	9.6
of which:											
CEAO	319	0.2	19.2	1.1	0.8	15.1	15.9	24.4	9.1	6.9	12.6
MRU	110	-2.0	56.5	-6.3	-11.5	4.4	8.7	13.0	0.1	0.1	0.6
CEPGL	167	-1.7	22.1	1.8	2.4	6.5	9.7	12.2	0.2	0.2	0.7
UDEAC	978	1.0	19.8	-0.7	6.0	11.9	22.5	19.2	8.4	4.1	5.9
PTA	471	0.1	16.8	0.8	1.6	-	-	-	-	-	-
Latin America											
LAIA	2018	-0.7	12.2	5.5	-2.5	21.2	28.1	21.5	10.2	13.5	10.8
of which:											
Adean Group	1256	-1.0	17.0	-2.9	-0.5	29.3	31.6	18.1	2.3	3.5	4.9
CACM	932	0.4	18.4	-2.4	-0.5	29.6	30.8	23.2	26.5	22.0	13.1
CARICOM	1511	0.7	28.4	-0.6	-0.7	16.6	20.0	14.4	7.3	6.4	4.5
Asia											
ASEAN	3008	4.1	38.7	5.7	4.9	31.7	35.6	37.0	14.7	17.8	17.7
Bangkok Agreement	1338	5.2	15.7	8.7	5.5	20.4	31.7	23.0	1.5	1.8	1.6

Source: OECD, Trade Directorate, Trade Committee Working Paper (91)/65.

Appendix Table 2 Changing export patterns of developing countries (per cent shares)

Exporter		Destination: LAFTA	South Asia	Mid East + Sth Med	Africa excl Sth Africa	East Asia excl Japan	OECD	Rest of world	World
LAFTA	1970	12.4	0.1	0.9	0.6	0.9	73.9	11.2	100.0
	1990	13.7	0.5	3.3	1.4	5.3	66.8	9.1	100.0
South Asia	1970	0.3	1.9	10.4	7.9	3.5	50.7	25.2	100.0
	1990	0.3	2.2	8.2	2.9	18.4	57.1	20.9	100.0
Mid East + S Med	1970	1.4	1.4	5.5	2.8	13.0	67.1	8.9	100.0
	1990	2.8	2.7	9.4	3.0	10.1	64.4	7.6	100.0
Africa excl SA	1970	0.7	1.6	1.9	7.5	1.2	75.2	11.9	100.0
	1990	1.3	0.7	2.9	5.3	3.6	80.7	5.6	100.0
East Asia excl Japan	1970	0.8	0.4	1.7	2.2	20.8	67.0	7.1	100.0
	1990	1.1	1.4	2.8	1.8	21.8	61.8	9.4	100.0
OECD	1970	3.9	0.7	4.0	3.7	4.4	74.2	9.2	100.0
	1990	1.8	0.7	4.5	2.4	8.1	76.7	6.0	100.0

Source: International Economic Data Bank; IMF Direction of Trade Statistics, Australian National University, April 1992.

Appendix Table 3 Changing import shares from developing countries (per cent shares)

Importer		Sources: LAFTA	South Asia	Mid East + S Med	Africa excluding SA	East Asia excluding Japan	OECD	Rest of world	World
LAFTA	1970	14.8	0.1	2.1	1.1	0.7	77.3	4.1	100.0
	1990	19.9	0.1	7.8	1.8	3.4	60.0	7.0	100.0
South Asia	1970	0.7	1.8	9.0	9.3	1.3	61.0	17.0	100.0
	1990	1.6	1.2	17.6	2.6	13.6	53.0	10.5	100.0
Mid East + S Med	1970	1.0	2.2	7.7	2.3	1.6	68.7	16.6	100.0
	1990	2.2	1.2	10.3	1.7	5.7	74.0	5.0	100.0
Africa excl SA	1970	0.7	1.6	3.7	7.2	2.4	70.4	14.1	100.0
	1990	1.7	0.8	6.1	5.0	7.3	71.4	7.8	100.0
East Asia excl Japan	1970	0.9	0.7	5.0	1.1	15.6	68.5	8.2	100.0
	1990	1.6	0.7	5.3	0.9	20.0	58.9	12.7	100.0
OECD	1970	4.6	0.7	5.0	5.0	3.5	75.1	6.1	100.0
	1990	2.8	0.6	4.8	2.8	7.8	74.7	6.5	100.0

Source: International Economic Data Bank, IMF Direction of Trade Statistics, Australian National University, April 1992.

Appendix Table 4 Import trade among regional groups and countries, 1970 and 1990 (% shares)

Exporter		Destination NAFTA	Japan	East Asia (excl Japan)	EC	EFTA	ANZ CERTA	Rest of world	World
NAFTA	1970	36.0	9.0	4.6	24.7	3.1	2.2	20.5	100.0
	1990	41.7	10.4	10.4	20.2	2.5	1.9	12.7	100.0
Japan	1970	34.6	-	20.9	12.1	2.8	3.6	26.1	100.0
	1990	34.7	-	27.6	18.8	2.9	2.8	13.1	100.0
East Asia (excluding Japan	1970	28.1	18.9	20.8	15.9	1.7	2.6	12.1	100.0
	1990	27.3	15.1	21.8	15.7	2.4	2.1	16.1	100.0
EC	1970	10.1	1.2	1.8	53.1	11.7	1.6	20.6	100.0
	1990	8.3	2.1	3.6	60.5	10.3	0.8	15.0	100.0
EFTA	1970	8.4	1.4	1.5	52.1	18.1	1.0	17.6	100.0
	1990	8.5	2.6	3.9	57.8	13.5	0.9	12.8	100.0
ANZ CERTA	1970	16.6	22.5	8.5	26.3	0.7	5.9	19.6	100.0
	1990	12.8	27.2	20.7	13.0	2.1	7.2	17.0	100.0

Source: International Economic Data Bank, IMF Direction of Trade Statistics, Australian National University, April 1992.

Appendix Table 5 Export trade among regional groups and countries, 1970 and 1990 (per cent shares)

Importer		Source: NAFTA	Japan	East Asia (excl Japan)	EC	EFTA	ANZ CERTA	Rest of world	World
NAFTA	1970	41.5	11.5	5.6	20.9	3.0	1.8	15.6	100.0
	1990	34.4	15.2	12.8	16.8	3.0	1.1	16.8	100.0
Japan	1970	35.2	-	12.9	8.5	1.7	8.8	32.81	100.0
	1990	26.9	-	21.9	15.0	3.1	6.0	27.0	100.0
East Asia	1970	18.3	28.5	15.6	16.2	2.1	3.6	15.9	100.0
	1990	17.7	23.1	20.0	12.7	2.5	3.0	21.0	100.0
EC	1970	13.3	1.7	1.5	50.2	8.8	1.5	23.0	100.0
	1990	8.6	4.3	3.6	58.0	9.7	0.6	15.2	100.0
EFTA	1970	8.6	2.3	1.0	58.3	15.3	0.3	14.2	100.0
	1990	7.3	4.9	2.9	61.1	13.0	0.2	10.7	100.0
ANZ CERTA	1970	27.1	12.1	4.2	35.8	3.8	5.8	11.2	100.0
	1990	23.9	18.5	12.6	22.5	4.8	7.4	10.3	100.0

Source: International Economic Data Bank, IMF Direction of Trade Statistics, Australian National University, April 1992.

Annex 1

Major regional groupings among developing countries

Africa

Economic Community of the West African States (ECOWAS) was founded in 1975 with 16 members, with overlaps with the West African Economic Community (CEAO) and the Mauo River Union (MRU). It was intended to be a comprehensive scheme to promote cooperation and development in a single market for almost 200 million people. The trade liberalization program has not been implemented and no allocations have been made to the fund for compensation and development.

Little political support was forthcoming for an agreement that had no foundations; incomes deferred widely between the members, their economic structures were similar with little neutral trade prior to the agreement, and surpluses for trade were small in such poor countries. Trade within this regional trade agreement increased slowly after 1975 while trade with outsiders fell steeply; real incomes declined.

The West African Economic Community (CEAO) was created in 1974 by seven members of ECOWAS and had a population of 50 million in 1989. A common external tariff was to be established and a single tax on intra-area trade used to finance development. The common market has not been achieved; only 400 products receive regional preferences.

The seven countries of CEAO were more cohesive than ECOWAS, having a common currency within the French franc zone and similar income levels. Industrial structures were sufficiently different to allow gains from intra-regional trade. But the CEAO became inward looking and trade with outsiders declined sharply, and intra-regional trade declined, too, resulting in stagnation of incomes.

The Mauo River Union (MRU) comprises three other ECOWAS countries - Guinea, Liberia and Sierra Leone - with a combined population of 6.5 million. The goal was to establish a customs union and to enhance development with joint industrial projects. Initial trade among the members was very small and the motives for the MRU appear to have been political rather than economic. Some progress was made up to 1981, when a common external tariff and a joint industrial development unit were in place, but since then barriers have been erected against intra-area trade and outsiders. Trade with non-MRU members declined by 50 per cent between 1974 and 1985, while intra-area trade recorded little change.

The Economic Community of the Great Lakes Countries (CEPGL) comprises three former Belgian colonies with a population of 47 million. It had primarily political motives and was, in fact, a free trade area. Integration was to be achieved by liberalizing trade (without a common tariff or policy harmonization), increasing factor mobility and through joint industrial projects. In 1976, there was almost no trade among these countries, although all three countries were very dependent on trade with outsiders. Very little trade liberalization has taken place within CEPGL, while external exports have fallen sharply.

The Central African Customs and Economic Union (UDEAC) was notified to GATT in 1964. Its six francophone members have a total population of 24 million and it was formed to retain colonial ties. The aim was to create a common market and monetary cooperation to promote development. The prospects for UDEAC were good because of relatively high incomes and rudimentary industrial sectors and monetary stability. However, poor transport links and low levels of intra-area trade impeded regional integration. Regional trade liberalization could not be agreed, common projects failed and disparities in trade performance created adjustment problems that led to breakdown in monetary cooperation and instability. Like the other African agreements, trade with non-members declined while intra-area trade stagnated.

The Preferential Trade Area for Eastern and Southern Africa (PTAESA) has 15 members that began in 1981. It covers 163 million people and is intended to promote economic cooperation, improve and develop industrial structures, increase intra-area trade and to achieve a common market by 1992. In practice, few instruments have been implemented. The economic foundations are not sound; there is a wide dispersion of income levels among the member countries and intra-area trade is a small share of total trade. Altogether incomes are too low to provide markets suitable for efficient production, while disparities will create political difficulties over distribution of benefits. Only limited tariff reductions had been introduced by 1988 and difficulties remain over agreeing on schedules for trade liberalization. The members have reiterated their intentions but any progress will be slow.

East African Economic Community (EAEC). Economic cooperation between Kenya, Uganda and Tanganyika (Tanzarua after 1964 when Zanzibar merged with Tanganyika) began in the 1920s under colonial rule and a common customs tariff and common currency were in place when independence was achieved in the 1960s, and many common services were developed. Quarrelling over the distribution of benefits of the customs union resulted in some cross frontier barriers appearing and separate central banks and currencies were established. In June 1967, a new Treaty for East African Corporation was signed in Kaupala which reinforced the

common tariff regime, but with certain exemptions, including agriculture. Measures to promote balanced industrial development were also included. But the process of disintegration accelerated as political differences and internal instabilities increased. EAEC is no longer effective, in spite of its initial advantages.

Latin America

Latin American Integration Association (LAIA). In 1980, the LAIA replaced LAFTA which had been created in 1960, with the same 11 countries (including the 5 member Andean Group). The driving force behind LAFTA was the UN Economic Commission for Latin America. The Montevideo Treaty was adopted to promote intra-regional trade and economic cooperation, but the 12 year schedule to eliminate intra-LAFTA tariffs was never seriously pursued. LAIA is still based on the Montevideo Treaty - was more flexible, intended to facilitate bilateral trade relations on an *ad hoc* basis which could be extended to all participants. LAIA was intended to promote outward-looking policies without coordination of policies, which had failed in LAFTA. In the period 1960-88, the share of trade in GNP of LAFTA countries declined, and intra-regional trade showed little growth.

The levels of economic development in LAIA and the size of the market (380 million) suggest that regional integration would benefit member countries. But cooperation in trade has been difficult to achieve with countries pursuing import-substitution strategies and suffering poor economic performance. The focus of integration seems now to have shifted outside the region with the Bush proposal for Enterprise for the Americas.

The Andean Group has five members (Bolivia, Colombia, Ecuador, Peru, Venezuela); Chile withdrew in 1976. The Cartegena Agreement was signed in 1969 as a result of disappointment with LAFTA. It goes beyond trade liberalization to include regional industrial planning to promote capital-intensive projects and support for less developed economies (Bolivia and Ecuador). Trade liberalization and a common tariff were meant to be in place by 1983. A new agreement has been reached to liberalize internal trade, with a full common market by 1985.

In both political and economic terms the Andean Group has failed. Trade liberalization has been insignificant and the external tariff was never agreed and exemptions were widespread. The industrial strategy failed also; 'agreed specialization' came up against political barriers. The same problems impeded the Andean Group as has obstructed LAFTA.

The Central American Common Market (CACM) was formed with five members in 1960. It was one of the earliest regional groupings among developing countries and its progress until 1970 was impressive. These five small countries (Guatemala, Honduras, El Salvador, Nicaragua, Costa Rica) had liberalized 94 per cent of intra-regional trade and 80 per cent of external trade was subject to a common external tariff by 1970, and intra-trade had increased to 27 per cent of total trade and foreign investment had been attracted. After 1970, political problems arose (Honduras withdrew) and intra-trade declined. The more industrialized members gained the main benefits and others imposed intra-trade barriers, although trade with outsiders grew strongly. The treaty was resuscitated in 1990 and liberalization extended to agriculture. Free trade agreements have been signed recently with Mexico and Venezuela.

The Caribbean Common Market (CARICOM) was formed in 1973 to extend CARIFTA (1968). This association is founded in colonial links between these small inland economies, and designed to overcome this handicap. CARICOM has 12 members with a combined population of only 5.5 million and low income levels. The Treaty of Chaguarmas is intended to strengthen coordination of economic and trade relations to promote development through creation of a common market and cooperation in dealing with third countries. The treaty contains some differentiation in favour of the poorest members.

The structures of these island economies is largely dependent on agricultural exports and tourism (i.e. outward looking) and transport links are poorly developed. The scope for mutual development is limited. In practice, the external tariff was never agreed and intra-regional trade remains severely restricted. Political problems have resulted in the collapse of multilateral clearing arrangements. Despite their poor record, members have reaffirmed their commitment to CARICOM in 1988 and 1991.

Common Market of the Southern Cone (MERCOSUR). The Treaty of Asuncion was signed in March 1991 by Argentina, Brazil, Paraguay and Uruguay to accelerate economic development, through trade liberalization and coordination of economic and other policies to strengthen the integration process. The treaty calls for elimination of tariffs and non-tariff barriers by 1994, with some exceptions extended over 10 years. It calls also for a common external tariff but with no deadline. (The tariff dismantling is extended by 2 years for Paraguay and Uruguay.) National treatment for trade is not extended to investment in the region. This is thought to be an attempt to prepare the way for a trade agreement with the United States under EAI.

Wide disparities in economic and industrial development and economic size among the few countries do not augur well for their integration. Political discontent with the distribution of benefits is likely to obstruct full implementation, especially over the short 3.5 year timetable. Moreover, these four countries have records of macroeconomic instability and still face

major adjustment problems. Initial trade integration is only 6.7 per cent of total regional trade.

Economic cooperation between Mexico and Chile was extended with a bilateral agreement in September 1991, which is designed to extend trade and investment links. All non-tariff barriers are to be eliminated and tariffs on mutual trade will be dismantled either gradually until 1996, for eight sensitive products over 7 years; 105 products will be exempt from liberalization (mainly agricultural and petrol products). This agreement is wider than mere regional trade agreements in Latin America, but only a very small proportion of each country's trade is with the other.

Similar bilateral agreements are being considered or implemented among Brazil-Argentina, Mexico-Venezuela, Venezuela-Chile, Chile-Argentina, Mexico-Venezuela-Colombia. In many instances, these arrangements complete the circle among participating countries.

The main motive for these bilateral arrangements appear to be to prepare for negotiations with free trade agreement under the EAI. The US Administration has already agreed framework agreements with Chile, Venezuela and the MERCOSUR group, which identify areas of common interest and establish negotiating principles.

Asia

Association of South East Asian Nations (ASEAN) was founded in 1967 (Brunei joined in 1984). It has much wider interests than economic development. It was formed to achieve cooperation to solve problems of mutual concern. Efforts to promote regional tariff preferences and joint industrial ventures have achieved little, although more ambitious plans are under discussion since APEC was established (Malaysia's East Asian Economic Group was rejected by ASEAN Council in 1991 in favour of a free trade area in manufactures in 15 years, but no firm commitment yet.)

Despite the strengths of seeking integration in a region of 315 million people with some wealthy and industrialized countries, and scope for gains from specialization, little has been achieved. Political jealousies have impeded progress; only a limited range of commodities receive preferences in regional trade. Industrial cooperation, with agreed specialization to give one project to each member, has been less successful than trade.

The Bangkok Agreement (1976) by Bangladesh, India, Korea, Sri Lanka and Laos (Thailand and the Philippines agreed to join but did not ratify), aims to promote and enhance regional trade using trade preferences. Any ESCAP country may join. Only limited preferences have been provided so far, but there is potential for expansion. The core-countries have shown willingness to liberalize.

Annex II Regional trade agreement membership

Africa

ECOWAS - Economic Community of West African States Formed in 1975	Benin, Burkina Faso, Cape Verde, Cote d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone and Togo
CEAO - West African Economic Community Formed in 1974	Benin, Burkina Faso, Cote d'Ivoire, Mali Mauritania, Niger and Senegal
MRU - Mauo River Union Formed in 1973	Guinea, Liberia and Sierra Leone
UDEAC - Central African Customs and Economic Union Formed in 1964	Cameroon, Central African Republic, Congo -PR of, Chad, Equatorial Guinea, and Bagon
CEPGL - Economic Community of the Great Lakes countries Formed in 1976	Burundi, Rwanda and Zaire
PTA - Preferential Trade Area for Eastern and Southern Africa Formed in 1981	Burundi, Cormors, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia and Zimbabwe

Latin America and the Caribbean

CACM - Central American Common Market Formed in 1960	Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua
CARICOM - Caribbean Common Market Formed in 1973	Antigua and Barbuda, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines and Trinidad and Tobago
LAIA - Latin America Integration Association Formed in 1980	Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela
The Andean Group Formed in 1969	Bolivia, Colombia, Ecuador, Peru and Venezuela

Asia

ASEAN - Association of Southeast Asian Nations Formed in 1969	Brunai Darussalam, Indonesia, Malaysia, Philippines, Singapore and Thailand
The Bangkok Agreement Formed in 1976	Bangladesh, India, Korea, Laos -PDR of, and Sri Lanka

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