

**FROM GATT TO THE WORLD TRADE ORGANIZATION**

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**REGIONAL INTEGRATION AND THE WORLD TRADE ORGANIZATION****"Partners not opponents" says Peter Sutherland**

"Quick and comprehensive" implementation of the World Trade Organization Agreements will ensure that "regionalism and multilateralism will continue to be partners and not opponents" said Peter Sutherland, Director General of GATT, in a speech delivered in Sao Paulo today.

Major points in the speech on Regional Integration and the WTO, given to the third Euro-Latin American Forum, were:

- The trend towards regional integration has accelerated since the start of the Uruguay Round in 1986 - 25 preferential trade agreements having been notified to the GATT in that time.
- However, since the average level of tariffs in developed countries is low and, because of the Uruguay Round, subject to further cuts, the scope for granting preferential market access in a customs union or free-trade area has declined.
- At the same time, those outside regional groupings have been concerned at the potential for investment and trade diversion and at the danger that they would have to bear the burden of protection for sectors undergoing adjustment within the groupings.
- Nevertheless, "the conclusion that the world is witnessing the creation of three inwardly-oriented 'trading blocs', based in North America, Western Europe and the Asia-Pacific region is not supported by an analysis of trends in the pattern of world trade".
- While the Uruguay Round clarifies and strengthens Article XXIV of GATT, which provides rules and disciplines for customs unions and free-trade areas, some issues remain outstanding. These include the need for greater transparency in regional agreements and the requirements for their collective monitoring, in the future, by the WTO.

The full text of Mr Sutherland's speech is attached.

**Regional Integration and the WTO:**

**Conflict or Compatibility?**

**Address by Peter D. Sutherland, Director-General, GATT  
to the  
Third Euro-Latin American Forum**

**São Paulo, 7 July 1994**

Less than a year ago I visited your continent and spoke on the GATT and regional integration. Those were days of great apprehension and excitement with the conclusion of the Uruguay Round on the horizon but still tantalizingly far off. I am very happy to be back to this part of the world and to discover that integration in your region has pushed forward with a steady pace. I am even happier to be able to say that integration efforts around the world can now find comfort in the agreements signed by Ministers in Marrakesh a little over two months ago.

At that gathering in Morocco, Ministers reiterated their belief in the rule of law, and not of the jungle, as the basis for international trade relations. Implicit in their endorsement was also the recognition of the crucial place that trade occupies in international economic peace and prosperity - particularly now in the shifting alliances of the post-Cold War period. A more solid structure has been put in place which heralds a new era in trade policy and international economic relations.

I have followed with great interest the impressive achievements of Latin America in the last ten to fifteen years. We all remember the scale of the social, economic and financial difficulties in which the international debt crisis had landed countries in the region in the beginning of the last decade, a situation which persisted for much of the eighties. This makes all the more remarkable the dynamism which today is ushering in comprehensive and solid economic reform in the region. The Latin American approach to liberalization - to move forward vigorously at all policy levels, unilateral, regional or multilateral - provides fresh inspiration for those who place great hopes on the emerging trade regime embodied in the World Trade Organization - the WTO.

**II**

The General Agreement on Tariffs and Trade provides for customs unions and free trade areas, as the major exception to the fundamental principle of most-favoured-nation (MFN) treatment, which requires equal treatment among imports from GATT members. These provisions have been invoked extensively by GATT contracting parties in the postwar period, particularly in Western Europe. As of the beginning of 1994, almost all of GATT's (then) 115 contracting parties were members of at least one preferential trade agreement, with the preferred vehicle being free trade areas - they out-number customs unions five-to-one.

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Since the start of the Uruguay Round in September 1986, the trend towards regional integration has accelerated, with twenty-five preferential trade agreements notified to GATT. In addition to new initiatives, existing regional integration initiatives have been deepened.

This is often described as a trend towards greater 'regional economic integration' (although not all agreements involve countries that are in the same geographic region), and its possible implications, both for the GATT and for trading relations generally, have been the subject of a great deal of discussion and debate. Elements which have been discussed include:

(i) the problems affecting the GATT system which provided the original stimulus to launch the Uruguay Round;

(ii) the repeated delays in bringing the talks to a successful conclusion, which led a number of countries to undertake or to contemplate new economic integration initiatives as an 'insurance policy' in the event of failure,

(iii) a reversal of the longstanding opposition of the United States to participation in preferential trade agreements, and

(iv) a resurgence of interest in completing such agreements by developing countries in Asia and in Latin America. Some observers cite recent trends as evidence that the world trading system is fracturing into three 'trading blocs' centred in North America, Western Europe and the Asia-Pacific region, signalling the end of multilateralism as the primary vehicle for postwar economic integration.

Viewing regional integration agreements in terms of their impact on the implementation of GATT's most-favoured-nation (MFN) principle was, understandably, the over-riding concern of third parties during the first decades of GATT's existence. But the average level of tariffs among the developed countries is already low, and subject to further cuts as a result of the Uruguay Round. Therefore, the scope for granting preferential market access in a customs union or free trade area has declined. (This assessment is qualified for developing countries by the relatively higher level of tariffs and the relatively lower scope of bindings). Among the new areas of concern of third parties is the potential for diversion of investment capital away from them to members of regional agreements. There is also concern that demands for protection by sectors undergoing adjustment within the regional arrangement will be borne primarily by third party suppliers. An additional concern is the scope for trade diversion linked to the rules of origin members of such arrangements are required to agree and administer.

Throughout the history of the GATT, third parties have used the GATT's procedures to communicate their concerns to members of preferential trade agreements. Notification of agreements provides third parties with an opportunity to analyse the effects of a new preferential trade agreement on their commercial interests, and the process of examination by a working party provides a forum for queries to be answered. However these processes have their shortcomings. Among these is the fact that, though the working party process was originally intended to assess the conformity with the rules of particular regional agreements, more than fifty working parties have been unable to reach unanimous conclusions as to the conformity with the GATT of individual customs unions or free trade areas.

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### III

Nonetheless, the view that regional integration is complementary to the multilateral process is widely held among GATT contracting parties. At the most general level, this view may be ascribed to the fact that the liberal trade principles of the GATT are intended to promote the process of economic integration on a global scale. Thus, their adoption and further refinement at the regional level is generally perceived to reinforce the GATT process. The increasingly broadly-based adoption of outward-oriented policies by countries in the 1980s, especially in the developing world and in central and eastern Europe, has renewed the interest in regional integration. At the same time, regional integration initiatives are generally seen to be at their most effective when anchored to a GATT system that is strong and viable, at least by the smaller trading partners in such arrangements.

Countries in this region have been among the leaders in demonstrating that promotion of dynamic regional arrangements and a strong commitment to multilateralism are essential counterparts. I understand that during the Uruguay Round trade within Mercosul increased by over 20 per cent a year with the exception of the 1989-90 period. Trade values nearly tripled during the round, from around 2 billion dollars in 1986 to roughly 6 billion dollars in 1992. And similar results were achieved in other parts of the world where countries also combined involvement in regional agreements with active participation in the GATT negotiations.

Latin America does, however, have an additional distinction: the impressive number of countries which have joined the General Agreement since the Uruguay Round started in 1986, a fact which contrasts starkly with the situation ten years ago when membership was limited to only some of the region's larger economies. Now only Ecuador and Panama - both in the process of accession - are not yet contracting parties to the GATT. For Latin America, at least, the verdict seems clear.

More generally, there is further support of the complementary nature of postwar regional integration agreements in the evidence that they appear to have had a negligible impact on the structure of world trade, with the important exception of Western Europe. One reason why Western Europe may be an exception is that the regional agreements linking West European states - the customs union between the members of the EC, the free trade area established by the members of EFTA, and the free trade agreements between the EC and EFTA member states - are among the few that have been fully implemented.

The unique nature of West European integration, both in terms of its historical antecedents, and the political commitment of EC member states and their neighbours to carry integration far beyond the economic level, makes it risky to draw conclusions from its experience that would be applicable to other agreements. Even for Western Europe, however, the ratio of extra-regional trade to GDP has not changed much in the postwar period, suggesting that the increasing openness of Western Europe - as measured by the ratio of total trade to GDP - has tended to offset a higher propensity to trade intra-regionally. In particular, the conclusion that the world is witnessing the creation of three inward-oriented 'trading blocs', based in North America, in Western Europe and in the Asia-Pacific region is not supported by an analysis of trends in the pattern of world trade.

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#### IV

The successful conclusion of the Uruguay Round in December 1993 has helped allay many of the concerns posed by the trend to regional integration. The agreement by OECD countries to cut tariffs on industrial products by 40 per cent represents a further reduction in preferential margins. Similarly, the multilateral agreements on trade in agriculture, on subsidies, services and on intellectual property protection represent, for most contracting parties, more far-reaching attempts at liberalization in these sectors than has proved possible in regional agreements.

The Final Act clarifies and strengthens Article XXIV, and these and other results of the Uruguay Round are imbedded in a stronger legal and institutional framework in the form of the World Trading Organization (WTO). This will increase the prospects for enforcing the rules effectively, which will in turn enhance the degree of compliance of members. More generally, the conclusion of the Uruguay Round has restored the confidence of many governments in the viability of the multilateral trading system. Still, the issues raised by the interaction between preferential trade agreements and the multilateral trading system are unlikely to disappear from the international economic agenda.

Available evidence points to a continuation of the trend to regional integration in the 1990s.

- As of early 1994, enlargement negotiations were proceeding between the European Union and four of the six remaining members of EFTA (Austria, Finland, Norway and Sweden), with the aim of accession by 1 January 1995. Over the medium-term, the European Union has accepted that "the associated countries in central and eastern Europe that so desire shall become members of the European Union" (Copenhagen summit declaration of June 1993), and other countries have formally requested accession.
- The EU intends to negotiate free trade agreements with the Baltic states, plans have been made to complete a free trade area with the Russian Federation by 1998, and similar agreements may be reached with other states of the former USSR.
- The expansion of NAFTA to other states is under consideration, and although plans for a free-trade area were set aside by members of the Asia-Pacific Economic Council, several members have indicated their interest in pursuing such an avenue for the future.
- More generally, the trend to regional integration in Latin America is clearly set to continue, and initiatives are likely to be re-activated for Africa, as well as for the Middle East.

Three sets of issues are relevant to future discussions of regional agreements and the multilateral trading system. The first concerns the question of compliance with the rules under Article XXIV, both for new and existing agreements. The second concerns agreements reached by developing countries, for which the precise relationship between obligations under existing rules is unclear. Third, there is the question of the relevance of GATT provisions to concerns of third parties regarding rules of origin or the use of contingent protection in free trade agreements, as well as issues related to liberalization in areas other than merchandise trade.

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One avenue for the future on which there is likely to be little controversy is the need for greater transparency. The renewal of biennial reporting requirements for members of agreements foreseen in the Final Act is important in this regard. While experience has shown that *ex post* examination may not lead to revisions to the agreements, it is still true that *ex post* evaluation and surveillance can have a greater impact on regional agreements than is implied by the virtual absence of *ex post* revisions. Peer pressure is a key "enforcement mechanism" in the world trading system, and countries generally try to forestall future conflicts by keeping their multilateral obligations in mind and potential concerns of third parties when drafting and administering regional integration agreements.

At the procedural level, however, one disadvantage of both the working parties and biennial reports is the "insider/outsider" structure which emphasizes the divergent interests of members of agreements and of third parties. In this regard, a periodic *collective* monitoring exercise would have the advantage of revealing the simultaneous status of most contracting parties as both third parties *and* members of agreements, shoring up the collective interest in sustaining the credibility of the multilateral rules. Such an exercise would permit the contracting parties to periodically assess regional integration initiatives, ensuring that these do not weaken the trading system, but contribute to the goal of maintaining an effective multilateral trading system.

## V

It has been said that the maintenance of the GATT system appears simple and straightforward compared with the maze of problems that would result from an expanding network of preferential trading arrangements. We all know how "simple and straightforward" the Uruguay Round was but now that all that is behind us we must take a hard look at regional trading arrangements based on the new and improved disciplines of the emerging trading regime.

The job of policy-makers has been made considerably easier now that the WTO is being created. Whether in ensuring that existing and future regional agreements remain open or in defining their trade policy in relation to the rest of the world, policy-makers can now rely on the strengthened GATT system to combat divisive approaches which favour the strongest at the expense of the weakest.

In order for the Round's results to turn into tangible and lasting benefits for Latin America as for the global economy as a whole, governments must make sure that the WTO Agreements are ratified by the target date of 1 January 1995 and implemented as quickly and comprehensively as possible. Only then can we rest assured that regional integration will serve the interest of all countries by giving trade the importance it deserves while keeping barriers across regions to a minimum. Only then can we be sure that regionalism and multilateralism will continue to be partners and not opponents.

END