



REGIONALISM AND MULTILATERALISM: COMPLEMENTARY OR SUBSTITUTES?

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Abstract

The increase in number of regional trade agreements over the past two decades gave rise to an ongoing debate on whether such regional agreements promote the growth of multilateralism or hinders it. This paper reviews the pioneering work of various prominent economists on this issue.

Keywords: *Multilateralism, regionalism, RTAs.*

I. Introduction

As the economists deal with the question of whether regional integration agreements are desirable or undesirable for the multilateral system, the literature on regionalism versus multilateralism is emerging. Though regionalism and multilateralism are much used terms in the theory of international trade but their meanings have not been much defined.

Multilateralism is signified by the attempts undertaken for global liberalisation of international relations. This began in the area of trade in goods when General Agreement on Tariffs and Trade (GATT) was signed. GATT further expanded to cover wider areas like trade in services, investment, agricultural products and intellectual property rights, and was taken over by its more refined successor— World Trade Organisation (WTO). Multilateralism has three basic characteristics. It changes qualitatively, quantitatively and formally. ‘Qualitatively’ could be explained that GATT expanded into broader scale to other areas described above and was conclusively confirmed by the signature of General Agreement of Trade in Services (GATS) and Trade Related Intellectual Property Rights (TRIPS) under the WTO framework. ‘Quantitatively’ can be illustrated as, from original 23 GATT countries WTO had 164 members in 2017, and ‘formally’ can be described that institutional structure of the WTO is much robust and tries to impact state authority substantially.

Multilateral Trade Agreements consists of fundamental obligations regarding trade policy which all the members of the WTO have accepted. They are a part of the “single undertaking” applied in the Uruguay Round. That is, all agreements form part of a single package that was accepted by the members as a whole.

Ruggie (1992) has defined multilateralism as, “a deep organizing principle of post war international trade, with three defining characteristics; indivisibility, generalised rules of conduct and diffused reciprocity.” By indivisible system, author meant that a system which allows for extremely deep and very wide network of trade links where governments of different nations are in contact with one another. He viewed the presence of the system as distinct from the individual trade links between participants and its distinct presence is considered as valuable. Author opined that most essential and general principle of this system is non-discrimination which is known to all as Most Favoured Nation (MFN). This principle automatically extends bilateral agreements to all the members of WTO. By diffused reciprocity, author meant that governments even give its consent for individual actions that does not seem to be in their own interests. It is commonly acknowledged that, in general, all the countries will gain from this system.

On the other hand, members to regional trade agreements (RTAs) opposing the principle of most favoured nation provide each other with more favourable treatment in issues relating to trade as compared with the rest of the world, even the WTO members. Regional integration agreements are economic arrangements among two or more countries wherein countries signing the agreement agree to lower and even eliminate barriers to trade like tariffs, quotas etc. The member countries that are the countries signing the agreement even at times make an attempt to coordinate their monetary and fiscal policies. Regional economic integration also termed as regionalism is a process where countries work together with each other to lower or remove barriers to the transnational flow of products, people, or capital for the purpose of increasing cross-border trade and investment and raise living standards. Considering the current patterns of regional trading agreements regionalism can be defined as phenomenon in international trade where nations form groups for the purposes of trade and mutually reduce barriers of trade within the group.

The number of RTAs involving WTO members has increased notably in over the past two decades. In the period 1948-1994, the GATT received 124 notifications of RTAs (relating to trade in goods), and since the creation of the WTO in 1995, over 400 additional arrangements covering trade in goods or services have been notified. In

June 2016, Mongolia and Japan notified an RTA between them, subsequent to which, there is an RTA in force of all the WTO members now. As of 20 June 2017, the WTO had been notified of 659 RTAs out of which 445 RTAs are in force.¹

This upsurge in regional agreements has triggered the economists to ponder whether such agreements are in favour of the world trading system or are detrimental to it. Following section discusses the various studies done by economists in context of multilateralism as against regionalism.

II. Regionalism or Multilateralism

Bhagwati (1990) studied that the general belief for trading blocs is of the discriminatory regional organisations which has the fundamental task of promoting the mutual economic agenda of member nations by safeguarding domestic markets from foreign competition. In this respect, trading blocs are considered as an open threat to multilateralism as well as to the aim of free trade formulated at the conference of Bretton Woods. As per this explanation, the global structure represented by the institutions like the GATT/WTO, International Monetary Fund (IMF) and the World Bank seems to be substituted by a narrower objective of fractional and biased trade liberalization based upon regionalism. Consequently, the weakening dedication to multilateralism might cause disintegration of the international trading system and endorse formation of closed trading blocs whose personal geo-economics motives could bring about a global dilemma.

Bhagwati (1992) and Krueger (1997) articulated deep apprehensions regarding negative impact of increasing regionalism. They were concerned that RTAs dissuade focus from the multilateral trading regime. Bhagwati specifically focussed on the gains from free trade and overruled the cases for the need of regionalism as a substitute or a supplement to the GATT for nations which intend to liberalize faster.

Baldwin (1993) framed the Domino theory of regionalism as a response to the arguments of why economies have a preference for regional integration agreements as compared to multilateral liberalization. Author indicated that alarms like deeper integration of an already existing regional block could lead to requests of membership from the nations which were earlier contended being non-members. The attitude of government with respect to gaining the membership of a regional bloc is the outcome of a political equilibrium that considers both anti-membership and pro-membership factors. He exemplified that the pro-integration factors for a country are the industries which export to the regional block. The exporters in the non-member nations start higher pro-regional political activity as closer integration lowers the profits of non-member nations. This extra activity might bend the country in the support of accessing membership to regional integration agreement which otherwise was nonaligned to it. Author suggests as the regional block gets bigger, the cost for the non-members nations rises as they would have to handle the cost disadvantage in larger number of markets. This would cause higher pro-regional political activity in countries which at present are not the members of the regional agreement leading to more expansion of the bloc. Therefore, author concluded that regionalism grows fast and wide across the globe.

Levy (1997) explained his study in a Heckscher-Ohlin context where trade agreements have an impact on prices of the goods. Using Stolper-Samuelson effects, author explained that the income of individuals depends on their factor endowments. He explained that a bilateral agreement might give uneven benefits to the population of the country and thereby weakening encouragement for an otherwise viable multilateral trade agreement.

Baldwin (1997), Ethier (1998) and Lawrence (2000) consider regionalism as a support for multilateralism by considering it as “building blocks rather than stumbling blocks”. Baldwin contemplated that North American Free Trade Agreement (NAFTA) prompted demand for regional agreements as a type of domino effect. Both Baldwin and Lawrence contemplated that such liberalization supports the exporters and pro-trade forces. Ethier emphasised that “the new regionalism” is the immediate outcome of the global recognition of multilateral liberalization.

Krishna (1998) realised that there is a political support for preferential agreements which divert trade away from the rest of the world. He concluded that such preferential agreements would lower the incentives for multilateral liberalization.

Krishna (1998) used a distinct structure wherein national markets are segmented and oligopolistic firms are essential to define the systems of trade. Even then the author unexpectedly found alike outcome that the RTAs can bend the producers in opposition to a multilateral agreement than they would else support as free trade would put an end to the rents generated by the RTAs. His study depicts a discouraging opinion on the desirability of RTAs.

Winters (1999) deliberated on the question whether regionalism sets up forces that promote or prevent evolution toward globally freer trade. He suggested to find out the meaning of multilateralism since it means different things to different people. He cautioned that if regionalism is allowed then sector-specific lobbies are a danger as they tend to stop blocs from going forward to the way to global free trade. Author also stated that when trade is highly restricted, regionalism seems likely to facilitate freer trade, by allowing stronger internalization of the gains from trade liberalization. He warned that the possibility of regionalism increases the risks of misfortune in the trading system.

Andriamananjara (1999) explained that selecting the path of the preferential route as the passage involving minimal resistance might cause the multilateral trading regime into a vicious circle of competitive discrimination

¹ Source- https://www.wto.org/english/tratop_e/region_e/regfac_e.htm

instead of an arrangement of competitive liberalization. The author concluded "open membership" and minimum MFN tariffs (not compulsorily zero) for the rest of the world in regional agreements can allow for multilateral trade.

Panagaria (2000) debated convincingly in support of multilateral trade liberalization as opposed to regional agreements basing his study on systematic economic analysis. He asserted that preferential trade agreements (PTAs) can divert trade and reduce welfare for the member countries. Author proposed several ways to lower the unfavourable impact of PTAs. First, to lay suspension on the enlargement of PTAs leaving aside those which are in concluding stage of negotiation. Second, to revise Article XXIV of GATT for fixing the tariffs to the pre-PTA level. Third, to implement the alterations in Article XXIV regarding measures of anti-dumping. Fourth, to ensure there be no Rule of Origin (ROO) on a product in a member economy which has the lowest tariff in the union.

Crawford and Laird (2000) suggested that the environment of unilateral reforms and expanded membership to the robust multilateral regime implies that the current trend towards regionalism is slightly less harmful to non-member economies and to the multilateral regime as compared to the previous experiences. Their suggestion is supported by the characteristics of the recent agreements, which have a broader coverage of product and instruments in comparison to the previous agreements thereby, increasing the degree of integration. According to the authors it is hard to find substantial proof that RTAs have been harmful to the third countries.

Crawford and Sam Laird (2001) evaluated how the spread of regional trade agreements have led to the weakening of the multilateral trading system. Authors studied the extent to which such agreements pose a threat to the system. They concluded that recent strong trend towards regionalism is somewhat less dangerous to third countries and to multilateral system than earlier experiences because new agreements have wider coverage of products and instruments than earlier agreements. The economic benefits to members in RTAs would be higher if the liberalisation is done on a wider and multilateral scale.

McLaren (2002) studied the role of negotiating costs and sunk investments in particular sectors instead of focussing on the political-economy opinion. He learnt that regional agreements can also prove to be detrimental for the vision of world-wide free trade. This is because, a projected trading bloc persuades private players in all the member economies to invest in each other's economy. It reduces the ex-post benefits from multilateral free trade. McLaren concludes that, "expected regionalism creates its own demand" and as a consequence, economies lose interest in multilateral liberalization when they start participating in regional agreements.

Schiff and Winters (2003) opined that the progress of multilateral trade liberalization is influenced by regionalism through several routes. They are, by altering the internal incentives for trade liberalization, by impacting the way in which integrating countries interact with each other, and by altering the interactions among integrating countries and the rest of the world. Essentially, there are three arguments for this. The first is that the behaviour of the major blocs— the European Union (EU), NAFTA, and Asia-Pacific Economic Cooperation (APEC)— will influence the multilateral regime in a way which is primarily exogenous for developing nations. All that the developing country can do is to try for affecting such behaviour, perhaps via international institutions, and prepare itself for its consequences. The second is that integrating agreements also comprising of developing economies might impact the behaviour of developing economies themselves, changing their own tendencies for non-discriminatory liberalization and their readiness to defend and protect the multilateral regime. This will have a systemic impact in case sufficient number of developing economies take direct responsibility for the effects of regionalism. The third is that regionalism can also impact the processes of multilateralism along with its results.

Pal (2005) traced the causes behind the profound growth of regionalism and reviewed the literature on regional integration agreements and its relationship with the multilateralism. The study revealed that the profound growth of regionalism could have an unfavourable influence on the WTO governance. As the WTO keeps regional agreements beyond its purview, this has provided the countries a way to avoid the WTO regulations. The study also throws light on welfare impact of RTAs and whether development of RTAs would be trade creating or trade diverting. The study further found that apart from the issue of trade diversion, the complicated chain of RTAs can also create unreliability in the international trading system. Besides the issues linked to the imbalanced power structure, exploitation of developing countries by developed countries could be more serious issue in a regional agreement.

Nataraj (2005) discussed the concept of regional agreement, rules overseeing such agreements in the WTO, factors for developing regional agreements together with the diverse notions of regionalism in the form of "old regionalism versus new regionalism". The study also discussed the ongoing debate between regionalism and multilateralism. The study argued that regionalism is complementary to the multilateral trading system and not a substitute since there is a similar approach in the fundamental goal of both the regionalism and the multilateralism which is to increase the trade among economies. The study asserted that the new regionalism concept of regional agreements led to trade and investment-oriented integration in contrast to old regionalism approach which was centred just on trade effects.

Estevadeordal, Freund and Ornelas (2006) realised that regionalism supports the multilateral system. Authors conjointly stated that the apprehensions regarding negative impact of regionalism on multilateralism in developing economies is being exaggerated. Also, they depicted that higher the tariff preference that an economy offers to the other member economies for a certain product, the more an economy is induced to lower its MFN tariff for that product for non-member economies.

Chand (2006) deliberated upon the causes behind the Asian countries for preferring regional integration in trade. Author studied the effect of regional agreements in Asia on regional and world-wide welfare. Author also studied the changes in the regional concentration of agricultural and non-agricultural trade in Asia during the 1990s and examined its consequences for future liberalization of trade. Author concluded that the preferences or strategic interest had altered the type of trading agreements from RTAs to preferential trading agreements. The study suggested that in the long run free trade area in Asia may cause the end of regionalism in favour of multilateralism.

Limao (2006) debated that to prevent the argument between preferential and multilateral liberalization a different tactic is needed that acknowledges the demand for trade agreements by WTO member's while at the same time ensures that the members do not delay the progress of multilateral liberalization or at least compensates non-members.

Sally (2006) surveyed the FTA activity of the major regional economies of Asia: China, India, the Association of South East Asian Nations (ASEAN) countries, Japan and South Korea. Author concluded that emerging FTA's being weak and partial will not help in integrating with the global economy. On the contrary, if the multilateral trading system weakens further, FTA's can cause regional economic disintegration. FTA activity is distracting attention from the WTO, unilateral liberalization and domestic structural reforms. Author suggested for improving the Asian trade policies on unilateral and multilateral tracks, forming WTO-plus FTA's with simple, harmonized rules of origin and redirecting attention to the WTO. Author concluded by saying that trade policy matters more than trade negotiations.

Saggi and Yildiz (2009) examined the task of free trade agreements (FTAs) in promoting multilateral liberalization among countries when non-discrimination rule of WTO is present. Authors concluded that if FTAs are not allowed, a country may resist a multilateral FTA as it can use the benefits of the liberalization efforts of others. The risk imposed by formation of such trade agreements could converse the aforementioned situation by providing the liberalizing nations a solution to prevent the non-members from free riding.

III. Conclusion

Some economists consider regionalism to undermine the multilateralism as it defies MFN. Some regarded RTAs as divisive, since it intensifies the inclination of countries to consider some economies more eagerly than on others. On the other hand, some economists consider regionalism as complementary to multilateralism. If the status Doha Round of negotiations (it started in 2001 and has not been concluded yet) is considered, it can be said that regionalism complements multilateralism. The principle goal of both is to increase the trade among countries. If the countries participating in regional trade agreements lower the MFN tariffs for non-member countries, then such regional agreements have a positive impact on overall trade thereby achieving the objective of enhancing trade globally.

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