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The Brave New World of Cross-Regionalism

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THE BRAVE NEW WORLD OF CROSS-REGIONALISM

SUMMARY

The paper deals with a new phenomena in the realm of preferential trading which has alternatively been called by various experts with different names: "Cross-Regionalism", "Transoceanic Agreements", "Preferential Trade Agreements", "Polilateralism", "Regionalism Without Regions", "Competitive Regionalism" and "Additive Regionalism". A distinctive feature of this new trend is the simultaneous participation of countries in various Free Trade Areas (FTAs). In many cases, these FTAs have highly differentiated trade rules (usually also being implemented over different periods) and include countries belonging to different geographic regions. The launching of agreements of the new sort challenges geographical proximity as a necessary element promoting and making integration viable. Geographic distance is no longer perceived as a criterion for choosing preferred trading partners. This paper has adopted the concept of "cross-regionalism" used by WTO experts to describe this new trend.

About one third of the FTAs currently under negotiation are among countries that belong to different world regions, with a growing share of North-South agreements. Cross-regional agreements account now for a large proportion of the total increase in PTAs (preferential trade agreements). Both the EU and the USA try to encroach themselves in the sphere of influence of the other. Some middle-income countries (such as Israel, Chile, Singapore, Mexico) strive to escape their initial uncomfortable status of so-called "spoke" by signing agreements with more than one "hub". The most daring of them go forward and conclude also side agreements with other high-income "spokes"(e.g. Chile with Canada or Israel with EFTA).

Every developing country seems to have realized, as some middle income countries did some times before (e.g. Israel and Mexico), that whereas a country can belong to only one Customs Union, it can be a member to an infinite number of Free Trade Areas. Nobody can prevent it from doing so, neither the USA nor the EU. Developing countries and middle income countries do not need to be a "spoke" of only one "hub"; and it can also become a "hub" as well. This dynamic is what would then explain the "free-for-all" atmosphere characterizing this new wave of preferentialism.

Individual PTAs increasingly overlap one with another. This was exceptional in the past but it is rapidly becoming the rule now. The "hub-and-spoke" model tends to disappear or at least to be diluted.

Confronted with this development, the WTO Secretariat has sharply reacted, by stating that the multiplicity of preferential tariff rates (depending on the countries, the groupings or the rules of origin applied) would bring the system to a confusing state of affairs that private sectors would not enjoy.

In fact, the number of actual cross-regional FTAs implemented already is still quite small for the moment; this is why not much can be said yet about the real quantitative and/or welfare impact these new agreements might have.

Assuming that proximity determines the geographic distribution of trade (something which is questioned in the paper), natural trading partners are from the same region or continent by extension. Of course technological change affecting transport costs might influence the degree of "naturalness". Frankel (1998) correctly indicates that if these costs fall with time, the regionally-based FTA will be less and less beneficial. He also introduces the interesting concept of "supernatural FTAs". These are those FTAs concluded among continental partners that are welfare-reducing due to low intercontinental transport costs.

This being said, the rapid conclusion of cross-regional agreements between "non-natural" trading partners in recent years poses the theoretical question of why they are concluded. Economically, independently of who of the two partners gains or losses, the overall diagnosis should be that *caeteris paribus* they may not increase welfare, but rather decrease it. Politically the argument whereby preferential trading allows large countries to create around them spheres of influence or promote democracy cannot be invoked since the shares of trade of the large country in the small one are far from being dominant. Economically, the only justifications seem to be 1) to overcome Frankel's "supernaturalism", i.e. to neutralize the deleterious effects derived from having previously signed with a neighboring country leading to too much costly trade diversion; 2) for the small country to overcome the transport cost differential favoring non-preferred neighbours with preferential market access to the large country. Politically for the small country to sign with a far-away large country implies a reduction of dependence vis-à-vis the local hegemon, which is positively evaluated by some politicians. In other words, whereas differential country size in semi-natural FTAs leads to economic gains for the small and political gains for the large trading partners, in the case of non-natural FTAs, the two sides have both economic and political gains insights.

Insofar as the Multilateral Trade System is concerned, there are some good news and some bad news deriving from the new wave of cross-regionalism:

1. There is no danger of trading blocs emerging nor of a clash between them.
2. There are no new exclusive spheres of influence being created.
3. The new foreign policy goal of preferentialism is to neutralize the influence exerted by rival trading powers in a given zone; reverse trade diversion in favour of the distant trade power must be considered as positive, since it unravels previous trade diversion.
4. Economic opportunity is what drives the choice of preferred trade partners made by developing countries.
5. The proliferation of PTAs is taking place without any control whatsoever.
6. Large negotiating partners are favoured by the proliferation of preferential trading.
7. Least developed countries tend to be less favoured by emerging economies than other more developed ones (including other emerging economies).

ABSTRACT

Cross-regionalism is a new fashion in preferential trading whereby countries, large or small, participate simultaneously in various Free Trade Areas. They seem mostly to be a reflection of the increasing rivalry of the United States and the European Union for drawing the attention by emerging middle-sized and small economies. This trend is profited then by the latter to diversify their previous (almost) exclusive economic relations with a given "hub". A strategy consisting in multiplying the number of Free Trade Areas is perfectly suited both to "hubs" and "spokes". According to the old North-South pattern, economic powers concluding preferential deals sought mainly to reap the political benefit of extending their sphere of influence and small countries the economic benefit of market access to a large market. Now new pattern is emerging whereby the two partners are motivated both by economic and political reasons. One clear result is that spheres of influence are on the wane. But this is of no help to least developed countries.

Classification JEL: Trade negotiation, Regionalism.

Keywords: F13, F15.

**LA MULTIPLICATION DES ACCORDS PREFERENTIELS
CONDUIT-ELLE AU MEILLEUR DES MONDES ?**

RÉSUMÉ NON-TECHNIQUE

Ce document de travail traite d'un nouveau phénomène dans le domaine du commerce préférentiel qui a été appelé par les experts avec des noms très divers : "Régionalisme Croisé", "Accords Trans-Océaniques", "Accords Commerciaux Préférentiels", "Polilateralisme"; "Régionalisme Sans Régions", "Régionalisme Compétitif" ou encore "Régionalisme Additif". Une caractéristique de cette nouvelle mode est la participation simultanée de pays à plusieurs Zones de Libre-échange (ZLE). Dans beaucoup de cas, chacune d'elles possède des règles spécifiques (généralement appliquées sur des périodes différentes) et inclut des pays n'appartenant pas à la même région géographique. La signature de tels accords met en cause la proximité géographique comme élément nécessaire pour la réussite des processus d'intégration commerciale. Apparemment, la distance économique n'est pas perçue comme un critère pour choisir les partenaires commerciaux préférés. Ce document adopte le concept de "Régionalisme Croisé" utilisé par les experts de l'OMC pour décrire le nouveau phénomène.

A l'heure actuelle à peu près un tiers des ZLE en cours de négociation se font entre des pays qui appartiennent à divers continents ou régions, avec une part croissante réservée aux accords de type Nord-Sud. Les accords de régionalisme croisé représentent à l'heure actuelle une large part de l'augmentation totale dans le nombre d'accords préférentiels. Non seulement l'UE et les Etats-Unis, chacun pour sa part, essayent de s'implanter dans la sphère d'influence de l'autre, mais certains pays à revenu par tête intermédiaire (comme Israël, le Chili, Singapour ou le Mexique) luttent aussi pour échapper à leur situation initiale inconfortable de "satellite", en signant des accords avec plus d'une "planète". Les plus dynamiques parmi eux vont de l'avant et concluent aussi des accords latéraux avec d'autres "satellites" à haut revenu par tête d'habitant (par exemple le Chili avec le Canada ou Israël avec l'AELE).

Chaque pays en voie de développement paraît s'être rendu compte de nos jours, comme ce fut déjà le cas auparavant pour d'autres pays à revenu intermédiaire (comme Israël ou le Mexique), qu'alors qu'un pays ne peut appartenir qu'à une seule Union Douanière, il peut en revanche être membre d'un nombre infini de Zones de Libre-échange. Aucun autre pays ne peut l'interdire, pas même les Etats-Unis ou l'Union européenne. Ces pays ne doivent pas être les "satellites" d'une seule "planète". Et ils peuvent à leur tour devenir une "planète". Cette dynamique contribue à la désorganisation qui caractérise cette nouvelle vague de développement des accords commerciaux. Les accords préférentiels individuels se superposent de façon croissante. Ceci était exceptionnel par le passé mais c'est en train de devenir la règle à l'heure actuelle. Le modèle "moyeu et rayon" ("hub and spoke") a tendance à disparaître.

Confronté à ces développements, le Secrétariat de l'OMC a réagi fortement, en déclarant que la multiplication des droits de douane préférentiels (dépendant de pays, de groupes ou de règles d'origine) mènerait le système à un état de confusion néfaste pour l'économie mondiale.

En fait, le nombre de Zones de Libre-échange du nouveau type déjà mises en place est encore très réduit pour le moment. C'est pourquoi on ne peut encore évaluer précisément l'impact réel sur le commerce et le bien-être que ces accords de régionalisme croisé vont avoir.

En supposant que la proximité détermine la répartition géographique du commerce (une hypothèse qui est remise en cause dans le document), les partenaires commerciaux dits "naturels" font partie de la même région ou du même continent. Evidemment, les changements technologiques qui affectent les coûts de transport peuvent affecter le degré de "naturalisme". Frankel (1998) signale que si ces coûts diminuent avec le temps, les ZLE basées sur une région donnée seront de moins en moins bénéfiques. Il introduit aussi le concept particulièrement intéressant de "ZLE super naturelle". C'est la ZLE conclue parmi des partenaires continentaux qui réduit le bien-être parce que les coûts de transports intercontinentaux sont faibles.

La conclusion récente d'accords de régionalisme croisé entre des partenaires commerciaux "non naturels" pose la question théorique de leur raison d'existence. Economiquement, mis à part le fait de savoir lequel des deux partenaires gagne ou perd, le diagnostic d'ensemble devrait être, qu'en toute probabilité, ces accords n'augmentent pas le bien-être, mais tendent plutôt à le réduire. Politiquement l'argument selon lequel le commerce préférentiel permet aux grands pays de créer autour d'eux des sphères d'influence ou de promouvoir la démocratie ne peut pas être invoqué dans ce cas, car la part du commerce des grands pays dans les échanges extérieurs des petits est loin d'être dominante. Economiquement, les seules justifications semblent être 1) surtout pour le grand pays, de dépasser le problème du "supernaturalisme" signalé par Frankel, c'est-à-dire de neutraliser les effets néfastes découlant des accords préférentiels signés auparavant avec un satellite voisin, menant tout droit à de coûteux détournement de commerce; 2) pour les petits pays, de dépasser le différentiel de coûts de transport favorisant les pays voisins non-préférés en obtenant un accès préférentiel au marché du grand pays. Politiquement, pour le petit pays signer un accord avec un grand pays lointain réduit la dépendance commerciale vis-à-vis de la puissance hégémonique régionale. Pour le grand pays, l'intérêt politique du régionalisme croisé est d'éviter la création de zones d'influence par un autre grand pays rival. En d'autres termes, alors que le différentiel dans la taille des pays qui s'associent dans le cas de ZLE naturelles tend à produire des gains économiques pour les petits pays membres et des gains politiques pour les grands pays membres, dans le cas de ZLE non naturelles, les deux partenaires ont aussi bien des gains économiques que des gains politiques en vue. Pour ce qui est du système commercial multilatéral mis en place en 1948, la nouvelle vague de régionalisme croisé apporte des bonnes et des mauvaises nouvelles :

1. Le danger que des blocs commerciaux se créent et, pis encore, que ceux-ci s'affrontent, a pratiquement disparu.
2. Il n'y a pas des nouvelles créations de sphères d'influence.
3. Le but nouveau du *préférentialisme* en matière de politique étrangère est de neutraliser l'influence exercée par des puissances commerciales rivales dans une zone géographique donnée; le détournement de commerce inverse qui en résulte à la faveur de la puissance commerciale distante doit être considéré comme positive, car elle défait des détournements de commerce créés auparavant.
4. C'est l'opportunisme économique qui guide dorénavant les choix des partenaires commerciaux privilégiés par les pays en développement.
5. La prolifération d'accords préférentiels est en train de se développer de façon incontrôlée.
6. Les grandes puissances commerciales sont favorisées par la prolifération d'accords préférentiels.
7. Dans un tel contexte, les pays les moins développés ont tendance à être moins préférés que d'autres pays plus développés par les pays à économie émergente.

RÉSUMÉ

Le régionalisme croisé est une nouvelle mode appliquée par de grandes comme de petites économies dans le domaine du commerce préférentiel, qui consiste pour celles-ci à participer simultanément à plusieurs zones de libre-échange. Il semble être pour la plupart un reflet de la rivalité croissante entre les Etats-Unis et l'Union Européenne pour attirer l'attention des économies émergentes de taille petite et moyenne. Cette tendance est mise à profit par ces dernières pour diversifier leur relations économiques pre-existantes (presque) exclusives avec un pays "moyeu" donné. Une stratégie consistant à multiplier le nombre de Zones de Libre-échange s'adapte parfaitement aux objectifs aussi bien des "moyeux" que des "rayons". Dans l'ancien modèle Nord-Sud, les puissances économiques concluant des accords préférentiels essayaient de tirer le bénéfice politique d'étendre leur sphère d'influence et les petits pays le bénéfice économique découlant de l'accession à un grand marché. Dans le nouveau modèle, les deux partenaires sont motivés par des raisons économiques et politiques à la fois. Un résultat clair est que les sphères d'influence tendent à disparaître. Mais ceci n'est pas de nature à aider les pays en développement les plus démunis.

Classement JEL : Négociation commerciale, Régionalisme.

Mots Clés : F13, F15.

THE BRAVE NEW WORLD OF CROSS-REGIONALISM

Alfred Tovias¹

1. A BRAVE NEW WORLD

In his book "Nineteen Eighty-Four", published in 1949, George Orwell pictured a world divided between three rival totalitarian powers: East-Asia, Oceania and Eur-asia, which would be in perpetual war, always two of them allied against the third in sequence. Similarly, quite a few experts in international economic relations, whether economists or political scientists, were predicting less than a decade ago that the 21st century would be characterized by the emergence of trading or trade "blocs" in the context of what was then baptized as the "New Regionalism"². Quite a number of books, reports and articles written in the second half of the 1990s contain in their title the word "blocs", including from the most serious international institutions (e.g. see World Bank, (2000)).

Even the former GATT's General Secretary, Renato Ruggiero, said in a speech in 1997 that the new RTAs (Regional Trade Agreements) were about "securing regional spheres of influence in a world, marked by growing competition for markets, for investment and for technology" (quoted in Mathis, (2002), p.127). Clearly Ruggiero's scenarios remind the setting of the 1930s. He feared the development of concentric circles around two focal points or hegemonic trade superpowers, namely the US and the EU. For him, it reflected an inability of the transatlantic community to coordinate its trade interests and vision, all being an outcome of the end of the Cold War. Some time before, Huntington (1993), in his remarkable article on the Clash of Civilizations, had evoked the possibility of international friction, if not war, between different "tectonic plates", an idea bearing some commonality with the concept of "blocs". The world was suffering from a bout of so-called regionalism, namely a doctrine or ideology that argues that countries should promote trade preferably with countries of the same region³ rather than with any other country in the world. This is the case for different reasons, be they political, cultural, defensive and last but not least economic. It may have potentially lethal consequences not only for the open multilateral world trade system as embodied by the laws of the WTO but also for world peace (Tovias, 2000a).

¹ I especially wish to thank Lionel Fontagne, Agnes Benassy, Matthieu Crozet and Daniela Persin for their comments on an earlier draft of this paper.

² This would happen through a domino process of bloc creation. For instance Frankel and Wei (1998) explain how the creation of a continental trade bloc (made up of natural trade partners) may lead to the creation of a competing second one, and so on.

³ A region is characterized by a geographical dimension in conjunction with its extra-regional perception and regional identity.

In recent years, and to the astonishment of many, the international business press has reported about the conclusion of trade agreements that not long ago would have been considered belonging to the realm of political fiction. A good illustration, for instance, of what is here mentioned is the announcement posted in mid-2005 on the website of the General Directorate for Economic Affairs of Chile explaining that Brunei, Chile, New Zealand and Singapore were to conclude negotiations on a Trans-Pacific Strategic Economic Partnership Agreement and presented as a "bridge between Latin America, the Pacific and Asia". This Free Trade Agreement would enter into force on January 1 2006. In other news, the press revealed in November 2004 that Chile and China were to start negotiations towards the conclusion of a Free Trade Agreement⁴. Experts of the World Bank have been using the term of "Additive Regionalism" when relating to the new wave of agreements with multiple partners concluded by countries such as Singapore, Mexico, Chile and Israel as it would be a new fashion or trend. The US has concluded an FTA agreement with Bahrain in 2004 (see Table 1), whereas the latter country is a member of the Gulf Cooperation Council, aspiring to become a Customs Union. Obviously, sometimes new programs or policies are launched and never come to fruition. But what seems important here is that they are openly announced. The EU-25, an hegemonic trade superpower, has not been able to achieve its negotiations for the conclusion of an FTA with Mercosur, a Latin American scheme initially aiming at the creation of a Customs Union (hence allowing the EU to negotiate with it as a unit).

This working paper deals with this new wave or fashion, dating back to the year 2000 (see later Table 1 for a list of the agreements in force), which has alternatively been called by various experts with different names: Cross-Regionalism (Crawford and Florentino, 2005), Transoceanic Agreements (Peridy, 2004), Preferential Trade Agreements (Bhagwati and Panagariya, 1999), Polilateralism (De Sebastian 1995), Competitive Regionalism (Abugattas Majluf (2004)) and, last, but not least, Additive Regionalism (Harrison et al., 2002). A distinctive feature of this new trend is the simultaneous participation of countries in various FTAs, even if, in many cases, these agreements have very different trade rules (usually also being implemented over different periods) and including countries not belonging to the same geographic region at large. The launching of agreements of the new sort challenges geographical proximity as a necessary element promoting and making integration viable. Economic distance is no longer perceived as a criterion for choosing preferred trading partners. These agreements challenge the classical notion of a region. This paper has adopted the concept of "cross-regionalism" used by Crawford and Florentino (2005) to describe the new trend.

About one third of the FTAs currently under negotiation are among countries that belong to different world regions, with a growing share of North-South agreements. According to Crawford and Florentino (2005), cross-regional agreements account now for a large proportion of the total increase in PTAs (preferential trade agreements)⁵. And both the US

⁴ Free Trade Agreement (FTA) refers in this document to a special type of Preferential Trade Agreement (PTA), in that tariff preferences applied on substantially all import trade originating in the partner country reach 100 percent.

⁵ As of January 2005, 312 PTAs had been notified either to the GATT (before 1994) or to the WTO since then. Of these 170 were in force, and 65 were operational but not yet notified by that time. Also according

and the EU would like to be the first in integrating units like Mercosur. Actually, both the EU and the US try to encroach themselves in the sphere of influence of the other. Some middle-income countries (such as Israel, Chile, Singapore, Mexico) try to escape their initial uncomfortable status of so-called "spoke" by signing agreements with more than one "hub". The most daring of them go forward and conclude also agreements with other high-income "spokes" (e.g. Chile with Canada or Israel with EFTA). Some of the agreements are economically very significant. For instance, the US-Australia FTA, composed by two important OECD countries, is likely to account for a larger share of world trade than many regional South-South or even North-South agreements.

2. HISTORICAL BACKGROUND. FIRST, SECOND, THIRD WAVE OF REGIONALISM: WHAT IS NEW?

In the 1950s, 1960s and 1970s, PTAs were among countries of similar development levels, usually in close geographical proximity and focused on eliminating tariffs on industrial goods. They took the form of Customs Unions (e.g. the EC, UDEAC) or Free Trade Areas (e.g. EFTA, LAIA, Andean Pact). One exception to this type of regionalism was the EC which already then started signing some reciprocal trade agreements with countries or FTAs in its proximity (e.g. the 1972 EC agreements with individual EFTA countries). For the rest EC cooperation agreements with developing countries (such as Mediterranean or ACP countries) were non reciprocal⁶.

The turn to the second type of regionalism at the end of the 1980s was, according to different experts, the result of declining US hegemony and the world economic recession, combined with the demise of the Soviet empire. What was new then was that the US wanted to establish itself as a regional benevolent hegemon in the Western Hemisphere. Admittedly, Latin America had been the backyard (and, for some, the private garden) of the US since at least the 1940s. But with the end of Cold War, the US could take a more relaxed view of Latin America. It could for instance try to promote democracy and reform in Latin America without taking big security risks for itself. This could be done in a business-like manner by drawing very enticing FTA agreements for the Latin American candidates, namely tariff-free unimpeded and secured access to the largest national market of the world, namely the US (including agricultural markets). In exchange Latin American countries would have to respect some US-imposed rules (labour standards, environmental norms, Intellectual Property Rights). Hence the rapidly-

to the WTO, between January 2004 and February 2005, 43 PTAs had been notified to this organization. 70 other agreements were under negotiation. The number of PTAs quadrupled between 1990 and the end of 2004. Actual trade between PTA partners makes up nearly 40 percent of total trade and this percentage increases to more than 50 percent if one includes prospective PTAs. For some WTO members preferential trade covers now 90 percent of their total trade flows. In fact, but for the (in) famous exception of Mongolia, every country of the world is involved in one or more PTAs. On average each WTO member is now in 6 agreements. Northern countries have 13 PTAs on average; the average developing country has nowadays 5 PTAs. There are however some exceptions, e.g. East Asian countries which for the moment have very few agreements (World Bank 2005).

⁶ Different GSP schemes (including the one of the EC) are not counted here, since they were based not on bilateral agreements but on unilateral temporary trade concessions made by developed countries to all developing countries without discrimination.

concluded deal of NAFTA and the proposal for an FTAA (Free Trade Area of the Americas) were proposed by the US government to Latin America. At the same time the US administrations of the period felt the US could not act anymore (as had been the case since 1945) as a global hegemon. As Woolcock shows in Geiger and Kennedy (1996), in the first half of the 1990s the preoccupation of multilateralists in GATT and as from 1994 in the WTO was with the emergence of trading blocs, i.e. contiguous countries forming a region (exemplified by the EU, NAFTA and Mercosur and the project of ANZCERTA⁷) and the possible reaction of all this by ASEAN countries. Among others, this was due to the uncertainty about the fate of the Uruguay Round of multilateral trade negotiations which had started in 1986 and had been stuck at different instances. Another frequently-mentioned factor by the relevant literature was the fear of seeing the emergence of Fortress Europe as an outcome of the Completion of the Single Market (the so-called EC1992 program) together with the perspective of further EU Enlargements. Observe, as well, that the main tensions during the Uruguay Round were between the US and the EU, with middle income and developing countries wondering if it was no time to get a separate deal with the local hegemon. This was the time of the so-called domino regionalism and the hub-and-spoke systems, popularized in Baldwin, Haaparanta and Kiander. (1995) and Baldwin and Venables (1995).

Since the formal initiation of the Doha Round in 2001 (and after the failure of the 1999 Seattle meeting) the fight is between North and South (around the group of the G-20, captained by Brazil). The fear then is not anymore that closed trading blocs will emerge as a result of a possible failure of the Doha Round which is a clear possibility (see below). By now every developing country has learned, as some middle income countries did some times before (e.g. Israel and Mexico) that whereas a country can belong to only one Customs Union, it can be a member to an infinite number of Free Trade Areas. Nobody can prevent it from doing so, neither the US nor the EU⁸. Countries need to be a "spoke" of only one "hub", and they can become a "hub" as well. This dynamic explains the "free-for-all" atmosphere characterizing this new wave of preferentialism, which is the object of this paper. It is a development going well beyond the so-called "hub-and-spoke" pattern. What seems to be emerging now is a multipolar trade system, rather than the multilateral one envisaged by the architects of the WTO a decade ago (Mathis (2002)). Individual PTAs increasingly overlap one with another. This was exceptional in the past but it is rapidly becoming the rule now. The "hub-and-spoke" model tends to disappear or at least to be diluted, not only because there are agreements between the spokes, but also because some of the spokes become hubs (Chile, Mexico, EFTA, Canada, Israel, Singapore) and some of the hubs become spokes themselves (the US, the EU).

⁷ ANZCERTA is the Australia-New Zealand Closer Economic Relations Trade Agreement which came into effect on January 1 1983.

⁸ As strange as it might sound, Japan, Australia and many Eastern Asian countries seemed to have ignored until recently this possibility, although there must have had second thoughts. For instance, the International Herald Tribune of December 17 1999 contained an article entitled: "WTO Flop Spurs Pacts at US expense", which argued that as a result of the Seattle debacle, countries like Japan had begun to look for special deals including one with Mexico, not in its region. The article underlined the dangers of Balkanization of the global economy, but quite interestingly, its author did not yet preach the US government to make special deals with countries across the oceans.

An answer to the "spokes" rebellion developed quickly as from 2001-2002 when the first US George W. Bush Administration launched what was denominated by its USTR Representative of the time, Robert Zoellick, "competitive regionalism", namely that the US was open from now on to signing special preferential trade agreements (of course officially conforming with WTO rules and taking the form of FTAs) with any country in the world regardless of its location. The Economist, February 24 2004, reported that since the Cancun Summit ending in total discomfiture at the end of 2003 the US had turned bilateral and that it had reached a deal with Australia.

The EU did not wait for the "rebellion of the spokes" to unfold when it decided as from 1999 to try to get a deal with Mercosur. This was violating the unspoken rule of a division of the trade world into specific spheres of influence (see the first and second regionalism). At the time it seemed as something innocuous, as the US had not budged when the EU succeeded in signing a separate FTA deal with Mexico which entered into force in 2000. But maybe the reason for the US passivity then was that the EU presented the agreement as an answer to NAFTA's trade diverting potential against the EU.

In any case it is the impatience with the lack of progress at the WTO multilateral level that explains the present race. Pessimism about the fate of the Round reached a high point for the first time after the *sine die* formal suspension of the negotiations by the WTO's Director General, Pascal Lamy, on July 24 2006⁹. A subsequent meeting of the G-4 (i.e. Brazil, the EU, the US and India), held in Potsdam on June 19 2007, failing to produce concrete results, has only confirmed the prevailing pessimistic prognosis for the present Round¹⁰. Therefore it does not come as a surprise that some countries have actually felt since quite some time now that they could beat at this race not only some other competing countries but more to the point all of them by betting on the fact that the Doha Round results would and will not succeed or in any case will take a lot of time to be implemented if at all. For instance, already in June 2000 (about six months after the Seattle debacle), EFTA invited Chile to initiate conversations for the creation of a bilateral FTA. The agreement was signed already in June 2003 entering into force in December 2004. And Chilean exporters are already benefiting greatly of a previous FTA signed with the EU, which entered into force in January 2003. A report the government of Chile published in January 2004 states that exports to the EU increased 18 percent in 2003, while exports to the world only by 13 percent. Exports were also diversified as the share of copper decreased and also the geographical distribution in favour of the EU in total exports had increased. The EU represents now 24 percent of total Chilean exports, rising from 18 percent before the agreement. Moreover interviews made to new foreign investors in Chile said to the authors of the report that the multiplicity of Chilean FTAs was a factor in the decision taken.

⁹ At that date the countries of the G-6 (Brazil, Argentina, India, the EU, Japan and the US) had not yet been able to narrow their positions regarding the main obstacle in this Round, namely agriculture concessions. See Decreux and Fontagné (2006).

¹⁰ See M.Kohr, "WTO: Why Potsdam Failed", *Economic and Political Weekly*, June 30 2007, www.epw.org.in/epw/uploads/articles/10768.pdf

Confronted with this development, the WTO Secretariat has sharply reacted by stating that the multiplicity of preferential tariff rates depending on the countries, the groupings or the rules of origin would bring the system to a confusing state of affairs that private sectors would not enjoy (*The Economist*, October 24 2003). The multiplicity of rules of origin might lead an exporter to tailor its products in accordance to a daunting array of product-specific criteria in order to reap benefits. In many cases he might give up. And as well known, enforcing origin rules has administrative costs, which in the case of EFTA have been estimated to be around 3 percent of the value of intra-EFTA and EFTA-EU trade (Baldwin and Venables, 1995, p. 1635). Moreover small countries with limited human resources to examine and negotiate trade deals will be disadvantaged (see below).

3. PRESENT, PAST AND PROSPECTIVE CROSS-REGIONAL TRADE AGREEMENTS

Below is a list of the most significant agreements considered in this paper in chronological order with the date of entry into force. The reason for indicating the latter is that it is not the date of negotiations which is economically significant, nor the dates of signature or ratification, but the actual entry into force, as this is normally the date when an important share of mutual trade starts to be freed between the parties on a discriminatory basis. From the table it appears that the number of actual cross-regional FTAs in force is still quite small for the moment and that only in individual cases one can try to verify if the agreement has had an actual impact on trade flows. One must mostly rely for the moment on anecdotic evidence, as the one reported above by Chile. In the Annex, a Table has been included with the amounts of bilateral trade involved and the latter's relative importance compared to the size of the partners' GDP.

Before proceeding, observe that some important preferential trade agreements have not been included, because they are not properly speaking cross-regional in character. More concretely, this paper will assume that agreements signed by a hegemonic trade power with partners in their continent's periphery are not part of its focus. In other words, the paper excludes so-called Hemispheric Hegemonic Regionalism from the count. There are three typical cases:

Table 1:
Cross –regional trade agreements and date of entry into force (in chronological order)

8/1985	Israel-US	
1/1995	Bolivia-Mexico	
7/1997	Canada-Chile	incl. services agreement
9/1997	Israel-Canada	
8/1999	Chile-Mexico	incl. services agreement
7/2000	Israel-Mexico	
7/2000	EC-Mexico	services agreement 3/2001
1/2001	New Zealand-Singapore	incl. services agreement
7/2001	EFTA-Mexico	incl. services agreement
12/2001	US-Jordan	incl. services agreement
2/2002	Chile-Costa Rica	incl. services agreement
6/2002	Chile-El Salvador	incl. services agreement
11/2002	Canada-Costa Rica	
1/2003	EFTA-Singapore	incl. services agreement
2/2003	EC-Chile	services agreement 3/2005
7/2003	Singapore-Australia	incl. services agreement
1/2004	US-Singapore	incl. services agreement
1/2004	Chile-US	incl. services agreement
1/2004#	Panama-Taiwan	
4/2004	Republic of Korea-Chile	incl. services agreement
7/2004#	Mexico-Uruguay	
12/2004	EFTA-Chile	incl. services agreement
1/2005	Thailand-Australia	incl. services agreement
1/2005	US-Australia	incl. services agreement
4/2005	Mexico-Japan	incl. services agreement
7/2005	Thailand-New Zealand	incl. services agreement
8/2005	Jordan-Singapore	incl. services agreement
1/2006	US-Morocco	incl. services agreement
3/2006	Korea-Singapore	incl. services agreement
7/2006	Guatemala-Taiwan#	
7/2006	Japan-Malaysia	incl. services agreement

8/2006	US-Bahrain	incl. services agreement
9/2006	EFTA-Korea	incl. services agreement
10/2006	Chile-China	
not implemented yet	Chile-New Zealand--Singapore-Brunei	
not implemented yet	Panama-Singapore	
not implemented yet	US-Malaysia	
not implemented yet	US-Oman	
not implemented yet	US-UAE	
not implemented yet	US- Republic of Korea	
not implemented yet	US-Thailand	
not implemented yet	US-SACU ¹¹	
not implemented yet	Peru-Thailand	

= not notified to the WTO

Source: WTO and various other sources.

1. EU preferential trade agreements derived from colonial legacy

This includes the present Cotonou agreement as well as future EPAs with so-called ACP countries (African, Caribbean and Pacific states). Africa has been perceived for many decades, if not centuries, as a geographical extension of Europe. For the same reason this paper does not include the EU's FTA agreement with South Africa and its dependencies, signed in 2000. This agreement can be considered as regional insofar as one can speak of a large Euro-African region dominated by geographic contiguity, proximity, historical legacy, colonial bonds and not separated by an ocean. Taking an historical perspective of more than 100 years now, the present agreements can be considered as a perpetuation of those trade bonds, only that formal independence of African states has meant a scaling down of the Customs Union regime imposed by the colonizer on its colonies to a softer version, namely a Free Trade Area Regime¹².

¹¹ SACU is the Southern African Customs Union.

¹² A similar scaling down will certainly take place the day the Palestinian Authority becomes really independent from Israel. At present a Customs Union regime is applied by the occupying power (September 1994 agreement) but the PA has been persistently asking for a switch to an FTA regime. Observe that the EPAs are based on reciprocity and reverse preferences, to conform with WTO rules, and that they would have been rejected before 2000 by African leaders, such as Senghor of Senegal, who consistently called reciprocally-based PTAs as "neo-colonial".

2. EFTA

EFTA was created in 1959 by seven countries: Britain, Switzerland, Austria, Sweden, Denmark, Norway and Portugal. Although all these countries are geographically-dispersed and non contiguous they belong to Western Europe, therefore to the same "region". Geographical dispersion had some bearing on theoretical analysis to predict results. Shibata (1971) and later on Curzon (1974) discovered the existence of an idiosyncratic effect of FTAs (the so-called shifting effect) which did not exist in the case of Customs Unions. In short, the high-tariff country in the FTA would tend to import after the agreement from the low-tariff country, which would in turn reduce sales in its local market to give way to imports from the Rest of the World. However this shifting effect would only happen if differential transport costs would not neutralize the difference between the tariff rates of the high-tariff country and the low-tariff country. That seemed to be precisely the case of EFTA: shifting effects seemed unlikely to happen, not only because dispersion but also because generally tariff rates of the participants on industrial products were not so far apart. Meantime, EFTA has contracted to four countries through progressive inclusion of most of its erstwhile members in the EU (Norway, Switzerland, Iceland and Liechtenstein).

3. FTAA

The FTAA (Free Trade Area of the Americas) proposal contemplating preferential free trade among all countries of the Western Hemisphere. It is a soft version of the J. Frankel's "continental trading bloc" (Frankel 1998), as no common commercial policy is to be introduced. It is also a pale version of the Monroe doctrine of 1823, as the US was well aware when producing the proposal that an FTA is not a Customs Union and that partners are able to sign as many FTAs as they want. This would help to dispel any suspicion possibly held by some of the Latin-American potential partners that the continental hegemon was trying to impose its trade policy on others.

Looking to the past, there is of course a very important historical precedent for non-geographically based agreements and/or arrangements, namely colonial empires. They were justified in many cases on the basis of "historical kinship" and also in the case of the British Imperial Preferences contemplated in the Ottawa Agreement of 1932, as a reaction to European regionalism of the first part of the XX century (Clavin, 1996, p.51). Security considerations played of course also a role although Britain was menaced by continental Europe while the Empire was menaced by Japan. As colonial empires took the form of Customs Unions (although in practice they were Customs Annexations), a given country could only belong to one Empire and not to several. Moreover, it must be noted that after WWII, in the minds of the US negotiators of the GATT, there were no differences to be made between imperial and regional preferences. All would have to be equally banned (but for the conditional exception of Customs Unions, Free Trade Areas and *interim* agreements leading to the latter). Note incidentally that article XXIV of the GATT does not contain any mention of words with a "geographical" connotation, and proximity is not imposed on prospective partners to an integration agreement.

Focusing now into the future, there are two large-scale projects on the drawing board, which meanwhile have confronted many obstacles in being implemented:

1. APEC (Association of Pacific Exporting Countries)

In November 1989 the concept of "Asia-Pacific" emerged in the press when it started to be used in connection to a new project, launched then when a new association with no historical background was formed, namely the Association of Pacific Exporting Countries. APEC would not be a typical regional trade agreement. It was created as a reaction to the emergence of the EEA (European Economic Area) and the possibility of the EU further enlarging North and East. At first it was only a high-level forum on economic co-operation. But there has been an on-going lack of consensus on the ultimate objectives of APEC and how these might be best realized. It is now 16 years old and the results are meager. In 1989, the target was to reach free trade by the year 2010 for the developed members of the group and by 2020 for the others. APEC was initially conceived as a mini OECD, not an FTA, but by 1993-94 there was a shift in the position of some important members, such as the US and Australia, and trade liberalization was given priority. But Asian members were in fact only keen on trade facilitation and economic and technical cooperation. At the beginning the idea launched was to practice what has been called "concerted unilateralism", but very quickly it appeared that the US was against and requested reciprocity from whoever wanted to be part of APEC. If for instance the EU was to benefit of APEC it would have to commit itself to unilaterally liberalize as well. In passing it is interesting to note (Young and Perkidis 1996, p.72, p. 104) that at the beginning of APEC, a clash of interests between the EU and the US developed regarding ASEAN's role in APEC as the US considered it part of the US sphere of influence. As a result and more concretely, EU leaders feared that the ability to combine US and Japanese tactics would allow APEC original members to corner the EU in GATT negotiations.

One common problem to APEC and the FTAA projects (see above) is that with their large number of members they look suspiciously like the WTO, whereas they do not have a solid institutional basis as the GATT or WTO. The sheer complexity of the APEC project did make it unpractical. Given that, the divergent objectives of the members, and to cap it all, the bad taste left by the Asian financial crisis of 1997/98, nothing came about in terms of PTAs and it is precisely the frustration with APEC that has led its developed members to go bilateral (Singapore, New Zealand, Australia and the US).

APEC failed again to move on the issue of creating an FTA at its last Annual Summit in Sidney held in September 2007. It decided instead to support ongoing WTO negotiations. Consequently, the EU does not see APEC as a competitive threat anymore and EU-ASEAN trade relations in the form of ASEM are not likely to be upgraded significantly in the foreseeable future.

2. EU-Mercosur

This project is still unfinished business, although there are reasons to think that it is stalled and some experts predict its failure. Independently of the minutiae of the negotiations which were suspended *sine die* in September 2004, the main strategic reason for this pessimistic outlook is the paralysis affecting the US project of the FTAA (see above). Because of the importance of this large-scale cross-regional project, some background seems warranted. First, it is to be noted that historically the EU preceded the US in

engaging in systematic cross-regionalism (excluding the isolated case of the 1985 US-Israel FTA). The idea that the EU should engage in preferential trading with Latin American countries dates back to the second Delors' five-year period as President of the European Commission in the early 1990s, before the establishment of NAFTA. In 1993-94, both the Trade Commissioner, Mr. Leon Brittan and the Commissioner in charge of Latin America and Mediterranean Countries, Mr. Manuel Marin, lined up with the president of the Commission in proposing a new external trade policy. It had to be adopted as a result of the toughening of requirements introduced in amendments to the GATT 1947 Treaty and particularly its article XXIV during the Uruguay Round (1986-1994). From now the EU would only sign agreements with third countries complying strictly with article XXIV, i.e. agreements based on reciprocity, e.g. FTAs. Initially nothing came out of it. It would be the actual implementation of the NAFTA agreement which gave a decisive push to the idea that the EU should counteract the US moves by concluding FTAs with Latin American countries. Quite curiously, at the beginning, no EU member state seemed interested, not even Spain or Portugal. This project will have to wait until 1999 when the former Prime Minister Aznar from Spain and President Chirac of France in a bilateral summit say that such links are geo-strategically important for the EU. But already then they insist that institutional agreements should set agriculture aside. This last subject should be dealt with at the WTO level. This of course is an excuse since the real reason is that the EU is not considered particularly competitive in agriculture when compared with some Latin American countries, such as Brazil. In 1999 at the Rio Summit of Heads of State of EU and Latin American countries a decision is taken to start negotiations for the conclusion of an EU-Mercosur FTA agreement. They have not yet concluded at the time of writing and they will not seemingly be concluded in the foreseeable future.¹³

On the EU's side the proclaimed political objectives have been:

- a) To launch an institutionalized political dialogue with Latin American countries chosen. Not to be forgotten is that timid political ties between Latin America and the EU date only back to the 1980s (e.g. the San Jose process in Central America)¹⁴; in fact the so-called Monroe doctrine of 1823 of non-interference by Europeans in Latin America had been scrupulously respected by the EU until then. And the EU's wish of political dialogue would be centered only on the larger Latin American countries (Brazil, Mexico, Chile, and Argentina) and not everywhere, as the US hegemon was trying to do.
- b) To promote democracy in Latin America by including elements of political conditionally in agreements to be signed; e.g. the automatic suspension of the agreement between the parties in case of violation of the democratic regime or Human Rights in one of them.

¹³ The EU negotiated an FTA with Chile more recently which came into effect in 2003, based on the experience gained in negotiations with Mexico. Although some agricultural concessions to Chile were made by the EU, it was nothing of the order of what the experts expected to be involved in the context of EU-Mercosur negotiations.

¹⁴ For a thorough review of the EC policies regarding Latin America in the 1980s, see Tovias (1990).

- c) To spread in South America the EU's model of integration of national economies by concluding a region-to-region transatlantic FTA between two Customs Unions (the EU and Mercosur) and in this way consolidate the latter (Vaillant and Ons, 2002)¹⁵. Mercosur was a process of integration modeled on the EU and therefore a strategic and long-term partnership between the latter and Mercosur was sought. More generally, the EU wanted to transfer examples of its own best practices to Latin America and to diffuse European norms outside (Grugel, 2004).
- d) To help building a new multilateralism based upon a more balanced relationship with the US by establishing a strategic partnership with emerging structured regions such as Mercosur. Accordingly relations with Mercosur would become high priority for EU foreign policy, supported strongly by Portugal, Spain and Italy for historical reasons and by Germany to protect its important foreign investments there (Vasconcelos 2001). One related political reason was the hope that the strategic partnership would lead Mercosur to support the EU at the United Nations.

Because of these last two reasons, when in more recent years, Mercosur has been existentially menaced under pressure from centrifugal forces; the Commission has adopted policies to prevent Mercosur from collapsing (a position diametrically opposed to that of the US). For instance the EU has warned Mercosur members that if Mercosur unravels the EU does not plan to sign FTAs with each of them.

Economically the objectives were:

- a) To avoid trade diversion against the EU should a Free Trade Area of the Americas (FTAA) become reality (Szymanski and Smith 2005). There were reasons to think that several Latin American countries signing FTAs with the US would raise their applied tariff rates (to levels of course not exceeding the much higher bound rates in WTO) on non-members so as to compensate for the invasion of US products on local markets. This was not fantasy; Mexico did so upon the establishment of NAFTA (e.g. in the domain of textiles), leading to a substantial fall in the EU's share in Mexican imports (from 9 percent in 1993 to 6.4 percent in 1999). Mexican imports from the EU fell from 11.9 billion \$ to 9 billion \$ between 1993 and 1997¹⁶.
- b) To support existing and potential European FDI flows to Latin America, e.g. by including government procurement clauses discriminating in favour of EU firms in EU agreements with Latin American countries.

To sum up, it appears that the EU's fear of losing the already reduced influence it had in favour of the US in Latin America played a big role in defining both the EU's active and

¹⁵ An EU official involved in the negotiations and interviewed for this research used the expression of "EU messianic mission" to describe the EU's intentions.

¹⁶ It is quite symptomatic of the enormous EU fears that the Commission tried first the stick and not the carrot by warning Latin American countries not to engage in the FTAA project with the US. Another more unspoken fear was that these countries could adopt later on US rules and standards.

the reactive policies there. This fear reached a height in the second part of the 1990s when the EU was focusing increasingly in deepening relations with Central and Eastern Europe. It has sharply decreased after the freeze applied by the US government on FTAA negotiations (and the knowledge that the President's fast-track authority for this goes until 2007 only) and with the emergence of India and China as the new trade superpowers. This would explain why the EU has not considered the end of the current round of negotiations between the EU and Mercosur in October 2004 a catastrophe.

4. ECONOMIC ANALYSIS OF CROSS-REGIONALISM

4.1. Bilateral Trade , distance and contiguity: theory and evidence

Caeteris paribus countries that are close geographically trade more than countries that are not (Michaely, 2004, p.99). First, transport costs play a small role in total costs. Second, time can be of the essence in transforming a good that was non-tradable into tradable (e.g. perishable goods, like fish or live animals). There are goods that simply cannot be transported over long distances because they are bulky (e.g. construction materials) or lose their qualities or their very essence (e.g. electricity). Geographically close countries also share similar preferences about the provision of common policies thus increasing the incentives to integrate. Social, labour, and environmental standards tend to converge. And neighbouring countries should trade even more, because of the possibility of cross-border trade. For instance, in many cases, the supply of a service depends on the simultaneous presence of the consumer and producer, something which is quite easy if the consumer or the producer must simply cross one border. The existence of common borders and small distance is positively related to intra-industry trade. The former not only minimize transportation costs but even more important information costs, two key factors entering production functions of differentiated products. Common borders and short distances favour intra-industry specialization and a better exploitation of national and international scale economies.

This being said, there are goods or services which are quite insensitive to proximity. And geographic proximity *per se* is often related to some other attributes that may hamper trade, such as ethnic conflict among neighbours. Hostility and historic fear are more common among neighbours than among distant trade partners. Also *caeteris paribus* factor endowments tend to be similar among neighbours (e.g. Gulf countries). All these negative attributes of proximity might and often override all the positive ones mentioned before.

4.2. Preferentialism, distance and natural trade partners

Krugman (1990) showed the importance of economic geography in concluding FTAs. For instance, with prohibitive intercontinental transport costs, continental FTAs increase welfare unambiguously. On the other hand, with zero intercontinental transport costs, continental FTAs decrease welfare unambiguously. Krugman then concluded that because most FTAs are among natural trading partners (those spontaneously trading a lot before the FTA is concluded), the likelihood of trade diversion is small and prospective moves to regional free trade would surely do more good than harm to the members of the FTA. Assuming that proximity determines the geographic distribution of trade (something which

is questionable, as indicated above), natural trading partners are from the same region or continent by extension. Of course technological change affecting transport costs might influence the degree of "naturalness". Frankel (1998) correctly indicates that if these costs fall with time, the regionally-based FTA will be less beneficial with time. He also introduces the interesting concept of "supernatural FTAs". These are those FTAs concluded among continental partners that are welfare-reducing because low intercontinental transport costs. In other words, bilateralism among natural partners might become sometimes excessive. On the other hand, the net welfare gains from a natural FTA increases the greater are intercontinental transport costs relative to intra-continental transport costs.

There is some empirical evidence sustaining what is posited above. Baier and Bergstrand (2004) find strong evidence that pairs of countries' governments tend to form FTAs the closer are the two countries in distance and the more remote a pair of continental trading partners is from the rest of the world (e.g. the pair Australia-New Zealand); but also the larger and more similar in economic size are the two partners; the greater the difference in K/L ratios between them; and the smaller the difference of the members capital-labour ratio is with respect to the rest of the world's capital-labour ratio. In particular, they find that in only 15 percent of the cases of bilateral FTAs among natural partners, bilateralism was excessive: 43 out of 286 country pairs with FTAs. On the other hand 31 country pairs that had not an FTA should have had an agreement. Excessive bilateralism was found regarding EU-Maghreb FTAs and agreements among Latin American countries. On the other hand, FTAs were "lacking" most among those countries called to become future members of the FTAA and some of APEC.

4.3. The balance of political and economic reasons in North-South cross-regional PTAs compared to regionally-based PTAs

Most theoretical models of the 1960s/1970s assumed implicitly that the reciprocal trade agreement was being signed between a small (A) and a large country (B), non neighbours, while the Rest Of The World (C) was huge and would not notice anything (Vanek, 1965; Kemp, 1969; Lipsey, 1970). Observe that transport costs were ignored. For instance in all general equilibrium models presented in Kemp (1969), the small country was exclusively trading with its future partner, the large country, which was also trading with the rest of the world, represented by given international terms of trade (world prices). In that context, A gains, B loses and non members are indifferent. This simple model could be applied then to partial preferential agreements signed between the EC and small Mediterranean countries (such as Morocco, Tunisia or Israel) or the membership agreements between Portugal and the EC or Greece and the EC. Theoreticians thus questioned the economic wisdom of the EC signing these agreements; quite validly they stressed that only political reasons could justify the EC's policy: the EC's wish of creating its own sphere of political influence in the Mediterranean or its wish to consolidate democracy in Southern Europe. With the emergence, though, of the new trade theories in the 1980s a new economic rationale was found in the EC to justify what it was doing: the EC by signing FTAs with countries in its proximity and vicinity could expect to gain from the establishment of intra-industry trade in some specific sectors (such as textiles): this is the outsourcing argument for FTA creation. Observe that the agreements between the EC and its neighbours were "natural" for the latter but "unnatural" for the EU, as its small partners accounted each for a very small share of

the EU's total trade. Therefore these agreements were only "semi-natural" (e.g. the EU might be the natural trading partner of Mediterranean countries, but the latter are not the natural trading partner of the EU). This stands in contrast to EU agreements with EFTA countries; they were probably a natural trade partner for the EU.

The conclusion of cross-regional agreements between "non-natural" trading partners in recent years poses the theoretical question of why they are concluded.

First of all, independently of who of the two partners gains or losses, the overall diagnosis should be following Krugman (1990), Frankel (1998) and Baier and Bergstrand (2004) that they do not increase welfare, but rather decrease it. Politically the proximity argument of the large country creating spheres of influence or consolidating democracy cannot be invoked since the shares of trade of the large country in the small are far from being dominant. Economically, the only justifications seem to be:

- 1) overcome Frankel's "supernaturalism", i.e. to neutralize the deleterious effects derived from having previously signed with a neighbouring country leading to too much costly trade diversion; this argument applies in particular to the large country, which has an interest in having the preferences of neighbouring small countries being eroded.
- 2) for the small country to overcome the transport cost differential favouring non-preferred neighbours with preferential market access to the large country.

Since the economic rationale for the small country to sign with a far-away large country is less compelling if compared to the one of signing with a local hegemon, there must be non-economic, i.e. political reasons invoked by the small, e.g. a reduction of dependence vis-à-vis the local hegemon. In other words, whereas differential country size in semi-natural FTAs leads to economic gains for the small and political gains for the large trading partners, in the case of non-natural FTAs, the two sides have both economic and political gains in sight.

5. A POLICY-MAKER PERSPECTIVE OF WHY A COUNTRY OR AN ASSOCIATION OF COUNTRIES WOULD WANT TO HAVE A PTA WITH A NON-NEIGHBOURING PARTNER RATHER THAN WITH A NEIGHBOURING ONE

There are economic and political reasons for geographically discriminating in trade, i.e. for preferentialism, whether regional or non-regional. But why distinguish between distant and neighbouring or near-abroad/near-outside countries¹⁷? Are the objectives of developed countries in cross regionalism the same as for regular regionalism, such as preventing migration or such as creating spheres of influence? Are the aims of the small, emerging economies and developing countries identical as when striving to conclude an agreement with the trading hegemon in the neighbourhood? In what follows, reasons for and against have been carefully enumerated on the basis of examination of official documents, declarations, and articles, paraphrasing the arguments typically put forward by policy-makers:

5.1. Political and other non-economic reasons:

Of small and large countries alike:

- 1) "a series of distant countries have more historical links with us (a common past, ethnic origin, language, culture) than neighbouring countries"; this is e.g. underlined in the case of Australia in relation to the US.
- 2) "several distant countries are more important military and/or political allies, than closer countries"; this is the sort of argumentation heard in the US regarding Jordan and vice versa.
- 3) "in a country as ours open to global trade, bilateral preferential agreements with neighbours are not as likely to prevent war with them as in the past. They are politically less necessary". As argued by Martin, Mayer and Thoenig (2007, p.29), multilateral trade openness reduces the opportunity cost of going to war with any given country. Clearly, insofar as a country is increasingly trade-dependent on countries other than the neighbour(s), it will be less deterred in engaging in war against the latter.
- 4) "our neighbours do not want to have PTAs with us; it is a matter of ideology" (e.g. the case of Japan and its neighbours until recently).

¹⁷ A term borrowed from Russian geo-politics and nowadays adopted sometimes by experts dealing with the new EU's Neighbourhood Policy, known as ENP; see e.g. Tovias and Magen (2005).

Of small countries:

- 4) "neighbours are our enemies"; in some cases (as in the case of Israel) "neighbours are boycotting us. Even if there is no Cold nor Hot War, there is only Cold Peace (e.g. the case of many Arab WTO member countries at present)".
- 5) "we will gain negotiating experience"; among the typical motivations for having a PTA with any country is that it can be a laboratory for change; it provides the relevant country with valuable negotiating skills.

Of large countries:

- 6) "we will be able to put pressure on WTO negotiators representing the other large countries"; this is an acknowledged hope entertained in the US regarding the fate of the Doha Round.
- 7) "a rival power across the ocean has made an agreement with one of his neighbours to increase influence there and there is need to neutralize it by signing also an agreement with it"; this is the sort of argument used by the EU to justify its pursuit for an FTA with Mexico.

5.2. Economic reasons

Of small and large countries alike:

- 1) "our neighbours have small markets" (a typical argument heard in Singapore and Israel).
- 2) "we have already agreements with the region/the neighbours; we must improve market access elsewhere" (an argument stressed by EFTA countries).
- 3) "our exports are distance-insensitive" such as financial/ insurance/ software/ accountancy services, high-tech, diamonds, crude oil (an argument heard in Israel).

Of small countries:

- 4) "we need to secure demand for our goods and services in distant OECD markets". There have been , e.g., voices in Morocco in favour of increasing exports to the US to somehow diminish exclusive trade dependence on EU markets.
- 5) "we need to draw specific technologies via FDI from a particular OECD country which is distant from us". There is no doubt that behind some of the trade agreements signed by Korea (e.g. with EFTA or with the US) is the wish to be less technologically-dependent on Japan.
- 6) "we need to compensate what Frankel (1998) calls *supernaturalism*: previous preferential agreements with our *natural* trading partners have made us artificially dependent on them; on top of it we bear a huge cost of trade diversion in their favour";

this is the sort of argument which led Mexico to get an FTA with the EU after the conclusion of NAFTA; also argued is that "with such an agreement we diminish our historical dependence on our local hegemon".

- 7) "we are engaged in defensive preferentialism; a country competing with us has signed a PTA with the country to which most of our exports are destined, thus obliging us to have also a PTA with that country"; e.g. the EC/SACU agreement of 2000 is supposed to have driven the US to negotiate an agreement with the SACU. This could also be called "domino cross-regionalism", paraphrasing Baldwin.
- 8) "we must overcome the "spoke" syndrome and unravel the prevailing hub-and- spoke system" This is an argument used in Israel by those that suggested already in the 1990s to engage in FTA relations with Turkey and with Eastern European countries not yet in the EU.
- 9) "we must prevent the politicization of trade relations" (advanced as an argument in Israel).
- 10) "we must prevent the emergence of trading blocs; bet on universal standards, ROO (rules of origin)" This is an argument that was advanced by those appaled in the EU by the perspective of seeing an FTAA emerging.
- 11) "we must beat the Doha Round by several years". This argument has been advanced by a large amount of emerging economies distressed over the fact is taking a lot of time in being concluded, if at all, successfully.
- 12) "we might be graduated out of the GSP" ; this is a common fear to most South Eastern Asian countries at present. Some have actually been already graduated (e.g. Singapore).

6. A POLICY-MAKER PERSPECTIVE OF WHY A COUNTRY OR AN ASSOCIATION OF COUNTRIES WOULD REFRAIN FROM HAVING A PTA WITH A NON-NEIGHBOURING PARTNER.

6.1. Political and other non-economic reasons:

Large countries:

- 1) "a PTA would not have any political content".
- 2) "we would not gain any increased influence on the partner, derived from artificially developing dependence on our markets or on our resources".
- 3) "there is no way to improve political stability over there with a PTA, since their trade dependence on us is limited".
- 4) "a PTA does not help to reduce migration nor drug flows from the trade partner".

- 5) "in an era of globalization, geography continues to be important and good neighbourhood relations remain paramount; stability across the border must be maintained at all cost"; this is an argument that was used by the High Representative of the EU, Javier Solana, in a recent speech.

Small countries:

- 6) "neighbours are more important than non neighbours; potentially they constitute a more direct menace, therefore there is an additional reason to cooperate with them; we need to make them win from exchanging with us (and not only that we win from exchanging with them); our neighbours are also more important than non neighbours because they are a bulwark in relation to outer-lying countries; being in good terms with them helps indirectly our security".
- 7) "signing PTAs with non-neighbours will be looked upon by our neighbours as a treason and display of hostility to the region"; this is a fear that has been evoked by Chilean and Singapore policy circles.

Large and small countries alike:

- 8) "the PTA will not reduce the risk of political or military conflict with the preferred trading partner, since mutual trade dependence is small".
- 9) "such a PTA cannot constitute a political project towards creating a federation or political union".
- 10) "there are no common environmental problems to be solved between us and distant countries, no common regional identity, we share nothing in common with them (language, religion, culture, values, ethnic origin, history, customs, folklore)".
- 11) "we do not share a similar political and legal framework".

6.2. Economic reasons

Large countries:

- 1) "our large negotiating resources should preferably be devoted to multilateral trade negotiations; we are committed to the WTO"; this is the argumentation used by the EU at present to justify the suspension of an all-out bilateral trade policy with countries/clubs not in the European neighbourhood.

Small countries:

- 2) "there are too many potential external partners and we have limited human resources to negotiate and/or monitor the agreements".

- 3) "adding non-critical trade agreements will translate in a real mess for prospective exporters which will be confused and perplex, since they will face an array of different trade regimes; on top of it the bureaucratic power of our public officials will be enhanced since a lot of discretion in the hands of customs officers will become the rule; this might also increase corrupt practices".
- 4) "concluding such agreements cannot replace unfortunately the usefulness of multilateral trade negotiations in important domains for us."

Large and small countries alike:

- 5) "there are no lock-in effects involved". This refers to the external anchoring role that many PTAs and FTAs have for one of the two partners involved (e.g. for Mediterranean Arab countries having signed with the EU an association agreement under the Euro-Mediterranean Partnership)
- 6) "there is no potential for environmental cooperation, since there are no reasons for it"; while, in general, with neighbours there is a "public good" dimension (e.g. Mediterranean weather, the same season, the same time, the same water, the same air) and a "public bad" dimension (pollution, earthquakes) dimension, this does not exist in the case of distant countries; between neighbours there is more osmosis than with non neighbours.
- 7) "there is no much scope for engaging in trade facilitation activities, since the latter are disproportionately related to contiguity and sharing common borders, thus pointing to a need in sharing common infrastructures".
- 8) "there is no much scope for intra-industry trade nor FDI flows linked to the latter and the possibilities of fragmenting production on a regional basis and reaping economies of scale are limited; the long distance to inputs supply for our producers is a handicap".
- 9) "such a PTA would not enhance our bargaining power in the GATT/WTO or when a trade conflict arises, compared to Customs Union which are almost always regionally-based".
- 10) "less gains from trade derive from these type of agreements compared with those with closer countries; in a region there is more trade potential, more gains from trade to exploit; this is due to similarity of demand structures *a la* Linder (common culture, language, religion, ways of life, political systems)".
- 11) "servicing and maintenance of equipment sold by us to the preferred trade partner or bought by us from him is problematic over long distances".

7. ARGUMENTS FOR PREFERENTIALISM WHICH ARE INSENSITIVE TO DISTANCE (INCLUDING PREFERENCES IN SERVICES)

Of large countries:

- 1) PTAs might improve the terms of trade vis-à-vis third countries.
- 2) PTAs enhance the accession to protected service markets in emerging or developing economies.
- 3) they enhance Intellectual Property protection in developing countries.
- 4) PTAs can improve labour standards markets in emerging or developing economies.
- 5) preferentialism can enhance environmental standards markets in emerging or developing economies.
- 6) it prevents a free ride by countries unwilling to reciprocate in multilateral trade negotiations.
- 7) a PTA can sometimes take care of issues which are impossible to deal with at the WTO level .

Of small countries:

- 1) a PTA frequently improves the terms of trade in trade with the partner.
- 2) it allows for exploitation of scale economies (the local market is too small).
- 3) trade liberalization, even if done on a discriminatory basis, improves the competitive environment.
- 4) FDI will be attracted.
- 5) PTAs are insurance policies against retaliation by the large preferred partners in the case of a generalized trade war.

Of large and small countries alike:

- 1) more market access is better than less market access.
- 2) prices for final and intermediary consumers will be cheaper (trade creation).
- 3) a PTA may help gain privileged access to strategic raw materials.
- 4) harmonization or mutual recognition of standards is a step in the right direction and is better than maintaining standards at the national level.

Observe that all the arguments above are economic; with (almost) no political content.

8. ARGUMENTS AGAINST PREFERENTIALISM WHICH ARE INSENSITIVE TO DISTANCE (INCLUDING PREFERENCES IN SERVICES)

- 1) the cost of trade diversion.
- 2) it leads to a deterioration of relations with non members.
- 3) it undermines the non-discrimination principle ("most-favoured-nation") on which WTO is based.
- 4) it increases administrative costs of monitoring imports at the national borders.
- 5) some issues cannot be solved at the bilateral level such as the subsidization of agricultural products.
- 6) it allows hegemony to impose rules which are theirs and not universal (labour/environmental standards); not only they are not universal; they might be unsuitable for developing countries.
- 7) multilateral trade liberalization on a most-favoured-nation basis and, more generally, world trade globalization deters multilateral conflicts and global trade wars, which are the most costly in terms of human welfare (Martin, Mayer and Thoenig 2005, p.30).

Observe, again, that all the arguments above but the last one are economic, with (almost) no political content.

9. SMALL COUNTRIES CROSS-REGIONALISM: THE DILEMMAS OF THE SOUTHERN SPOKES

When focusing on the large-scale projects launched by the two trade hegemony, the US and the EU, some of the reasons behind their behaviour were spelled out. But what about the fascinating case of emerging economies, which until recently were confined to the role of "trade satellites" or "spokes"? After all and using Krugman's terminology, the EU or the US seemed to be the "natural trading blocs" with which, any Mediterranean country or Latin American country respectively had an interest to be linked up. The main reason is economic geography combined with the economic muscle of the EU or the US. In distribution activities what counts is the time of delivery and economic distance and this is valid for Mediterranean or Latin American countries as well. It is particularly relevant for highly perishable, service-intensive or bulky products, as well as goods depending on fashion. The short geographic distance between the Southern developing economy (either Mediterranean or Latin American) and the Northern developed one (either the EU or the US respectively) facilitates real-time commercial intercourse (e.g. opening and closing times are practically the same; quick feedback from markets is possible; highly perishable products are tradable). The Northern trading bloc and its Southern partner share frequently

the same sea and meteorological factors, conferring easy knowledge of the natural conditions prevailing in the respective trading partner¹⁸.

Both the EU and the US have also limited time to devote to their respective Southern neighbours. One possibility open to the latter is of adjusting progressively and unilaterally to the regulations of the Northern partner (in the case of the EU to the so-called *Community acquis*). Apart from the cost of trade diversion, a disadvantage is that the Southern exporters would not try to adjust to world standards but rather to the Northern trade bloc's standards. This is what Australia did in the 1950s and 1960s when it decided to adopt British patterns and standards with very bad results. An example often given is Australia's clinging to the sterling area in the 1940s and 1950s at a time Britain was enduring frequent currency crisis. The same applies to the case of the Eastern European members in the ex-COMECON. And unilateral adherence to the hub's rules will be increasingly unacceptable for democratic countries in the periphery (such as Israel, Chile, Mexico or Turkey), which do not participate in the decision-making process of the respective hub.

If allowed, Southern countries should try to be associated with more than one hub, or to be closely associated to them if it appears that full membership in one of the hubs is excluded. True enough, the EU has never said that its Free Trade Agreements with third countries are incompatible with the FTA agreements the US might have with the same third countries. Neither has the US said anything of the same kind about the EU. However there may be limits to such a strategy. If the Southern partner thinks of eliminating some NTBs in trade with the natural trading hub - be it the EU or the US -, it might be to the detriment of relations with other key economic partners. Or think about future dilemmas of managing the Euro-Dollar relationship for Mediterranean countries, which have been using until now the dollar as their international currency, and which might be tempted to link their currency to the Euro, given existing trade dependency on the EU. What would the US think should Egypt change the composition of its currency reserves in favour of the Euro, in view of the fact that it receives from the US more than \$2 billion annually since 1979?

Underlying all the strategies explored above is that relative economic size matters. As important as horizontal economic relations are from a political viewpoint, if the main objective of Southern developing country policy-makers is to achieve a rapid improvement in the economic situation of their countries, they should focus on deepening their institutional trade relations with the EU or the US respectively. This can be done by signing improved agreements in order to facilitate their access to markets that are many times larger than the largest market in the Middle East, North Africa or Latin America. In fact, one apparently minor agricultural concession by the Northern hub within the framework of a future FTA agreement with it may create more jobs in the Mediterranean or Latin American

¹⁸ Note that in the particular case of the EU, any enlargement increases mechanically the importance of the EU for all its Southern neighbours as a trading partner, e.g. relative to the US or Japan. This being said, the main problem for the Mediterranean partner is that the widening EU is also a confederation in-the-making and the former is not a part of this double process. It is not being consulted and sometimes not even informed in time. The EU is a moving target. Catching-up with it is difficult *per se* and is aggravated by the fact that the EU has other priorities than deepening its relations with Mediterranean countries, assuming that this is what the latter wish or need (e.g. going beyond tariff- and quota-free trade). More on this in Tovias (2000b).

country than across-the-board preferential tariff reductions on industrial imports by neighbouring countries (so-called South-South agreements). Economically speaking it is of the first order of importance for the small peripheral Southern country to deepen therefore its relations with their "natural" trading bloc (whether the EU or the US), in particular to prevent that the gap between the treatment received on one hand, by other spokes and on other hand by itself becomes larger.

However a second priority should be to conclude FTA agreements with other important trade blocs or hubs so as to lessen the trade diversion costs and the political dependence on the neighbouring hegemon. This is where cross-regionalism has a role to play. Alejandro Jara, the former Chile's ambassador to the WTO and recently named deputy director of the WTO, described at a recent WTO Public Forum Chile's trade policy strategies¹⁹, stressing that his country had tried everything and did not privilege one approach over the other two, namely the unilateral, bilateral or multilateral approach. He said simply that Chile is for a "lateral" trade policy, whether "uni", "bi" or "multi". Whenever there was a possibility to liberalize trade Chile would go for it. It had no choice, he said, given that the multilateral process was really too slow.

Jara went on and said that there was also the discrimination paradox, where the actors are really firms in the private sectors. They were the ones that came to the Chilean government so that the latter would try to avoid discrimination against them, something which inevitably meant for Chile to do discrimination in turn. The Chilean government sought by the same token in signing multiple FTAs the seal of approval to economic reforms made by Chile given by large and/or reputed (generally OECD) trading partners willing to sign bilaterally PTAs with Chile, such as the US or the EU. This would also attract FDI. The foreign investor would think that if the US or the EC signed with Chile, "there must be something good about the Chilean economy, the rule of law, its seriousness". That would raise the country's credit worthiness.

The added advantage was that the country brings down not only tariffs but NTBs, modernizing the production apparatus, fostering transparency and improving the quality of governance. He stressed that it might be that the bilateral agreements were not a big deal in commercial terms but that they were good for governance. And transaction costs were reduced, because there was more certainty, more predictability for exporters than under the GSP. In cross-regionalism, bilateral agreements are after all mainly based on reciprocity, not on conditionality.

If so, the question arises whether the Southern country should limit the number of PTAs or not. Jara argued by the negative as long as the different agreements are not incompatible. Otherwise not only is that bad law but investors' uncertainty would be increased and confusion would reign. Another hidden cost of signing many FTAs is the multitude of rules of origin that will have to be respected by the small trade partner, unable of course to impose its own system of origin rules on larger countries or blocs, such as the US, the EU or EFTA. Not to be forgotten in this perspective is that enforcing rules of origin has

¹⁹ Notes taken by the author at the Forum in Geneva, May 2004.

administrative costs, which in the case of EFTA have been estimated to be around 3 percent of the value of intra-EFTA and EFTA-EU trade.

Summing up this section, one can interpret the new wave of cross-regionalism as the follow-up of the strategy adopted since about 15 years by emerging economies (such as Poland, Vietnam, Mexico, Israel, Chile, Singapore) to integrate the world economy. At first they favoured both starting to participate in the multilateral game and favouring occasionally some kind of unilateral liberalization steps. After a while they realized that in multilateral trade negotiations they were mainly spectators (e.g. the case of Singapore, Chile or Israel); their lack of weight, critical primary resources or expertise in negotiating explained this outcome. Quite apart, the level of ambition of multilateral WTO talks appears to them, generally speaking, too low and the process too slow and inflexible. The dilemma at that stage of history is that they have by then operated the required reforms and what they urgently need is new market access. This can be gotten by signing PTAs requiring fewer human resources than in WTO talks and becoming actors being able to focus on subjects of their interest. So here the objective is to secure market access and attract FDI, not anymore to reform, or to better relations with neighbouring countries, former enemies or for other foreign policy reasons. Cross-regional agreements are to be signed for opportunistic reasons without any particular higher goal.

10. IMPACT ON THE MULTILATERAL (TRADE) ORDER

There are some good news and some bad news deriving from the new wave of cross-regionalism. Starting with the good news our analysis shows that:

- 1) There is no danger of trading blocs emerging nor of a clash between them

During the decade of the 1990s, it became a fashion among theoreticians and practitioners alike to predict that one of the consequences of the "New Regionalism" would be the emergence of a limited number of "trading blocs", each of them having its own "sphere of influence" and "secured supply of raw materials". As stated in the introduction to this working paper, even Renato Ruggiero, the former and then WTO Director, predicted in a speech made in 1997 that the new regional trade agreements were about securing regional spheres of influence. The New Regionalism was based on institutional relations between neighbours, mostly Northern and Southern, large and small ones, developed and developing ones or developed countries and-transition economies. Previous trade dependency among members of the RTA was part and parcel of it. Because of the difference in country size, the small partner would gain economically, the large one politically. As illustrated by Hirschman (1945), these types of agreements were used to relegate the small and neutral countries to one regional sphere of influence or another. Another famous observer, J. Bhagwati (1991), of Columbia University and special adviser to the WTO, feared then that RTAs were "stumbling blocs", not "building blocs" to multilateral trade liberalization, but another trade policy expert, Stephen Woolcock in Geiger and Kennedy (1996, p.124) of the LSE, stated more optimistically that until then all RTAs had operated as building blocks and not stumbling blocs. From the European scene, two more typical forecasts were those of Sapir (1997) and Rollo (1994, p.56-7). The first said it was likely that by 2010 there would be two hegemon-centered trading blocs. The second one said that historically the EU

had always avoided PTAs with non-European countries, except for the case of ex-colonies (such as ACP and Maghreb countries). Therefore the solution for non-European countries was to have a competing trade bloc. APEC was the model. But Rollo took care to say that a world of rival, competing trading blocs would not be the only choice. The new trade agenda looming at the time (dealing with competition, environment and social policies) could eventually lead to cooperation among trade blocs. Observe that even so the belief was that separate trading blocs were emerging.

This view was not proprietary of European researchers. On the other side of the Atlantic some US political scientists and academic economists were forecasting a world of trading blocs. Gamble and Payne (1996, p.247) writing on the New Regionalism referred also to neo-realist writers that saw regionalism leading to conflict with a high risk of economic war. In the same vein as in the thesis presented by Huntington (1993), neo-realists of the Orwell sort were saying there was some likelihood of a clash of trading blocs, since nothing can be negotiated because not only business but identities were at stake; trade wars could become holy wars. On the economic theory front, Frankel and Wei (1998) explained how the creation of a continental trade bloc (made up of natural trade partners) might lead to the creation of a competing second one, and so on, a dynamic slant being given to this hair-raising perspective.

But as a recent World Bank report states (World Bank, 2005, p.51), the world is not evolving into three disparate, autarkic trading blocs. Countries are linked by a web of business ties across oceans that bind the world market together. If there are no trading blocs in sight, there is neither a danger of a clash nor trade wars between them. There is neither a perspective of a cartel-like arrangement emerging which would divide the world Yalta-like into trading blocs. On the contrary, there seems to be increasing competition of the leading trade blocs for influence. In fact the present trend is more likely to lead to anarchy, chaos and disorder, which are the real dangers the WTO should be aware of.

2) There are no new exclusive spheres of influence being created

PTAs were left out of GATT in the late 1940s partly to avoid new imperial trade relations from being developed (akin to those usually applied in the 1930s by Nazi Germany to exclude other European trade countries from Central Europe or by the UK with the 1932 Ottawa Agreement to exclude Japan and the US from Eastern Asia and Australia). The unconditional form of the Most-Favoured-Nation Clause (MFN) was the instrument to achieve that goal. Only some particular forms of preferentialism were accepted but clearly trying always to avoid the possibility that spheres of influence would be created by large trading powers through the use of preferences. While the advent of classic and new regionalism could point in that direction merely on the basis of the realities of economic geography (i.e. regionalism as an outcome of regionalization or natural trading blocs), it is clearly unrealistic to expect new spheres of influence to emerge if almost each trading power is engaged in signing cross-regional agreements with countries in the backyard of other trading powers.

- 3) Regionalism is on the way out and previous trends pointing to the regionalization of world trade could be neutralized

Regionalism was seen from early on by the US as a pernicious form of preferentialism when applied liberally by the EC in the 1960s and 1970s; with the EC's pyramid of preferences the Europeans were again practicing disguised neo-colonialism and imperial policies. Later on, in the late 1980s and 1990s, the US shifted gears, applying a doctrine based on the dictum: "If you cannot beat them, join them". The EU, in the eyes of the US, had been trying to build its own sphere of influence since the end of the 1960s after the completion of the Customs Union in July 1968. The US would also built up its own sphere of influence in the Western hemisphere (e.g. with the emergence of NAFTA or the FTAA proposal). Clearly the new trend towards trans-oceanic agreements has the advantage of removing the inherent dangers of regionalism insofar as spheres of influence and empires are more difficult to create. Empirical research shows that RTAs tend to cause (among others) some trade diversion in favour of the partners to the preferential trade scheme (World Bank 2005). Therefore they must have been contributing to the regionalization of world trade. This is certainly the case of the EU and its enlargements, as well as NAFTA. Therefore and logically a strong wave of cross-regionalism, as the current one, should be instrumental in neutralizing, if not unraveling past trends towards regionalization.

- 4) The new foreign policy goal of preferentialism is to neutralize the influence exerted by rival trading powers in a given zone; reverse trade diversion in favour of the distant trade power must be considered as positive, since it unravels previous trade diversion

The proliferation of cross-regional agreements tends to reciprocally neutralize previous preferential moves made by the EU and the US in their neighbourhood (e.g. EU with Israel, Morocco and Jordan; the US with Mexico and Chile) and therefore unraveling trade diversion in their favour in neighbouring countries. There is increasing regulatory competition between the US and EU in bilateral negotiations, e.g. in the domain of Intellectual Protection. This is good *per se*. As happened during the height of the Cold War between the US and the USSR, the trade powers are fighting for influence in some key countries of the developing world (e.g. Egypt, Chile, Mercosur). The EU dares to artificially heighten its trade presence in Latin America to the annoyance of the US, but then the latter does the same in the Southern Mediterranean. The question arises whether neutralization implies de-politicization of trade relations or not. It is the first insofar as trade powers tend to give preferences to most developing countries in the world and on the other hand the latter get tariff preferences from all the important trade powers²⁰. As is well known, giving a preference to everybody means not giving a preference to anybody. And getting a preference from everybody is equivalent to not getting a preference from nobody. If every trading power prefers every other developing or emerging economy and each of the latter is preferred by every other trading power, then *de facto* no trading power prefers any developing country in particular and no developing country is particularly preferred among other developing countries by trading powers. On the other hand, the inherent

²⁰ But see what it is said later under point 9 on least developed countries.

encroachment of the stranger trade power in what is considered the backyard ("la chasse gardée") of the local trade power could easily lead to friction, conflict and even war.

- 5) Economic opportunity drives the choice of preferred trade partners made by developing countries

Setting aside the first best which is multilateral trade agreements based on MFN treatment, it can be argued that the present cross-regional trend although a second best is better than conventional regionalism. The reasoning is as follows: Small developing countries pick potential partners with which to negotiate preferential trade liberalization not because the latter are militarily powerful, ethnically similar or like-minded countries but simply because they are looking for markets, wherever they are. These multiple FTA dealings are driven by the private sectors of developing countries. If the market is in the US, so be it; if in China, so be it. Therefore there is less scope in developing countries for trade relations to be based on non-commercial considerations, which is what the introduction of MFN was trying to obtain as well.

The bad news is that:

- 6) The proliferation of PTAs is taking place without any control whatsoever and PTAs are spreading with uncertain, possibly negative effects on the WTO

About 300 PTAs have been notified to the WTO. The World Bank (2005) suggests that most agreements do not contribute to international trade. While the WTO is now fortunately putting a finger on notified PTAs under the Trade Policy Review mechanism, never an agreement was reached among GATT and WTO members about the lawfulness of any of the PTAs notified. Nobody wants to discuss them seriously because everybody has problems in defending his own PTAs. So they multiply without any control. The most courageous institution on this issue is the World Bank, but it has no direct competence on judging PTAs. Meanwhile the proliferation of PTAs *per se* creates vested interests against multilateral trade negotiations as more producers will oppose moves eroding advantages acquired through application of restrictive rules of origin, preferential margins, and so on. The world could be slowly approaching the chaos of the 1930s, only that all is happening in a silent and creeping manner. Since everybody in WTO is guilty, nobody wants to speak about the systemic effects.

- 7) Confusion and complexity can lead to less and not more trade

A patchwork system is messy. The confusion of the trade operator in a widespread system of regional and cross-regional agreements becomes extreme as for a given country the different agreements have different depth, preference margins, coverage of sensitive products, phase-out periods, and last but not least Rules of Origin (ROO). Bhagwati (1995) has called this the "spaghetti bowl" phenomena. It translates in a tariff of multiple columns, each one referring to a different PTA and therefore different origin rules, different NTBs, and so on. It is clearly a step backward from the single column Tariff envisaged by GATT and the WTO. And the multiplicity of origin systems to be respected raises transaction costs, all other things equal. In many cases exporters might drop out. The solution to this

problem would be, of course, to agree at the WTO level on universal preferential rules of origin. It does not seem that they will be decided upon in the foreseeable future, not in any case in the current Doha Round. This leads to the next point.

8) Large negotiating partners are favoured by the proliferation of preferential trading

Developing countries are asked in PTA negotiations to adopt ROO de facto determined by each of the trade powers and the latter are quite different. The trade powers argue that being large means they are "natural hubs" and therefore it is impossible for them to have different ROO according to the needs of the satellite countries. The same applies to norms and standards. Observe that this is debatable, since by definition a cross-regionally-based system makes of every developing country at least half-a-hub (assuming that it is not interested in South-South PTAs). So every developing country will argue that it has also the right to ask for the harmonization of the EU and US ROO or standards to at least become OECD ones. Apart from this, size is also a relative matter. Whereas Iceland or Israel can reasonably accept not to discuss origin rules in PTA negotiations with the large OECD countries of the world, this is not the case of Brazil, India or China.

9) Least developed countries tend to be less favoured by emerging economies than other more developed countries (including other emerging economies)

Those poor developing countries with no strategic primary resources will not be courted by any emerging economy. The weakest countries (such as many Sub-Saharan Africa countries, Bangladesh, Guyana) are marginalized, a forecast made by Jacob Viner (1965) and others whereby in a world without MFN it is the weakest that lose. As basket cases, they will have to rely on philanthropic unilateral initiatives such as AGOA (African Growth and Opportunity Act) or EBA (Everything But Arms) put in place in recent years respectively by the US and the EU or by other advanced developed economies (as done recently by Japan).

11. CONCLUDING REMARKS

Until a decade ago, many observers in the trade policy sphere were predicting that a world of trading blocs or empires was bound to emerge sooner or later. One bloc would be built around the European Union, including most probably Mediterranean Non Member countries as well as Sub-Saharan Africa. A second trade bloc would have the United States at its center and it would include all the other economies of the Western Hemisphere. At the time there were debates around the question of whether Japan would be led to counteract the moves of the other two economic powers by promoting the creation of a third bloc around it.

Clearly nothing of the sort has taken place. In part, this is due to technological innovations particularly in the domain of air transport but also in telecommunications. It has made the world even more than before a "global village". But, as this paper contends, it is also due to trade policy innovations. On the one hand, many erstwhile small emerging economies have become in the last decade sizable markets in their own right. They cannot be ignored anymore even by the large economic powers, as the EU and the US. The latter will thus not

refrain in opening negotiations with emerging economies which are not in their traditional sphere of influence. This is done even if necessary with countries belonging to the sphere of influence of rival economic powers with attendant political implications, if not costs. Typical examples are Mexico for the European Union or Morocco for the United States. In turn, emerging economies realize that their exclusive dependence on one single albeit large export market to which they have gotten privileged access is potentially dangerous. This perception has been visible for a while now among Israeli and Chilean policy-makers. They sense there is a need for diversification of export markets but the latter is only feasible if they engage in negotiations to get preferential access in additional large markets.

This remarkable change in the trade policies of both large and small countries could lead in the medium term to a sort of meltdown of still-existing, although loose, spheres of influence (such as the one the EU has in the Southern Mediterranean and in Sub-Saharan Africa or the US in the North and Central America). Note to conclude that in a world of cross-regionalism, least-developed countries tend to be the losers. This is due to the fact that neither economic powers nor emerging economies consider the markets of least developed countries worthwhile markets to be covered by Free Trade Area agreements (which by definition are based on reciprocity).

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