1. **Introduction**

I first met Rolf and Ana Maria when they were both graduate students at Yale in the early sixties. I was then teaching there after completing my dissertation, also at Yale. Both Rolf and Ana Maria were in my graduate econometrics course in the fall of 1964 as auditors, if my memory serves me right. Econometrics in those days was relatively simple and consisted mostly of the standard linear regression and simultaneous equation models of the Cowles Commission and the then new Tobit models. Having learned my statistics under the great statistician C. R. Rao at the Indian Statistical Institute, Calcutta, I was reasonably comfortable teaching econometrics. But I would not dare teach it now, or for that matter teach microeconomics theory which I once taught at the graduate level! Analytical developments in theory and econometrics have been dramatic in the four decades since I was a graduate student. Regrettably I did not keep abreast of the developments and instead concentrated on the applied fields of international trade and economic development. But Rolf was different—although he also developed an interest in applied theory and policy, he remained a distinguished theorist until his very last moment.

Rolf and Ana were my gracious hosts during my last visit to...
Buenos Aires in 1997. Rolf was to have participated and presented his paper in a conference in my honor at Yale in March 1998. Unfortunately, a riding accident in Israel prevented him from participation. Little did I realize then that Rolf would be no more within a year. With his death the economics profession at large and in Argentina has lost one of its deep thinkers and theorists.

Rolf, of course, was celebrated for the result that there is not much one can say about aggregate excess demand functions other than their homogeneity of degree zero in prices and that they satisfy Walras' Law. One would have thought that with that result much of international trade theory, let alone econometrics of demand, would go down the drain. After all, a country's net offer curve is its excess demand curve. If one cannot say much about its shape, one can say even less about trade policy, since policy analysis is no more or no less than comparative statics of equilibria. Fortunately all was not so bleak after all—Rolf himself, with Ana Maria as his coauthor, wrote several important papers on international trade issues. Also, my colleague Professor Donald Brown and my former colleague Professor Rosa Matzkin, another distinguished Argentinean economist, are currently engaged in research on refutable restrictions on observations on consumer choices implied by general equilibrium theory.

One of the many topics in the theory of international trade to which Rolf Mantel made significant contributions is economic integration of nations, a topic that includes the theory of Customs Unions, Free Trade Areas and, more broadly, Preferential Trade
Agreements. He and his wife Ana Maria wrote two remarkable papers (Mantel and Martirena-Mantel (1980, 1982), neither of which has received the attention it deserves. The earlier of the two (which is an English version of a 1975 paper in Spanish) is a tour-de-force—it analyzes not only the welfare impact of integration between two economies as is common in the literature but also the changes in consumption structure following integration. The analytical framework adopted by the Mantels was one of general equilibrium and they made no restrictive assumptions either about the preferences of different social groups or about production technology (except the standard one of down sloping transformation curves). Government was assumed to produce public goods and services using its own resources, technical knowledge and the revenues it obtained from tax paying social groups and from taxes on foreign trade. The latter paper started with a partial equilibrium geometrical set up reminiscent of traditional public finance analysis of dead-weight losses, but also included an Appendix where the analysis is done in terms of the algebra of general equilibrium.

The most interesting feature of both papers is their explicit recognition that the pre-integration tariff structure of the two economies considering integration is not arbitrary and historically given as was commonly assumed in the traditional Vinerian type of analyses, but the result of a non-cooperative Cournot-Nash tariff game. As such, the Mantels argued, that in assessing the effects of integration one should not include the effects arising from the fact, that by definition, in the integration negotiation the authorities of
the two economies would bargain rationally in contrast to their non-cooperative behavior in the pre-integration situation. A second notable feature of the analysis of the Mantels is their approach to the welfare of countries which are not members of the group that has integrated. In their second paper they define an equilibrium Benevolent Union as a Customs Union, which starting from a pre-union non-cooperative Cournot equilibrium in tariffs among its members, frees trade within the Union and establishes a common external tariff so that the rest of the world is not affected at all. Thus the Benevolent Union is the analogue of the union analyzed by Kemp and Wan (1976) for the case of historically given (rather than non-cooperatively determined) pre-union tariffs in member countries. A Belligerent, in contrast to the Benevolent, Union is one whose common external tariff is optimally chosen to maximize union welfare in the absence of retaliation by non-members.

The Mantels dismiss the benevolent customs union altogether with the assertion "We find no empirical content to the benevolent customs union, carefully designed not to hurt the non-partners of the union" (Mantel and Martirena-Mantel (1982) rough English translation). I am sure if Rolf were to be with us today, he and Ana Maria would agree that they would rethink this assertion. First of all, it was not clear how they arrived at the conclusion of lack of empirical content in a benevolent union, though I must admit that I am sympathetic to their view. Second, while they correctly dismiss the assumption of historically given and arbitrary initial tariffs in the member countries on the ground that governments set tariffs in their
interest and not arbitrarily, by assuming the rest of the world (ROW) to remain passive in response to the common external tariff chosen by the union, they do not extend this logic to the ROW.

The Mantels justify the passive behavior of ROW (Country C in the notation of the 1980 paper) towards the union of A and B on one of two grounds. They argue that "This is certainly justified whenever countries A and B are small since in that case their action will not affect C at all" or (paraphrasing Chamberlain) the "influence will be spread over so many other countries that the impact felt by any one of them is negligible and does not lead it to retaliate" (Mantel and Martirena-Mantel (1980, p. 352). If we take the first argument literally, not only the common external tariff should be zero and the distinction between the two types of unions disappears, but also even the pre-union Cournot game in tariffs becomes moot with both countries rationally adopting free trade.

The second justification is more plausible but it rests on some implicit collective action problem among countries constituting the ROW. Indeed the excellent economists that the Mantels were, they themselves must have felt uncomfortable with their justifications. In fact they qualify their analysis to say "In the event that C does retaliate, our analysis has to be considered as a first approximation. In that case, it will be assumed that C's offer curve corresponds to tariff levels of the pre-integration policy equilibrium. The gains from integration for A and B will then be the gains before C's retaliation to the union" (ibid, p. 352). Thus C's policy makers are assumed to have been rational before the union of A
and B and also would be rational in the future after the union, but
the analysis covers the interregnum between the formation of the
union and the rational response of C.

I would like to draw attention to one more interesting aspect of
the analysis of the Mantels. While they do not make any reference to
Article XXIV of GATT which requires, inter alia, that substantially
all trade among members of a proposed Customs Union be free for the
Union to be GATT-compatible, they assume it to be the case in their
1982 paper. However in their 1980 paper, they allow the members of a
union to bargain over tariffs to be applied on intra-union trade.
This is very interesting in that it contrasts the non-cooperative
Cournot behavior of the two integrating countries prior to
integration with the rational process of bargaining over post-union
tariffs on internal trade. The latter is over the choice of a point
on the portion of the contract curve that lies within the bargaining
set defined by the initial equilibrium which, by definition, is not
on the contract curve and hence not Pareto Optimal. As such, post
union internal trade will not be free, if the free trade point (which
by definition is on the contract curve) is not in the bargaining set.
Even if it is, the bargaining equilibrium need not settle on it.
The literature on the requirement of Article XXIV that substantially
all internal trade be free has not, to the best of my knowledge,
approached internal tariffs of a union from the perspective adopted
by the Mantels. Also whether the extended time frame within which
internal tariffs were (or are) to be dismantled in customs unions of
the contemporary world, such as the EU, MERCOSUR or NAFTA could be
rationalized using the framework of Mantels, is an open question. Figure 1 is a slightly amended version of Figure 7 of Mantel and Martirena-Mantel (1980). It illustrates the above point. I want to use it also to raise an issue that I am sure the Mantels thought about but chose not to address. In Figure 1 asterisks are used to denote a country with which the home country (denoted without asterisks) is considering integration. I have also eliminated, as the Mantels did, the ROW from the Figure since it is assumed to behave passively. Trade indifference curves AA'(A'A') denote the autarky indifference curves, FF'(F'F') the free trade indifference curves, NN'(N'N') the trade indifference curves corresponding to the pre-integration Cournot-Nash tariff equilibrium. The locus of tangencies of indifference curves of home and foreign countries representing Pareto Optimal trades is the contract curve CACoCa. As is well known, the free trade equilibrium FTE is on the contract curve.

As long as countries cannot be forced to trade, viewed from autarky at the origin, the relevant portion of the contract curve is that between the C and C on the two trade-indifference curves passing through the autarky point, viz. the origin. Starting from the initial Nash equilibrium point NEn, the bargaining set (i.e. the set of trades that makes neither country worse-off relative to NEn) is the set of points in the lens NEnCDCoNEn. The Mantels argued that a bargaining equilibrium will be some point on the part CCoCo of the contract curve that lies in the lens. As depicted, the free trade point FTE is not on it and hence will not be a potential bargaining
equilibrium

The Mantels were of course correct in saying that in the post-integration bargaining equilibrium trade need not be free. But a question arises: why did the countries behave non-cooperatively in the first place and then bargain rationally during the integration process? Had they begun their negotiations ab initio from their autarky positions and bargained rationally, their bargaining set would have been the lens formed by the two autarky indifference curves and it would have included the free trade point FTE. The entire contract curve \( c_aG_a \) would then be possible bargains. I wonder why the Mantels, having forcefully and rightly argued that the initial equilibrium should not be viewed as arbitrary, did not push their argument even further to autarky and initiation of trade between the two countries.

I have gone into the work of the Mantels on economic integration at some length, not only because we want to celebrate the life of Rolf Mantel, which was so tragically cut short, and his work, but also because many of the contributions to the large and still expanding volume of analytical literature on Preferential Trade Agreements or PTA's since the start of the Uruguay Round of multilateral trade negotiations, have adopted the basic approach of the Mantels that the choice of tariffs by governments be seen as equilibrium outcomes of some well-specified game (one shot or repeated). Unfortunately, the authors of these contributions seem to have been unaware of the papers of the Mantels, perhaps because they were published in Spanish and even the English version of one of them
was in a volume published by the Organization of American States.

The analytical literature is diverse in terms of issues analyzed, perspectives adopted and whether a static or dynamic view is taken. Some excellent surveys of the literature (Baldwin and Venables (1995), Winters (1998) and collections of papers, (Anderson and Blackhurst (1993), de Melo and Panagariya (1993), Baldwin et al. (1998), Bhagwati, Krishna and Panagariya (1997)) are available. A symposium on Regionalism and Development appeared in the May 1998 issue of *World Bank Economic Review*. Apart from strictly economic benefits or losses to member and non-member countries from a PTA, non-economic aspects of such agreements have been analyzed. Not surprisingly, the political objective, namely, to prevent yet another world war originating in Europe, was the primary reason for the formation of the European Coal and Steel Community in 1951, which later in 1957 became European Economic Community and after the Single Market decision of 1992 became the European Union. Political and the related national security considerations leading to a PTA are analyzed in some recent works (e.g. Schiff and Winters (1998) and the literature cited therein). More generally, domestic political economy considerations and their implications for preferential versus multilateral trade liberalizations are explored in several contributions (Raff 1998a and the literature cited therein). In particular, whether entering into a PTA with a strong partner is a more credible commitment mechanism than membership in the WTO for pursuing economic reforms by a weak government is another issue that has gained popularity in the context of economic reforms in Latin
America. In a world where not only international trade in goods and services but also international capital flows are important, whether entering into a PTA enables an economy to attract a larger volume of more desirable type of capital flows is yet another issue. The implication of membership in a PTA on capital inflows is one of many issues which are put in the category of 'deep integration' meaning issues of coordination, if not full harmonization, of domestic policies (e.g. competition policy, product safety standards) among members. These non-conventional aspects of PTA's are nicely surveyed in Fernandez and Portes (1998).

As in many fields of economic research, any new tool that becomes available is soon applied to analyze a variety of problems. Analysis of PTA's is no exception. The development of the so-called New Trade Theory based on scale economies in production and the resultant imperfectly competitive market structures, as well as the so-called New Economic Geography based on positive transport costs, agglomeration and scale economies, have both been applied to analyze PTA's. A nice example of the former is Puga and Venables (1998) in the context of industrial development of less developed countries and of the latter is Ludema (1999) in the context of tax competition for foreign direct investment. Of course the literature spawned by Krugman (1991) on "Natural Trading Blocs" is illustrative of the implications of transport costs on the benefits and costs of regionalism. The role of PTA's in the competition of footloose foreign capital through tariff protection (inducing tariff jumping investment) and domestic profit taxation (offering tax holidays and
concessions to attract investment) is modeled as sub-game perfect equilibria in Raff (1998b).

In several empirical analyses of the effects of the trade liberalization from the Uruguay Round agreement, the tools of applied general equilibrium analysis (static, dynamic, with or without scale economies in production, with or without purely competitive market structure) has been effectively used. But only a few of these addressed the impact of PTA's (Martin and Winters (1996)). The impact of particular recent PTA's (e.g. Chang and Winters (1999), and Yeats (1998) on MERCOSUR, Krueger (1999) on NAFTA) and of membership in PTA on bilateral trade of the partners have been examined using cross-sectionally estimated gravity models of trade (e.g. Frankel (1997), Soloaga and Winters (1999)). Most of the exponentially growing numbers of cross-country growth regressions often include measures of openness (e.g. Sachs and Warner (1995) but not often any variable to capture the impact of PTA's. The latter is taken up in Ben-David (1993) and Vamvakidis (1998).

Finally I should mention the literature on systemic issues raised by the trend towards regionalism starting from the now oft referred to question raised by Bhagwati (1991), "Are regional agreements 'stepping stones' or 'stumbling blocks' on the path towards global free trade?" In a series of papers, Bagwell and Staiger (1996a, 1996b, 1996c, 1997a, 1997b, 1999a, 1999b) have explored in depth the role played by the cardinal principle of GATT, namely, non-discrimination (or the Most Favoured Nation principle) and the role of reciprocity between countries in the exchange of
tariff reductions, for example, in preventing opportunism afforded by future regional or bilateral agreements to erode the benefits to non-members from current multilateral agreements. Several others (e.g. Bond (1999), Levy (1997, 1999), Syropoulos (1999)) also address some of the issues.

It is beyond my capability (let alone its implication for the length of this paper) to survey this literature in depth. However, the overall impression that I gathered is that it is not firmly established in theory or in empirics, that first, most of the non-traditional (political, investment, commitment etc.) benefits of PTA's could not be obtained through the multilateral process. Second, the traditional Vinerian trade diversion effects of recent regional agreements appear to be significant. Third, notwithstanding the many insights from using models that deviate from the traditional assumptions of pure competition, complete markets and the absence of scale economies and externalities, still the case for multilateral trade liberalization remains robust. With these more or less obiter dicta out of the way, I will proceed by drawing heavily on Srinivasan (1998) in a selective survey of the literature, analyze what has come to be called "Open Regionalism) and conclude with some remarks on amendments to Article XXIV of WTO relating to PTA's.

2. **Regionalism and Multilateralism**

In his excellent survey, Winters (1998) laments that while the topic of "Regionalism versus Multilateralism" is much discussed by trade economists, the literature is "surprisingly short on precise
measures," by which he means quantitative indices of the extent of regionalism or multilateralism in the outcomes of trade policies of countries. But, as he himself recognizes, the more serious problem is in defining the terms regionalism and multilateralism. Bhagwati (1993) and Winters (1998) (who points to the looseness of the definition) define "regionalism" as preferential reduction of trade barriers among a subset of countries which might, but need not, be geographically contiguous. The emphasis, presumably, is on the fact that preferences are restricted to a subset, indeed to a proper subset, and not extended to the whole set of countries of the world trading system. Thus, discrimination in liberalization is the essential feature of regionalism under this definition. As such, if multilateralism is to be viewed as the antithesis of regionalism then it has to be defined as a non-discriminatory reduction of trade barriers. But then unilateral reduction of trade barriers by one or more countries on a non-discriminatory basis will also be deemed multilateralism. However, one can distinguish MFN or non-discrimination from multilateralism following Jackson (1992, p. 134).

According to him, multilateralism

"is an approach to international trade and other relations which recognizes and values the interactions of a number, often a large number, of nation states. It recognizes the dangers of organizing relations with foreign nations on bilateral grounds, dealing with them one-by-one. MFN, on the other hand, is a standard of equal treatment of foreign nations."

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1 Bhagwati (1993) distinguishes between multilateralism as a "process" (i.e., MFN) for liberalization and multilateralism (i.e., MFN) as an outcome. Unilateral liberalization on an MFN basis, as with Peel's's repeal of the corn Laws, is then a multilateral outcome.
I return to this view of multilateralism as a process below.

It is instructive to view non-discrimination and multilateralism from the perspective of the fundamental objectives subserved by the WTO. The charter of WTO is of course a constitution that enunciates the "rules of the game," so to speak, for international trade in goods and services as well as trade-related investment measures and intellectual property rights. It also includes, most importantly, a mechanism for settlement of disputes among countries on the observance of rules. But all constitutions are frameworks for achieving more fundamental goals on the basis of accepted rules and for containing exercise of power by those endowed with it. In the case of WTO, it is fair to say that the fundamental objective is a global trading (and presumably also investment) system that is free of policy created barriers to flows of goods, services and capital between countries. Arguably, even this is not the ultimate objective, which is a global welfare in the sense of a Pareto Optimum. Efficient allocation of resources through unimpeded trade in competitive international markets is an instrument to achieve it.

Given that a global competitive equilibrium (over time and under uncertainty) will be a Pareto Optimum only under a set of assumptions about the existence of a complete set of markets, absence of externalities and so on, I do not wish to pursue this line of argument, although not doing so leaves open the issue of non-instrumental justifications for a free trading system.

A system that is free of trade barriers is by definition non-discriminatory with respect to the use of trade policy instruments.
But, to the extent other non-trade, i.e. purely domestic, policy instruments are effective substitutes for trade policy instruments in achieving discrimination in trade among a country's trading partners, eliminating trade barriers need not result in non-discrimination in trade outcomes. Indeed, this issue has been highlighted in the debate about trade effects of domestic policies with respect to environment, labour standards and market structure. Analogously, domestic corporate tax policies have effects on international flow of capital. The belief that labour, environmental and competition policy standards in all countries of the global trading system have to exceed some internationally agreed minima, if not the same everywhere, for free trade to be beneficial has been politically powerful. Non-governmental groups have been pushing these issues on the agenda of the WTO with only a limited success so far. They have had greater success in influencing regional free trade agreements, such as NAFTA. In fact, this success has been viewed by some as a strength of a regional approach to trade liberalization. Without delving into the burgeoning literature on the international effects of domestic policies, let me just assert (citing Bhagwati (1996, p. 24) in support) that GATT Article XXIII on "nullification and impairment" could be used to address the problem arising from the deliberate use of domestic policy instruments by one or more countries to deny trading partners of benefits from their earlier nondiscriminatory liberalization.

One of the many issues raised in the recent literature is whether a regional or multilateral approach (or a combination of
both) to reduction in pre-existing barriers is superior for eventually achieving non-discriminatory free trade for all. Bhagwati (1993), who is the originator of several felicitous phrases in this literature, has called this "the dynamic time-path question." In an earlier work (Bhagwati (1991)), he had raised the same question by asking whether trade blocs, i.e. preferential trading arrangements (regional and others), are "stumbling" or "building" blocks towards free trade for all. Of course, to be able to answer the question a norm for establishing the superiority of one approach or path over another has to be specified.

A number of alternative norms are found in the literature, though not always in an explicit form. For example, Summers (1991) in his oft-quoted and criticized remark, took the "building block" view in saying that

"Economists should maintain a strong, but rebuttable, presumption in favor of all lateral reductions in trade barriers, whether they be multi-, uni-, bi-, tri-, plurilateral. Global liberalization may be best, but regional liberalization is very likely to be good." (p. vii)

Implicit in this assertion is a norm for comparison, viz. global welfare (presumably in a utilitarian sense), so that global gains from Vinerian trade creation can be compared to global losses from trade diversion. As Barfield (1995) points out,

"Summers and other proponents of regionalism base their case on a belief that total trade creation will outweigh trade diversion in most cases, that the multilateral process is too slow to produce substantial progress toward further trade liberalization, and that regional free trade arrangements will allow some nations to speed up liberalization and ultimately produce a
self-reinforcing process toward more open markets." (p. vii-viii)

Kemp and Văn (1976), on the other hand, explicitly use a partial ranking based on the Pareto principle, rather than the implicit complete utilitarian ranking of Summers, to show that as long as lump sum income transfers among consumers within a CU are feasible, it is possible to choose the common external tariff for a CU of an arbitrary collection of countries in such a way that no consumer in any non-member country is made worse off, and at least one consumer in the CU is made better off as compared to the pre-CU trading equilibrium. Thus, progressive Kemp-Văn style enlargement over-time of CUs ending up with the whole world within a CU, i.e. global free trade, is a dynamic time-path in which the trading equilibrium at each point of time Pareto dominates earlier equilibria. In general, Kemp-Văn tariffs are not unique.\(^2\) Being just a possibility and existence theorem, the Kemp-Văn result has no direct operational implication for the pursuit of regionalism in the real world.

An alternative way of assessing the entire time-path of equilibria is to define a norm for the whole path. One, admittedly extreme, approach is to rank time paths according to the time each takes to reach a global free trading equilibrium. Thus, the answer

\(^2\) I have elsewhere (Srinivasan (1997)) characterized Kemp-Văn tariffs.
to another of Bhagwati's (1993) questions, viz. "Is regionalism quicker?," is in the affirmative, if one can show that a time-path, based on some version of regionalism minimizes the time to global free trade among all other feasible time-paths to the same goal, including ones based on multilateralism. However, an alternative welfare-oriented norm for a path of equilibria is the appropriately discounted sum of global welfare over the indefinite future along that path, whether or not it leads to global free trade in finite time or asymptotically. The presumption, however, is that a time-path that maximizes intertemporal welfare in this sense will be one that achieves global free trade at least asymptotically.

It should be clear in comparing alternative time-paths using the criterion of discounted sum of global welfare that along any such path of multilateralism and regionalism could, in principle, be pursued in any sequence, for any length of time, or even simultaneously. Indeed, even the possibility that pursuit of one initially precluding the pursuit of the other subsequently is not ruled out. Thus, paths corresponding to what Bhagwati and Panagariya (1996) call independence and interdependence between the pursues of multilateralism and regionalism are in principle included among the alternative time-paths. Interdependence could arise in two senses. First, the pursuit of, say regionalism, could trigger and ease the pursuit of multilateralism. Second, the outcomes of the option pursued later in time could depend on that pursued earlier.

Instances of interdependence in both these senses are cited in the literature. For example, Winters (1997) points to many
commentators having argued that the creation of EEC, i.e. regionalism, led directly to the Dillon and Kennedy rounds of multilateral trade negotiation, although Winters himself does not share this view. It is also said by some, though denied by others, that the Seattle APEC summit in November 1993 was perceived by the European Union as a threat by the US to go the route of regionalism and spurred it to compromise enough in those areas where it differed from the US in the Uruguay Round negotiations for the Round to be successfully concluded in December 1993. These are two instances of interdependence in the first sense. WTO (1995) flatly asserts that "There is little question that the failed Brussels Ministerial in December 1990 and the spread of regional integration agreements (especially after 1990) were major factors in eliciting the concessions needed to conclude the Uruguay Round" (WTO, 1995, p. 54, emphasis added). This is an example of interdependence in the second sense in so far as the outcome, i.e. the failure or success of the multilateral negotiations of the Uruguay Round, was influenced by the prior spread of regional agreements.

The results from the analytical models so ably surveyed by Winters (1998) are unfortunately extremely fragile and model dependent. A few examples will suffice. In the symmetric model of Krugman (1991a,b) without room for comparative advantage to play a role, global welfare is minimized when the world consists of two or three blocs. Srinivasan (1993) and Deardorff and Stern (1994) show with different non-symmetric models, in which comparative advantage
plays a significant role, that Krugman's result need not hold.\textsuperscript{3}

Levy (1997) examines whether incentives for multilateral trade liberalization are blunted by the possibility of concluding regional trade agreements in a median-voter-political-economy model of trade policy determination. More precisely, he considers two periods, during the second of which an opportunity for multilateral liberalization arises, and asks whether two countries concluding bilateral trade agreement in the first period will retain any interest in multilateral liberalization in the second period. In a standard Heckscher-Ohlin-Samuelson model with median voter politics, the answer is in the affirmative, since the only effect of trade liberalization, bilateral or multilateral, is the Stolper-Samuelson effect on factor prices induced by terms of trade changes. However,

\textsuperscript{3}Hamada and Goto (1999) show that in a symmetric world in which all trade is in differentiated products, and market structure is one of monopolistic competition, the formation of a CU, that is consistent with Article XXIV in the sense that its common external tariff is no higher than the common (because of symmetry) tariff that each individual member had in place prior to the formation of the CU, worsens the welfare of non-members.
if the model is one of differentiated-product-monopolistic-competition, there is an additional effect to consider, namely, the expansion of the varieties of the product available for consumption with trade liberalization. In such a model, concluding a bilateral agreement in the first period might result in the two countries losing interest in multilateral liberalization in the second period. Thus, the answer to the time-path question depends on the model of trade!

Krugman (1991a,b) and several others have contended that countries that trade with each other in larger volume than with other nations are "natural" trading partners and hence that preferential trading arrangements (PTA's) among them are likely to be welfare enhancing. It is further argued that countries that are contiguous are likely to trade more with each other and hence are "natural" partners to each other so that "regional" PTA's are welfare enhancing. A related assertion is that regional PTA's are likely to improve welfare by minimizing transport costs. The models of Bhagwati and Panagariya (1996) challenge each of these assertions.

Bagwell and Staiger (1997a,b, 1996a,b,c) have analyzed the dynamic time-path question using a repeated-game-dynamic framework, in which any deviation from cooperation (for example, maintaining low multilateral tariffs) is punished by reversion forever after to non-cooperative Nash tariffs. Since they explicitly rule out enforcement of agreements by third parties and focus exclusively on self-enforcing contracts, their analysis assumes that any WTO enforcement mechanisms is unlikely to be effective, and hence is not entirely
relevant for assessing the relative strength of multilateralism. Be that as it may, the conclusion of Bagwell and Staiger (1996c) is sufficient to illustrate the non-robustness of the results of their model:

"Our analysis suggests that the consequences of regional agreements for multilateral tariff cooperation need not be clear cut: Effects exist under which regional agreements complement multilateral liberalization efforts, and effects also exist under which regional agreements undermine the multilateral liberalization process." (p. 1)

There have been many attempts to evaluate empirically the likely effects of multilateral trade liberalization of the Uruguay Round. WTO (1995, p. 45) refers to numerous ex ante and ex post attempts to estimate the trade and other economic effects of regional integration agreements, principally those among developed countries. Again, because of differences in modeling, data used, degree of aggregation, etc., the estimated effects often differ not only in magnitude but even in sign. A brief survey of empirical evidence on regionalism vs. multilateralism leads Winters (1998) to conclude "Regrettably it seems as ambiguous as the theory, at least so far as issues of current policy are concerned." Thus, neither theory, nor evidence, provides a robust guide to the choice between regionalism and multilateralism. Obviously, merely counting a priori arguments in favour of one or the other is not much of a guide either. Inevitably, an overall judgment implicitly weighing all three has to be made.

3. Open Regionalism: An Oxymoron or a Fruitful Concept?
The United States, under the Clinton Administration, has been actively pursuing the regional route. The Council of Economic Advisers (CEA) to the President in their annual report for the year 1995 claimed that "possibly the most distinctive legacy of this Administration in international trade is the foundation it has laid for the development of open, overlapping plurilateral trade agreements as stepping stones to global free trade. The Administration's plurilateral initiatives in North America, the rest of the Western Hemisphere, and Asia embody principles of openness and inclusion consistent with the GATT" (CEA (1995), pp. 214-215). I have elsewhere (Srinivasan (1995)) critically examined several of the arguments offered by the CEA in favour of plurilateralism and found them unpersuasive.

The CEA also defined the term "Open Regionalism" that had been earlier advocated by

Richard Pomfret, in commenting on Srinivasan (1998), disagreed with this. He claims that the conclusion of NAFTA and the hosting of APEC summit in Seattle in 1993 by the Clinton administration were in fact reversals of the earlier Republican administrations' aggressive unilateralism and pursuit of regionalism through the Caribbean Basin initiative and free trade agreements with Israel, Canada and Mexico. He argues that concluding NAFTA was essential to gain support for the Uruguay Round and the US embrace of APEC was in fact a signal that the U.S. was not wedded to Eastern Pacific regionalism. This is a very imaginative reading of the events! I prefer to rely on what the administration spokesmen have said or written!
"Open regionalism refers to plurilateral agreements that are nonexclusive and open to new members to join. It requires first that plurilateral initiatives be fully consistent with Article XXIV of the GATT, which prohibits an increase in average external barriers. Beyond that, it requires that plurilateral agreements not constrain members from pursuing additional liberalization either with non-members on a reciprocal basis or unilaterally. Because member countries are able to choose their external tariffs unilaterally, open agreements are less likely to develop into competing bargaining blocs. Finally, open regionalism implies that plurilateral agreements both allow and encourage non-members to join. This facilitates the beneficial domino effect described above." [CEA (1995), p. 220].

In assessing these claims, it should be noted that by its very definition any plurilateral free trade agreement provides preferential market access to members and, as such, violates the MFN principle. Even if, in the face of experience to the contrary, such agreements are declared to be in conformity with the updated Article XXIV, any extension of any liberalization among parties to the agreement to others, except on an MFN basis, cannot possibly be viewed as other than conditional and preferential market access. It is available to only those non-members who are willing to meet
whatever conditions (e.g., reciprocity) are attached to such an extension. Viewed in such a perspective, Open Regionalism is nothing but an oxymoron.

Although the EPG recommended “unilateral liberalization to the maximum extent possible” and recognized that any individual APEC member can unilaterally extend its APEC liberalization to non-APEC members on an unconditional MFN basis, they do not think that either is likely or even desirable.\(^5\) For example they point out that

> “the largest members, including the United States, are unlikely to liberalize unilaterally when they can use the high value of access to their markets to obtain reciprocal liberalization from others. The same view applies in other economies in the region ... we would note ... that the region would give away an enormous amount of leverage ... if its members, especially its largest members, were to liberalize unilaterally to any significant degree” \cite{APEC1994}.

The EPG candidly admit that

\(^5\)Pomfret draws a distinction between the U.S. and Western Pacific members of APEC. In his view, while the U.S. is wedded to reciprocity, governments of some Western Pacific nations apparently have accepted that trade liberalization is good for the liberalizer even without reciprocity. Be that as it may, APEC leaders have disbanded the EPG, and its chairman, Fred Bergsten, has acknowledged that the disappointing results of APEC liberalization thus far threaten to make the Manila summit of November 1996 a failure, thereby undermining APEC’s credibility \cite{FinancialTimes1996}.
"We rejected the concept of unconditional MFN treatment of non-members as the sole means of implementing open regionalism for the economic and political reasons...." [APEC (1994), p. 34]

The main reasons were the familiar free rider problem and the claim that it is rare that benefits of politically negotiated trade liberalization, multilateral or regional, have been extended to non-participants on a non-reciprocal basis.

The 'free rider' argument and the demand for reciprocity reflect a mercantilist view of trade liberalization, namely, that a country's offer of liberalized access to its markets is a costly 'concession' for which it has to be compensated by reciprocal liberalization by its trading partners. Except in cases where significantly adverse terms of trade effects are induced by liberalization (an unlikely event certainly for small countries, and most probably even for as large a grouping as APEC), this argument does not carry much weight.

One should have thought that if indeed the goal of EPG is globally free and open trade, far from bowing to political expediency, they should have used their prestige to educate the political leaders of APEC that their fears of unconditional MFN extension of their liberalization to non-members are unwarranted.

It is thus difficult to avoid the conclusion that 'Open regionalism' if not an oxymoron, is not a particularly fruitful new concept in the arena of trade liberalization. If the smaller developing countries of APEC, instead of pursuing their unilateral liberalization on an MFN basis, succumb to the 'Open regionalism'...}

6 I am ignoring the role of reciprocity in preventing opportunism discussed in the contributions of Bagwell and Staiger (1999a, b).
they will be subjecting themselves to what Bhagwati terms “a process by which a hegemonic power [and often manages] to satisfy its multiple trade-unrelated demands on other weaker trading nations more easily than through multilateralism” (Bhagwati (1995), pp. 13-14).

It is unfortunate that the regional route to liberalization and a version of open regionalism have been embraced by Mr. Renato Ruggeiro, the former Director-General of the WTO. He suggested

"The regional liberalizing impulse is not in itself cause for alarm among the upholders of the multilateral system. Regional initiatives can contribute significantly to the development of multilateral rules and commitments, and in regions such as Sub-Saharan Africa they may be an essential starting-point for integration of least-developed countries into the wider global economy. At the most basic level the real split is between liberalization, at whatever level, and protectionism. Viewed from this perspective regional and multilateral initiatives should be on the same side, mutually supportive and reinforcing." [WTO (1996), p. 10]

But he added

"However the sheer size and ambition of recent regional initiatives means we can no longer take this complementarity for granted, if indeed we ever could. We need a clear statement of principles, backed up by firm commitments, to ensure that regional schemes do not act as a centrifugal force, pulling the multilateral system apart.

The answer is to be found, I suggest, in the principle which some of the newer regional groupings have enunciated -- Open Regionalism." [Ibid, p. 10]

Ruggeiro contrasted two interpretations of Open Regionalism

The first essentially required that any regional preferential trade arrangement be consistent with Article XXIV of GATT 1994 and the understanding on its interpretation incorporated in the UR agreements on Trade in Goods. In the second
"... the gradual elimination of internal barriers to trade within a regional grouping will be implemented at more or less the same rate and on the same timetable as the lowering of barriers towards non-members. This would mean that regional liberalization would in practice as well as in law be generally consistent with the m.f.n. principle." [Ibid, p. 11]

He concluded

"The choice between these alternatives is a critical one; they point to very different outcomes. In the first case, the point at which we would arrive in no more than 20 to 25 years would be a division of the trading world into two or three intercontinental preferential areas, each with its own rules and with free trade inside the area, but with external barriers still existing among the blocs." [Ibid, p. 11]

He clearly expressed his preference for the second, arguing, in sharp contrast to the CEA, that it

"...points towards the gradual convergence of regionalism and multilateralism on the basis of shared aims and principles, first and foremost respect of the m.f.n. principle. At the end, we would have one free global market with rules and disciplines internationally agreed and applied to all, with the capacity to invoke the respect of the rights and obligations to which all had freely subscribed. In such a world there could and must be a place for China, Russia and all the other candidates to the WTO." [Ibid, p. 11]

Notwithstanding the Director General's preference for the second interpretation, it seems odd: after all, if regional liberalization is to be extended on the same timetable "in practice and in law" to non-member countries on an MFN basis, it would be multilateral and not regional. If that is the case, why would any group initiate it on a regional basis in the first place?

The concern of the Director General that mere consistency with
Article XXIV is not enough to preclude the possibility of a world of trade blocs is well taken. Whether a changed Article XXIV would prevent such an outcome is an open question.  

4. **Saving Non-Discrimination: Enhancing Credibility of WTO Processes Relating to Preferential Trading Arrangements**

The dismal failure of the GATT Working Party mechanism for examining the consistency of proposed PTA's with the conditions laid down in Article XXIV and making recommendations to the governing council of GATT was documented in Section 1. The reasons for the failure, as noted earlier, were largely in the vagueness of the conditions in Article XXIV itself. Under the circumstances, one approach to reform is to replace Article XXIV by a better alternative which is precise, transparent and predictable in its application.

An attractive alternative is one which retains the notification requirements of Article XXIV and lays down a precise time limit (say five years) within which, first, any and all preferences (tariff and

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non-tariff) that are included in any existing or proposed PTA's are required be extended to all members of the WTO on an MFN basis; second, in the case of Customs Unions, if the common external tariff structure results in an increase in tariff relative to what prevailed in any country prior to its becoming a member, such increases are to be rescinded within the same period; third, in the case of FTA's any increase in the applied external tariffs of a member following its formation, even if it is within its previously bound levels, are to be rescinded within the same period. Any disputes relating to the observance of these conditions would be resolved using the Dispute Settlement Mechanism of the WTO. This alternative restores non-discrimination within a set time limit and avoids having to examine whether PTA's satisfy specified conditions to be given a permanent waiver from MFN. It is extremely unlikely, however, that this proposal will attract support from countries that are members of existing PTA's such as EU and NAFTA. As such, one has to examine possible ways of strengthening Article XXIV.

The imprecision of the requirement of Article XXIV that duties and other regulations of commerce should be eliminated with respect to substantially all the trade between members in products originating in them has led to serious problems of interpretation (WTO (1995), p. 13): should the word 'substantially' be interpreted qualitatively (i.e., no major sectors are excluded) or quantitatively (i.e., share of trade of the members covered)? Does exclusion from elimination of barriers with respect to trade among members in unprocessed agricultural commodities, as in most PTA's, violate the
"all-the-trade" requirement? Are all types of non-trade barriers to be eliminated, whether or not such barriers are sanctioned under other Articles, for example, those relating to safeguards, anti-dumping and national security? Are other members of a CU or PTA to be exempted when one member takes actions in the form of quantitative restrictions under the safeguard clause, actions that would otherwise have been non-discriminatory?

The fundamental objective that prompted the inclusion of the "substantially all" trade condition was to "avoid a mass of protectionist oriented a la carte agreements that exclude a broad range of "sensitive" sectors" (WTO, 1995, p. 66). One way to achieve it while avoiding problems of interpretation is, first, to substitute the phrase "substantially all trade" by "trade in all products and services except those explicitly exempted from MFN or NT requirements under other articles or understandings of WTO." Second, if a member of a CU or FTA avails of administered protection permitted under WTO articles which is required to be applied on a non-discriminatory basis, other members should not be exempted from its application.

The second major problem of interpretation of Article XXIV arises with respect to the requirement that the common external tariff and other restrictive regulations imposed at the time of the formation of CU not be "on the whole higher or more restrictive" than those imposed by its members prior to its formation. The Understanding reached in the Uruguay Round with respect to Article XXIV clarified that for purposes of comparison,

"... the general incidence of the duties and other regulations of commerce applicable before
and after the formation of a customs union shall in respect of duties and charges be based upon an overall assessment of weighted average tariff rates and of customs duties collected. This assessment shall be based on import statistics for a previous representative period to be supplied by the customs union, on a tariff-line basis and in values and quantities, broken down by WTO country of origin. For this purpose, the duties and charges to be taken into consideration shall be the applied rates of duty." (GATT 1994, 32)

The substitution of the vague phrase "general incidence" by a much more precise criterion for comparison of pre- and post-union tariff structures was a step in the right direction. However, no rationale for the proposed criterion was offered. Nor was it established that one can infer how the welfare of non-members is affected by the formation of CU by using the suggested comparison.

Two of the proposals for reform of Article XXIV in this context are by Bhagwati (1991) and McMillan (1993). Bhagwati proposed that a CU should be approved only when its common external tariff is set at the minimum of the pre-union import tariffs of the member countries. An implication of this is that the CU will engage in free trade with all non-members, if at least one member had a zero pre-union tariff for each of the traded commodities! Even if this were not the case, the Bhagwati proposal could lower welfare of some members of the CU and raise that of non-members (Srinivasan (1997)). Since such a possibility could deter the formation of a union, the Bhagwati proposal may still be treated as a desirable reform which in effect sets a price or hurdle on WTO members who wish to enter a customs union and thus compromise the MFN principle.

McMillan (1993) suggests that
"A proposed RIA [Regional Integration Agreement], in order to get GATT's imprimatur, would have to promise not to introduce policies that result in external trade volumes being lowered. And, if after some years the RIA is seen to have reduced its imports from the rest of the world, it would be required to adjust its trade restrictions so as to reverse their fall in imports." (p. 300)

Measuring trade volumes is certainly more workable. But changes in aggregate volumes of trade with non-members need not necessarily indicate changes in global welfare. Besides, by substituting outcome variables (viz. trade volumes for instrument variables, viz. tariff rates) when in fact outcomes are impossible to predict with any accuracy, the McMillan proposal runs into problems similar to those afflicting the malodorous "managed-trade" approach to trade policy.

The Kemp-Wan (1976) tariff structure by a CU, as mentioned earlier, is sufficient to ensure that the welfare of non-members is not adversely affected by its formation. It is certainly not necessary--after all, one cannot rule out the possibility that in spite of the change in the prices faced by non-members incidental to the adoption by a CU of a tariff structure that differs from a Kemp-Wan structure, welfare of non-members is not adversely affected.

Even if a theoretically more satisfactory averaging of pre-union tariffs could be specified, still the facts that tariffs are not the only barriers to trade, non-tariff barriers cannot always be converted to equivalent tariffs, and most important, that pre-union barriers could reflect expectations then about the future evolution of the world economy, suggest that whatever tariff averaging procedure is suggested for comparing pre- and post-union barriers
with respect to trade with non-members, it is difficult to ensure that it will guarantee that the welfare of non-members in the post-union future is no lower than what it would have been in the counterfactual world without such a union. Thus, from the only appropriate perspective, viz. in determining whether a proposed CU or FTA adversely affects the future welfare of a non-member relative to what it would have been in the absence of that CU or FTA, none of the proposed modifications of Article XXIV are of much help.

A third and equally thorny issue that arises with respect to FTAs is their rules of origin (ROOs) which determine which products receive duty-free treatment when such products use intermediates imported from non-member countries in their production. The Uruguay Round agreement on ROOs envisages a work program for harmonizing rules of origin and the establishment of a Technical Committee with responsibilities, inter alia to examine technical problems in the day-to-day administration of ROOs and to prepare and circulate periodic reports on technical aspects of the agreement on ROOs. My reading of this agreement is that it can at best bring transparency and technical coherence to ROOs. But it does not come to grips with the crippling conceptual issue whether ROOs can ever be harmonized in a meaningful sense in a world where several countries are members of more than one overlapping preferential trade arrangements.

I should also mention technical difficulties involved in determining the local (i.e., FTA) content for products when there is local production as well as imports of several intermediates from third countries. It is natural to consider using an input-output
matrix for this purpose, thereby assuming that input coefficients are technological constants. A typical coefficient $a_{ij}$ of the input-output matrix $A$ represents the amount of input of commodity $i$ needed to produce a unit of output of commodity $j$. But there is no way to decompose $a_{ij}$ into domestically produced and imported quantities of $i$ if there is import competing domestic production of $i$. Besides, the constancy of the coefficients of the $A$ matrix is itself a strong assumption. Krueger's (1992, 1995) analysis of ROOS and overlapping FTA's illustrates how in establishing ROOS, non-transparent lobbying by protectionist interests is very likely. But the problem goes deeper and arises also in a CU. For example, the French apparently worry about and insist on value added rules in determining whether an automobile produced in the U.K. in a Japanese-owned plant should be allowed duty free. Of course, if Article XXIV is replaced a time-bound phasing out of preferences, the problem of ROOS will become moot as well.

To the extent that PTA's are driven primarily by political objectives (e.g., the fundamental reason for the establishment of European Coal Steel Community and later the European Community was to reduce the prospects of yet another European war) and those objectives are shared widely, the past "practice of looking the other way when Article XXIV runs up against overriding political goals" (WTO, 1995, p. 65) will continue whether or not Article XXIV is strengthened. Nonetheless, requiring that any proposed PTA be notified prior to its being ratified member countries so that the WTO can weigh in with its recommendation, as suggested in WTO (1995), is
a sensible idea even though WTO's efforts could be wasteful in those cases where the proposed agreement is not ratified.

The recommendations in WTO (1995) on improving transparency and surveillance are also sensible. Indeed, the GATT had a biennial reporting requirement for developments within individual PTA's but this was not met. A revised and stricter enforcement of this requirement would be helpful. Perhaps instead of requiring CU's or FTA's to submit reports, a better procedure would be for the WTO itself to draw up such reports using the Trade Policy Review Mechanism.

There are also claims that recent regional agreements go beyond conventional trade arrangements, addressing not only trade in goods, but also the liberalization of trade in services, movements of labor and capital, the harmonization of regulatory regimes, and the coordination of domestic policies that influence international competitiveness. It is arguable that such harmonization is not always beneficial and, even if it is, there are perhaps more efficient ways of achieving it. In any case, there is no convincing analytical argument establishing that trade or investment preferences of a PTA are either necessary or sufficient for a successful pursuit of regional integration in other areas. All said and done, in my judgment the adverse systemic and other effects of discriminatory PTA's far outweigh any beneficial effects. Rather than try to reform

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8Pomfret argues that governments of member countries of CU's code sovereign power over external trade policy and tax revenue to the Union and as such are inevitable precursors of some form of federation. To expect them to multilateralize their preferences is utopian in his view. While there is merit in his argument, it seems
Article XXIV, a better approach, as suggested earlier, will be to ensure that all PTA's, regional or otherwise, are temporary features of the global trading system. In fact, the best approach for WTO members could well be, first, to follow the advice of Nancy Reagan and "Just say no" when presented with any proposed PTA for approval and, second, to follow the advice of Senator Robert Dole when he suggested to the proponents "Just don't do it"!

It is for this reason that I am not persuaded that the recommendations of Serra et al. (1997) for improving the rules for RTA's are appropriate. Besides, being 'Rube-Goldbergian' in their complication, the recommendations treat RTA's as permanent and irreversible features of the global trading system.


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