

**THE CHALLENGE OF MULTIPLE MEMBERSHIPS IN
REGIONAL TRADE ARRANGEMENTS: THE EASTERN AND
SOUTHERN AFRICAN CASE.**

By

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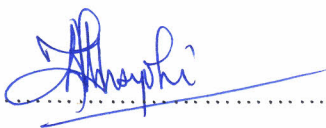
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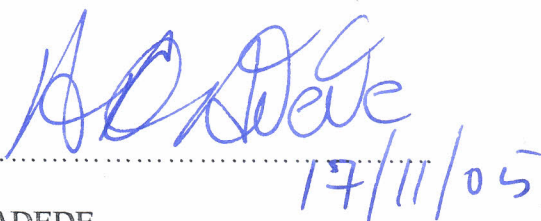
DECLARATION

I, Musyoki W. Kimanthi, do hereby declare that this thesis is my original work and has not been submitted and is not currently being submitted for a degree in any other University.



MUSYOKI W. KIMANTHI

This thesis has been submitted for examination with my approval as University Supervisor



DR. A. O. ADEDE

DEDICATION

To my entire family, whose diligence, fortitude and unity are always a source of inspiration.

To Michael John Greany, whose very sincere and deep friendship has brought me this far.

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I am heavily indebted to my very able supervisor, Dr. A. O. Adede, who patiently read through this paper and who did not hesitate to contain me when I got excited about the topic of discussion. I also learnt a lot of new English words, the ones he would use to describe my verbosity. I consider myself lucky to have worked under a Man of such great wisdom, and patience.

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LIST OF ABBREVIATIONS

| | |
|-----------------|---|
| ASEAN | Association of South East Asian Nations |
| CARICOM | Caribbean Common Market |
| CET | Common External Tariff |
| COMESA | Common Market for Eastern & Southern Africa |
| CU | Customs Union |
| EAC | East African Community |
| EU | European Union |
| FTA | Free Trade Area |
| GATS | General Agreement on Trade in Services |
| GATT | General Agreement on Tariffs and Trade |
| MERCOSUR | Mercado Comun del sur |
| MFN | Most Favoured Nation |
| NTB | Non-Tariff Barriers |
| NTP | National Treatment Principle |
| REG | Regional Economic Grouping |
| RIA | Regional Integration Agreement |
| RIA | Regional Integration Agreement |
| RTA | Regional Trade Arrangements |
| SACU | Southern African Customs Union |
| SADC | Southern African Development Community |
| WTO | World Trade Organization |



CHAPTER ONE

1.0 MULTIPLE MEMBERSHIPS IN REGIONAL TRADE AGREEMENTS

1.1 INTRODUCTION

Economic integration appears to be the thing to do for countries that seek the goals of, *inter alia*, balanced economies of scale, regional security, bargaining leverage in the international economic arena, pooling of resources, trade creation and even mere political influence over the co-operating partners. Whereas the international legal regime that regulates international trade generally favours a system of open and free trade amongst all nations of the world through the Most Favoured Nation (MFN) and National Treatment Principle (NTP), the same regime offers an exception to this general rule. The General Agreement on Tariffs and Trade (GATT) Article XXIV permits regional economic groupings, whose effects amount to discrimination between members and non-members. Members of a regional economic grouping have certain rights and privileges that non-members do not enjoy. It is through formation of such small regional economic integration groupings that countries enjoy the rights arising therefrom to achieve the above-mentioned goals.

The same international legal regime for world trade does not place any limits as to the number of regional or sub-regional groupings that a State may join. The implication of this is that a state is free to join as many economic groupings as it wishes so long as it feels its national interests are best served through such membership.

It is common sense that rights have their corresponding obligations. As observed hereinabove, members of a regional economic grouping (REG) have certain rights and privileges that non-members do not have. This means that for member-partners to fully enjoy their rights under their treaty agreement, they must observe certain obligations that are owed to their partners- mainly by denying certain rights and privileges to non-members.

What then becomes of a State which is a member of various economic groupings with conflicting obligations on specific trade issues? This question forms the crux of investigation in this paper with special reference to the Kenyan case. I will attempt some explanations as to why countries find themselves in such a state; how best they can do to juggle their obligations without necessarily hurting any other member; examples of such obligations – whether they are actual or just potential.

1.2 BACKGROUND OF THE PROBLEM

Kenya is a member of the East African Community (EAC). It is also a member of The Common Market for Eastern and Southern Africa (COMESA). Apart from membership in these two sub-regional trading organisations, Kenya is also a member of the global trade regime; the World Trade Organization (WTO). As members of EAC, Kenya, Uganda and Tanzania extend certain rights and privileges to one another that should not be extended to any other country. On the other hand, Kenya and Uganda are members of the COMESA whereas Tanzania is a member of Southern African Development Community, SADC. Just as under the EAC arrangement, members of COMESA extend certain rights and privileges

to one another and not to countries outside this arrangement. The question then arises: at what point and to what extent would Kenya deal with Tanzania as a non-COMESA member partner while at the same time respecting her obligations to Tanzania as a partner member in the EAC? Whichever way Kenya deals with Tanzania, Kenya's obligations under the EAC Treaty will one way or another clash with her obligations under the COMESA Treaty. Further, Kenya also has obligations under the WTO regime that are also bound to feel violated.

Legal questions from overlapping membership can arise in the light of the law of one regional agreement when a country joins a second regional grouping. Conceivably, obligations under various regional trading arrangements could collide when a country is obliged, by regional agreement A, to grant Most Favoured Nation treatment to its regional partners under that agreement and then, by joining another agreement B, which at some point evolves into a higher level of integration than agreement A, will have to grant its trading partners under B more favourable treatment than under its partners under agreement A - this would be in violation of Agreement A. Another is that a country may be a member of a customs union and at the same time, member of a free trade area (this is the situation for which member countries of the Southern African Customs Union are heading as a result of integration in the SADC framework). Here, a possible conflict could arise when a country C grants duty free treatment to its partners in the free trade area F, while it is obliged, under the customs union agreement U, to apply the same tariffs to all its trading partners as its customs union partners are doing (and we are assuming that these customs union partners are not granting duty free treatment to the products coming from countries in F). As already mentioned, legal implications are by far not the only issue in such

situations - politics and economics are just as important. For instance, let us assume that members of a customs union rely heavily on tariff revenue for their national budget (as is very frequently the case for developing countries) and let us further assume that a customs union has one economically dominant member who is responsible for the majority of imports, but there is a revenue sharing arrangement, providing that tariff revenue is shared equally among the member countries (the dominant country then transfers a certain percentage of the tariff revenue it has collected to its less developed customs union partners). Now, if the dominant country decides to enter into a free trade agreement with a major trading partner (which implies duty free treatment), it will cease to perceive tariff revenue and accordingly, there will be less money to share with the less developed customs union members. This loss of tariff revenue will not hurt the dominant country's government too much, as the relative importance of this source of revenue is limited in its case, but will have much greater financial implications for the weaker customs unions partners.

The legal difficulties outlined above can possibly (at least partially) be avoided if, for instance, both regional groupings maintain the same level of integration and the same level of trade concessions or simply, if the respective agreement provides for some kind of special treatment of the multi-membership country. Better still, the difficulties could be avoided if states limited their memberships into regional trade arrangements to one.

In pursuit of the desire to fulfill their national interests, States seem to be in a rush to join economic groupings without a thorough check of the treaty obligations arising therefrom and the effect of this has been a lack of a viable economic union in sub-Saharan Africa.

This problem has been compounded by political arrogance of the ruling elite where they are all too-ready to pronounce their political sovereignty whenever a co-operating partner complains of a 'co-operation-distorting' activity of another. Further, there are few ideological links of unity in Africa. For instance, upon getting independence in the early 1960s, the three East African countries followed different paths. Kenya favoured the capitalist system and was considered the blue-eyed boy of the West while Tanzania, under the indefatigable African statesman Julius Nyerere, chose the socialist path. Uganda by then had been snared by political hatred that saw leaders like Idi Amin Dada - who authored the deaths of tens of thousands of his fellow citizens - forcibly seizing power.

During the period immediately before or after independence, the formation of many intra-sub-regional groupings was based on linguistic ties and historical links or on personal relationships between the African elite, or between African leaders and leaders in metropolitan or donor countries. An example is the case of Julius Nyerere of Tanzania and Milton Obote of Uganda, and Nyerere's personal involvement in Uganda affairs after the toppling of the Obote government by Idi Amin. Integration is also hampered by the existence of weak states and political opposition to sharing sovereignty. Integration arrangements are not characterized by strong supranational bodies and virtually all integration institutions are intergovernmental. Institutional weaknesses, including the existence of too many regional organizations, a tendency towards top-heavy structures with too many political appointments, failures by governments to meet their financial obligations to regional organizations, poor preparation before meetings, and lack of follow

up by sectoral ministries on decisions taken at regional meetings by Heads of State all contribute to failure in integration efforts.¹

Integration proceeds most rapidly when it responds to socio-economic demands emanating from an industrial-urban environment and security born by the growth of a new type of society². Such a society can both be plural or monoculture and be able to compete with each other more or less rationally for political power and social status. Mobilization of the population to participate in this process is essential. Many countries in Africa are dominated by non-pluralistic structures and are therefore poor candidates for integration. Even if their governments do partake at the official level, the consequences of their participation are not felt elsewhere in the social structures; and given the important role of the population in maintaining the economic units; such units do not stand the test of time³.

1.3 STATEMENT OF THE PROBLEM

Most African countries pursue economic integration without a serious check on the obligations arising therefrom. The effect of this has been a proliferation of multiple economic groupings with none of them being able to withstand political turbulence. The multiplicity problem within the sub-regional arrangements weakens the integration process. It leads to costly competition, conflict, inconsistencies, duplication of efforts, fragmentation of markets and restriction in the growth potential of the sub-regional

¹ Laporte, G. 1995. Regional cooperation and integration in Africa: An agenda for action at the national level. In: Regional Cooperation and Integration in the World Today: Papers from the First Open Forum, Maastricht, 20 April 1993. Maastricht: Province of Limburg: 67-75.

² Earnest B. Haas, "International Integration; The European and the Universal Process, International Organisation Vol.15, 1961. pg. 374

³ Dr. Otieno-Odek, in an Article titled, "Re-appraising the Framework for Regional Economic Integration in Africa" pg. 5 (unpublished)

arrangement. While recognizing that the diversity of economic and social needs of African countries and the complexity of international economic relations may require or justify the existence of many organizations in one sub-region, it is patent that better results would be obtained through a limited number of larger multipurpose institutions which would contribute to the establishment of a basic equilibrium among all states within the same sub-region, and provide economies of scale for quicker economic transformation.

The international legal regime on international trade has not contributed to development in this area. That countries are able to join multiple economic groupings through GATT, the regime which permits States to form such groupings is the cause of the confusion on policy problems in Africa. Under World Trade Organisation (WTO) rules, the Most Favoured Nation clause obliges members to extend any favourable trade terms offered to any one country to be extended equally to all other members. Though Regional Trade Agreements (RTAs) involve a departure from this basic norm, the rules permit the formation of Free Trade Areas (FTAs) and customs unions, provided they comply with the requirements of Article XXIV of GATT 1994 for trade in goods, Article V of General Agreement for Trade in Services (GATS) and the Enabling Clause for RTAs involving developing countries.

One-way preferences granted by developed countries to developing countries have also been legitimised under the Enabling Clause both for equitable reasons and as a means of accelerating the integration of developing countries into the world economy. Where the parties to a preferential arrangement are both developed economies, the grant of a waiver by the WTO has generally been required before their establishment.

Article XXIV is the closest that one can come to a generally accepted definition of what constitutes a Free Trade Area (FTA) and a customs union for the purposes of international trade law. However, it has to be remembered that, legally, the definitions therein are only valid "for the purposes of" the WTO agreement.⁴ Paragraph 8 of Article XXIV sets out both the internal and external parameters of a customs union.

A customs union is described as a single customs territory where, internally, the duties and other restrictive regulations of commerce are eliminated with respect to substantially all the trade between the member states of the union. With regard to the outside world, its members establish and apply a common external tariff, duties and other regulations of commerce to the trade of non-members of the union. Article XXIV also provides that for a customs union the barriers to trade with non-members imposed at the institution of the union be, on the whole, no higher than their general incidence in the constituent territories before the formation of the customs union.

An FTA, on the other hand, is defined as a group of customs territories in which the duties and other restrictive regulations of commerce are eliminated on substantially all the trade between the constituent territories in products originating in such territories while each member remains free to apply its own tariff to trade with the non-members.

Where FTAs are concerned, the duties and other regulations of commerce applicable in each constituent territory at the formation of the FTA ought to be no higher or more restrictive than they were prior to the formation of the FTA.

⁴ Mutai, Henry "Membership in Multiple Regional Trading Arrangements", 22nd August 2003 KIPPRA.

It should also be noted that WTO rules contain an acknowledgement of the fact that RTAs do not come into being overnight and the WTO permits countries to enter into interim agreements leading to the establishment of RTAs provided a plan and schedule for the formation of the RTA within a reasonable time is included.

The establishment of an RTA will have differing consequences for the foreign trade policy options available to participating countries depending on the kind of RTA created. WTO rules do not prescribe the type of RTA that members can establish nor do they limit the number of RTAs that a member can be a part of.

Some of the policy questions that a country needs to address when deciding whether or not to enter into an RTA are with whom to form the RTA, the form of RTA to establish, the depth of integration to be undertaken and the range of activities to be covered.

From a legal perspective, two points are worth bearing in mind. Firstly, in deciding whether and with whom to form an RTA, a state must remember that under general principles of international law, treaties in force are binding on parties to them and must be performed by the parties in good faith, unless there subsequently emerges supervening circumstances that create impossibility of performing for the party. Secondly, it is a general rule of international treaty law that a treaty does not create either rights or obligations for a third state without its consent. This point is especially worth remembering where a state party to an RTA establishes a new RTA with third parties that do not include all the parties to the earlier RTA.⁵

⁵ *Ibid*

At the lowest level of integration, the formation of a partial or sectoral trading arrangement has little or no impact on the formulation of external policies by the members. Though individual agreements will differ in the precise details, such agreements will, at most, only require members to grant each other MFN status with regard to any new agreements that they negotiate. Since states party to such agreements would not undertake to unify their negotiating positions vis-à-vis third parties, they will not be obliged to consult each other regarding new trade agreements with third parties.

A similar position exists with regard to an FTA. As defined earlier, members of an FTA remain at liberty to conduct the external trade policies that they wish. However, once again, the precise position will depend on the individual agreement. To take an example, the Trade Protocol setting up an FTA in the SADC region provides in Article 28(2) that "Nothing in this Protocol shall prevent a Member State from granting or maintaining preferential trade arrangements with third countries, provided such trade arrangements do not impede or frustrate the objectives of this Protocol and that any advantage, concession, privilege or power granted to a third country under such arrangements is extended to other Member States." So far as SADC is concerned therefore, SADC member states retain full autonomy to formulate a trade policy vis-à-vis the rest of the world that will best serve their national interests.

For customs unions, the situation is different as explained earlier. The setting up of a common external tariff necessitates the formulation of a common trade policy, at least with regard to tariffs. In a fully-fledged customs union, members are obliged to present unified positions in trade negotiations with third parties with the resultant voluntary restriction of

their autonomy in this area. How this general rule is put into practice depends on the customs union in question.

Both FTAs and Customs Unions are further distinguishable from Common Markets and Economic Unions. In the case of common markets and economic unions, the need for establishing common positions among members is even greater. This is due to the fact that such arrangements go beyond the mere harmonisation of tariffs and other duties to the harmonisation of regulations governing "behind -the-border" issues or the elimination of all forms of internal trade barriers among the members.

What then are the implications for the formulation of trade policy of membership in multiple overlapping RTAs?

From a legal point of view it is possible to design RTAs in a manner that permits members to continue to pursue individual foreign trade policies, even when the arrangement they are a part of is supposed to negotiate as one, the resulting web of complex links may be economically undesirable. Given the limited resources of governments and the private sector in the African region, it would seem that the simpler the linkages, the more likely it would be that the benefits of regionalisation would be enjoyed.

It is accordingly essential for a state to identify where its economic interests lie and then shape its policies accordingly. Policy makers must be aware of the implications of entering into the different forms of trade agreement and concentrate on establishing and consolidating those that best serve their national interests.

The International legal regime, the WTO, could have helped in discouraging overlapping membership in multiple regional economic groupings by limiting States' memberships in regional economic groupings to one, in addition to international membership of the WTO. This way the problem of conflicting obligations and divided loyalties could have been obviated.

1.4 RESEARCH QUESTIONS

1. What are the challenges to regional economic integration organisations amongst the Eastern and Southern African States arising from the simultaneous membership of these States in the global trade organisations such as the WTO?
2. What role should be played by the African States themselves and the World Trade Organisation in addressing the integration problems and challenges?

1.5 HYPOTHESIS

1. Regional integration efforts in Eastern and Southern Africa are compounded by the problem of multiple memberships into various groupings.
2. The States concerned are to take responsibility for lack of viable regional economic groupings in the region.
3. The WTO should take a more active role in detecting the possible incompatibilities between its rules and those proposed by regional economic integration organisations.

1.6 THEORETICAL FRAMEWORK

The desire to create a larger market which, among other aims, encourages States to establish regional or sub-regional economic groups can be achieved without unnecessary problems if a more careful assessment is made by the States concerned of the possible conflict between the proposed regional trade rules and the rules of the WTO applicable to them.

1.7 LITERATURE REVIEW⁶

1. Krueger, Anne O. 1997. "Free Trade Agreements versus Customs Union." *Journal of Development Economics* 54:169-87
2. Mc Millan, John. 1993. Does Regional Integration Foster Open Trade? Economic Theory and GATT's Article 24." In Kym Anderson and Richard Blackhurst, eds. *Regional Integration and the Global Trading System*. London: Harvester Wheatsheaf.
3. Frankel, Jeffrey. 1997. *Regional Trading Blocks in the World Economic System*. Washington, D.C.: Institute for International Economics.
4. Biggar, James. March 2005. "Does Africa need all there Regional Groupings?" East African Newspaper 28th March 2005.

1.8 RESEARCH METHODOLOGY

The research was mainly library and internet-based.

⁶ For a detailed list of Literature Review please refer to the Bibliography on page 67 of this paper.

CHAPTER TWO

2.0 GENERAL CHALLENGES ARISING FROM MEMBERSHIP IN MULTIPLE REGIONAL TRADE ARRANGEMENTS

Over the past decade, there has been a renewed regional push to achieve real trade liberalization and economic integration. With this effort has come a growing concern that the current proliferation of Regional Trade Arrangements (RTAs) could prove counterproductive in the long run. Regional policy makers are therefore faced with several important challenges. Key among these are the question of how these arrangements, with their differing goals and strategies, are going to relate to and coexist with each other internationally and at a national level, and what the implications of membership in multiple and overlapping RTAs are for the formulation of external trade policy of a State. Although from a legal point of view it is possible to design RTAs in a manner as to allow exceptions that permit members to continue to pursue individual foreign trade policies, even when the arrangements under their respective RTA require them to negotiate as one, the resulting web of complex links may be economically undesirable to an individual member.

It is accordingly essential for a State to identify where its economic interests lie and then shape its policies accordingly. Policy makers must be aware of the implications of entering into the different forms of trade agreement and concentrate on establishing and consolidating those that best serve their national interests.

A close examination of the various regional structures and agreements in Africa highlights the potential problems of overlapping membership, particularly among those with commitments to forming a customs union, and those negotiating economic partnership agreements with the European Union. Within Eastern and Southern Africa there are a number of regional economic groupings and bilateral agreements taking place within the context of the worldwide multi-lateral trading system, the WTO. These include (among others):

- Southern African Customs Union (SACU)
- Southern African Development Community (SADC)
- Common Market for Eastern and Southern Africa (COMESA)
- East African Community (EAC)
- Indian Ocean Commission (IOC)
- Economic Community of Central African States (ECCAS).

While the existence of numerous agreements within the region in itself is not a problem - although it does reduce the benefits to be obtained from integration - overlapping membership between the groupings has the potential to cause conflict and certainly imposes greater transaction costs on the business communities and governments. As these regional groupings move toward deeper trade and economic integration, these problems become more severe. The move toward free trade areas within the above groupings has so far been technically possible. But the next stage - establishing a customs union - is not.

It may be observed that while members of an FTA have autonomous control of their external trade agreements, but they cannot give more preferential treatment to any third party than they give to the current members of the FTA. Within a customs union, however, this autonomy is lost and each member of the Customs Union must adopt the group's common external tariff and apply this rate to all third parties. One country cannot realistically apply two different external tariffs. This poses a major problem for the regional economic communities mentioned above, which have already implemented or are in the process of implementing a customs union. None of these groups is exclusive, with at least one member state belonging to another African economic grouping. The overlapping multiple agreements would not be such a problem if there was an overall plan, through the WTO to synchronize the common external tariff of each group so that in the end they would all form one large trading bloc. But such a long-term regional plan does not appear to be in place - other than the ultimate goal of establishing the African Economic Community by 2025.

Not only will there be theoretical, political, and logistical problems with all the above blocs attempting to form their own customs union, but the current agreements as they stand will be in contradiction to one another's treaty obligations. For example, Article XXXI paragraph 3 of the new SACU agreement prohibits members from entering into new agreements with third parties without the consent of the remaining member states. Thus, Swaziland cannot negotiate further with COMESA without the approval of the rest of SACU members.

Similarly, in terms of the SADC Protocol on Trade (Article XXVIII, paragraph 2), member states cannot enter into a preferential trade agreement with third countries that may:

'impede or frustrate the objectives of [the] protocol and that any advantage, concession, privilege or power granted to a third country under such agreements is extended to other Member States.'

This is to be read against Article 56 of the COMESA Treaty which states:

'Member States are free to enter into bilateral or multilateral agreements provided that such agreements are not, and would not be, in conflict and do not undermine the COMESA FTA and CU.'

Moreover, Article 37 (4a) of the EAC Protocol on the Establishment on the East African Customs Union says:

'A Partner State may separately conclude or amend a trade agreement with a foreign country provided that the terms of such an agreement or amendments are not in conflict with the provisions of this Protocol.'

A formal agreement toward the implementation of another common external tariff is therefore 'in conflict' with the first agreement signed.

Another problem of overlapping membership has arisen in the context of the current Economic Partnership Agreement (EPA) negotiations with the European Union. Ideally, each region would negotiate its own agreement, but due to the membership of different blocs, countries in southern Africa have had to create new groups from which to negotiate. South Africa, a member of SADC, has already negotiated its own agreement with the European Union (EU), while SADC has split two other ways as well, with several

members joining a selection of COMESA members in pursuit of an agreement with the EU. If the current blocs of SACU, SADC, COMESA and the EAC insist on retaining their own customs unions, the current form of the regional integration agreements will not be sustainable.

The launch of the East Africa Customs Union in January does not actually mean that there is new internal free trade in East African economic community. Tariffs on a wide range of goods exported by Kenya to Uganda and Tanzania remain in place and are as high as 25% although they must be phased out over the coming five years. Goods qualifying for preferential EAC duty rates must also satisfy EAC rules of origin, and as many traders probably know only too well, satisfying rules of origin in the East African countries is not an easy matter. It is often difficult for traders to know about and understand these rules of origin, the examination of which we have dedicated a separate chapter hereinbelow.⁷

Membership in multiple regional integration schemes is likely to adversely affect implementation of the EAC Treaty through contradictory obligations, increase in complexity of rules and/or policies that may adversely affect decision-making by the private sector and therefore affect investment through diversion of the energy and commitment that is required to pursue depth and width of EAC integration. EAC members should honour the tariffs agreed in other trading arrangements like the COMESA and WTO. Matters are made a bit more complicated, as noted earlier, because two of the three EAC members (Kenya and Uganda) are also members of COMESA and one (Tanzania) a member of SADC. COMESA & SADC both have ambitions to have full economic and

⁷ Please refer to Chapter Three, on page 37 below.

monetary union and a common currency- ambitions that are also part of EAC's long term agenda. Like the EAC, the SADC is also grappling with obstacles in the SADC trade negotiations including rules of origin and non-tariff barriers to trade, as well as details regarding tariff-reduction schedules.

Legal obligations arising from membership in overlapping agreements establishing economic groupings can have costs. Countries will have to negotiate in a number of forums and agree to implement a range of policies which may be conflicting or irrelevant. As an example, the SADC rules of origin on a number of products are more restrictive than those of COMESA. This means that companies trading in countries which are members of both Regional Trade Arrangements may opt for the COMESA rules of origin, although customs officers will then need to be trained in both sets of the rules of origin. The transaction costs to negotiate and attend meetings of SADC, COMESA, SACU, EAC and WTO for small countries are very high.

The two most significant regional integration agreements in terms of membership, COMESA and SADC, are following very different approaches to regional integration. Since its inception as the Preferential Trade Area, COMESA has been following an approach based on classical Vinerian arguments, looking at the benefits of Regionalisation to derive almost exclusively from a trade angle. Its integration programmes are thus centred on trade, e.g. removal of tariff and non-tariff barriers; programs embodied in the concept of trade efficiency; and other trade-related issues such as trade and investment, trade and competition policy, trade and labour migration (not labour standards yet), trade

and finance (payment and settlement systems, currency convertibility, trade finance, etc), trade and procurement policy, etc. However, although seemingly functioning smoothly on the regional level and in pushing forward its regional integration agenda, the latter has not necessarily been effectively supported by country-level institutional changes and by addressing prevailing structural constraints, which are required to successfully implement this agenda.⁸

In contrast, SADC, stemming from the economic independence desires and political security needs of the Front Line States, has had a development approach to regional integration. For it, the strongest argument for Regionalisation has been hinging on issues other than trade, with structural weakness being regarded as the critical constraint to intra-regional trade. Thus, up till now, it has followed largely a sectoral cooperation approach to regional integration. The implementation of its trade protocol, however, heralds an era of market integration for SADC, a move which is also firmly entrenching the overlap in mandate with COMESA and which, in turn, is associated with potential conflicts for governments and the private sector operators. Furthermore, it is particularly in the area of sectoral cooperation where the variable geometry approach is appropriate for regional integration, but the implementation of its trade protocol would require thorough planning and effective management to bring the various sectoral cooperation initiatives within its market integration framework, apart from further strengthening intra-sectoral cooperation.

⁸ See Imani Development, 2001. Richard Hess & Simon Hess. *Rationalization of Regional Integration Institutions in Eastern and Southern Africa. An overview of the Current Situation* and separate studies on SADC, COMESA, EAC, SACU, RIFF, IGAD & IOC for the Global Coalition for Africa Economic Committee of 2-3 May, 2001, SA

Multiple membership of overlapping Regional Trade Agreements with different trade regimes can introduce particular complexities and concerns for such countries-their governments and private sector. Suffice to say that it is particularly joint members of SADC and COMESA that are increasingly facing confusing and conflicting situations as the respective integration agendas are deepening. Traders have to operate within a number of trade regimes each with its own tariff rates, rules of origin and procedures. The risk of trade deflection becomes high as goods that have been preferentially imported from say Kenya (a member of one of these regimes) are subsequently preferentially re-export to say South Africa (a member of only the regime). The official barriers to trade become very porous in such situations. Whilst it is technically possible (although difficult) for the COMESA and SADC FTAs to co-exist, it will be impossible for any member state to belong to more than one regime when (if) they adopt a Common External Tariff (CET) and become a Customs Union (CU), unless each regime adopts the same CET and the same CU regulations. Should COMESA becomes a CU as expected, those COMESA countries that are also participating in the SADC/ FTA⁹ implementation program may well be in violation of GATT Article XXIV if they seek to maintain preferential tariffs for imports from the SADC countries.

In addition, for Namibia and Swaziland, their joint membership of COMESA and SADC has become a dilemma with the introduction of the COMESA FTA. These countries have been unable to implement preferential tariffs for other COMESA countries and cannot

⁹ The SADC Trade Protocol, signed in 1996 and with implementation that commenced on September 1 2000, aims at establishing a SADC Free Trade Area within eight years. The agreement allows for tariff cuts on 12,000 defined product areas in the sub-region. By 2008, 85% of intra-SADC trade would be tariff free and from 2008-2012, sensitive products will be liberalised to create the FTA.

introduce free trade for imports from other COMESA countries in terms of this FTA. The SACU agreement CET cannot be broken by some members granting preferences in terms of other FTA regimes, unless all the other members agree to this arrangement. South Africa, Botswana and Lesotho have not given their consent to such action by Namibia and Swaziland, because once the CET wall is broken it would be very difficult to prevent goods illegally crossing to other SACU members without payment of duty. This is probably also in violation of GATT Article XXIV paragraph 8 (a) (ii).

The constituent countries' overlapping and differential membership of several RIAs have tempered the expectation that the EAC would introduce an FTA and CU based on the COMESA model. Tanzania is a member of SADC and purportedly favours adoption of SADC rules by the EAC, whilst the other two countries are already trading in terms of the COMESA FTA.

The dilemma of the multiple memberships is not confined to trade issues, but also extends to other areas ranging from finance, where divergent solutions to development or compensatory funds and payment and settlement systems are sought, to the infrastructural sectors, where different policy harmonization options and strategies are being pursued in e.g. telecommunication and transport.

So one might as well ask why so many countries in Eastern and Southern Africa have overlapping membership in these different regional trading arrangements. In particular why are countries committed to joining different Customs Union? It would appear

unadvisable for any one country to be a member of more than one Customs Union. And how can poor States provide the financial resources to maintain participation in so many different trading arrangements? One of the reasons given for Tanzania's withdrawal from COMESA was that she was already a member of other regional bodies, and that their goals were all to promote trade. She lamented that membership fees were burdensome on the country and that there was overlap and duplication of objectives. President Benjamin Mkapa¹⁰ stated that there was a propensity for starting and joining all kinds of organisations with the result that they were spending more time in conferences than implementing the decisions. Tanzanian predicament is a paradigm illustrating a core reason why economic co-operation in the region has more often faltered namely the existence of multiple regional bodies all having overlapping mandates.¹¹

Logic demands that EAC members should withdraw from the larger COMESA/SADC groupings. Better still, where there is a need to give a lot more attention to ways of adding value to primary products so that there may be an increase on export earnings, provision of employment, development of skills and relief of grinding poverty, a proliferation of regional trading arrangements does not seem the right way to go.¹² The servicing of operations such as EAC, COMESA and SADC is expensive, especially key skills from central government. Given that good trade policy skills are such a scarce commodity in most African countries, these must be well deployed and this cannot happen if there is a

¹⁰ In an interview with the Financial Times newspaper of London shortly after Tanzania's pull-out from COMESA

¹¹ Wachira, Charles, in an Article titled "Multiple Regional Bodies Block Cooperation in Eastern Africa" published in *The Standard*, August 1999

¹² James Biggar, in an Article titled "Does Africa need all these regional groupings?" published in the *East African* on 28th March 2005

proliferation of regional organizations. These disadvantages seem to far outweigh the desire for the creation of larger markets with greater populations that would attract and absorb more foreign direct investment in the region, as one of the possible rationale for REGs.

Tariff-based revenues form an important component of government revenues, thus explaining the reluctance of the States to adopt a low Common External Tariff (CET) under Regional Trade Arrangements. Also revenue loss should not be the only consideration when setting a CET, as welfare gains or losses and impact on industrial development of members are also important. In fact, the level of CET is an important determinant of the likelihood and cost of trade diversion and the likelihood of agglomeration of economic activity with higher CETs increasing such likelihood and costs.

Some members of Regional Trade Agreements are directly or indirectly involved in political conflicts with one another. This raises doubts whether economic integration is possible under such circumstances. Both goods and factors of production are unlikely to move freely in the region if conflicts persist. Some member countries insist on guarantees that would protect their countries before endorsing any FTA agenda. This means that they are not ready to face stiff competition from fellow member countries, let alone the rest of the world. Also, some member states have foreign currency problems and the devaluation policies have met stiff resistance from political leadership who fear that the worsening socio-economic environment may result in social upheaval.

Some bilateral and multilateral trade agreements initiated by some external agencies might be divisive in regional integration impact. For example, African Growth Opportunity Act (AGOA) of the American Congress is essentially bilateral; Economic Partnership Agreements (EPAs) between the European Union and African Caribbean and Pacific (ACP) countries aims at separate accords with each Regional Economic Grouping (REG) and no country may belong to more than one REG, thus ending the pragmatism of variable geometry mode of expanding developmental integration space.

Hard-won citizenship rights (of representation and self-government) are also unlikely to be given up easily, keeping pressure on politicians to remain accountable to the wishes of their electorates. All REGs are products of negotiated treaties. Treaties become effective only when they are reconciled with national constitutions and domesticated. Since most national constitutions pronounce the sovereignty of a people, more often than not any other domesticated law tends to be lower in hierarchy to the constitution and remains subject to rejection at the slightest invocation of the constitution. For instance, in Kenya provisions in international instruments are hardly ever adjudicated upon in the courts and attempts by advocates to invoke any such provisions are met with hostility by the Bench. An example of such conflict was brought out in the case of *Okunda and Another vs. Republic*¹³ where it was held that laws of the Community were other laws within the Kenyan Constitution, section 3, and were void to the extent of any inconsistency with the constitution. This position was subsequently affirmed by the Court of Appeal on appeal by the then East African Community¹⁴ when it was stated that: the Constitution was paramount and laws of

¹³ [1970] EA 453

¹⁴ East Africa Community vs. Republic [1970] EA 457

the Community that conflicted with it were void; that treaties did not become part of the law of Kenya until made so by the law of Kenya; and that having been made the law of Kenya any such treaty which was in conflict with the Constitution was void.¹⁵ This quest by a people to retain their identity is likely to persist and it serves only to jeopardize the stability of Regional Trade Arrangements. This has already been experienced with the more developed European Union when France and Netherlands voted to reject the European Union Constitution.

Major issues of regional economic integration in Africa would be grouped into two interrelated broad areas: issues of implementation and the limitation of insight from both the theoretical and empirical literature regarding the specific approaches that are appropriate for the continent. Implementation issues cover both the economic, political and institutional constraints that surface at the implementation stage of economic integration treaties. The approach issue refers to the menu of options available to pursue economic integration. These options range from a step-wise bilateral co-operation to continent-wide integration.

¹⁵ Brief facts of this case are as follows: Prosecutions were brought by the Attorney General against two persons under the Official Secrets Act 1968 of the then East African Community without the consent of the counsel to the Community. Section 8(1) of the Act provided that the consent was necessary to a prosecution. The question whether the Attorney General could institute such prosecution without the consent of the counsel to the Community was referred to the High Court. On reference counsel for the Community was allowed to appear. Section 26(8) of the Constitution provided that the Attorney General was not subject to the direction or control of any person in the exercise of his functions, and it was submitted that s. 8(1) of the Official Secrets Act was inconsistent with s. 26(8) of the Constitution which prevailed since the East African Community was a creation of Parliament which was itself subject to the Constitution. *Counsel for the Community argued that s. 8 (1) was purely procedural, and that any conflict should be resolved in favour of the Community by reason of the requirement imposed by art. 95 of the treaty for East African Co-operation on the partner States to pass legislation to give effect to the treaty and confer on Acts of the Community the force of law in their territories.*

Most REGs depend on donor support of programmes for harmonisation of their policies depending on short- term interests of the donor. Such donor influence creates not only harmonisation problems but also unhealthy competition among REGs. Also lack of common position among Member States (partly because of the capacity and desire of the sponsoring institutions to deal with individual members) had also created harmonisation problems. Implementation of all the regional agreements requires the deployment of scarce management skills, for instance to administer diverse rules of origin. Besides, it dilutes commitment and allegiance to one particular organization, and suggests a wait-and-see-posture.

Whereas the implementation of WTO rules remains a difficult task for Regional Trade Arrangements, one can imagine how even more daunting it becomes when States are faced with the challenge of implementing those rules in more than one forum. We look at some of the main requirements of the WTO rules on Regional Trade Arrangements.

2.1 Requirements of the WTO Rules on Regional Trade Arrangements

The main requirements of the WTO rules on RTAs can be summarized as follows:

1. For trade in goods, Article XXIV: 5(a) provides that, with respect to a customs union, the “duties and other regulations of commerce imposed at the institution of any such union ...in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation

of such union...”. With respect to a free trade area, Article XXIV:5(b) makes the same requirement for the trade policy of each of the countries which are party to such an agreement.

The 1994 Understanding on the Interpretation of Article XXIV made clearer the methodology to be used to judge this requirement in the case of a customs union. With respect to tariffs and duties, the evaluation should be based on an overall assessment of weighted average tariff rates and of customs duties collected. The calculation is done by the WTO Secretariat based on import statistics for a previous representative period on a tariff-line basis using the methodology used to compute the tariff offers in the Uruguay Round negotiations. Importantly, it is specified that the duties and charges taken into consideration should be the applied rates of duty. For non-tariff measures, individual examination to assess whether their overall trade restrictiveness has increased or not should be undertaken.

2. Article XXIV:8(b) specifies that duties and other restrictive regulations of commerce, except as otherwise permitted under General Agreement on Trade and Tariff (GATT) rules, should be eliminated on substantially all the trade between the constituent territories. Article 5:1 of the General Agreement on Trade in Services (GATS) has similar language that an agreement should have substantial sectoral coverage, which is defined in terms of the number of sectors, the volume of trade affected and modes of supply. Specifically, to meet this condition, agreements should not provide for the *a priori* exclusion of any mode of supply.

3. Article XXIV:5(c) requires that any plan to form a customs union or free trade area must show that it will be completed within a reasonable length of time. In the 1994 Understanding, this is defined as not exceeding 10 years except in exceptional cases. The GATS does not contain an equivalent provision with respect to a regional agreement covering trade in services.

4. If, in forming a customs union, it is necessary for a Member to raise a bound rate of duty, other Members have a claim for compensatory reductions in bound tariffs on other goods. The 1994 Understanding specifies that, in calculating the amount of compensation required, due account should be taken of reductions of duties on the same tariff line made by other parties to the customs union upon its formation. The idea of compensation is not provided for in the GATS with respect to regional trade agreements covering services. However, Article V:6 does provide that nationals or firms of any WTO Member which engage in substantive business operations in the territory of parties to a regional agreement are entitled to whatever special treatment is provided for in that agreement. There is no reciprocal obligation on third countries which benefit from a reduction of duties following the formation of a customs union, or from more liberal market access under an EIA services agreement, to offer any tariff or other concession to its members.

5. With respect to trade in goods, the Enabling Clause permits “regional or global arrangements entered into among less-developed contracting parties for the mutual reduction or elimination of tariffs and... non-tariff measures, on products imported from one another”. Two aspects of this provision can be highlighted. *First*, it allows for preferential trade agreements which fall short of either an FTA or a customs union. That is,

it does not require the elimination of duties, nor does it require that substantially all trade should be liberalized. *Second*, the only constraints on the operation of preferential trade arrangements between developing countries are that (i) they shall be designed to facilitate and promote the trade of developing countries and not to raise barriers or to create undue difficulties for the trade of any other contracting parties, and (ii) they shall not constitute an impediment to the reduction or elimination of tariffs and other restrictions to trade on a most-favoured-nation basis. This language is less demanding than the corresponding injunction in Article XXIV that the post-agreement trade policies shall not be more restrictive than the trade policies in force in the constituent countries prior to the formation of the agreement. Finally, there is no requirement for any indicative timetable for such liberalization with respect to trade in goods.

With respect to trade in services, where the Enabling Clause does not apply, Article 5:3 of the GATS provides special and differential treatment for developing countries, in two dimensions. First, where developing countries are party to an Regional Trade Arrangement involving services, flexibility can be shown, particularly with respect to the requirement that substantially all discrimination must be removed in the service sectors covered by the Regional Trade Arrangement, in accordance with the level of development of the countries concerned, both overall and in individual sectors and sub sectors. Second, in the case of Regional Trade Arrangements involving only developing countries, more favourable treatment may be granted to juridical persons owned or controlled by natural persons of the parties to such an agreement.

6. All Regional Trade Arrangements concluded by WTO Members require notification to the WTO. Regional Trade Arrangements involving developed countries are sent to the Committee on Regional Trade Agreements (CRTA) for examination, while Regional Trade Arrangements among developing countries under the Enabling Clause are notified to the Committee on Trade and Development. Some WTO Members argue that the Enabling Clause is not appropriate to deal with Regional Trade Agreements which take the form of either a customs union or FTA which should be covered by Article XXIV. According to this view, the Enabling Clause should be confined to preferential trade agreements which stop short of an FTA or customs union.

2.2 Controversies in the interpretation of WTO rules

There are a number of controversies in the interpretation of these requirements. These have been summarized by the WTO Secretariat in two documents dealing with “systemic” issues related to Regional Trade Arrangements (WT/REG/W/16 and WT/REG/W/37). A summary of the issues discussed in these documents is reported here:

2.2.1 *The neutrality of trade policy*

Measuring the neutrality of before and after trade policy. While the 1994 Understanding clarified the methodology to be used in evaluating tariff policy in a *customs union*, questions still remain.

For a customs union, a global assessment of tariff neutrality is not necessarily relevant to an individual country whose exports may be concentrated in particular sectors. Economists also point out that it is still possible for trade diversion to occur even if tariffs are reduced.

Some observers have proposed using trade levels as a better indicator of whether or not trade diversion occurs as a result of an RTA, but this test is only feasible ex post and does not help in an ex ante assessment of the compatibility of an RTA with WTO rules. Other proposals to ensure the neutrality of trade policy effects include requiring an open accession clause that would minimize the possibility of trade diversion and the ‘hub and spoke’ effect of multiple RTAs, or requiring the use of the lowest pre-CU tariff rate as the common external tariff. The growing scope and importance of non-tariff measures covered by RTAs, such as anti-dumping, preferential rules of origin, technical standards, subsidies and countervailing measures, also makes it more difficult to evaluate damage to third countries when a customs union is formed or extended.

While the neutrality of tariff policy in a customs union is to be evaluated on the basis of applied rates, there is disagreement as to whether applied or bound rates are relevant when evaluating an FTA. With respect to non-tariff barriers in FTAs, there is disagreement whether preferential rules of origin come within the scope of the “other regulations of commerce” concept in Article XXIV. The possibility that preferential rules of origin may lead to trade diversion is used as an argument for their inclusion. Some Members object to this on the grounds that rules of origin merely determine which goods qualify for preferential treatment and thus cannot be considered a regulation of commerce.

Is the introduction of new quantitative restrictions justifiable when a country or countries join or form a customs union? This issue highlights a potential conflict between paragraph 8 of Article XXIV (which requires all members of a customs union to apply substantially the same trade policies to third countries) and paragraph 5 (which requires that non-tariff

barriers should not be more restrictive on average). In the WTO *Turkey-Textiles* case, the Appellate Body ruled that new restrictions could be defended provided it was part of integrating into a customs union and that the party demonstrates that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue. However, the burden of proof lies with the defendant to show that the customs union meets the requirements of Article XXIV and that there were no alternative means available to it that would be compatible with the formation of the customs union. Where non-tariff barriers are extended in this way, the issue arises of how to compensate third countries so as to maintain the overall neutrality of trade policy before and after.

2.2.2 Substantial coverage

This has been a major source of difficulty in the examination of Regional Trade Agreements by GATT and now WTO. Essentially, there are two views on how to interpret the phrase “substantially all trade” as used under Article XXIV:8(b) of the GATT/WTO rules and Article 5:1 of the GATS. The quantitative view proposes a statistical threshold on the proportion of trade covered (such as 95 per cent, or 90 per cent of all existing trade between the partners). Objections to this procedure include the fact that a ‘one-size-fits-all’ approach may not have the flexibility to take into account case-by-case circumstances, that a volume of trade measure may be biased by the existence of high trade barriers in the base period, and that it does not allow for the possible expansion of trade over time as a result of the RTA. The alternative qualitative view argues that the provision should be interpreted as meaning that no sector (or at least no major sector) should be left out of intra-RTA trade liberalization. But this approach may simply push the controversy back to the definition of

a sector. In practice, the debate revolves around the exclusion of agriculture, or agricultural products, from the regional integration process.

The recent EU-South Africa Trade, Development and Co-operation Agreement sets out an explicit understanding of the WTO requirements. The Agreement has interpreted 'substantially all' as meaning an *average of 90 per cent* of the items *currently traded* between the two partners. All three italicized items could be challenged. The averaging procedure is used to permit an asymmetrical agreement under which the requirements on South Africa are less onerous than those on the EU. Hence, while 94 per cent of the goods imported into the EU will be covered by the FTA, only 86 per cent of those imported into South Africa will be so covered. One wonders about situations where the imbalance would be even greater, raising the question whether the lower figure fulfils the 'substantially all trade' criterion.

2.2.3 Notification and examination

Issues arise over the timing of notifications, the amount of information which should be supplied, and non-compliance with the notification requirement. Despite the flexibility allowed to Members in the timing of the notification of RTAs, the WTO Secretariat notes that a large number of RTAs in force today have not (yet) been notified to the WTO. Even the status of those agreements which have been notified and examined remains unclear. Only one of the reports on the examination of RTAs adopted to date (the Czech Republic-Slovak Republic Customs Union) states clearly that the RTA is fully compatible with the relevant GATT rules. Opinions differ on the status of the remainder. One view is that where reports are adopted without recommendations to the parties, such RTAs are

tolerated or deemed compatible by the WTO. Others argue that, in the absence of a conclusive report, WTO Members retain the right to challenge an agreement under dispute settlement provisions.

Given these controversies, one can appreciate that formation of rule-abiding Regional Trade Arrangements is not an easy task. What then would be the situation where States are in more than one RTA? In the Doha Declaration, WTO Members agreed to initiate negotiations to clarify and improve RTA-related disciplines and procedures. While recognizing that RTAs can play an important role in promoting trade liberalization, WTO Members stressed the need for a harmonious relationship between the multilateral and regional processes.

2.3 Should then WTO encourage Regional Trade Agreements?

Proponents of RTAs argue that they help nations gradually work towards global free trade by allowing countries to increase the level of competition slowly and give domestic industries time to adjust. In addition, RTAs can be valuable arenas for tackling volatile trade issues such as agricultural subsidies and trade in services. Political pressures and regional diplomacy can resolve issues that cause deadlock in multilateral negotiations. Proponents of RTAs, such as the US trade representative Robert Zoellick, a number of economists, and trade policy analysts, describe them as circles of free trade that expand until they finally converge to form expansive multilateral agreements.¹⁶

Other policy analysts express doubt about the benefit of booming RTAs. Some describe them as a complex web of competing trade interests that hinder multilateral agreement.

¹⁶ "Regionalism in a Multilateral World," Wilfred J. Ethier, University of Pennsylvania Policy Paper.

Because RTAs create preference systems that transcend regional boundaries, some argue that political and economic tensions will lead to hostility and increased retaliation.¹⁷ The fear is that anti-dumping charges will increase and the dispute settlement process in the WTO will be complicated by unclear and conflicting regional trade laws. Additionally, RTAs may negatively impact global trade because regional preferences and rules of origin distort production by making location of production or source of raw materials the driving incentive.¹⁸ Others fear that RTAs prevent complete liberalization in the multilateral arena. Countries that benefit from regional trade agreements may be reluctant to expose themselves to the risks of opening their markets on a multilateral level if they expect relatively insignificant returns.

2.4 Concerns and Issues Surrounding Regional Trade Agreements

There are concerns that RTAs are incomplete, unequal, or counter-productive that even those who support the recent proliferation of the agreements believe must be addressed. The volume of RTA activity stretches negotiation capacities to their limit, and in the case of developing countries, prevents them from actively participating in all proceedings. The WTO has partnerships with the United Nations and the World Bank to build capacity in smaller countries and give aid money to support participation in trade negotiations.

Additionally, there is a fear that in agreements formed outside the WTO, developing countries do not have the power of collective bargaining to negotiate RTAs (particularly bilateral agreements) that are in their best interest. For example, Chile recently concluded

¹⁷ "On the Relationship between Preferential Trade Agreements and the Multilateral Trade System," Soamiely Andriamananjara, US International Trade Commission

¹⁸ "Regional Integration Agreements," OECD Chapter on RIAs (RTAs)

an agreement with the US in which it committed to lowering tariffs on agriculture products and deregulating investment, but could not gain any concessions from the US regarding farm subsidies. Since developing countries often depend on progress made in the WTO on sensitive issues it is important that multilateral negotiations retain a top priority.

The foregoing has been an examination of some of the challenges faced by Regional Trade Arrangements in their quest for expanded markets while at the same time ensuring balanced trade. We have looked at some of the WTO requirements on Regional Trade Arrangements and without a doubt their interpretation and implementation has not been a mean feat. We have also looked at the ever difficult question of rules of origin, together with their accompanying controversies. It could be noted that whereas these challenges have been examined on the basis of a single RTA, the enormity of the challenge in the case of overlapping memberships can only be imagined. This has been the bane of Africa's integration efforts.

CHAPTER THREE

3.0 RULES OF ORIGIN AS A SPECIFIC CHALLENGE TO MEMBERSHIP IN MULTIPLE ECONOMIC INTEGRATION AGREEMENTS

Rules of origin are emerging as one of the most important issues in the context of preferential trading relations of a country which is affected by membership in multiple REGs. They are a set of instruments, a lack of consensus on which can, and have, delayed several agreements on trade. For instance, lack of agreement on such rules has delayed the implementation of the Draft Framework Agreement on the India-Thailand free trade agreement (FTA). The recently signed South Asia Free Trade Agreement (SAFTA) treaty has also kept this issue open for further negotiations, while it was with great difficulty that India and Sri Lanka agreed upon rules of origin during the negotiations for their bilateral FTA a few years back. The absence of provisions relating to rules of origin under the India-Nepal FTA too raised concerns about imports from Nepal into India, thereby having adverse implications for some Indian domestic sectors. The problem was finally tackled by setting these rules in place during subsequent negotiations¹⁹. This situation is no different from that obtaining in Eastern and Southern African States that are making efforts at integration. Even within the ambit of negotiations on non-preferential rules of origin under the WTO framework, consensus on this issue has proved to be elusive.

¹⁹ Ram, Upendra Das. 10th May 2004. "Rules of Origin need proper prospective under Trade Pacts" Financial Express, Delhi.

The obvious question that follows is why rules of origin are so important as to have such a strong bearing on the outcome of international trade negotiations. The answer perhaps lies in the conceptual ambiguity which envelopes this policy instrument in developing countries. Whether or not a product has originated in a particular country is decided if the product has undergone substantial transformation. There are three major ways of determining this:

- a) First, the change in tariff-heading test, implying that the tariff-heading of the final product is different from the tariff-headings of its inputs.
- b) Second, a percentage test is applied, according to which a minimum percentage of total value addition should be achieved with the help of domestic inputs.
- c) Finally, specified process tests require a product to undergo certain stipulated processes.

However, agreement on implementing these tests is often difficult. For instance, the extent of 'substantial transformation' for different products would depend on the level of disaggregation on which tariff-shift is envisaged. Similarly, fixing of percentages of minimum value addition varies between products, depending on the prevailing labour costs and the product-specific import dependence of the country in terms of intermediates.

In this context, it is worth recalling the nature of policy concerns that were raised during the SAFTA negotiations. A few members viewed the system of rules of origin as an obstacle to intra-regional trade flows. It was felt that diluted origin-rules facilitate intra-regional trade, as lack of adequate natural resources as well as intermediate and capital

goods make these economies import-dependent, which in turn prevent them from meeting the local-content requirement of the rule of origin system. These policy conflicts can be resolved if the role of origin-rules are clearly understood.

One of the prime functions of rules of origin is to prevent trade deflection in trading arrangements. In any FTA, members set their own external tariffs but give preferential treatment to each other. The divergence between external tariffs of the members and the preferential tariffs becomes a potential source of trade deflection. In the absence of any rules of origin within the FTA, the country with the lowest external tariffs is likely to serve as an entry point into the partner's market for the goods of the non-member countries. In this sense, rules of origin are important tools for checking trade deflection of third country goods from one member country to another.

The three modalities of determining the origin of a product aim at substantial transformation in inputs. Together, they facilitate value-addition in the manufacturing country and play a developmental role. Such requirements have the potential for generating backward and forward linkages in a country adhering to the rules.

Thus, a member country is prevented from becoming a mere trading country as these requirements act as a deterrent to assembly production kind of activities. However, rules of origin should be designed in a manner that is not trade restrictive. They should not become trade barriers due to their complex methods of implementation.

Developed countries use rules of origin for developmental purposes, although in some cases they do act as non-tariff barriers (NTBs). NAFTA or the North American Free

Trade Agreement is a case in point, wherein for the automobile sector different percentages of the regional value content are laid down for various phases. For instance, 56% between 1998 and 2002 and 62.5% thereafter for some categories of motor vehicles.

In practice, the costs of implementing rules of origin are high. They mean that controls on goods crossing internal frontiers in both an FTA and a Customs union have to be retained to ensure compliance and to collect customs duties that are due. Some years ago these costs were estimated at 3 to 5 percent of f.o.b. prices for EFT-European Community trade (Herin 1986). They also allow customs authorities –and individual customs officers-a good deal of discretion, and the attendant danger that such discretion might be abused.

Rules of origin are particularly complex because they have to take into account tariffs on imported intermediate goods used in products manufactured within the FTA. The principle behind a rule of origin is that imports from outside the FTA should pay the tariff of the country of final sale, but additional value added in FTA members should be tariff-free. For example, if one million dollars worth of shirts are manufactured in FTA member A and exported to member B, and these shirts use \$ 100k of cotton imported from outside the FTA on which the country B tariff is 20 percent, then \$20k of duty is payable to B; furthermore, the exporting firm should be rebated any tariff it paid to country A on the cotton. In practice calculations are not made on such an exact basis but instead according to more or less arbitrary rules, typically stating that exports have to derive a certain proportion of their value from local content or undergo certain production processes within the FTA to obtain duty-free treatment.

The rules are complex and hard to negotiate (the EU's agreement with Poland has 81 pages of small print in its rules of origin section, and NAFTA some 200 [Krueger 1997]). Since they do not match the exact inputs in each commodity, they introduce further biases and sources of distortion. For example, NAFTA rules of origin in some sectors have serious protective effects that shift trade and investment patterns from lower-to higher-cost sources. Most clothing produced in Mexico gains tariff-free access to the North America U.S and Canadian markets only if its inputs are virtually 100 percent sourced in North America (WTO 1995). In the automobile industry, the origin requirement of 62.5 percent local content has induced Japanese automobile manufacturers with plants in Canada to produce components in the United States rather than import cheaper ones from Japan. NAFTA rules of origin require colour television tubes to be of North American origin, causing five television tube factories to be planned or established in North America by Japanese or the Republic of Korean firms, probably at the expense of expansion in Southeast Asia.

It is also worth noting that even with complex rules of origin in place, the problem of imports to the FTA entering through the country with the lowest external tariff is not entirely solved. A low-tariff partner can meet its own requirements for a product from the rest of the world, and export a corresponding amount (or all) of its own production to its partners. This is *indirect trade deflection* (Robson 1998).

Thus, there are substantial benefits to going to a Customs Union, yet, only a small minority of RTAs notified to the GATT/WTO are in fact Customs Unions. What are the costs?

First harmonization of external trade policy means a loss of national autonomy. Second, there is the potential for politically divisive redistributions due to a common external tariff—for example, in the antebellum United States. Political institutions need to be put in place to ensure that these tariffs are set in a consensual way. Further-more, tariff revenues generated by the common external tariff have to be distributed between member countries, and this too can be divisive. In the EU these revenues are part of the central budget and are spent on agreed programs, yet the level of each member's net contribution or receipt from the budget remains contentious. In many developing country customs unions, difficulties of agreeing on a common external tariff and distribution of revenues have proven to be great. Thus, the GCC has to date not been able to achieve consensus on its common external tariff. Similarly, the implementation of a common external tariff by CARICOM, originally scheduled for 1981, was delayed until the 1990s; the original scheme, adopted in 1991, was subsequently revised, and CARICOM members are in the process of implementing a new tariff structure (IDB 1998). In the case of the CACM, the common external tariff was rendered largely ineffective because of exemptions granted by some members for "necessary" imports (De la Torre and Kelley 1992).

The third problem with a common external trade policy is the additional adjustment costs—and lobby opposition—that may be encountered in moving to the common schedule. A good example is the difficulty that the EU had in harmonizing non tariff barriers. Despite being a

customs union, for its 30 years the EU allowed members to maintain their own quotas on certain third country imports (for instance, clothing, footwear, and steel) and prevented those from crossing internal borders (Winters 1992, 1993).

It is clear from the above that rules of origin, if designed adequately can not only prevent trade deflection possibilities, but also act as a catalyst to value-addition efforts in members of an FTA. Their implementation should, however, not swing to the other side of spectrum wherein its effects are akin to NTBs. This remains a policy challenge, especially in FTA negotiations in the developing world.

3.1 Treatment of the 'Rules of Origin' in International Trade Agreements²⁰

Satisfaction of rules of origin requirements poses yet another challenge to formulation of proper Regional Trade Arrangements. Preferential rules of origin have proven to stifle technological developments networks and joint manufacturing, and to unduly restrict third-country sourcing, leading to trade diversions. Moreover, they can create obstacles to trade facilitation by increasing administrative complexity and costs at customs. One specific example is the proliferation of different preferential rules of origin- a prominent source of trade costs and complexity in today's global market place in which companies depend on the rapid delivery of products and components from multiple overseas sources. Such effects are costly to business and detrimental to the regional trading areas.

²⁰ Guzman, Gustavo Manrique. "Treatment of Origin in International Trade Agreements" Coordinator, ANDEAN Community General Secretariat

The treatment of the concept of origin in trade and economic integration agreements is crucial for making the most of access to markets. That treatment may play a significant part in orienting trade flows by favouring given sectors of production, or affecting the competitive position of an enterprise, in accordance with the established stipulations of rules of origin and the vigour of the countries' trade.

The rules of origin are more significant when there are important differences in degree of economic development and production structures among the countries being integrated. This significance may be enhanced if the countries involved in the integration process, demonstrating marked differences in production structure, are trading partners of some importance, such as the United States-Brazil or the Andean Community-Mercosur, for example. Even so, if despite the existence of differences in degree of development between partners in an integration process, there is a heavy dependency on the supply of raw materials and inputs, agreement on the rules of origin will be reached with no major problem.

A demanding application of the rules of origin could, however, exclude a state from enjoying the benefits of an enlarged market in the short and medium terms economies that are more dependent on intermediate goods or imported raw materials and capital goods and economies with fledgling production processes. On the other hand, flexible or indefinitely complacent rules of origin could generate unfair competition that is detrimental to products with a larger value added, without ensuring the development of products in the smallest economies.

The treatment of origin that is agreed upon, even if demanding, will be a more equitable instrument in integration processes between countries with more homogeneous levels of development and production infrastructures. Even in those cases, notwithstanding, if the rules of origin are designed improperly, in a departure from neutrality, they can create restrictions on access to the enlarged market and biases favouring particular production sectors. They can also produce inefficiency if they fail to offer alternatives for the normal supply of goods.

It follows that using specified inputs or products from the countries involved in the integration process because of a rule of origin, may mean succumbing to the notion of positive lists that favour existing producers. The adverse effect of such positive lists, seen more clearly when monopolistic or oligopolistic products exist, may be attenuated if the alternative is available to pay an external tariff in the case of customs unions.

The rules of origin, if they are to assume their true function as the minimum conditions for conversion or value added that make a product worthy of enjoying trade preferences, must bear the cited aspects in mind. In order for the treatment of origin to function as a neutral and complementary mechanism making it possible to take due advantage of agreements on trade access or deregulation, it is necessary to avoid commercial objectives or sectoral favouritism.

No less important than the possible impact of the rules of origin on production conditions and profitable market use is the degree of commitment to the trade agreement in which the treatment of origin will be applied –whether it is a customs union, a free trade area, a trade preferences area, or merely concessions in the nature of assistance.

When considering integration processes with free trade areas or more as their goal, it is advisable to design rules of origin that would operate as an equitable instrument capable of responding to the different conditions of production prevailing in the participating countries and that would not create sectoral distortions or biases, particularly if the economies involved are highly dependent upon each other.

As they are progressively perfected, customs unions and common markets should ensure that the payment of a common external tariff – CET - becomes more important than the rules of origin for gaining access to the enlarged market. They are also used to identify the origin of goods subject to corrective measures or restrictions of some kind; this has been termed non-preferential origin.

The earliest Latin American integration efforts made use of general criteria of origin, which should not by reason of their being termed traditional or first-generation criteria, be considered obsolete or ineffective. These are the criteria that refer to fully-manufactured goods, the changing of tariff subheadings in the case of the production process, value added and, in isolated cases, specific requirements of origin. These rules, as a whole, are not very demanding and thus raise the risk of making it possible for third parties to enjoy the benefits of integration. On the other hand, their virtue is to be neutral and equitable by not keeping less developed countries or sectors from taking advantage of the conditions of access.

The most recent trade agreements in the region, which are geared toward building free trade areas, have so-called new generation rules of origin. The tendency of those rules is to establish origin at the level of classification chapters, headings and subheadings and to

favour the notion of substantial transformation. General criteria, already known and cited, are put to use for this purpose, including the changing of tariff subheadings and value added. The equivalent of specific requirements, such as the use of regional inputs, specified processes, or a combination of two or more criteria and requirements, are also employed.

The latter trend is, in most cases, more demanding and detailed than the traditional use of general criteria because it deals with the productive realities of the countries involved, which is relevant if the integration is one of economies that are more or less homogeneous. While it seeks to ensure control over switch transactions by determining the pertinent criterion of origin for each product, it makes it easy to give in to the temptation of assigning criteria in accordance with the productive characteristics of each country or sector. This could lead to the undesirable or inequitable effects.

A treatment of origin of this kind, if neutrality is lost, may annul the concessions obtained in negotiations for access by some countries and products that are unable to comply with given levels of demand. The global balance of the chosen system may also create involuntary sectoral biases if the productive reality in certain areas is more familiar than in others.

To sum up, the key difference between the new generation and the traditional treatment of origin lies in the fact that while in the former case each product has its assigned rule of origin, in the latter some products have the option of using a given criterion. The degree of strictness or flexibility of the requirements is determined by the negotiating process. New

generation origin, once agreed upon, is less discretionary than traditional origin, with all of the corresponding positive and negative effects in each case.

3.2 Administrative and control procedures

Another important element that must be considered when defining the rules of origin in an economic integration system is that of the means and procedures for certification, control and sanctioning.

In any of the possible scenarios and independently of the flexibility or strictness of the treatment of origin, on aspiring to advanced integration commitments, strict regulation is necessary, taking care to see that it does not result in overly complex and costly processes. In these terms, the strictness of the certification and control procedures generates confidence in the trade operations and makes them dynamic.

The expeditiousness or complexity of the administrative procedures for the rules of origin varies in direct proportion to the existing trust and sanctions. The desirable state of affairs is for each producer or exporter to assume responsibility for complying with the rules of origin without the intervention of government agencies to certify that compliance, as is the case in NAFTA. The sanctions for non-compliances or irregularities should be so effective that they act as deterrents.

Until one reaches this marvellous scenario of trust, the administrative procedures generally call for producers or exporters to declare the criterion of origin of which they avail themselves for their goods. The government authority or private institution authorized by

their government then certifies the state of origin of the products after checking the declaration.

The first step in this process results in a declaration of origin that is kept in the data base of the certifying institutions for a period that can range from six months to two years, unless the production conditions change during that time. With the speed of technological development and the need to continually add value to the production, except in the case of commodities or agricultural products, the declarations of origin should be subject to frequent amendment.

The second step is the issuing of the certificate of origin, a form containing the basic information about the goods, the tariff code, amount, unit value and criterion of origin the product fulfils. The certification is carried out by public or private officials authorized by each government, whose names, signatures and seals are made known to the governments and customs administrations of the other countries participating in the integration agreement.

The unending and useless debate between those who want the certifications to be government approved in order to make them credible and those who claim that the authorized private institutions are more effective, can be settled through the training of the public or private officials involved, good computer data support, and good communications and a transparent relationship with producers or exporters. All that is necessary to boost the efficiency and transparency of the procedure and to put an end to the useless discussion is to design sanctions that are appropriate for both commercial operators and certifying agencies that commit irregularities or careless mistakes.

The certificate of origin duly issued by the authorized official of the exporting country is the only document that is needed in order for the customs authorities to apply the negotiated trade preferences.

If any reasonable doubt exists over the origin of the products or the authenticity of the certificate, then controls or sanctions are in order. The indicated steps in such cases are the immediate communication of the alleged irregularity to all parties involved in the participating countries; a short prudential period for explanations or verifications; and, if discrepancies continue to exist, the submission of the case to a competent body or, failing that, to dispute settlement procedures.

In the new generation free trade areas, the absence of an institutional structure normally makes it necessary to turn to general dispute settlement mechanisms to resolve litigations over origin, with levels that can prove to be ponderous and complicated and whose results could involve a certain degree of discretionality or answer more to negotiated settlements.

This aspect also is particularly important. What is to be desired, once all of the bilateral explanatory or conciliation stages have been exhausted, is for the final definition of any disagreement over origin to be assigned to a technical body that is impartial and multilateral and whose judgment will be handed down rapidly and will be binding. This does not necessarily mean creating a permanent bureaucracy, for there are a number of multilateral bodies in the region and in the world, as well as ad-hoc methods for dealing with matters of this kind.

3.3 The Costs of Administering Preferential Rules of Origin

Rules of origin whilst an essential element of free trade agreements add considerable complexity to the trading system for traders, customs officials and trade policy officials. For companies there is not only the issue of complying with the rules on sufficient processing but also the cost of obtaining the certificate of origin, and any delays that arise in obtaining the certificate, as well as the costs of actually proving compliance with those rules of origin. The costs of proving origin involve satisfying a number of administrative procedures so as to provide the documentation that is required and the costs of maintaining systems that accurately account for imported inputs from different sources to prove consistency with the rules. The ability to prove origin may well require the use of, what are for small companies in developing and transition economies sophisticated and expensive accounting procedures. Without such procedures it is difficult for companies to show precisely the geographical breakdown of the inputs that they have used.²¹

There is limited information on these costs but the available studies suggest that the costs of providing the appropriate documentation to prove origin can be around 3 per cent of the value of the export shipment for companies in developed countries. The costs of proving origin may be even higher, and possibly prohibitive, in countries where customs mechanisms are poorly developed. Thus, even if producers can satisfy the rules of origin, in terms of meeting the technical requirements, they may not request preferential access because the costs of proving origin are high relative to the duty reduction that is available.

²¹ Brenton, Paul, 2003. Integrating the Least Developed Countries into the World Trading System: The Current Impact of EU Preferences under Everything but Arms. World Bank Working Paper No. 3018 of April 4, 2003.

An important feature of most preferential trade schemes is the requirement of direct consignment or direct transport. This stipulates that goods for which preferences are requested are shipped directly to the destination market and that if they are in transit through another country then documentary evidence may be requested to show that the goods remained under the supervision of the customs authorities of the country of transit, did not enter the domestic market there and did not undergo operations other than unloading and reloading. In practice it may be very difficult to obtain the necessary documentation from foreign customs.

Rules of origin are therefore a major impediment to countries in Africa and elsewhere. One argument of the complexity of these rules of origin is that they were developed at a time when manufacturing was largely a single country/multi-process operation whilst the current global trading environment is characterised by multi-country processing with assembly/finishing occurring in a country providing the best advantage in terms of labour and/or energy costs. It then follows without saying that if rules of origin are such a big headache to single units of Regional Trade Arrangements, the problem can only be compounded if there is an overlap of these Regional Trade Arrangements as a result of multiple memberships by States.

CHAPTER FOUR

4.0 CONCLUSION

The instrument we have for international policy on regionalism is the WTO, and this section explores how it manages regionalism and whether its rules could be reformed to help it do better. RIAs are officially sanctioned-but conditional-exceptions to the GATT's rules on non-discrimination. The conditions imposed on RIA formation doubtless constrain and mold the pattern of regionalism in the world, but they are neither adequate, nor adequately enforced, to ensure that regionalism is economically beneficial for either its members or excluded countries. The responsibility for good outcomes falls on governments themselves; they cannot tie their own or each other's hands sufficiently tightly in the WTO to preclude the possibilities of signing harmful RIAs.

The world trade system works-pragmatically and consensually. The GATT was created in 1947 as a temporary body to assist countries in trade liberalization. Its role was to codify and record a series of tariff reductions that its members wished to make, and provide a structure to give credibility to those reductions. It discouraged the reversal or nullification of tariff cuts by restricting policies that impose duties on an ad hoc basis, such as antidumping duties and emergency protection, and equivalent policies such as internal taxes on imports. It also defined important mechanics of trade, such as the valuation of trade for customs purposes. A key concept of the GATT, indeed the cornerstone of the present world trading system, is nondiscrimination between different sources of the same imported good, which is achieved by requiring members to give each other MFN

treatment, except in specified circumstances. With an assurance of nondiscrimination, when A negotiates a reduction in one of B's tariffs, it knows that the commercial value of its effort will not be undermined by B then offering C an even lower tariff. This, in turn, makes A more willing to "buy" the concession by reducing one of its own tariffs on B, and so encourages trade liberalization.

Given this background, the WTO can enhance the economic well being of developing countries in four ways. First, if sufficient members wish, it can organize periodic rounds of tariff negotiations that offer opportunities and incentives to members to reduce their barriers to trade. Second, it provides guidelines for domestic policy—directly in some cases, but more often directly by shaping the terms of the debate. Governments resisting pressures to protect particular lobbying groups are immeasurably strengthened if they can point to prohibitions in the WTO agreements. Third, the WTO can protect the rights of members against certain rules violations by other members. It cannot necessarily, however, protect members against harm. Fourth, it provides a forum and mechanism for governments to manage the spillovers from members' trade policies onto their partners. These four links provide the frame work for assessing the WTO's current rules about RIAs and exploring whether they can be improved.

Article XXIV is generally an aid to better RIAs, but it is certainly not sufficient for good economic policy. Even if the conditions were applied without exception they would not preclude harmful RIAs. Wholly GATT compatible RIAs can be predominantly trade

diverting, excluded countries can suffer terms-of-trade declines, and institutions can arise that make liberal policies less likely.

There are major difficulties in interpreting the conditions of Article XXIV. Even following the Uruguay Round Understanding there is no agreement about what "substantially all trade" means, nor even whether it refers to the proportion of actual trade covered or the inclusion of all major sectors of the economy. Similarly the treatment of non tariff barriers in assessing the overall level of trade restriction is not defined, nor is that of rules of origin. The requirement that "other restrictive regulations of commerce" be removed between members is ambiguously worded: several exceptions to this requirement are identified explicitly but other barriers, including antidumping duties and emergency protection, are not. Complete integration between members of a RIA would abolish these barriers and so their continuation- in NAFTA or the Euro-Med agreements-suggests an unwillingness to proceed too far in that direction.

Perhaps because of its ambiguities, Article XXIV has been notoriously weakly enforced. RIAs have to be notified to the GATT and until 1996, each was then reviewed by an ad hoc working party to see if it was in conformity with the Article. WTO (1995) reports that of 69 working parties reporting up to and including 1994, only 6 were able to agree that a RIA met the requirements of Article XXIV, of which only CARICOM and Czech-Slovak CU remain operative. However, the remainder did not conclude that agreements were not in conformity-they merely left the matter undetermined.

This lack of enforcement of an important rule is essentially the product of the GATT's consensual nature. The first major test of the article was the Treaty of Rome establishing the EEC. The political pressure to permit it was enormous: EEC countries would almost certainly have put the EEC before the GATT in the event of conflict and the United States strongly supported the treaty. The treaty, however, clearly violated Article XXIV, and so the only feasible solution was not to push the review to conclusion. Given a start like this, the EEC's willingness to support more or less any RIA in the GATT, the need for working parties to reach consensus, and the GATT's inability to make an adverse determination without the acquiescence of the party at fault, it is hardly surprising that future views proved little more demanding. Nor have matters improved with the establishment in 1996 of a single Committee on Regional Trading Agreements to conduct the reviews. The inability to rule on whether RIAs conform to article XXIV does not mean that the rules have had no effect, for we do not know the extent to which they have influenced the structure of RIAs that have come forward, nor which potential arrangements they have discouraged. It is not an encouraging record; however, either from the point of view of enforcing current rules or from that of rewriting the rules to increase their ability to distinguish good from bad RIAs.

Finally, Articles XXIV.10 and XXV of the GATT can be used to grant waivers to make otherwise inadmissible policies GATT-LEGAL. This was done for the European Coal and Steel Community (1952) and the U.S.-Canada Auto Pact (1965). Under WTO, waivers are still feasible but are time-limited.

Article XXIV of the GATT refers to trade in goods. The equivalent for services is Article V of the GATS, which is modelled closely on it. The requirement not to raise barriers to third countries is rather tighter: it is applied sector by sector rather than “on the whole,” and third country suppliers already engaged in “substantive business” in a RIA territory before the RIA is concluded must receive RIA treatment. The “substantially all trade” ambiguity is only slightly abated, with an explicit note that the word “substantially” be understood in terms of number of sectors, volume of trade, and modes of supply.” For covered sectors “substantially all discrimination” is to be removed, but since this is defined as comprising elimination of barriers or prohibition on new or more discriminatory barriers, or both, it need amount to every little. Developing countries receive “flexibility” on “substantially all” discrimination and exemption from the need to give RIA treatment to least third country firms with “substantial business” in member countries.

If all this were not enough, a further complication for developing countries is an “Enabling Clause” introduced in 1979 that significantly relaxes the conditions for creating RIAs that include only developing countries. The clause drops the conditions on the coverage of trade, and allows developing countries to reduce tariffs on mutual trade in any way they wish, and non-tariff measures “in accordance with criteria which may be prescribed” by the WTO members. It then supplements the first condition on ‘not on the whole raise protection against excluded countries’ with the non-operational requirement that the RIA not constitute a barrier to MFN tariff reductions or cause “undue difficulties” for other contracting parties.

In practice, developing countries have had virtual *carte blanche*. Twelve preferential arrangements have been notified under the Enabling Clause, including the Latin America Integration Association, ASEAN, and the GCC. Internal preferences of 25 percent and 50 percent figured in ASEAN's trading plans and also in many of the arrangements concluded under the Latin American Integration Association and in the GCC. There is little sign that internal preferences have undermined MFN agreements with other trading partners but then, until recently, these countries did not make many MFN agreements. Indeed, until the late 1980s, the Latin American and African countries' frequent use of regional arrangements and weak participation in the multilateral rounds might suggest a substitution of one form of liberalization for the other. More worrying were the sectoral agreements that abounded in Latin America.

The enabling Clause dilutes the weak discipline that Article XXIV imposes. Even if Article XXIV does not actually stop many harmful practices, it does at least avoid automatically giving them the respectability of legal cover. Thus, while the GATT knowingly and willingly permitted Latin American Free Trade Area (1960) and the initial notification of ASEAN (1997) to violate Article XXIV (Finger 1993). At least it required continuing consultation with partners and left open the possibility of challenge in the dispute settlement process. The Enabling Clause offers more cover in various areas, and thus erodes even this discipline.

The WTO rules on RIAs are not exactly broken, but they are creaky, and it is worth asking what might be done about them. We focus here on their economic content, and on the

feasibility of reform. Feasibility seems to be more binding constraint than devising economically sensible rules. Indeed, major political backing for tightening looks improbable, as few countries within RIAs appear to seek tighter discipline, as the EU continues its Mediterranean agreements and considers replacing the trade provisions of the Lome Convention with an FTA, and as the United States contemplates the Free Trade Area of the Americas.

A RIA that does not reduce external barriers may cause trade diversion. One discipline on this would be to require RIA members to liberalize, both to reduce diversion and to induce external trade creation with non-members. Finger (1993) views these reductions as a price to be negotiated to persuade non-members to forgo their MFN rights. How far the parties are prepared to go in a negotiation, however, is determined by the prevailing rules and enforcement mechanisms that define the outcome if negotiations fail; unfortunately, these currently leave non-members almost no negotiating power. Hence authors have made more concrete proposals.

Bhagwati (1993) suggest requiring that for each tariff heading a CU's common external tariff be bound at the minimum tariff for that heading among all members. This does not guarantee the elimination of trade diversion-suppose the tariffs of three members were 98 percent, 99 percent, and 100 percent- but will clearly reduce it. It would impose a high (mercantilist) price on RIA formation, so only "serious" integrators would pay it, and would, overall, be quite trade-liberalizing. As a reform it is admirably clear, and if feasible,

it would be desirable economically. Its demanding nature, however, makes it very unlikely to succeed in the present circumstances.

Related is a proposal that members of FTAs be required to bind their tariffs at actual applied rates on the eve of the RIA. Apart from what this might do to pre-FTA applied rates, this suggestion is random in its liberalizing effect, which reduces its moral force. Bhagwati would just ban FTAs. This is also consistent with seeking to restrict RIAs to those that are committed to far-reaching integration, but again faces severe feasibility constraints, especially since some FTAs proceed quite far in the other directions.

Tied up with the FTA question is that of rules of origin. Some suggest a requirement that they be no more restrictive than before the RIA, but this is difficult to determine, ad hoc, manipulable in nature, and potentially very complex in the face of technological changes. Better would be a requirement precluding the manipulation of such rules for protectionist purposes, such as that countries should adhere to a single set of rules of origin agreed internationally, or that a country's preferential rules should be the same as its nonpreferential ones. Wonnacott (1996) suggests a number of milder reforms in this direction: for example, that rules of origin be banned where tariffs differ between members by less than, say, 2 percentage points, or that for each commodity they be banned for the FTA member with the lowest tariff. These might be acceptable, but would only scratch the surface.

One proposal has been made to adopt *ex post* reviews to determine whether nonmember exports have fallen since a RIA was created and demand changes in policies if they have (McMillan 1993). Although frequently taken seriously (for example, Frankel 1997), the proposal is wrong in virtually every respect. Exports are the wrong criterion, quantitative targets are the wrong way to formulate trade policy, the internal costs of trade diversion are ignored, economic modeling is still too imprecise to identify causes with any credibility, and *ex post* adjustment after five years is no basis for the policy predictability sought by investors.

There are three major proposals for creating a “liberal dynamic.” Srinivasan (1998) proposes that RIAs be permitted only temporarily by requiring all RIA concessions to be extended to all countries within, say, five years. This is effectively a ban on RIAs, and certainly foregoes any gains that they might offer in terms of deep integration or nation building. It is not a serious contender.

Second, stretching back at least to the United States submission to the Preparatory Committee of London Monetary and Economic Conference of 1993, scholars and policymakers have argued that requiring RIAs to admit any country willing to accept their rules both reduces their adverse effects on excluded countries and establishes a liberal dynamic (Viner 1950). While this may be true if admission can be guaranteed, virtually every RIA extant has geographical restrictions on membership and has features that require negotiation. The latter vitiate the promise of “open access.”

A more feasible approach than unconditional open access is to define and enforce current rules more rigorously. A precise definition and enforcement of “substantially all trade” would be a useful innovation. A quantitative indicator would be clear, but need to be high given that the kinds of trade restrictions countries wish to maintain typically constrain existing trade quite fiercely. The frequently cited 80 percent, which dates consideration of the Treaty of Rome is not adequate. Even 90 percent, which seems to inform current-MERCOSUR talks, is not indicative of serious intent to integrate. We would advocate 95 percent after 10 years and 98 percent after 15 years. Similarly a more constraining view of “other restrictive regulations of commerce” would be useful- ensuring that they include the effects of rules of origin on excluded countries, and that obvious barriers such as safeguards actions and antidumping duties are abolished internally. The latter requirement would increase the degree of trade creation, since these policies are explicitly aimed at preserving domestic output levels. Thus they would raise the bar “serious” regionalism.

However, even these changes might encounter fierce opposition and will require major political commitment by the major powers, they will certainly need to be accompanied by a grandfathering clause to assure current RIAs that they will not be undermined by new interpretations.

A vehicle to take forward reform measures is the Committee on Regional Trading Agreements (CRTA), which reports to the WTO’s General Council, and was established in 1996 to increase the transparency, efficiency, and consistency of the WTO’s treatment of RIAs. It was seen as a means of ensuring more rigorous review of new RIAs because a

single group would review all of them using the same criteria and with more searching notification and information requirements. It would also undertake periodic review of existing RIAs, and could resolve some of the systemic issues that remained after the Uruguay Round \. The more thorough review was seen as a route to better compliance with WTO requirements, while the consideration of conceptual issues was a step toward refining and codifying the rules more precisely.

Unfortunately the CRTA has not yet reached its stride. Its assessments of particular cases have been stymied by the lack of clear systemic rules, and the discussion of rules stalemated on exactly the same 'substantially all' and 'other regulations' issues as the previous Uruguay Round discussions. By December 1997 the Committee had initiated consideration of 59 RIAs (including 32 inherited from previous working parties). It had completed factual analysis of 30 of these, and was "elaborating conclusions" on 26. To date, no analyses have been released or conclusions reached.

The future development of the CRTA could take several routes. Review of existing RIAs is not likely to be productive. Although RIAs are open to dispute if third party countries feel aggrieved (at least until the CRTA has formally certified their WTO-conformity), the rules seeking serious intent to integrate are not really susceptible to this process. Non-member countries are unlikely to press RIAs to include more sectors when they expect this to increase trade diversion. Similarly, why would a nonmember country seek to free RIA members from the threat of each other's antidumping legislation? Members do not normally bring internal disputes to the WTO.

When it comes to new RIAs., one possibility is to have a detailed case-by-case study of the likely effects to the RIA. But the CRTA faces a serious timing problem. Unless agreements are submitted to the WTO early in the process of negotiation- in which case they will be very provisional –reviews will generally be too late to influence their initial form. Otherwise, reviews will be too late to affect public debate and will, if they call for changes, upset carefully negotiated compromises. For reason they will be resisted and resented by members, which is bad news for a consensual organization. Thus considerable political courage will be called for to enforce CRTA findings until their requirements are sufficiently understood and respected by members to be met *ab initio*. This process of process of review and response would have to be aided by detailed economic studies of RIAs stretching well beyond the legalities of Articles XXIV and V.

The better way forward is for review of new RIAs to be restricted to ensuring compliance with the tighter Article XXIV rules on liberalization of “substantially all trade” and “other restrictive regulations of commerce” which we proposed above. As we have argued, these rules would raise the bar “serious regionalism,” while leaving it clear that WTO approval does not validate the economic benefits of a RIA for its members. The responsibility for good RIAs lies with governments themselves.

The foregoing has been an examination of the challenges of Regional Trade Arrangements as perpetuated by WTO Rules. It has been observed that the problem of multiple

memberships is one that has been occasioned by loose provisions of the Rules compounded by weak enforcement, thus confirming our hypotheses that the problem of multiple memberships is one of the WTO itself. As stated elsewhere in this paper, as long as the Rules remain as they are the responsibility of ensuring that African States do not simply join a multitude of otherwise uneconomic RIAs falls on the governments themselves to think through the obligations-and benefits-they accrue by joining these RIAs. On the other hand, the WTO regime, as proposed in hereinabove, could also help obviate the dilemma of African States by ensuring strict interpretation and enforcement of the Rules, coupled with a requirement that States limit their membership in REGs to one.

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