The Multilateral Trading System and Preferential Trade Agreements: Can their Negative Effects be Minimised?

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ABSTRACT

Preferential trade agreements pose a big challenge for the multilateral trading system. At the end of 2007, almost 400 agreements were notified to the WTO. However, these agreements have a range of disadvantages compared with the multilateral regime, e.g. in trade facilitation and in dispute settlement. Whilst it will be difficult to stop the further spreading of this wave, attempts can be made to reduce the negative effects of trade agreements that do, by definition, discriminate other countries. In the working paper, I discuss a range of potential remedies, from a moratorium to the better enforcement of WTO rules on preferential agreements as well as improved monitoring.

Keywords: World trade, preferential trade agreements, rules of origin

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1. Introduction

One of the biggest challenges for the multilateral trading system in the 21st century is the rise of preferential trade agreements.[1] Both the number and the scope of these agreements is rising rapidly. The collapse of yet another Ministerial Meeting of the Doha Round, in July 2008 in Geneva, will further fuel the trend toward preferential agreements. Today, no country or region is abstaining from this trend. Whilst the European Union, which started with the implementation of a customs union in 1958, has been implementing preferential agreements for many years, particularly Asian countries did not contribute to the rising number of preferential agreements before the year 2000. In recent years, Asian economies, including China, have contributed to a dangerous trend.

After the collapse of the July 2008 ministerial meeting Geneva, there will be new demand for preferential agreements. The arguments we have heard in recent years will be repeated. A lack of progress in the multilateral arena will be given as the prime reason for preferential agreements, and of course this argument is now more powerful than before. With no agreement on the Doha Development Round in sight, the global economy is poised for a new round of preferential agreements.

The collapse of the talks in Geneva in 2008 has some parallels with the London Economic Conference of June 1933. Whilst the immediate purpose of the latter conference was not to achieve an agreement on trade, but rather on financial affairs, the willingness to sacrifice multilateral agreements in favour of narrow national economic goals is a striking parallel. Both then and today, the United States have been suffering from self-inflicted economic turmoil and have been unwilling to make sufficient concessions to their economic partners.[2] Following the failed London Conference, the global economy became less integrated and preferential agreements were concluded all over the world, leading to fragmentation rather than integration. The 1930s were a decade of non-cooperation.

> Multilateralism was replaced by bilateralism, non-discrimination by discrimination, free trade by comprehensive protection, freedom for capital flows by exchange controls and free movement of labour by rigorous restrictions (Wolf 2003: 399).

[1] Throughout this paper, I will use the term preferential agreements for all types of trade agreements that exclude other countries, i.e. bilateral and plurilateral free trade agreements and customs unions.
[2] Franklin D. Roosevelt's rejection to contribute to the stabilization of exchange rates was the final nail in the coffin of the Gold Standard (James 1996: 25).

Of course, parallels with the 1930s should not be overdrawn. Nevertheless, policy makers should be aware of the risks that preferential trade agreements pose for international economic relations.[3] By definition, preferential trade agreements exclude other countries. Countries do make concessions in preferential trade agreements, but not to the entire membership of the WTO or all economies. Thus, preferential agreements do discriminate. This, of course, weakens the central pillar of the post-war trade regime. Non-discrimination was intentionally the core norm of the General Agreement on Tariffs and Trade, embodied in Article I of the General Agreement on Tariffs and Trade (GATT). The idea behind this clause was not purely, perhaps not even primarily economic. Non-discrimination was considered to contribute to the stability of international relations. Increasingly, policy makers seem to forget that international relations cannot flourish in an atmosphere of discrimination and exclusion.

Against these historic lessons, the first best solution would be to eliminate preferential agreements all together. In a world without preferential agreements, countries could either have unilateral restrictions on trade or agree in multilateral forums on liberalisation measures. Today, however, this is not a plausible proposal. All countries, or at least all WTO member countries, would have to agree on the prohibition of preferential trade agreements. This appears to be pure wishful thinking. In an era of non-cooperation that is characterised by the increasing unwillingness or inability of the major players to reach consensus on vital issues, how can one realistically expect policy makers to forego a policy instrument that is so attractive to them?[4] Thus, the challenge today is to implement measures that minimise the negative consequences of preferential trade agreements, which is one of the purposes of this paper.

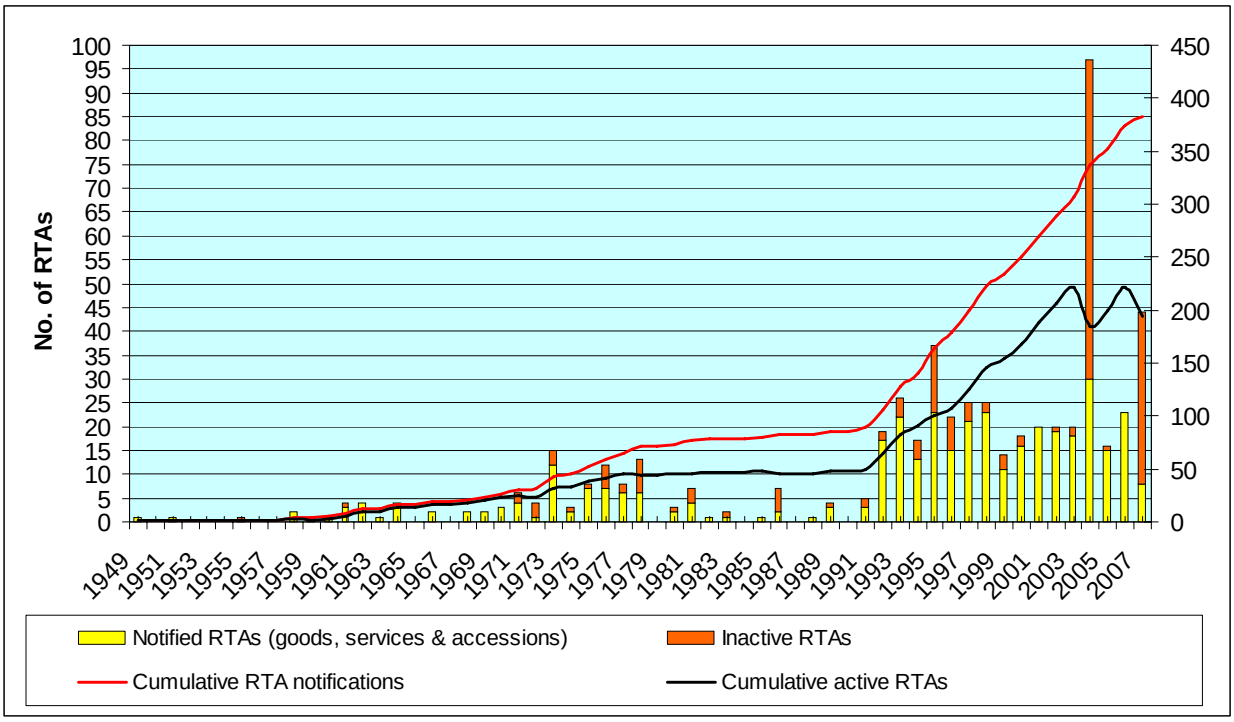
Several questions have to be asked about the causes and the consequences of this trend. First, what are the motives for policy makers to push preferential agreements rather than regulation in a multilateral context? Second, which are the negative consequences of preferential agreements, in particular for developing countries? Third, how can these trade agreements be modified so that their negative effects are minimised? In this article, these questions will be discussed in turn.

2. The rise of preferential agreements and their variance in form

[3] For a discussion on the tensions between regional and multilateral regulation see Katzenstein 1996.
[4] For a discussion of the changing geopolitical context see Dieter and Higgott 2009, chapter 1.

In the 1950s and 1960s, the number of preferential trade agreements notified to the GATT was very small, resulting in a total of less than ten agreements at the end of the 1960s. In recent years, as figure 1 demonstrates, the number of notifications has risen to almost 400 by the end of 2007.[5]

Figure 1: The Evolution of Preferential Trade Agreements 1948 to 2007



Source: WTO Secretariat.

In contrast to previous decades, virtually all players in global trade in the early 21st century are engaged in preferential agreements. In particular, the United States, the European Union, Japan and China have been pushing these deviations from non-discrimination. The United States now seems to offer preferential agreements to those countries that are willing to accept the (market-opening) US template for preferential agreements, which puts particular emphasis on intellectual property rights and market opening in financial services and whose foreign and security policy tends to accord with that of the USA.[6] The European Union has long joined

[5] Some 300 of them are trade agreements covering trade in goods and are notified under Article XXIV, whilst 58 cover trade in services and are notified under Article V of the GATS, and 22 are notified under the Enabling Clause of 1979, i.e. agreements between developing countries.

[6] Countries actively supporting the invasion of Iraq, e.g. Australia, were given the "privilege" (US Trade Representative Bob Zoellick in 2003) of a free trade agreement, whilst a country like New Zealand, which

this trend and has recently given up its moratorium on new agreements. In Asia, both China and Japan have been actively pursuing preferential trade agreements since the turn of the century.

One of the great paradoxes of today is the fact that the member countries of the WTO demonstrate a wide gap between their rhetoric, which continues to be multilateral, and their policy actions, which favour preferential agreements. The existence of an alternative to the multilateral system, even if that alternative is a flawed one, may have been the decisive factor that has hindered a successful conclusion of the Doha Round so far and conceivably for good. But what are the motives of policy makers for negotiating and concluding preferential agreements?

- The length of negotiations in the current round causes difficulties for democratically elected governments, which tend to operate within shorter electoral cycles of three to five years. Preferential agreements can be tailored to fit into such time frames.
- Bilateral agreements seem to provide immediate, reciprocal gains for the own economy. This perception allows governments to work with coalitions supporting liberalization, which are instrumental in overcoming internal opposition to an agreement. Reciprocity is a useful political tool and is more easily promoted to domestic constituencies than some arcane economic theory about the benefits of unilateral or multilateral trade liberalization.
- Transnational cooperations are increasingly pushing the implementation of preferential agreements. Two distinct motivations can be identified. First, some companies are pursuing an offensive strategy, seeking the opening of hitherto closed markets, e.g. in financial services. Second, other companies claim defensive motives, suggesting that the implementation of free trade agreements by third countries puts them at a competitive disadvantage.[7]
- The vanity of politicians and trade negotiators contributes to the current trend. Negotiators and politicians do not get much praise, if any, for successfully concluding a multilateral agreement, but preferential agreements seem to get a more positive media response and are an opportunity to enjoy television coverage, the so-called

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refused to join the invasion forces, did not get such an agreement (for a discussion of the securitisation of US trade policy see Dieter and Higgott 2007).

[7] One example is the European car industry, which pushes preferential agreements between the European Union and ASEAN countries, citing these countries' preferential agreements with Japan as their prime concern.

CNN effect. Bilateral agreements allow the leaders of not-so-great powers to have their fifteen minutes of fame; especially in a bilateral deal with a major global or regional power. The prospect of media coverage may encourage the engagement in bilateral negotiations. The CNN effect can be an important visible expression of state sovereignty and can boost regime authority. In addition, some agreements are concluded because of diplomatic pressures, i.e. the willingness of foreign policy elites to express positive political relations with a trade agreement.

Of course, this short list of reasons for the emergence of the strong trend for preferential trade agreements is not comprehensive.[8] However, it demonstrates that the motives for implementing preferential agreements are embedded in the political systems of WTO member states. This pattern is unlikely to change in the short- or medium term.

In addition to the variance that we can observe with regard to the partners in preferential trade agreements, their scope does show great diversity. In recent years, some agreements have gone well beyond trade in goods and services and have addressed policies on mutual recognition of standards, competition policy, the movement of persons as well as investment and cooperation agreements (Whalley 2008: 518). Thus, we observe a range of agreements, some of which go far beyond the regulation of trade. Of course, the interest of countries to pursue so-called WTO-plus agreements also reflects the problems of agreeing on new issues of economic governance, both within the WTO and in other multilateral organisations.

3. The disadvantages of preferential trade agreements

In principle, there are two schools of thought on preferential agreements. The first one argues that these agreements are contributing to deeper global integration. The second school of thought questions the utility of these agreements and considers them to be dangerous for internat² (economic) relations.

Obviously, one could argue that as long as trade liberalization occurs, it does not matter whether it is at a bilateral, regional or multilateral level. In theory, preferential agreements can have significant benefits, e.g. promoting technology and knowledge transfers, domestic reforms, productivity gains and improved developmental prospects. By contrast, the critics of

[8] For a more detailed discussion see, for example, Baldwin 2006, Garnaut and Vines 2006, Ravenhill 2003.

preferential agreements emphasize the negative effects, including the distortion in trade patterns between 'insiders' and 'outsiders' which undermine the welfare gains arising from expanded trade.

The most critical and widely recognized issue with regard to preferential agreements is the erosion of GATT's fundamental non-discrimination principle. The two key exceptions to this principle are found in Article XXIV, permitting preferential trade agreements (PTAs), and the Enabling Clause of 1979, permitting preferential treatment of goods from developing states. Today, the increased use of these two "exceptions" is reducing the most favoured nation clause to the exception, rather than the rule.

A major disadvantage of all preferential agreements is the need to establish the 'nationality' of a product. In an entirely open world economy with no restrictions on the flow of goods, rules of origin would not matter. Today, however, the origin of a product does matter in preferential agreements. All preferential agreements require rules of origin to establish the 'nationality' of a product given that participating countries continue to have diverging *external* tariffs. Since only goods produced within the territory of the agreement qualify for duty free trade, there have to be procedures that differentiate between goods produced within and goods from the rest of the world. The preferential system becomes complicated and expensive. The administrative burden of issuing certificates of origin is, of course, most problematic for those countries that have limited resources, i.e. developing countries.

> What makes RoO (rules of origin) particularly relevant is that they are not a neutral instrument: given that RoO can serve as an effective means to deter transhipment, they can tempt political economy uses well beyond trade deflection. Indeed, RoO are widely described as a trade policy instrument that can work to offset the benefits of tariff liberalization (Estevadeordal/Harris/Suominen 2007: 3).[9]

The negative consequences of rules of origin rise with the number of agreements implemented. Furthermore, with multiple agreements companies are faced with diverging rules and procedures, which add to the costs of generating certificates of origin. The operational costs of meeting different requirements in different countries pose a major challenge, especially for small and medium-sized enterprises. Preferential trade agreements with these outcomes are clearly a second-best option compared to a multilateral agreement at the WTO with uniform rules applicable to all members.

[9] For a detailed discussion of the effects of rules of origin see, for example, Krueger (1993), Krishna and Krueger (1995), Estevadeordal and Suominen (2003), Dieter (2004) and Estevadeordal, Harris and Suominen (2007).

Some observers have suggested that over time, the negative consequences of preferential agreements will become so obvious that countries will stop implementing them and will return to the multilateral forum.[10] This may be the case, but waiting for such a learning process by policy makers in the WTO membership seems to be too little. Furthermore, the negative consequences of preferential agreements have been known since decades, and yet the availability of this knowledge has only led to some caution with regard to new preferential agreements, e.g. the unilateral moratorium EU Trade Commissioner Pascal Lamy implemented after 1999.

To this date, we do know relatively little about the degree to which preferences are utilised by companies. Available evidence is anecdotal. A study by the Canadian government suggests that even in the North American Free Trade Agreement (NAFTA), one of the older preferential agreements, only about 30 percent of preferences are utilised because of both the low level of existing tariffs and the cost of establishing origin (Whalley 2008: 522). In other agreements, such as ASEAN, the utilisation rate of under ten percent is even lower (Baldwin 2006: 1488). For many companies, paying the tariff is more attractive than incurring the cost of complying with the bureaucratic procedures for establishing origin (Baldwin/Thornton 2008: 14).

But there are additional disadvantages of preferential agreements. In particular, transferring dispute settlement to the bilateral level can be a deterioration. In many bilateral schemes, there is an option—either bilateral dispute settlement or multilateral dispute settlement. It is obvious that the bilateral route offers many possibilities for the more powerful partners to promote their case. Hierarchy and power—never fully absent in international trade—have a more prominent role in preferential trade agreements than in the multilateral regime. The existence of an alternative to the WTO dispute settlement mechanism provides the more powerful countries with an additional choice, but for weaker countries this is a drawback. It should be considered that in the WTO, (weaker) countries can form coalitions in dispute settlement, which both reduces costs and increases the bargaining influence. This is particularly important for weaker countries. The WTO dispute settlement mechanism appears superior to bilateral deals because of greater transparency and the ability to form coalitions of like-minded countries (Davis 2006:39).

[10] In May 2008, a high-level EU trade negotiator expressed this expectation in a public conference in Brussels.

4. How can the negative effects of preferential agreements be minimised?

It is widely recognized that preferential agreements are a bad way to organise world trade. The discrimination which is endemic in these arrangements is economically inefficient. Moreover, the deepening of international production networks, i.e. the sourcing of inputs from a range of countries, raises the costs of preferential agreements (Baldwin/Thornton 2008: ix). After the WTO membership proved to be unable to reach a conclusion of the Doha Round in 2008, the member countries of the WTO face a choice. They can either continue to observe the spread of preferential agreements without changing the rules, or they can address the problem by trying to minimise their negative effects.

At a quite general level, one way of reducing the attractiveness of preferential agreements would be to further reduce MFN tariffs (Baldwin/Evenett/Low 2007: 4). If these tariffs are below five percent, the costs associated with establishing origin in a preferential agreement are equal or even greater then the tariff, so the interest in preferential agreements would probably fade away quickly. However, the uneven structure of tariff lines has to be considered. Although many tariff lines are already quite low today, there continue to be high peak tariffs in both developing and developed economies.[11]

Given the deadlock in multilateral negotiations and the limited willingness of policy makers to unilaterally liberalise much further, the question is whether a political initiative by important countries could send a signal against the further spreading of preferential agreements. The Warwick Commission has suggested that the major industrialised countries as well as large developing countries should refrain from establishing preferential trade agreements with each other (Warwick Commission 2007: 53). Of course, the probably worst scenario for the multilateral regime entails separate preferential agreements between the European Union, the USA and major Asian economies. It is hard to envisage any progress in the WTO in such a scenario, and probably the sustainability of the organisation would be at risk quickly. Although not likely today, we have seen some developments in that direction, notably the negotiations for a transatlantic marketplace between the USA and the EU as well

[11] A few examples from the automotive sector illustrate this. For example, the USA still charges 25 percent duty on so-called light trucks, the currently unpopular commercial vehicles. A relatively advanced country like Thailand has an import duty of 80 percent on larger cars, and the European Union continues to have an import duty of ten percent on all vehicles.

as negotiations on a preferential agreement between South Korea and the USA as well as the EU.[12]

Beyond the recommendations of the Warwick Commission, a moratorium of OECD-countries on new preferential agreements is conceivable. For such an agreement, two ingredients would be essential. First, an alternative to preferential agreements would be necessary. The critical mass initiatives suggested by the Warwick Commission would constitute such an alternative. Second, the countries supporting such an initiative would have had to come to terms with their policies toward globalisation. Today, we observe a widespread reluctance to underwrite the concept of further international division of labour.[13] Thus, governments in OECD-countries may see little benefit in initiatives that risk electoral backlashes, even though the direct effect of a moratorium on preferential agreement would be to safeguard an established and valuable multilateral regime.

Quite promising are reforms which would directly address one of the most crucial problems of today's multilateral trade negotiations. Up until today, an unhealthy dichotomy has emerged. Since the Doha Round is a 'single undertaking'—i.e. nothing is agreed until everything is agreed— countries are using preferential agreements to get some progress in specific areas. The answer to that dilemma could be the introduction of so-called critical mass initiatives under the roof of the WTO. Inter alia, the Warwick Commission has suggested this approach.[14] In essence, countries willing to agree on certain specific policies could go ahead and implement policies without needing the consent of all WTO member countries. In effect, preferential agreements would cease to be the only alternative to the multilateral regime. Whilst a 'critical mass' approach does have disadvantages (see the contribution of Peter Gallagher and Andrew Stoler in this special issue), on balance this avenue is superior to the continuation of an uncontrolled and, given their popularity, probably uncontrollable spreading of preferential agreements.

One way of exercising greater control of preferential agreements is to strengthen regulation within the WTO. Preferential agreements are permitted under Article XXIV of the GATT, which permits preferential agreements, subject to certain conditions. However, the disciplines imposed by Article XXIV have never been adequately enforced. The key question is whether

[12] For a discussion of the risks inherent to a transatlantic trade agreement see Langhammer 2008.
[13] For a discussion of global economic governance in the 21st century see Dieter and Higgott 2009.
[14] See the Warwick Commission's report, pp. 30-31.

there are ways to discipline their use. In theory, preferential agreements could be reviewed under two different mechanisms. Firstly, WTO member countries must notify agreements and they are subsequently discussed in the Committee on Regional Trade Agreements. In practice, this track has been of limited utility. All WTO member countries can participate in the Committee, including the states participating in the preferential agreement. Although, in theory at least, the Committee could by consensus deem a notified agreement to be WTO-inconsistent, as a practical matter the Committee will probably never reach such a consensus.

Secondly, a WTO member country could challenge the WTO-consistency of a preferential agreement through the dispute settlement proceedings. Hitherto, member countries have refrained from pursuing this avenue. The legality of preferential agreements has not been challenged. A plausible explanation is that virtually all member countries have been implementing preferential agreements and could therefore face a challenge to their preferential agreements if they initiate a legal challenge against other countries. Consider, for example, a potential legal challenge of the legality of US trade agreements by the European Union. The dispute settlement mechanism of the WTO would either be blocked for years or the legitimacy of the dispute settlement might be questioned by one of the major players.

Moreover, given the uncertainty surrounding the precise legal frontiers of the line between lawful and unlawful preferential agreements—and the widespread acceptance of them on a de facto basis by WTO members—dispute panels should probably avoid making a definitive decision on the WTO-consistency of any particular agreement. Political issues have to be solved by policy makers, not the juridical system.

However, there is room for improvement within the sphere of activity of the WTO. The Committee on Regional Trade Agreements, which appears to be, at best, lacking courage and is, at worst, moribund, should be given a clear and strong mandate for the improvement of the supervision of preferential agreements. In 2006, the General Council of the WTO agreed on measures to improve the transparency of preferential agreements. Members, it agreed, should provide early information on ongoing negotiations and the notification process should also be speeded up. Nevertheless, as in other areas of regulation increasing transparency is only a first step. Even complete information will not alter the structural problems that are related to preferential agreements. To achieve this, bolder steps would be necessary.

The inherently discriminatory and puzzling system of preferential trade arrangements questions the WTO's ability to manage the increasingly complex system of trade governance. If the WTO and its members are unwilling to stop the glut of preferential agreements we have witnessed, one potential avenue for reducing the negative effects of this trend would be to transform the WTO into a supervising agency. In such a scheme, the WTO would monitor, evaluate and, where necessary, sanction preferential trade agreements. Member countries of the WTO would continue to be free to implement preferential agreements, but the criteria for permissible agreements would be sharp and coherent. Needless to say, such a regime would require a reasonably strong instrument for sanctioning unacceptable agreements. The simplest and yet most forceful one would be to allow the WTO to open the preferences granted in the preferential agreements to all other WTO member countries. Thus, if the WTO supervising body concludes that one element of a particular preferential agreement violates the WTO rules, other member countries would be permitted to retaliate by being permitted to take advantage of the agreement's preferences.

The WTO's evolution into a supervisory body—overseeing preferential agreements, developing a transparency mechanism and sanctioning non-conforming agreements—would constitute an effective response to the recent proliferation of preferential agreements. Nonetheless, this evolution would require two substantial policy shifts. First, member countries would have to agree on what constitutes an acceptable preferential agreement and what does not. In essence, the currently vague regulations of Article XXIV would have to be expanded and more explicit formulas would have to be found. For example, the term "substantially all the trade" would have to be made specific. Does that mean 80, 90 or 99 percent of all *existing* trade? Or would the regulation refer to all *potential* trade, i.e. including areas which countries considered to be unsuitable for increased competition from foreign companies? Second, member countries of the WTO would have to give the organisation a widened mandate and would permit it to interfere in their foreign economic policy. Whilst this has been the case in the past, giving the WTO explicit jurisdiction over preferential agreements would be an additional step.

In order to know which agreements have less negative effects than others, it would be necessary to develop best-practice guidelines for preferential agreements. Member countries would have to negotiate best-practice guidelines for preferential agreements (Baldwin/Thornton 2008: 38). By developing such a catalogue, the effects of any preferential

agreement would be much more transparent to both those involved in negotiations and to third parties.

However, the question is whether this is a plausible proposal. First, Article XXIV of the GATT does contain some guidelines, e.g. the provision that "substantially all the trade" ought to be covered by the agreement. Yet, member countries have frequently violated the principle, for example by excluding agricultural products more or less completely from preferential agreements.[15] Political pressures in member countries, in particular the powerful agricultural lobbies, will be an obstacle for the implementation of a rigid implementation of standardised regulations on openness. Second, some countries have used preferential agreements to advance the interests of domestic industries. A prominent example is the financial sector of the USA, which managed to have the prohibition of restrictions on capital flows to be included in some agreements, e.g. in those with Singapore and Chile. The question is whether these interest groups would and could be pacified with a best-practice agreement that would restrict the remit of preferential agreements to trade-related issues (which restrictions on capital flows of course are not).

Some of the proposals made in the discussion on preferential agreements are ignoring the fact that any binding agreement on best-practice would not be easily accepted in democratic societies. Baldwin and Thornton suggest that "nations would declare themselves and all of their RTAs as subject to this anchorage-building discipline. The benefit of self-declaration would be the signal it provided to potential investors that the nation was permanently committed to pro-market reforms" (Baldwin/Thornton 2008: xi). Such expectations, however, are politically naïve and do underestimate the level of resistance that so-called pro-market reforms have been generating in recent years. Whilst the Baldwin/Thornton approach may work in autocratic societies, it will most probably not work elsewhere. Consider, for example, the opposition in EU countries against the failed constitution. In the debate, many opponents claimed that the economic policies enshrined in the constitution where too market-friendly and did not give sufficient consideration to social issues. In developing countries, there has been enormous, lasting resistance against the Washington consensus, another variation of seemingly straightforward principles. John Williamson's description of policies that were

[15] For example, the preferential agreement between Japan and Thailand, concluded in 2005, excludes rice, wheat, beef, dairy products and fish. Of course, these are highly protected sectors of the Japanese economy, thus gains from liberalising would be greatest there.

considered to be essential for economic reform could have been considered to be a set of best practices, yet the academic and political reaction against them was overwhelming.[16]

Another example of the failure to establish a set of trade-related best practices are the so-called Singapore issues, which refer to transparency in government procurement, trade facilitation, trade and investment as well as trade and competition. Opposition to this set of best practices was opposed by many developing countries, most notably during the failed WTO Ministerial in Cancún in 2003.

This list is by no means complete, but it shows that the establishment of a consensus on economic policies at a global level is an extremely complex endeavour.[17] In an era in which the process of globalisation is contested both in developing and developed countries, the development of a set of enforceable rules on preferential trade agreements will be no less difficult than previous attempts to establish best practices.

Nevertheless, there are opportunities for reducing the negative effects of preferential agreements that appears to be more easily achievable. First, regions could decide to follow the example of the European countries and establish zones which accept so-called diagonal cumulation of origin. In effect, the region from which inputs can be sourced can be dramatically increased. The Pan-European Cumulation System (PECS), introduced in 1997, has eased trade within that system significantly: Any good that was deemed as originating in one country of the PECS zone has to be granted originating status in every other country in the zone (Baldwin/Thornton 2008: 32). Developing, for example, a Pan-Asian and a Pan-American cumulation scheme would at least ease trade *within* those regions. Of course, the unwelcome side-effect would be that the emergence of three large trading blocs would be facilitated.

Second, preferential rules of origin could be harmonised. Ideally, this would result in their standardisation. If there would be one set of criteria—uniform for all preferential trade agreements—this would significantly reduce the negative effects. However, some observers

[16] Williamson's 1990 paper was revised and published again in 2002 (Williamson 2002). Some of the policies, e.g. the proposal for the privatisation of state enterprises, were controversial, but by and large the recommendations were motherhood and apple pie. Capital account liberalisation, an important element of the financial crises of the 1990s, was not included in the Washington Consensus.

[17] One could add the failed Multilateral Agreement on Investment (MAI), in effect abandoned in 1998, as well as the fiasco the International Monetary Fund experienced with its "Contingent Credit Lines", which would have required countries to accept a set of best practices.

have argued that a complete harmonisation of rules of origin would be politically difficult because it would be "unpalatable to producers around the world" (Estevadeordal/Harris/ Suominen 2007: 44). Whilst it is true that striking a bargain on rules of origin would be difficult, it does not appear to be an unsurmountable hurdle. As in any liberalisation negotiation, those negatively affected must either be compensated or those benefiting from the measure ought to be powerful enough to safeguard implementation. Of course, mobilising political support for such a highly technical and complex area of regulation will not be easy.

Third, dispute settlement could be made exclusive to the WTO. Such a step would require that all preferential agreements would have to contain a clause that grants the WTO exclusive jurisdiction on its disputes. Of course, some larger countries would probably oppose such a scheme, in particular the European Union, which would most probably have no intention to give up jurisdiction over issues related to the single market. A potential solution could be that the WTO retains the jurisdiction for all free trade agreements, but permits the development of dispute settlement mechanisms for customs unions and common markets.

Another potential avenue for reducing the negative effects of preferential agreements would attempt multilateralising commitments that countries made in preferential agreements. In areas such as procurement, services, investment and competition policy, many countries, including developing nations, have been willing to make commitments in preferential agreements, but have resisted attempts to negotiate these matters at the multilateral level (Baldwin/Evenett/Low 2007: 35). The WTO could launch initiatives to multilateralise those commitments, and such an endeavour would, if successful, reduce the negative effects of preferential agreements.[18] The risk, of course, is that the WTO could itself come under attack from member countries for pushing them into a certain direction. If the organisation itself were pushing such initiatives, the WTO could loose credibility and legitimacy in some member countries. The potential losses would probably outweigh the potential gains.

5. Conclusion

On balance, preferential trade agreements do have very few advantages. They are inferior to regulating trade at the multilateral level, and they are not supporting deeper integration as some larger regional agreements, *e.g*. the EU or ASEAN, do. Preferential trade agreements are a third-best solution for regulating international trade. They are suboptimal with regard to

[18] For a discussion of potential initiatives see Baldwin/Evenett/Low 2007: 36-38.

economic efficiency and they are imbalanced, because they disadvantage the poorer players and systemically strengthen the more developed players. Despite these obvious drawbacks, a fundamental revision of countries' trade policies appears to be unrealistic. In the early 21st century, the willingness of nations to support the existing institutions of economic governance appears to be limited, and consequently preferential agreements are here to stay.

However, accepting the inevitability of a further spreading of preferential agreements does not mean that their negative effects cannot me reduced. Amongst the options discussed in this article, reforming the negotiating process with the WTO is the most promising avenue. The introduction of 'critical mass' initiatives under the supervision of the WTO would enable member countries to form coalitions of like-minded countries without having to opt out of the multilateral regime.

In addition, member countries could provide the WTO with a clear mandate for monitoring and supervising preferential trade agreements, including the application of sanctions for agreements that violate Article XXIV. The harmonisation of preferential rules of origin would be a further step to reduce the negative effect of preferential trade agreements.

By contrast, developing a set of so called best practices for preferential agreements appears to be difficult. The definition of what constitutes 'best practice' inevitably varies according to state of development of a country as well as to political preferences of societies, and past experience has demonstrated how controversial 'best practices' can be.

However, the changing geopolitical context appears to be more important than the details of trade agreements. As discussed above, we may currently witness a departure from multilateral governance not entirely different from the 1930s. The United States may decide that the disadvantages of globalisation outweigh the benefits and put more emphasis on preferential agreements, in line with other OECD–countries. The global economy seems to be returning to a regime where goods originating from befriended countries have easier access to a national market than others. There is discrimination between friends and foes. The post-war trading regime had the explicit goal of non-discrimination, and today's policy makers are sacrificing this philosophy on the altar of seemingly quick, but asymmetrical and eventually unsustainable economic gains.

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