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1 Discrimination, Regionalism, and GATT

Richard H. Snape

Preferential trading agreements are back in fashion. The purpose of this paper is to survey briefly the background to discriminatory trading arrangements and the economic effects of some forms of them. It discusses some problems with departures from nondiscrimination and proposes a manner in which nondiscrimination may be pursued further through the General Agreement on Tariffs and Trade (GATT).

Following the creation of the European Economic Community (EEC) and the European Free Trade Area (EFTA) in the late 1950s, many new trading arrangements were formed among developing countries, but without any notable long-term successes. Meanwhile, the British Commonwealth preference system, which had been at the center of dispute during the negotiations over the International Trade Organisation (ITO) and the GATT at the end of the Second World War, withered. In the 1970s, more emphasis was given in international negotiations to preferences for developing countries and the creation of commodity cartels. In the 1980s and early 1990s, the pendulum has swung back to the formation of free trade and other preferential trading areas, mainly on a regional basis.

Of particular importance has been the change in attitude of the U.S. government. Having been discriminated against in the prewar period, during which German and British hub-and-spoke bilateral systems dominated much of world trade, the United States was firmly against allowing discrimination in the club that was to become the GATT. It compromised to the extent of agreeing to the continuation but not the extension of existing preferences and to preferential arrangements that involved essentially free trade among the participants: customs unions and free trade areas. The United States supported

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the formation of the EEC for essentially political reasons and in the late 1960s reluctantly agreed to the generalized system of preferences for developing countries, negotiated through the GATT.

In contrast to its earlier position—that of being clearly the leader in developing a nondiscriminatory trading system—the United States has been at the front in the new wave of preferential trading arrangements, having granted unilateral preferences to Caribbean countries in 1983 and concluding free trade agreements with Israel in 1985 and Canada in 1988. Now, in the early 1990s, the Bush administration is currently seeking a free trade agreement with Mexico, has indicated that other Latin American countries may be candidates for similar agreements, and has put out feelers in other directions also.

Over the last nine years, successive U.S. trade representatives have explicitly stated that bilateral and multilateral negotiations would proceed together. The position was well stated in the Reagan administration's statement on trade policy of 23 September 1985: "While our highest priority remains the improvement of the world trading system through a new round of multilateral trade negotiations, the United States is interested in the possibility of achieving further liberalization of trade and investment through the negotiation of bilateral free-trade arrangements such as the one recently concluded with Israel. We believe that, at times, such agreements could complement our multilateral efforts and facilitate a higher degree of liberalization, mutually beneficial to both parties, than would be possible within the multilateral context."

While still the secretary of the U.S. Treasury, James Baker added, "[Our] approach is idealistic in aim, but realistic and often incremental in method. It seeks to move nations toward a more open trading system through a strategy of consistent, complementary, and reinforcing actions on various international fronts, bilateral and multilateral. . . . [The trade agreement with Canada] is . . . a lever to achieve more open trade. Other nations are forced to recognize that we will devise ways to expand trade—with or without them. If they choose not to open their markets, they will not reap the benefits."[1]

This statement of Baker's threatens the EEC, Japan, and others: join in the multilateral negotiations, or the United States will discriminate against you by entering into more favorable trading relationships with other parties. Many observers question whether this two-track approach can be sustained. Do the threat, pursuit, and negotiation of preferential arrangements stimulate and complement multilateralism as claimed in Baker's statement, or do they undermine it?

Preferences can be explicitly negative as well as positive. Sanctions against South Africa, Iran, and Iraq are examples of negative preferences. Amendment of the main safeguard provision of the GATT against "fair" trade (Ar-

1. Remarks made by James Baker to the Canadian Importers and Exporters Associations, Toronto, 22 June 1988.

ticle XIX) to allow discrimination ("selectivity") against those countries whose exports triggered the safeguard action was pressed by some countries in the Tokyo Round of multilateral trade negotiations but was resisted. It has resurfaced in the Uruguay Round, and it could emerge from it, if the Round is completed. The draft of a Safeguards Code (interpretation of Article XIX) that was on the table at what was intended to be the final ministerial meeting of the Uruguay Round in Brussels in December 1990 contained square-bracketed sections that would have allowed such selectivity "in exceptional circumstances."

Probably the most important of explicitly negative preferences are the Section 301 and the now expired Super-301 provisions of the 1988 U.S. Omnibus Trade and Competitiveness Act (Bhagwati and Patrick 1990). Many of the provisions allow for explicit discrimination against other countries in a manner that is inconsistent with the GATT (both with respect to the nondiscrimination provisions and because the relevant tariffs have been bound) and with the position adopted so forcefully by the United States in the negotiations that established the post–World War II international economic institutions. Indeed, it is reminiscent of the German and British policies of the 1930s (Condliffe 1940, chaps. 4, 8).

In comparing nondiscriminatory multilateralism and trade discrimination in all its forms, it can be instructive to recall the role of the price system in a market economy. The market allows (to varying degrees, depending on the nature of the transaction) the depersonalization of trading. This has several consequences, the foremost economic one being efficiency. Nonmarket systems function through obligations, responsibilities, love, hate, threats, war, queues, cooperation, and favors. This occurs at both the micro level of individuals and at the macro level of nations. Personal and political relationships come to the fore: markets help depoliticize transactions nationally and internationally. A corollary is that nontariff barriers to international trade invite discrimination and in some forms make it inevitable. Managed trade is political trade.

It may be that international transactions can never be completely depoliticized—trade policy is intertwined with foreign policy, as Cooper (1987) reminds us. Trade is between "us" and "them" (Kindleberger 1986, 1). There is no doubt, however, that the level of politicization is lowest with nondiscriminatory trade. Preferences granted can be removed, and, to the extent that trade policy is seeking international political favor, it is likely not to be economically efficient.

1.1 Forms of Barrier Reduction

Trade preferences may be given by selectively reducing trade barriers against the preferred countries or by raising barriers against others. Both tac-

tics were relevant in the discriminatory 1930s; they are both relevant in today's trading world also, with the threat of action by the United States in particular against countries that it judges not to be playing by the appropriate rules. But for the moment I focus on preferences granted by barrier reduction. Barrier reduction may be undertaken in a manner that discriminates against countries or does not; it may be undertaken as part of a negotiated international agreement or unilaterally. This gives four possibilities:

(i) unilateral nondiscriminatory reductions;
(ii) unilateral discriminatory reductions;
(iii) internationally negotiated nondiscriminatory reductions; and
(iv) internationally negotiated discriminatory reductions.

In this list, the GATT allows (i) and (iii), in the latter case provided that the reductions or concessions are passed on to all members of the GATT unconditionally. Except for preferences for developing countries, it does not permit (ii) and allows (iv) only if the negotiated agreement fulfills what on paper are stringent conditions, to which I shall return later.

Looking at the choice between (i) and (ii), why should a country discriminate among other countries if it is receiving nothing in return from those that it favors? Given the trade policy of other countries, a country will generally gain more in terms of real income from a nondiscriminatory reduction in its trade barriers than from a similar preferential barrier reduction: with nondiscrimination it could obtain all the trade creation gains (and more) without the trade diversion costs.[2] This statement should be qualified for a country that has market power with respect to its imports or exports and where the elasticities of supply or demand differ across its trading partners (and the markets can be segmented). But the optimal trade taxes necessary to exploit these terms of trade effects are difficult enough to calculate in practice where the rest of the world is treated as one market. Calculation of a set of discriminatory trade taxes that would increase a country's real income where the rest of the world is treated as a set of segmented markets is a problem of a much higher order. Further, the products for which such discrimination would be most relevant will generally be those over which the producing enterprise itself has market power and for which it will set prices on different markets that reflect the differential conditions on those markets. So any qualification of the general statement that, for given trade policies of other countries, a nondiscriminatory barrier reduction is likely to raise real income more than a discriminatory barrier reduction will probably be of minor importance in practice.

I now pass on to the choice between the unilateral and negotiated barrier reduction and then to that between discrimination and nondiscrimination.

2. Preferential reduction of nontariff barriers may result in trade diversion without any trade creation. This occurs, e.g., when a global import quota remains unaltered but preferential access is granted within this quota.

1.2 Unilateral or Negotiated Barrier Reduction?

The usual reason for undertaking liberalization in the context of *any* international agreement (preferential or not), rather than doing it unilaterally, is to obtain something in return from trading partners. To use the language of trade negotiation, such concessions not only provide a source of economic gain (including gain in the sense of reduced uncertainty) for the home country but also provide within that country the political balance of obvious and concentrated gainers, exporters, to be placed against the obvious and concentrated losers, producers of import-competing industries in which there is trade creation.

In addition to seeking concessions with respect to its exports, a government may choose to enter negotiated discriminatory or nondiscriminatory international agreements so as to constrain its own policies, even if little is obtained as "concessions" from abroad. There are times when governments are able to stand back and make assessments in the general interest relatively free from sectional pressures. External security considerations may provide such an opportunity, or the opportunity may occur soon after an election or after election debts have been paid. International commitments provide a bulwark against subsequent sectional pressures: they may be compared with the wax in the ears of Ulysses' sailors and the ropes that bound him to the mast so that they might all withstand the deadly temptations of the Sirens. A very important variation on the same theme occurs in the United States, where the authority has been granted by Congress to the administration to negotiate international agreements, which then must be passed or rejected by Congress in their entirety (the "fast track" authority). This process prevents the tariff-by-tariff logrolling by Congress of the sort that yielded the Smoot-Hawley tariff. Congress thereby has constrained itself (Destler 1986, chap. 2), and all tariff reductions since the early 1930s in the United States have come about through this process. More generally, the temptations referred to may not only be protectionist: they may also be manifest in loose monetary and fiscal policies that will be less sustainable in the presence of international commitments. Also, international negotiations themselves direct attention to an overview of economic policy that can also help keep pressures for inefficient policies at bay.

I address later the question of whether preferential or multilateral, nondiscriminatory negotiations are likely to provide the greater constraints.

1.3 Discrimination versus Nondiscrimination

The case for nondiscriminatory multilateralism as compared with preferential schemes can sound rather fundamentalist. It has been characterized as such recently by Rudiger Dornbusch in the *Economist* (Dornbusch 1991, 65). Part of the case for multilateralism and nondiscrimination is systemic and dif-

ficult to pin down in practice, much as it is difficult to pin on individuals the effects that their tax avoidance has on respect for (and compliance with) the taxation system as a whole. There are public good aspects to compliance with a nondiscriminatory world trading system as there are to compliance with a reasonable taxation system. The argument in favor of any particular preferential trading arrangement will thus appear to be stronger than the argument for preferential arrangements as a whole. Each has a systemic effect, to which reference was made earlier.

For the choice between discriminatory and nondiscriminatory barrier reduction, the question is whether the extra "something in return" in a preferential agreement compensates for the trade diversion costs; working on a larger canvas, however, governments can also consider the effect on the trading system as a whole of the development of preferential trading arrangements—the systemic effect—which can react on them adversely. While small countries may gain most from discrimination in their favor, they also stand to lose most from the collapse of a multilateral system. It was this systemic effect that was in the minds of those who pressed for tight constraints on preferential arrangements in the GATT, and I shall return to it later.

Usually the extra "something in return" for a preferential barrier reduction will be a greater decrease in the barriers against the home country's exports than could otherwise be achieved, although guarantees against increases in barriers against its exports are also important in some agreements. This has been so for Canada in its negotiations with the United States: it obtained special dispute settlement procedures in relation to antidumping and countervailing duty matters, selective exemption from restriction of its exports from safeguard action under the GATT's Article XIX unless the exports had themselves contributed "importantly" to the injury of an industry in the United States, and also exemption from any restriction that may be imposed on some exports from other countries, for example, meat and the enrichment in the United States of foreign uranium (Articles 704 and 1102, Chapter 19, and Annex 902.5 of the agreement; Snape 1988, 12; Snape 1989b, 194). Such guarantees are, of course, discriminatory: the provisions for meat and uranium discriminate against Australia. It can be expected that other countries that seek trade agreements with the United States will also seek preferential treatment with respect to contingent protection and dispute settlement.

Often preferential trading arrangements are part of larger preferential and political agreements—sometimes a key element of the larger picture as in the development of the EEC, sometimes rather incidental and minor as in ASEAN (the Association of Southeast Asian Nations). The assessment of the total gains and losses then may be beyond the calculus of economists, but this does not prevent this calculus being used to evaluate some of the economic effects of preferences.

Article I of the GATT does not permit any new preferential trading arrange-

ment between members of the GATT and any other *country*.[3] Amendments to the GATT have qualified this by allowing preferences to be extended to developing countries without reciprocity, while Article XXIV qualifies it by permitting contracting parties to form preferential arrangements[4] provided that:

(i) they are in the form of customs unions (free trade internally and common barriers externally) or free trade areas (free trade internally and differentiated barriers externally) covering "substantially all the trade in products" or are interim arrangements leading to these ends;
(ii) they do not result in raised barriers against nonparticipants (the "general incidence" must not be raised in the case of customs unions); and
(iii) GATT is notified of the intention to form such arrangements.

The view taken is clearly that free trade areas and customs unions that cover most trade among the members will tend to be more trade creating than diverting so that on balance they are liberalizing. There is also a judgment implied that the multilateralism of the GATT as a whole is not undermined by such arrangements.

In fact, very few free trade areas or customs unions have been authorized by the contracting parties to the GATT. Schott (1989, annex A) lists sixty-nine preferential trading arrangements considered by the GATT under the provisions of Article XXIV up to late 1988. Of these, only four have actually been deemed compatible with the Article, although it should be pointed out that, if the conditions of the Article are met, approval is automatic and requires no special action (Jackson 1969, 582). The conditions in fact have seldom been met, but no proposed agreement has been prohibited. It can reasonably be said that surveillance has been ineffectual (Schott 1989, 24–26).

An attempt has been made in the Uruguay Round negotiations to strengthen the conditions and surveillance of free trade areas and customs unions. The "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations" tabled for consideration by trade ministers in Brussels in December 1990 spoke of the "need to reinforce the effectiveness of the role of . . . [the GATT] in reviewing agreements notified under Article XXIV, by clarifying the criteria and procedures for the assessment of new or enlarged agreements, and improving the transparency of all Article XXIV agreements." One of the more significant provisions was that the "reasonable length of time" for interim arrangements prior to the adoption of free trade among members should not normally exceed ten years. Others were for calculating a common external tariff of a customs union to satisfy the provisions of Article

3. Often overlooked is that Article I provides that any trade concession granted to any other country (not just any other contracting party) by a contracting party must be extended unconditionally to all other contracting parties.

4. Article XXIV as written could appear to prohibit free trade or customs union agreements between members and nonmembers of the GATT. This is not the way it has been interpreted in practice (Jackson 1969, 582).

XXIV, for raising previously bound tariffs on the formation of a customs union, and for more effective review under GATT procedures of the proposed barrier reductions and their timetable. But, even if accepted, these provisions appear very weak given the flagrant disregard for some of the constraints of Article XXIV in the past. It is unlikely that the intended thrust of Article XXIV will be enforced unless a major player takes a lead. Such a lead has been advocated by Bhagwati (1990, 163), but at this juncture is appears unlikely—this being reflected in the weakness of the Brussels document—particularly in view of the current enthusiasm for free trade agreements which are unlikely to satisfy a reasonable interpretation of Article XXIV.

In section 1.2 above it was mentioned that international agreements and negotiations may have the useful role of constraining domestic policies for the general good. Following this line, a question arises whether preferential or nondiscriminatory agreements are more effective in providing the constraints on domestic policy. There does not seem to be a general answer to this. It depends very much on who the partners are in a preferential arrangement and on the nature of the agreements. It is probably easier to get tight, binding agreements between a small group of similarly minded and endowed countries than between a large number of diverse countries. Multilateral agreements are more likely to contain words that are intended to mean different things to different people. But a bilateral agreement between two countries that are not well matched politically or economically is unlikely to provide much of a constraint on the more powerful country.

Thus, when fully implemented, the U.S.-Israel Free Trade Agreement will constrain Israel's trade policy much more than it will that of the United States. The GATT provides a greater constraint on the trade policy of the United States than does or will the U.S.-Israel Free Trade Agreement; the opposite is probably the situation for Israel. On the other hand, there is not likely to be much pressure on most U.S. industries from imports from Israel (particularly as many agricultural products are effectively excluded from the agreement), and the pressure on the United States to break the agreement is therefore likely to be small.

Where there is a dominant party to an agreement, other parties are linked to an economy that may or may not prove to be dynamic. Nondiscrimination provides constraints on a country's industries and its policies from the world as a whole; preferential arrangements tie the parties to a significant extent to the efficiencies or inefficiencies of the dominant member. It is not clear that the tie to the British economy that the Commonwealth preference system provided for some countries was a net advantage to these countries in the two decades or so after World War II.

While the United States is at the center of current regional initiatives, regionalism is being advocated and preferential agreements formed between countries other than the United States. The Closer Economic Relations agreement between Australia and New Zealand is one of the freest of free trade

arrangements, covering all commodities, factor movements, and many services, while it has no safeguard provisions.[5] It more than satisfies the GATT provisions and does not appear to encourage substantial trade diversion, partly because both countries have been lowering their external barriers significantly against the rest of the world. On the other hand, from a historical perspective it is difficult to believe that actual and proposed trade agreements between Latin American countries will come anywhere near satisfying the GATT provisions or will provide effective constraints on their policies. Further, there is likely to be costly trade diversion while external barriers in Latin America remain high.

Agreements among a small number of participants may be negotiated more quickly than multilateral agreements, although Schott (1989, 19–20) questions the strength of this point. Negotiations that appear to be going nowhere are unlikely to constrain policies, and this is a problem associated with the stalling of the Uruguay Round. While a nondiscriminatory agreement under the GATT may be better for Latin American countries than an agreement among themselves or with the United States, waiting for this option to firm may miss the bus of opportunity (Dornbusch 1991, 65). But the arrival of the GATT bus may not be exogenous: a substantial push by Latin American countries may get it moving. Regional negotiations divert negotiating attention and muscle from multilateral negotiations. But if the Uruguay Round is unsuccessful, a set of agreements (or, better, a single agreement) with the United States may be better for these countries than nothing, and better than a purely Latin American agreement.

The completion of the single market in Europe in 1992 far exceeds the requirements of the GATT with respect to internal trade, although some questions can be raised with respect to external trade, particularly in agriculture, textiles, clothing, automobiles, and some electronic products. But the formation of such a trading bloc, and the possibility that disputes between it and the United States or Japan may be solved on a political bilateral level, with little regard and unfortunate consequences for other less powerful countries, has worried many commentators.

The greater are the concentrations of power, the less likely is a general rules-based system to function effectively unless it is established in a hegemonic manner. Yet rules of general application protect the weak against the strong. The GATT as a *general* set of rules—general with respect to countries and commodities apart from specific exceptions—provides such protection. Effective constraints on the actions of powerful countries are likely to be achieved by international agreements only if these agreements incorporate other countries, or groups of countries, of comparable power. But between

5. There are no safeguard provisions with respect to dumping or "fair" trade (cf. Article XIX of GATT), and the parties have agreed to abolish all production subsidies that may promote exports to each other. (Direct export subsidies are already proscribed by the GATT's Subsidies Code.)

countries of comparable power there is always a temptation to settle outside the agreement: to preserve the agreement and the benefits it provides, this temptation needs to be resisted, particularly when the relevant countries are large.

1.4 Hub-and-Spoke "Free" Trade Agreements

It can be argued that what the architects of the GATT had in mind in framing Article XXIV were agreements like the European Common Market with respect to most industrial (although not agricultural) goods, in which the members have reduced barriers progressively without generally raising them against the rest of the world (except for voluntary export restraints on a number of sensitive products) and in which new members have been added from time to time. On the other hand, the arrangements for agriculture in the EEC are clearly not consistent with this intention.

While the U.S.-Canada Free Trade Agreement is one of the cleanest from a GATT perspective, it is most unlikely that the GATT architects envisaged a set of bilateral agreements between a central country and others: the hub-and-spoke model that could develop around the United States.[6] While Canada has sought to be included in the U.S. negotiations with Mexico, it appears unlikely that one agreement will cover the United States, Canada, and Mexico. The U.S. Congress has ensured that new countries will not be added to existing bilateral agreements without its explicit approval. Differing labor costs and conditions and environmentalist pressures in the United States, will make it very difficult to incorporate Mexico into the existing U.S.-Canada Free Trade Agreement or to negotiate an agreement with Mexico that is close in its provisions to that with Canada. While Canada may also negotiate a pact with Mexico, it is unlikely that the three deals could be covered by one agreement—or, if they could be, it would in all probability require different provisions covering at least some of the trade between the three pairs of participants, perhaps with lengthy transitional arrangements. Similar considerations arise with respect to Chile, which could be next in line for negotiations with the United States, and they would apply even more strongly with respect to other Latin American countries, particularly as their macroeconomic policies would make it more difficult for free trade with the United States to be sustained. A hub-and-spoke network appears more likely than a multicountry free trade agreement, at least for a lengthy transitional period.

The United States, along with Britain and Germany, was central to a network of bilateral arrangements in the 1930s, but, in sharp contrast to the others, the U.S. arrangements were clearly trade liberalizing, albeit from very high tariff levels. It is often stated that it was out of the U.S. arrangements that the GATT was born—"that GATT was the Trade Agreements Program writ

6. For analyses of hub-and-spoke systems, see Wonnacott (1990) and Park and Yoo (1989).

large" (Diebold 1988, 11)—although this perhaps gives insufficient credit to James Meade and others on the other side of the Atlantic.[7] These U.S. bilateral agreements differed in important ways from the current U.S. carrot-and-stick approach in that (i) they were not generally accompanied by negative discrimination, actual or threatened, and (ii) the barrier reductions were quite limited in product coverage but were nondiscriminatory. The negotiations covered products of which the United States and the partner country were principal suppliers, and there was careful product selection and specification to ensure that the parties were the principal suppliers. But then the barrier reductions were not restricted to the partners but were extended to all countries, unconditionally (Diebold 1988, 7–11).[8] Minor existing suppliers and, more important, new suppliers could then benefit from the opening of trade.

A hub-and-spoke model centered on the United States would differ from the EEC model in that it would comprise separate bilateral arrangements, and additional countries would not be expected to enter under the same conditions. It would differ from the 1930s U.S. model in that the negotiated concessions would not be extended to others on an unconditional most-favored-nation basis. Because of the careful product specification, new agreements in the 1930s did not tend to undermine significantly the preferences granted in existing agreements; in contrast, the hub-and-spoke model with wide product coverage involves significant undermining of this sort as new bilateral or multilateral agreements are negotiated. (This point has more force with respect to explicit positive preferences than to commitments not to impose restrictions.)

If countries B and C have free trade agreements with country A, what should their relations be with each other? If the agreements were truly and fully free trade agreements, then it would be relatively easy to have a free trade agreement embracing all three, and this would be GATT consistent. Again, if the agreement between A and B were an open agreement, C could join and have the same relations with both A and B. But where preferential agreements are not open and do not embrace all trade, it becomes much more difficult to devise agreements between parties.

While each of the partners with the United States, in a hub-and-spoke system may benefit from its own bilateral relationship, an important question is what effect such a network will have on the multilateral trading system as a whole. In considering the prospect of a free trade agreement between Mexico and the United States, Ron Wonnacott points out that there is a risk that, "in responding magnanimously to requests for bilateral agreements that are in its interests and, at least initially, in those of the applicant nations, the United States could inadvertently be creating a discriminatory, inefficient, hub-and-

7. See Meade's proposal for an International Commercial Union, reproduced as an appendix to Culbert (1987).

8. The United States did retaliate against Germany and Australia by withholding most-favored-nation extension of concessions negotiated with others (Diebold 1988, 9; Copland and Janes 1937, documents 173, 183, 186).

spoke trading structure that will be unnecessarily damaging to its partners and may erode prospects for future multilateral liberalization" (Wonnacott 1990, 2).

Each additional country added to a hub-and-spoke system lessens the gains for those already in it, with the exception of the hub country, for each new entrant reduces the advantage that the others have in trading with the hub country. It is only the hub country that does not have its sourcing, whether for industrial inputs or final products, distorted by trade barriers within the hub-and-spoke system. If "rim" countries wish to have a network of agreements among themselves to lessen the discrimination, the number of possible agreements increases rapidly as the number of countries increases: a system of six countries around one hub has a possible twenty-one bilateral agreements. But the more countries that are in the system, the greater the incentive for outsiders to join. This incentive for outsiders to join also applies to a single GATT-consistent free trade agreement covering several countries; however, while embracing a multicountry free trade arrangement probably moves the global system closer to multilateralism, in adding more spokes to the hub bilateralism is multiplied.[9]

The complexity of the system and of the relationships it would bring could be quite damaging. Each agreement would involve discrimination against outsiders, in a different manner, and rules of origin and content (which could differ in the various agreements, unlike a customs union or multicountry free trade agreement) would be of considerable importance. Furthermore, should a network develop, many if not most of the agreements are unlikely to satisfy a reasonable interpretation of Article XXIV of the GATT, but, as past experience has shown with respect to the enforcement of this Article, this is unlikely to prevent their adoption, particularly as the erstwhile leader of multilateralism, the United States, would be involved. If the requirements of the Article were truly met with respect to free trade covering "substantially all trade in products," it would be relatively easy to move to a multicountry free trade agreement: it is the deviations from a really free trade agreement that lead to separate bilateral agreements. One source of difficulty lies in the favored treatment that countries would seek (following the Canadian example) with respect to the U.S. safeguard provisions against both fair and unfair trade and dispute settlement. These provisions could well vary with each spoke. The hub-and-spoke model could well bring substantial damage to the multilateral system as it has developed over the last forty-odd years.

There is another factor involved. The ability of a country's administration to focus on various negotiations and the supply of trade negotiating staff are limited, even in the United States. Distraction of attention can only be harmful to the Uruguay Round of multilateral trade negotiations, which ground to a

9. For more extensive considerations of these points, see Wonnacott (1990) and Park and Yoo (1989).

halt last December in Brussels and need full attention if they are to be revived. This applies not only to the United States but also to its potential partners, who may see a deal with the United States as an alternative to Uruguay.

1.5 Regionalism without Discrimination?

I have stated above that there can be no trade preference for one country without discrimination against others.[10] Is there a role for trade agreements between groups of countries that fall short of the multilateral but that do not involve discrimination? Of course almost anything that facilitates trade between a restricted set of countries will imply some trade diversion as well as trade creation. This can apply to treaties of friendship, commerce, and navigation, which aim at facilitating trade between the signatories without discriminating against other countries. Similarly, many if not most of the actions being taken within Europe to complete the internal market, such as recognition of standards, removal of internal customs posts, and the like, will have incidental trade-diverting effects for the rest of the world even though their net effects will almost certainly increase global efficiency and diversion is not the intention (Emerson 1989; Snape 1989a). There will be diversion of existing trade even if existing (or threatened) negative discrimination is removed between countries. In this case, both the trade diversion and the trade creation would be economically beneficial for the country removing the discrimination, and it is again likely to improve global efficiency, but it would adversely affect those trading partners that had not been discriminated against. Australia and some other countries concluded agreements with Japan in the late 1950s that aimed at the removal of such discrimination.

But there is probably no advocate of multilateralism and nondiscrimination who would argue that there should be no agreements with economic implications between countries unless the benefits are extended to others. The line drawn by the GATT with respect to trade barrier agreements has been described above: free trade internally on most goods with unraised barriers against the rest of the world.

Bilaterally negotiated tariff reductions that are extended on an unconditional most-favored-nation basis to all other members of the GATT (or all countries) also clearly pass GATT rules of nondiscrimination. However, in practice, the product selection and specification that might be finely drawn to prevent free riding (as in the U.S. bilateral agreements in the 1930s) could run into GATT problems. It is no accident that Article I of the GATT refers to concessions that when granted to one contracting party must be granted to all contracting parties for "like products," rather than for "the same product" or for "identical products." Tariff classifications cannot be drawn so as to make

10. Regionalism without discrimination is a theme of Drysdale (1988, esp. 237ff.) and Drysdale and Garnaut (1989).

contrived distinctions between products from different sources.[11] Such agreements would be GATT consistent in their nondiscrimination between countries (and in this respect are less discriminatory than agreements under Article XXIV) but could fail on grounds of product specification and/or breadth of product coverage.

All the GATT rounds of multilateral trade negotiations until the Kennedy Round proceeded on this principal-supplier basis but within a multilateral context, the results of the whole set of bilateral agreements being generalized without discrimination except that implied by product selection, within that allowed by "like products." GATT would still appear to be the most appropriate forum in which to negotiate such nondiscriminatory deals. Effort devoted to stand-alone bilateral or regional negotiations is likely to be effort diverted from multilateral negotiations.

The discussions and negotiations that have been undertaken over the last two years under the Asia Pacific Economic Cooperation (APEC) initiative have been aimed at trade facilitation among the participants with a minimum of discrimination against others.[12] One of the principles adopted at the initial ministerial meeting in November 1989, as set out in the "Chairman's Summary" of that meeting, was that "consistent with the interests of Asia Pacific economies, cooperation should be directed at strengthening the open multilateral trading system: it should not involve the formation of a trading bloc." Much of the focus so far, apart from attempting to push the Uruguay Round along, has been on the exchange of information, marine resource conservation, and like matters; the adoption of common standards in some areas such as telecommunications equipment is also under consideration.

In some quarters, a "Pacific Round" of trade negotiations and barrier reductions has been proposed, the negotiated barrier decreases to be extended to others countries unconditionally. Drysdale and Garnaut (1989) argue that, provided Latin American countries are included, the trade patterns are such that free riding by other countries should not be a major problem, the "tendency [being] for barriers to intra-Pacific trade to be highest in commodities and markets in which other Pacific economies are competitive suppliers" (p. 251). They suggest that the "Pacific Round" negotiations take place at a "time of crisis." Collapse of the Uruguay Round and U.S. congressional protectionist pressure could provide the crisis; APEC could provide the forum.

11. In an important decision, a GATT panel concluded the Spain should not impose different tariffs on Arabica and Robusta coffee, a difference that discriminated against Brazil (GATT 1985, Article I, p. 4).

12. Those countries participating in the discussions are the ASEAN six (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) together with Australia, Canada, Japan, the Republic of Korea, New Zealand, and the United States; a formula for incorporating the Peoples Republic of China, Taiwan, and Hong Kong is under investigation.

1.6 Conclusion

The case for multilateralism and nondiscrimination, particularly for small countries, is as strong as ever. Discrimination implies politicization. If trade liberalization is to proceed through international negotiation and commitment—and for many countries there are reasons for it to do so—nondiscriminatory agreements and rules of general application protect the weak.

There is a strong temptation to attempt to settle particular trade disputes and concerns bilaterally with specific rather than generalized reciprocity. But whether these settlements involve the lowering of specific trade barriers or the giving of commitments not to raise them, the efficient multilateral trading system is best preserved by extending any concessions to other traders. Unconditional most-favored-nation status is the surest way to do this. For preferential arrangements, the least damage (or the most good) will be done to the multilateral system by trade agreements that follow the rules of Article XXIV of the GATT strictly *and* that are open to new participants on the same conditions as the old. The hub-and-spoke system that could develop around the United States should it pursue more preferential trading agreements could significantly damage the multilateral trading system that the United States has worked hard to develop over the last forty-odd years.

For matters and disputes that embrace a limited range of products, countries may be unwilling or politically unable to take the unconditional most-favored-nation path when the issues are treated in isolation. Here the best way may be to revive the procedures of early GATT rounds—to have modest objectives concerning a limited range of issues and to conduct negotiations primarily between pairs or among groups of countries that have strong interests in particular issues, but to do this in a multilateral context. With enough issues considered and a sufficient number of participants in attendance, the concessions negotiated could be extended to all on an unconditional most-favored-nation basis. GATT rounds do not have to encompass everything, nor do they have to last forever. A more modest but more frequent set of negotiations could complement the blockbusters like the Uruguay Round and help enforce the day-to-day application of nondiscrimination, on which the *general* agreement and its multilateral benefits ultimately depend.

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Comment Koichi Hamada

This is an excellent paper, implemented with balanced judgment and rigorous logic. Economic, political, and legal aspects of the difficulties created by discriminatory practices and regionalism are carefully discussed, and the merit of the multinational approach through the GATT is forcefully presented. In my first reading, I felt as if I had found a trace of some possible Australian concern that it might become a potential outsider to various possible regional

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agreements. The author's presentation at the conference convinced me, however, that I had overstretched my imagination.

In the ideal world where neither negotiation costs nor domestic political constraints for trade representatives exist, it is easy to agree with the author on the importance of the overall approach based on the well-defined GATT rule. In this sense, I find many of his arguments quite convincing. Difficulties arise because we do not live in such an environment. Here, for the sake of argument, I would like to play the role of an antagonist and see how strong a case I can make for bilateral agreements and regionalism against multilateral agreements.

To begin with, I would like to distinguish between two types of bilateral agreements. The first type works to restrict trade at the expense of consumers. For example, voluntary export restraints (VERs), most ordinary market arrangements (OMAs), and compulsory import expansions (CIEs) between two countries fall into this category. Not only do they violate the principle of free trade, but they also represent a temptation to both countries because their incentive structure is such that both exporters and import competitors are eager to agree on these arrangements at the expense of consumers. We should be much concerned with this type of bilateralism.

On the other hand, in this paper the word *bilateralism* often refers to the creation of a free trade area that involves tariff reductions and the elimination of other trade barriers between two trading partners. This second type of bilateral agreement certainly exerts trade diversion effects on the rest of the world. In contrast to the first type, this type of regionalism has at least favorable efficiency consequences within the region. Hence, it can be regarded as a piecemeal approach to free trade. I think that there is something to be said for this kind of approach when the multinational way of achieving free trade is made difficult for political or other reasons.

My second point is about the number of negotiators. Multilateral negotiations and agreements often require many meetings or a creation of new institutions and therefore involve substantial costs. Often bilateral negotiations and agreements could save these costs. It would be an interesting study to compare the negotiation costs required for bilateral agreements with those required for multilateral agreements or agreements made through international organizations. Incidentally, the study of possible Parkinson's law effects in international organizations would be another research agenda.

Third, a thought experiment can be conducted by relying on the logic of the Coase theorem in law and economics. The theorem states that, if we have environmental problems, mutual negotiations seeking Pareto improvement would sustain the system. Suppose that there are only three countries—A, B, and C—in the world, and suppose that A and B first create a free trade area that is mutually beneficial. Is it possible to devise an international arrangement to compensate the loss to C? The answer to this question, however, would be that it is difficult. Another question to be explored is whether it is

more difficult for C to join the agreement and for the system to create a free trade world than it is for the three countries to create such a system from the outset in the absence of the free trade area between A and B? The answers to these questions depend on the economic and political structures of these countries.

If we argue Snape's point in reverse, we may ask the following question. Suppose that there is a free trade area between A and B. Will it then be beneficial for country C if the free trade area is divided again into A and B? There are cases, as an analogy to dividing a monopoly firm, where dividing pays, but this would not always be the case.

Finally, we should keep in mind the distinction between the normative question of international lawmaking, that is, the question of what the ideal trade regime is, and the positive question of how the trade regime actually emerges or changes. For the normative question, Snape's argument may be mostly correct, but in the actual world we must negotiate under political constraints. Given such consequences, piecemeal policy-making could be a faster way of achieving integration as well as a more efficient world market economy. It is necessary, of course, to devise an incentive mechanism to keep any regional integration from developing into a protectionist region or a "fortress."