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Regional Arrangements, the GATT, and the Quest for Free Trade

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REGIONAL ARRANGEMENTS, THE GATT, AND THE QUEST FOR FREE TRADE

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I. INTRODUCTION: FREE TRADE AGREEMENTS VERSUS THE GATT	

On February 5, 1991, the United States, Canada and Mexico announced their intentions to enter into trilateral negotiations aimed at creating a North American Free Trade Agreement (NAFTA).¹ In Europe, the twelve member nations of the European Community (EC) work steadily toward 1992 and their ideal of a single free market. In Asia, the economic powerhouse Japan along with the tigers of the Pacific rim hint at creating an East Asian Economic Grouping.²

1. *Canada Will Join United States and Mexico in Negotiations for Free Trade Agreement*, 8 Int'l Trade Rep. (BNA) 184 (Feb. 6, 1991). On February 5, 1991 President Bush announced intentions to enter into trilateral negotiations that would link Canada, the United States, and Mexico in "bold and far-reaching ways." *Id.* According to a joint communique issued by the three countries, the goals of the negotiations are to eliminate obstacles to the flow of goods, services, and investment; provide for intellectual property rights protection; and establish a fair and expeditious dispute settlement mechanism. *Id.* If the negotiations result in the creation of a free trade area, it would have a collective gross national product of \$5.5 trillion, and contain 355 million customers. *See* Bruce Stokes, *Yukon to Yucatan*, 22 NAT'L J. 2324, 2325 (1990).

2. Mahathir Mohamad, Malaysia's Prime Minister and architect of the plan, has said the grouping would include the six members of the Association of South East Asian Nations (ASEAN): Thailand, Singapore, the Philippines, Indonesia, Brunei, and Malaysia. In addition, the group would also include, *inter alia*, Viet Nam, Myanmar (Burma), Taiwan, Hong Kong, South Korea, and Japan. David E. Sanger, *Malaysia Trading Plan Seeks a Unified Voice*,

At first blush, the formation of these regional trade blocs seems beneficial to international free trade. The NAFTA and post-1992 EC may liberalize trade in some areas, and the Asian Grouping may create some advantages for global trade.³ However, free trade purists are suspicious of regional trading blocs since the 1930's era of trade protectionism.⁴ The February 5, 1991, free trade proposal can only serve to heighten these worries. In contrast, free trade realists see these free trade agreements as a viable means to successfully liberalize trade. With the stalling of the Uruguay Round,⁵ regional trade blocs have become an increasingly attractive alternative to many nation-states.

The debate over the advantages of regional trade blocs versus the advantages of the General Agreement on Tariffs and Trade (GATT) is one of long standing.⁶ Free trade realists argue that the issues are more complex than some free trade purists believe. Prior experience regarding the destructive role of regional trade blocs is informative but not dispositive. A more comprehensive analysis should examine why nation-states are becoming more interested in the regional trade bloc alternative. Moreover, one should ask whether regional trade

N.Y. TIMES, Feb. 12, 1991, at D6, col. 1. The plan is intended to turn East Asia into a leading exporting force and an "investment haven," said Malaysia, so the region may stand a better chance of competing against the European Community and North America. *Id.* The plan is still very tentative. A number of the potential members have not even addressed the subject, and Japan, whose membership is seen as crucial to a successful arrangement, has so far shown no signs of interest. *Id.* However, Malaysia predicts that as the North American and European trade zones become stronger and demand more concessions, Japan and the other East Asian countries, will have no choice but to join the grouping to protect their trade positions. Lim S. Hoon, *Mahathir's Brainchild Proves a Problem for Partners*, FINANCIAL TIMES, Feb. 6, 1991, at I8.

3. Robert Kuttner, *Bloc that Trade: The Second Marriage of Keynes and Adam Smith*, NEW REPUBLIC, Apr. 17, 1989, at 16.

4. *Id.* at 17-18. In the 1930s, bilateral agreements abounded. One of the more cynical uses of bilateral agreements during this period was that of the Third Reich, whose economics minister, Hjalmar Schacht, used bilateral trade deals as a deliberate adjunct to Nazi foreign policy. *Id.* at 18.

5. On February 16, 1991, a GATT spokesman announced that "low-level" talks would resume in the near future. The talks collapsed after a December meeting when the United States, Canada, Argentina, Australia, and other grain exporters failed to persuade the European Community to cut agriculture subsidies. *GATT Expects Talks on Trade to Resume*, N.Y. TIMES, Feb. 16, 1991, at 37, col. 5.

6. A more thorough examination of regional arrangements would differentiate among the various types of non-multilateral arrangements. See *infra* note 60.

blocs are necessarily harmful to global economic efficiency and liberalization. If not, is there a potential role for regional trade blocs within the GATT system?

This article will first look at the history of the post-World War II GATT system. Next, the article will focus on some specific weaknesses in the GATT and look at how one particular regional trade bloc arrangement, the Canada-United States Free Trade Agreement, provides its parties with greater economic efficiency. Finally, the article will examine the value and potential role of regional trade blocs in the GATT system. Two issues will be considered: 1) whether regional trade blocs are trade creating or trade distorting; and 2) whether the presence of regional trade blocs will hinder or facilitate global trade liberalization.

II. HISTORY: POST-WAR MULTILATERALISM AND THE GATT

Post-World War II multilateralism, exercised through the GATT, grew out of a desire not to repeat the global economic mistakes of the past.⁷ The 1930s saw an abundance of trade restrictions and discrimination, and many of the restrictions were more politically than economically motivated.⁸ The effects of the restrictions were dramatic. In the two years between 1930 and 1932, when the United States imposed the Smoot-Hawley tariff, the volume in trade of manufactured goods dropped by 40%.⁹

After World War II, the Allies developed three institutions designed primarily to avoid the economic instability of the previous decade.¹⁰ Of the three institutions, the GATT was most directly con-

7. ALAN OXLEY, *THE CHALLENGE OF FREE TRADE* (1990).

8. William Diebold, Jr., *The History and the Issues, in BILATERALISM, MULTILATERALISM, AND CANADA IN U.S. TRADE POLICY* 1, 9 (W. Diebold ed. 1988). See Kuttner, *supra* note 3.

9. See OXLEY, *supra* note 7. Nevertheless, discrimination practiced by the United States during the 1930s was minimal compared to that practiced by other nations. It was during this period, in fact, that Roosevelt's secretary of state, Cordell Hull, promoted the use of bilateral agreements containing most-favored-nations (MFN) clauses. The result was the Reciprocal Trade Agreements program, authorized by Congress in the Trade Agreements Act of 1934. ANDREAS F. LOWENFELD, *TRADE CONTROLS FOR POLITICAL ENDS* 7, 10 (2d ed. 1983). By 1938 one-third of product imports on which the United States had granted concessions came from countries other than those to which the concessions had been made. MFN treatment was consistently denied only to Germany during this period. See Diebold, *supra* note 8, at 9.

10. The institutions created were the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT). Originally, the GATT was to be only an interim and subordinate component of an International Trade Organization (ITO). However, the ITO was seen as a potential threat to national autonomy and was never ratified by Congress.

cerned with trade liberalization.¹¹ The GATT's objective was to prevent the spiralling falls in trade volume and economic growth caused by pre-World War II discriminatory and restrictive trade practices.¹²

The GATT was committed to the principle of non-discrimination and enunciated this commitment in the most-favored-nation (MFN) clause in Article I of the agreement.¹³ Upon acceding to the GATT and the MFN principle, the parties agreed that any reduction in tariffs negotiated with one party would be extended to all other parties.¹⁴ The MFN principle is the foundation of the GATT and is probably the best illustration of the GATT's multilateral orientation.¹⁵

After seven rounds of negotiations since 1948,¹⁶ the greatest success of the GATT has been the reduction of tariffs.¹⁷ Specifically, trade in manufactures among the industrialized nations has seen tariffs drop from 40% in 1945 to 5% in the 1980s, and trade volume has multiplied nine times.¹⁸ In fact, tariffs have been lowered to such an extent that tariff levels are no longer the main focus of GATT talks.¹⁹

Nothing to Lose but Its Chains: The ITO that Never Was, ECONOMIST, Sept. 22, 1990, at 7. The GATT remained to deal with tariff and trade issues. See OXLEY, *supra* note 7, at 4.

11. The United States adopted the GATT by executive order under the auspices of the Reciprocal Trade Act of 1945. 19 U.S.C. § 1351 (1945). Nevertheless, Congress has never formally approved or disapproved the GATT. RALPH H. FOLSOM, MICHAEL W. GORDON, & JOHN A. SPANOGLE, INTERNATIONAL BUSINESS TRANSACTIONS 383 (1986).

12. See OXLEY, *supra* note 7, at 4.

13. General Agreement on Tariffs and Trade, Article I, Oct. 30, 1947, 55 U.N.T.S. 194.

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation or exportation, . . . any advantage, favor, privilege, or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.

Id.

14. See OXLEY, *supra* note 7, at 6.

15. Comment, *Most-Favored-Nation Treatment and The Multilateral Trade Negotiations: A Quiet Revolution*, 6 INT'L TRADE L.J. 221 (1981).

16. See OXLEY, *supra* note 7, at 9.

17. The dates and locations of these talks, or "rounds," are as follows: 1947, Geneva, Switzerland; 1948, Annecy, France; 1950, Torquay, England; 1956, Geneva, Switzerland; 1960-61, "Dillon Round," Geneva, Switzerland; 1964-67, "Kennedy Round," Geneva, Switzerland; 1973-79, "Tokyo Round," Geneva, Switzerland; 1986-present, "Uruguay Round," Geneva, Switzerland. See Comment, *supra* note 15, at 222 n.16. United States participation in these rounds has always resulted from advance authorization by Congress. *Id.*

18. See OXLEY, *supra* note 7, at 9.

19. See Diebold, *supra* note 8, at 21.

III. STATUS QUO: FAILURES OF THE GATT; SUCCESSES OF FREE TRADE AGREEMENTS

A. *Failures of the GATT*

Notwithstanding the success of the GATT in reducing certain kinds of tariffs,²⁰ many now see the GATT as having reached a point of diminishing returns.²¹ These "trade realists" argue that the ideal of *laissez-faire* multilateralism is quixotic and point to the GATT's failures in dealing with a number of issues which still affect global trade after four decades under the Agreement.

For example, talks have failed to eliminate tariffs for a number of important products. GATT rules still do not apply to agriculture and many types of manufactures: steel, automobiles, ships, and textiles.²² Many of these products come from industries too vital to their national economies to risk inclusion in the arena of free competition. Therefore, many of these industries will probably remain outside of GATT coverage in the near future. Moreover, the GATT has so far been unable to usefully address emerging areas of international trade: services, intellectual property and foreign investment.²³

Another significant failure of the GATT is in the area of non-tariff trade barriers (NTBs).²⁴ The past fifteen years have witnessed a proliferation of NTBs in the form of voluntary export restraints, orderly marketing arrangements, widespread subsidies, and other trade distorting practices.²⁵ Although many see these NTBs as a major cause of the decline in trade growth since 1975, GATT talks have failed to establish rules which deal effectively with them.²⁶ This failure is significant. In the United States alone, 21% of the total value of imports is constrained by some kind of NTB.²⁷

20. The GATT now effectively applies to trade in manufactures among industrialized countries. These markets are generally open to all exports and imports; however, there are important exceptions even within this sector. An example of such an exception is trade in motor vehicles, which the United States and European community have practically removed from GATT coverage. See OXLEY, *supra* note 7, at 12.

21. *Nothing to Lose but Its Chains: Jousting for Advantage*, ECONOMIST, Sept. 22, 1990, at 5.

22. See Diebold, *supra*, note 8, at 19.

23. *Id.* at 30.

24. Robert Kuttner, *Guide to the GATT: The Tricky Road to Freer Trade; General Agreement on Tariffs and Trade*, NEW REPUBLIC, Sept. 15, 1986, at 26. Although an effort was made to deal with NTBs in the Tokyo Round, the resulting codes have had minimal effect. See Diebold, *supra* note 8, at 19.

25. See Diebold, *supra* note 8, at 19.

26. *Id.* at 8.

27. See OXLEY, *supra* note 7, at 12.

Aside from lack of GATT coverage over many significant barriers to free trade, the GATT structure suffers from ineffective enforcement of the existing rules.²⁸ This is due, in part, to a cumbersome dispute resolution procedure which suffers from too many opportunities for delay.²⁹ The progress of a dispute resolution can be blocked at various stages of the proceedings.³⁰ Pre-hearing negotiations between the disputants can be delayed by a party in interest, and, similarly, a single party can postpone the establishment of a mediation panel by opposing such in the GATT Council.³¹ A single party may be able to block the GATT Council's adoption of a resolution even after all the procedures are completed.³² Moreover, GATT procedures are based upon a mediation and conciliation model, rather than an adjudicatory one; once a resolution is adopted, there are no provisions in the GATT to make the resolution binding upon the parties.³³

In addition, the limited enforcement of existing GATT rules is due, in part, to the imprecision of the rules themselves.³⁴ A case in point is the ambiguity of the GATT Subsidies Code.³⁵ The United States

28. There is a widespread but generally accepted unofficial departure from the letter of the GATT. The GATT has been derisively called the "General Agreement to Talk and Talk," an epithet that reflects the belief of many parties that the "hands-off approach to trade is for suckers." See *supra* note 21.

29. See Judith H. Bello & Alan F. Holmer, *U.S. Trade Law and Policy Series No. 16: Settling Disputes in the GATT: The Past, Present, and Future*, 24 INT'L LAW 519, 520 (1990). The heart of GATT dispute settlement resides in Articles XXII and XXIII, GATT T.I.A.S. No. 1700, and is supplemented by an agreement reached in the Tokyo Round — the Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance, GATT Doc. No. L/4907. *Id.* at 521. GATT process provides initially for negotiations, or "consultations," between the disputants. Failing resolution, the complainant may request establishment of a mediation panel by the GATT Council. This independent panel of experts, if established, would then hear argument and make its recommendation to the GATT Council. The GATT Council would then decide upon adoption and approval *vel non* of the panel report. *Id.* at 523.

30. *Id.* at 520, 523.

31. *Id.* at 523.

32. *Id.*

33. *Id.* at 520.

34. Richard O. Cunningham, *The Restatement as Prologue to Turmoil in the Law: A Commentary on the Restatement of U.S. International Trade Law*, 24 INT'L LAW 315, 317 (1990).

35. Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade (GATT Subsidies Code), Geneva, 1979, GATT, 26th Supp. B.I.S.D. 56 (1980). Congress adopted the GATT formulation in Title I of the Trade Agreements Act of 1979. 19 U.S.C.A. § 1671 (1979). The GATT allows restrictions — countervailing duties — to be placed on foreign subsidized imports which threaten domestic industry. GATT Subsidies Code, part I, art. 4. Moreover, the GATT permits duties to protect domestic industries against dumping. Further, temporary duties are allowed to generally protect against strong competition. General Agreement on Tariffs and Trade, Article XIX, Oct. 30, 1947, 55 U.N.T.S. 194.

recently expanded its unfair trade laws beyond what many parties felt the Subsidies Code allowed.³⁶ However, due to the imprecision of the Subsidies Code, the United States has generally been able to apply its unfair trade laws without condemnation from the GATT Council.³⁷

Although more a symptom than the disease itself, perhaps the greatest harbinger of failure of the GATT is the loss of the United States as its prime advocate. During the 1950s, 1960s and 1970s, the strength of the United States' position in the world market made advocacy of free trade an obvious choice.³⁸ However, the heavy imbalance in United States' foreign trade in the 1980s and early 1990s resulted in a shift of focus from free trade to fair trade.³⁹ Reciprocity is now the operative word in the lexicon of many United States policy makers.⁴⁰ The argument of GATT multilateralism — that free trade encourages the most efficient use of resources — loses weight when policy makers feel world trade is distorted by foreign government intervention and abuse of market power.⁴¹ Consequently, the GATT has lost a large percentage of support it once had from the United States.

B. *Successes of Free Trade Agreements*

Given the failures of the GATT in dealing with many issues, it is not surprising that individual nations look to regional trade blocs to fill the need for stability and control. The GATT itself has always recognized the legitimacy of certain kinds of regional trade arrange-

36. See Cunningham, *supra* note 34, at 317, 319. The United States began to take aggressive action against alleged unfair trade following complaints from United States industries and labor in the 1970s and early 1980s. *Id.* at 319. Some examples of expansion of the unfair trade laws include: the 1970s extension of countervailing duty law beyond the accepted realm of export subsidies to the broader and controversial area of domestic or production subsidies; the 1974 expansion of antidumping law beyond price discrimination to include any type of below-cost selling; the 1974 creation of a new cause of action against non-market economies for "market disruption;" and the 1979 extension of countervailing duty law to cover a wide range of government benefits. *Id.* at 320.

37. The recent GATT ruling condemning aspects of § 337 of the Tariff Act of 1930 (19 U.S.C.A. § 1337) may portend a new willingness to challenge United States unfair trade practice laws. *Id.* at 321 n.20.

38. *Id.* at 318. Some argue that the United States is abandoning its purist free trade views, not just out of frustration with multilateral negotiations, but also because of a fundamental loss of competitiveness. *Id.* at 319.

39. See Diebold, *supra* note 8, at 21.

40. *Id.* at 22.

41. *Id.* at 23.

ments.⁴² But in recent years, there are new signs that GATT nations are becoming weary with the GATT and are willing to go beyond GATT allowances in creating regional trade agreements.⁴³ An examination of the successes of the Canada-United States Free Trade Agreement⁴⁴ (FTA) provides some explanations.

The FTA took effect on January 1, 1989⁴⁵ and was intended to deal with a number of issues unresolved in GATT rounds.⁴⁶ One of the FTA's major achievements was tariff elimination.⁴⁷ Under the GATT, United States' tariffs on Canadian imports averaged 3.3% and Canadian tariffs of United States imports averaged 9.9%. In contrast, the FTA eliminates all tariffs within ten years.⁴⁸

Another FTA achievement was the establishment of a framework of rules governing services.⁴⁹ Under the GATT, trade in services went largely unaddressed.⁵⁰ However, the FTA provides a structure of rights and obligations regarding national treatment, establishment, licensing, and certification procedures. Moreover, the FTA promotes the liberalization of some service sectors.⁵¹

42. General Agreement on Tariffs and Trade, Article XXIV, Oct. 30, 1947, 55 U.N.T.S. 194. Article XXIV permits regional arrangements (customs unions and free trade areas) if the following conditions are satisfied. First, the arrangement must be designed to facilitate trade between constituent territories and not to raise barriers to the trade of other contracting parties with such territories. Second, the arrangement must cover substantially all the trade between the constituent territories. Third, if the arrangement is to be implemented in intervals, there must be a plan and schedule to complete the transition within a reasonable time. Finally, the trade restrictions maintained by the arrangement, or the arrangement's parties, cannot on the whole be higher or more restrictive than the corresponding restrictions extant before the arrangement. *Id.* See Andreas F. Lowenfeld, *What the GATT Says (Or Does Not Say)*, in *BILATERALISM, MULTILATERALISM, AND CANADA IN U.S. TRADE POLICY* 55, 59-60 (W. Diebold Jr., ed. 1988).

43. *What Bilateral Deals Mean for Trade*, *ECONOMIST*, Feb. 6, 1988, at 63.

44. H.R. DOC. NO. 216, 100th Cong., 2d Sess. 297 (1988), reprinted in 27 I.L.M. 281 (1988).

45. See also United States-Canada Free Trade Agreement Implementation Act of 1988, §§ 401-10, 102 Stat. 1851 (1988).

46. Jeffrey J. Schott, *The Free Trade Agreement: A U.S. Assessment*, in *THE CANADA-UNITED STATES FREE TRADE AGREEMENT: THE GLOBAL IMPACT* 1, 2 (1988). Article 102 of the FTA delineates five specific objectives: to eliminate trade barriers to goods and services; to promote fair trade; to improve the investment climate; to establish joint procedures to administer the FTA and to resolve disputes, and to promote further cooperation on trade and investment issues both bilaterally and multilaterally. *Id.*

47. *Id.* at 15.

48. *Id.*

49. *Id.* at 29.

50. See Kuttner, *supra* note 24, at 26.

51. See Schott, *supra* note 46, at 29.

In the area of dispute resolution, the FTA system provides distinct advantages over the awkward GATT mechanism.⁵² The FTA establishes a Canada-United States Commission composed of officials from both countries to supervise the operation of the FTA and to resolve any disputes.⁵³ Moreover, the FTA establishes a bi-national panel specifically to hear disputes concerning countervailing duties and illegal government subsidies.⁵⁴ In addition, the FTA makes arbitration compulsory and binding upon both parties for disputes arising from application or interpretation of the Agreement.⁵⁵ The authoritative character of the FTA's dispute resolution system contrasts sharply with the GATT mechanism, which seeks to mediate and conciliate.⁵⁶

Although the FTA's specific achievements are easily recognized, experts predict long-term benefits for both Canada and the United States' economies.⁵⁷ An overall reduction in trade restrictions allows larger economies of scale and greater rationalization of industries and, thereby, increases output and employment.⁵⁸ Moreover, an efficient and authoritative dispute resolution system provides stability and decreases trade disputes which could balloon into destructive conflicts in trade policy.⁵⁹

The FTA is not representative of every viable type of regional trade bloc.⁶⁰ Nevertheless, in comparison with the GATT, the FTA presents many illustrations of how regional trade blocs can successfully deal with contemporary trade issues. Examination of the FTA's suc-

52. See generally J.G. Castel, *The Settlement of Disputes Under the 1988 Canada-United States Free Trade Agreement*, 83 A.J.I.L. 118 (1989).

53. See Schott, *supra* note 46, at 28.

54. *Id.*

55. Thus, the FTA sets up a two-track mechanism for dispute resolution. The first mentioned in the text is a general dispute settlement procedure, which covers most aspects of the FTA. It not only serves to expeditiously resolve disputes, but also to attempt to preempt potential disputes. *Id.* at 30. The second track deals with the limited area of disputes over subsidies, countervailing duties, and antidumping matters. *Id.*

56. Murray G. Smith, *What Is at Stake?*, in *BILATERALISM, MULTILATERALISM, AND CANADA IN U.S. TRADE POLICY* 69, 97 (W. Diebold ed. 1988). See also Robert E. Hudec, *The FTA Provisions on Dispute Settlement: The Lessons of the GATT Experience*, in *UNDERSTANDING THE FREE TRADE AGREEMENT* 31 (D. McRae & D. Steger eds. 1988).

57. See Schott, *supra* note 46, at 34.

58. *Id.*

59. *Id.*

60. Regional arrangements may exist not only in the form of free trade areas such as the FTA, but also as customs unions, an example of which would be the European Community. The main difference is that in the former, each member maintains control over commercial policy for, and trade negotiations with, third countries. In the latter, this control is ceded to a supranational mechanism. See Smith, *supra* note 56, at 85.

cesses in handling some difficult trade issues provides an understanding of why nation-states see regional trade blocs as a feasible alternative to the GATT.

IV. ANALYSIS: THE GLOBAL IMPLICATIONS OF REGIONAL TRADE BLOCS

There are conflicting views about the long-term implications of the emerging regional trade blocs. Are free trade purists correct in holding that regional trade blocs will, by their very nature, result in breaking up the global trading system? Are regional trade agreements like the FTA a movement down the slippery slope of 1930s-type protectionism? To answer these questions, one must consider two issues: 1) whether regional trade blocs will create or distort global trade; and 2) whether regional trade blocs will hinder or facilitate global trade liberalization.⁶¹

A. *Implications for Global Efficiency*

Free trade purists argue that regional trade blocs are discriminatory, even where the regional trade agreements do not raise new collective barriers to trade.⁶² This discrimination, they argue, undermines the spirit of the GATT and damages the economic efficiency the GATT was designed to foster.⁶³ Thus, the free trade purists contend that regional trade blocs distort global trade flow and reduce global economic efficiency.⁶⁴

While it is true that regional trade blocs violate the MFN principle,⁶⁵ it is not so clear that they injure global economic efficiency.⁶⁶ Free trade realists argue that the free trade blocs' removal of trade barriers among partners creates economies of scale at the industry level and economies of scope at the level of individual firms. Economies of scale and scope allow for increased rationalization of production,

61. *Id.* at 88.

62. See Kuttner, *supra* note 24, at 26.

63. See Smith, *supra* note 56, at 88.

64. This argument can be illustrated with an example. Suppose Country A produces crude oil, but at a very low level of efficiency. Country B is a net consumer of crude oil. Country A enters into a regional arrangement with Country B whereby all barriers to trade between the two are eliminated, although barriers to outside trade for the two remain at 10%. Even if there are outside countries which produce crude oil more efficiently than Country A, Country B will purchase its crude oil from Country A as long as Country A can produce (and hence, sell) it for less than 10% greater than outsiders can. Thus, the argument goes, regional arrangements divert trade and may foster inefficient use of resources.

65. See Kuttner, *supra* note 24, at 26.

66. See Smith, *supra* note 56, at 88.

which in turn leads to efficient use of resources.⁶⁷ Free trade realists contend this economic efficiency will result in greater global trade volume, which benefits outsiders as well as regional trade partners. This "spill-over" of net benefits to outsiders, the realists argue, may very well outweigh the net costs of the original diversion of trade.⁶⁸ Viewed in this light, regional trade blocs may support the GATT by creating global trade and by facilitating global trade liberalization.

B. *Implications for Global Trade Liberalization*

Free trade purists argue that regional trade partners tend to negotiate as a bloc in multilateral trade talks, rather than as individual nations. Thus, other nations are forced to develop regional trade arrangements of their own or risk the loss of bargaining power. Ultimately, free trade purists argue, the multilateral trade system dissolves into a few intransigent economic fortresses.⁶⁹

Although regional arrangements, such as the Canada-United States FTA, create preferences among regional trade partners, free trade realists argue that these preferences are unlikely to erode the multilateral trade system embodied in the GATT.⁷⁰ First, the extreme interdependence of nations remains despite current trade impasses.⁷¹ Second, regional trade blocs may actually encourage other countries to liberalize.⁷² Rather than using the "stick" of unilateral retaliation for unsatisfactory trade barriers, an outside country is presented with the "carrot" of membership if it liberalizes. Such an inducement, free trade realists argue, is preferable to the application of negative sanctions.⁷³ Using the "carrot" approach, the original regional trade blocs

67. *Id.*

68. The magnitude of this spill-over effect is determined by the scope of the agreement. The question of the trade creating qualities of a particular agreement necessarily turns on the issue of whether the agreement constitutes a customs union, or a free trade agreement. See *supra* note 60 and accompanying text. Smith argues that customs unions are less likely to have a trade creating effect, and are thus more likely to foster global inefficiency. See Smith, *supra* note 56, at 89.

69. A worst-case scenario portrays the multilateral world devolving into a tripolar economic and political environment, comprised of a North American bloc dominated by the United States, a European bloc, dominated by Germany, and a Pacific bloc, dominated by Japan. Political scientists have theorized that tripolar systems are the most unstable power configuration. C. Fred Bergsten, *The World Economy After the Cold War*, FOREIGN AFFAIRS, Summer 1990, at 96, 98.

70. See Smith, *supra* note 56, at 90.

71. See Kuttner, *supra* note 24, at 17.

72. See Smith, *supra* note 56, at 90.

73. *Id.* at 91.

could expand and merge to encompass more and more economies and, theoretically, result in an entire global economic system.⁷⁴

Furthermore, regional trade blocs serve as experimental models for the GATT by pioneering approaches to contemporary trade issues such as barriers to trade in agriculture, intellectual property and services.⁷⁵ Thus, regional trade blocs serve as "laboratories" to experiment with new rules. Where the inertia of the GATT rounds hinders innovation, regional trade blocs provide opportunities for experimentation. Successful procedures are then better received for implementation in the GATT. Such a system brings to mind the United States' federal and state system, where individual states often pioneer new laws which are then taken up by other states and, ultimately, by the federal system.

V. CONCLUSION: BENEFITS OF A MIXED-SYSTEM

Global trade has never been freer than it has been since World War II, and few would deny that the primary reasons are the Bretton Woods institutions set up in 1947. The GATT provided the world with dramatic liberalization of trade practices between nations and has forestalled, so far, any return to 1930s-type protectionism.⁷⁶ However, today many view the GATT multilateral trade system as overly cumbersome and largely incapable of dealing with the most important contemporary trade issues. Thus, the frustration caused by GATT inadequacies results in a search for viable regional alternatives.

Although many free trade purists see the new willingness to operate outside the GATT as presaging a future of global fragmentation and instability,⁷⁷ there is a more benign alternative. The emergence of regional trade blocs may in fact bolster the GATT rather than dismember it.⁷⁸ Trade liberalization presents the GATT with benefits, even if the liberalization is obtained on a regional basis.

The apparent trend towards regional trade blocs suggests that nation-states recognize a viable alternative to unadulterated *laissez-*

74. United States Secretary of State George Schultz explained that "[the United States] hope . . . is that the [FTA's] example of greater liberalization — and the recognition that the United States can pursue another course — will help motivate a larger group of nations to tackle the job of expanding trade on a global basis." *Id.*

75. William Diebold, Jr., *The New Bilateralism?*, in *BILATERALISM, MULTILATERALISM, AND CANADA IN U.S. TRADE POLICY* 128, 179 (W. Diebold ed. 1988).

76. See *supra* note 21, at 6.

77. See Bergsten, *supra* note 69.

78. See Kuttner, *supra* note 3, at 18.

faire multilateralism. The success of the Canada-United States FTA may motivate other countries to seek similar solutions.⁷⁹ If so, there is reason to hope that the cause of global trade liberalization will be strengthened, rather than weakened, by a measure of bilateralism and, possibly plurilateralism, within the GATT multilateral trade system.

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79. Of course, the FTA has already moved Mexico to attempt membership in a North American free trade area. *See supra* notes 1-2 and accompanying texts.

