CHAPTER 4

Policy Choices

Introduction

WE HAVE NOW REVIEWED MUCH OF THE THEORY AND evidence on the political and economic effects of regional integration schemes. How is this discussion brought to bear on a particular country faced with decisions on RIA membership? What choices will the country face, and how should the theory and evidence inform these choices?

We group the choices under four headings. The first is who—if anyone—a country's RIA partners should be. The political and economic forces described in the previous chapters will have different effects depending on the characteristics of the countries concerned. Here we bring these together, showing how the effects might work for hypothetical pairings of countries. Related to the choice of partner are issues to do with the size of the RIA, and with multiple membership: should a country focus on membership of a single RIA or opt for many?

The second set of policy choices is to do with the external policy of countries in a RIA, which in turn depend importantly on the type of RIA that is adopted: a free trade area or a customs union. There are considerable benefits from merging external trade policy through membership of a customs union, since it allows freer circulation of goods within the RIA. However, it also involves greater loss of sovereignty and more political commitment, as well as possibly leading to the formation of new trade policy lobbies.

We then turn to the third and fourth policy choices, the "depth" and "width" of integration. The question is whether to deepen an agreement to cover domestic policies that affect the ability of consumers and producers to engage in intra-RIA trade in goods; and whether to widen the coverage to extend beyond merchandise trade. The tradeoff running through all these cases is between the potential for greater benefit from making the integration deep and wide, versus the considerable practical problems and potential political difficulties that may be involved. We look at a number of issues, including contingent protection, product standards, trade in services, and investment rules to see the benefits and costs involved.

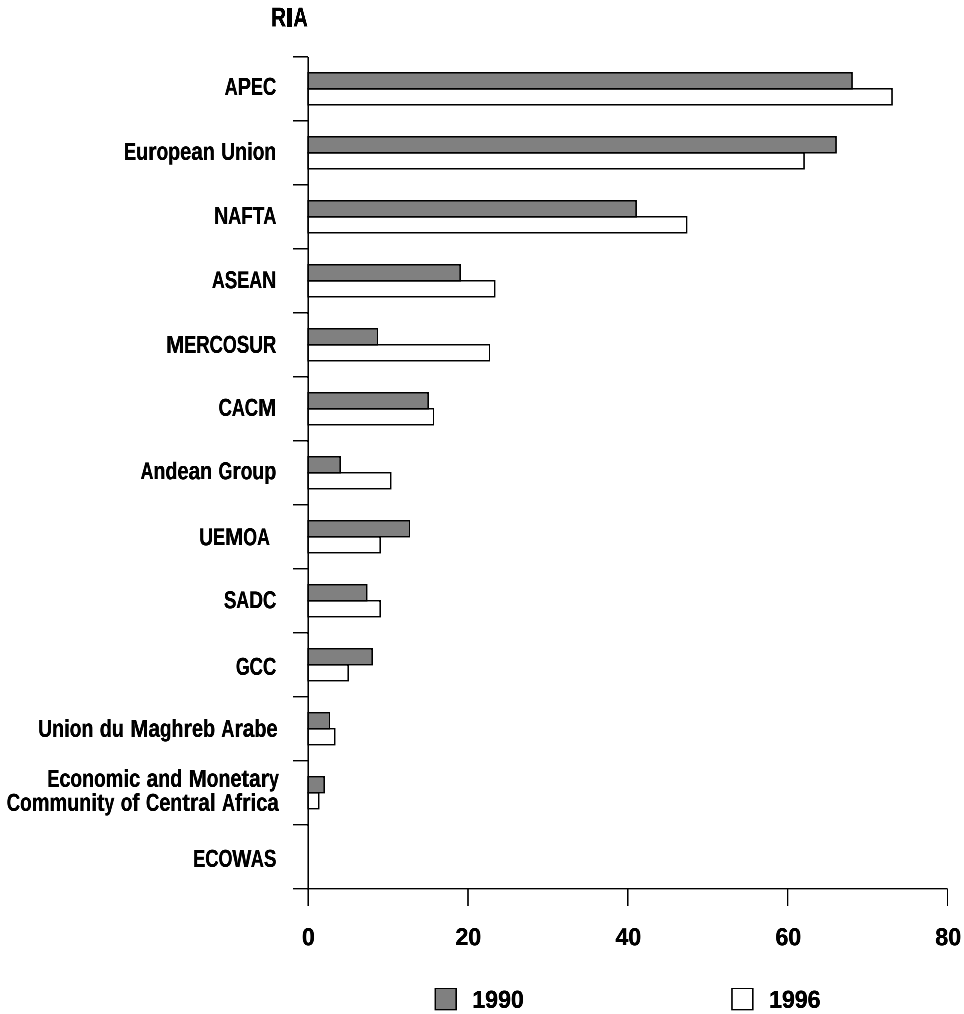
4.1 Partners: With Whom?

SOME RIAS ARE JUST BETWEEN HIGH-INCOME COUNTRIES (SUCH as EU or the European Economic Area), some only middle-income (such as MERCOSUR or the ASEAN Free Trade Area), and some only low-income (such as the West African Economic and Monetary Union (UEMOA)). Others contain a mixture, often with a dominant high-income partner (such as NAFTA or the EU Association agreements with Central European and Mediterranean countries). RIAs come in all sizes, both in terms of number of members, and in terms of income; the EU has 15 members and GDP of US$8.4 trillion, while UEMOA's eight members have a combined GDP of US$24 billion; many RIAs are just bilateral agreements between a pair of countries.

In some RIAs most trade is between members, while in others very little is. We see from figure 4.1 that the 1996 share of member countries' exports that goes to other member countries is 62 percent for EU-12 and 47 percent for NAFTA. In middle-income RIAs, the share is smaller, at 23 percent for MERCOSUR, dropping still further for low-income RIAs, at 9 percent for ECOWAS and UEMOA, and only 1.9 percent for the Economic and Monetary Community of Central Africa.

While no single country will face a menu of choices containing all these possibilities, we want to show how the effects discussed in previous chapters apply to these widely different options for regional integration. We do this by considering some hypothetical country pairings, which are given in table 4.1. Pairs of country types are given in the columns, and our main political and economic arguments are in the rows. The country pairings are not to be taken literally, and the signs of the effects, which we give in the body of the table, are not drawn from research on the particular named economies. Instead, the country pairs are representative of types of RIAs, and the body of the

Figure 4.1 Intra-RIA Exports as a Share of the RIA's Total Exports



Source: U.N. COMTRADE data.

table summarizes our judgment about the sign and strength of the forces we have discussed in preceding chapters. The four country groupings we have chosen are therefore intended to represent a middle-income country and a high-income country—we label them "Poland" and the "EU"; two middle-income countries—"Brazil" and "Argentina"; a pair of small low-income countries—"Burkina Faso" and "Côte d'Ivoire"; and a small low-income country and a large high-income country or bloc—"Kenya" and the "EU."

Table 4.1 Pluses and Minuses of Hypothetical RIAs

Category	*Poland*	*European Union*	*Brazil*	*Argentina*	*Burkina Faso*	*Côte d'Ivoire*	*Kenya*	*European Union*
Political								
Security	+	0	+	+	?	?	+?	0
Bargaining	0	0	+	+	0	0	0	0
Being noticed	0	0	+	+	+	+	0	0
Policy lock-in	+	0	+	+	0?	0?	+?	0
Cooperation	+	+	+	+	+	+	+?	0
Economic								
Scale and competition	+	+	+?	+?	0?	+?	+?	0
Trade diversion	–?	0	–	–	–	–?	–?	0
Fiscal	–	0	–?	–?	–	+?	–	0
Trade and location	+	+	+?	+?	–	+	+?	0
Technology transfer	+	0	+?	+?	0	0	+	0

Source: Authors.

Poland—EU

We start with the case of a RIA between a middle-income developing or transition economy and a large high-income country or bloc—such as with East European economies and the EU, or Mexico and the United States. On the political side, the most important element of likely gain comes from the policy lock-in argument. We saw in chapter 2 that two conditions need to be met for this argument to work; the country seeking lock-in must care about sanctions that the partner might impose, and the partner must have the incentive to impose sanctions, rather than let policy reversals go unremarked. Both these conditions seem likely to be met in this case. Suppose that "Poland" reneges on part of the agreement—perhaps imposing trade barriers, or violating political conditions. The partner (the "EU") is so large, and likely to account for such a high proportion of the country's trade that its actions will certainly impact on "Poland." At least when the countries are geographically close, the "EU" is likely to want to see economic and political stability in the region, and be prepared to act to enforce it. We have also scored "cooperation" positive; there is great potential for schemes ranging from environmental projects to technical assistance programs.

Turning to the economic arguments, there is considerable scope for gains from the “scale and competition” effects outlined in chapter 3. The middle-income country might typically have a broad range of industrial firms, many of them inefficient, perhaps because of lack of competition, or because they operate at small scale. Competition in a much larger market provides the opportunity for solving these problems.

What about the changes in trade flows and location? It seems likely that factor price differences should induce movement of relatively labor-intensive industrial activities to the middle-income country, in line with the experiences of Mexico, Hungary, and other parts of the European periphery we saw in chapter 3. Much of this might be driven by FDI, bringing with it new technology. A counter argument to this is that the established agglomeration of activity in the EU might draw activity out of the middle-income country, particularly since the EU is a “hub,” benefiting from numerous bilateral “spoke” agreements. Whether or not this happens will depend on how closely the two regions are integrated. If barriers—including transport costs—are sufficiently low then the middle-income country is likely to be drawn into Europe-wide production networks. But if obstacles to trade or to FDI remain, the outcome may be less positive; the middle-income country might find its industry threatened by imports, yet not be a sufficiently attractive place for FDI inflows.

Finally, if the middle-income country retains high external tariffs, there is scope for it to suffer from trade diversion, although this is likely to be small insofar as affected sectors have low protection in the high-income country (with obvious exceptions, such as agriculture in the EU). Tariff revenue loss may be significant, since large volumes of trade are likely to be covered by an agreement of this sort.

Brazil—Argentina

Now consider a RIA between two middle-income countries, both perhaps of considerable size. We have marked in possible benefits under all the political headings.

On the economic side, a pair of countries at this stage of development offers perhaps the greatest potential for scale and competition effects. This might increase efficiency levels in domestic firms, attract FDI, and also lead to terms-of-trade improvements, as foreign suppliers react to the more competitive market. FDI might bring with it benefits of technology transfer. However, the usual question mark remains over these effects. Securing effective competition has often been obstructed, and achieving it requires investing in "deep integration"; policies to achieve this are discussed later in this chapter.

What about the relocation of industries between countries? If there are differences in comparative advantage or in market size and access, then integration will create forces for relocation. However, to the extent that the economies are similar, and already have established manufacturing sectors and the infrastructure that goes with it, it seems unlikely that this would be a one-way traffic. Some industries will expand in one country, others in the other, so there may be clustering of particular sectors rather than of activity as a whole, bringing gains from specialization rather than from the costs of divergence.

These are the benefits, but there are also likely costs. There is a danger of substantial trade diversion in such a RIA. The countries involved may have developed their industry behind protective barriers, meaning that production costs are well above world minima. If tariff preferences induce importers to switch the source of supply from the rest of the world to inefficient production in the partner country, this will reduce income. There will also be loss of government tariff revenue, its significance depending on initial tariff rates, on initial trade volumes, and on the ease with which governments are able to activate alternative fiscal instruments.

Burkina Faso—Côte d'Ivoire

Regional integration between two small low-income countries may offer some real opportunities for benefits from increased cooperation on economic projects—such as water management, or development of infrastructure, particularly between coastal and landlocked countries. As far as bargaining power goes, the main potential benefit is that of "being noticed," providing that the member countries are willing and able to take a concerted position on world issues. "Lock-in" effects are unlikely to be strong; they require both that the partner is itself committed to reform, and that it has political capital to invest in securing reform in the partner country.

Turning to economics, some sectors may benefit from scale and competition effects. Rationalization and removal of inefficient duplication of plants is a possible outcome, bringing with it efficiency gains. Market enlargement may also bring an FDI inflow. As usual, these potential gains can easily be frustrated, and it is also possible that even the combined market is too small for scale and competition effects to operate. Against these gains are the costs. If external tariffs remain high then trade diversion is likely. Related to this, inward-FDI may be "tariff jumping," in which case it is not necessarily beneficial. Both these effects will be associated with loss of tariff revenue, likely to be a major source of government revenue.

It is also in relatively closed South-South RIAs that we think that the scope for uneven internal development is greatest, with production concentrating in a few locations. If one region has a head start in manufacturing—due perhaps to its location, endowment of factors of production, or simply due to history—then this region may well expand at the expense of other regions ("Cote d'Ivoire" in table 4.1). Linkages are likely to be strong, because of the paucity of the business infrastructure, and manufacturing as a whole is sufficiently small that it will not run up against the "centrifugal" forces outlined in chapter 3. In this case then, the effects of the RIA will be very different across the members; beneficial for some, but possibly adverse for others.

Kenya—EU

Kenya—EU represents a RIA between a small low-income country and a large industrial country or bloc. In table 4.1 we have set effects on the EU at zero—simply reflecting the relative magnitudes of the countries.

What of the effects on the low-income partner? On the political side, we have scored the bargaining and being noticed rows at zero. In the domains of security, cooperation and policy lock-in there are potential gains. Once again, for a regional agreement to work as a commitment mechanism we look for two conditions to be satisfied. The first is that the country seeking lock-in must care about sanctions that the partner might impose. This condition seems likely to be met:If the partner is large, constituting a significant market for exports, and perhaps also a considerable source of aid and technical assistance the threat of sanctions will be powerful. The second condition is that the partner must have the incentive to impose sanctions, rather than let policy reversals go without response. This is more questionable. The "EU" is unlikely to be directly affected by policy reversal or even instability in a small remote developing country, but there may nevertheless be reasons for it to enforce an agreement. One might be a history of involvement with the region. Another is the reputation of the "EU" itself; if it has entered many such RIAs, then the effectiveness of all of them can be damaged by the failure of one.

Evidently, large question marks surround the willingness of our hypothetical industrial country to constitute an effective commitment mechanism. This is an argument for designing the agreement in a way that makes explicit the commitments to reform, and perhaps also the sanctions that are to be followed in the event of policy reversal.

Turning to the economics, there are three dominant issues. The first is trade diversion: Is a RIA with the "EU" likely to cause the source of imports to switch from other lower-cost suppliers to relatively high-cost "EU" production? This effect is likely to be small, insofar as the "EU" itself has low protection, so production costs are close to world minima. Transport costs could however be important if our hypothetical low-income country were much farther away from the "EU" than from other sources of supply of manufactures. The second issue is government revenue. There may be significant loss of tariff revenue, and the low-income country should look to the agreement to make this up.

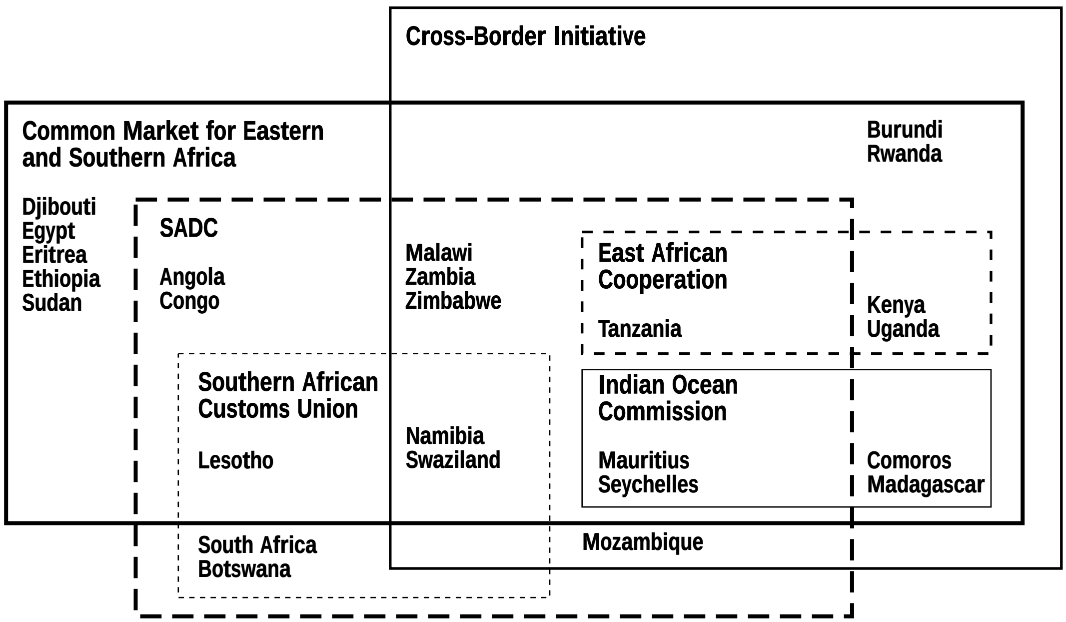
Third, and perhaps most importantly, are the trade and location issues. Will such an agreement enable a low-income country to develop effective export activities, supplying the partner country? Is there a realistic likelihood that the low-income country can be drawn into a "production network," undertaking labor-intensive stages of production activity? Low-wage costs suggest so, but working against this are transport costs, quality of infrastructure, and security of market access. The potential advantage of a regional agreement is that it can make progress on reducing these obstacles. This suggests a need for such an agreement to be relatively deep, so it can overcome trade frictions and secure guaranteed market access, for example, by removing contingent protection.

Size and Multiple Membership: How Many?

Many countries are members of more than one RIA. Probably the most extreme example of this is the EU, in which each member is also a member of EU agreements with EFTA countries (the European Economic Area agreements), most Mediterranean countries (the Euro-Med agreements), and with East European countries (the Europe Agreements). A structure of this type has been termed "hub and spoke regionalism"; it places Europe at the hub of agreements with other countries, most of which are not linked to each other through RIAs.

Complex patterns of multiple membership appear elsewhere. In addition to the large Latin American RIAs, many Latin American countries also have bilateral agreements with other countries or groupings. For example, Chile is party to 11 trade agreements (APEC and the Latin American Integration Association, plus bilateral links with Argentina, Bolivia, Canada, Colombia, Ecuador, MERCOSUR, Mexico, Peru, and Venezuela). Panama is a member of nine trade agreements; Mexico of eight; Bolivia, Costa Rica, and Nicaragua of five; and El Salvador, Guatemala, and Honduras four each. The picture is equally complex for Eastern Europe, with the Slovak Republic belonging to nine RIAs; the Czech Republic and Slovenia belonging to eight; Estonia to six; and Hungary, Latvia, Poland, and Romania to five. The pattern of RIA memberships in East and southern Africa is given in figure 4.2, which reveals a pattern of overlapping memberships.

Figure 4.2 Regional Organizations in Southern and Eastern Africa



Source: Authors.

In some cases membership in multiple RIAs creates obligations made in one that contradict those made in others. Customs union members must all set the same external tariffs, yet Bolivia, Colombia, Ecudor, the Republica Boliviarana de Venezuela, and Peru form the Andean pact (a customs union), while Colombia and the Republica Boliviarana de Venezuela are also in the Group of 3, a free trade area with Mexico. Similarly (see figure 4.2), Lesotho, Namibia, and Swaziland belong to the Common Market for Eastern and Southern Africa while also belonging to Southern African Customs Union (SACU), a customs union with Botswana and South Africa. Tanzania belongs to SADC while being a member of the East African Cooperation, a customs union with Kenya and Uganda. These obligations are contradictory, so it may be unclear which will prevail in practice, and special conditions and exclusions may have to be formulated.

What are the benefits and costs of being in multiple RIAs? First, there are circumstances where gains can be derived, by some countries at least, from being in more than one RIA. The best example of this is being the hub of "hub and spoke" regionalism. If one country (or group of countries) has RIAs with a number of countries that maintain barriers between each other, this hub country becomes the preferred location for investment—firms can reach more markets tariff-free than they can from any of the other locations—and this will tend to bid up factor prices and raise real income in the hub.

Second, membership in multiple RIAs may lead to complexity, which can hinder private sector decisionmaking. The extent to which this happens depends on how complex the individual RIAs are. Membership in a number of relatively loose free trade areas may be straightforward, but even here there is a possibility for conflicting rules—for example, rules of origin requirements—that are nontransparent and complicate the business environment. At worst, there are inconsistencies (as when some customs union members are also in a free trade area), which can only create uncertainty about how the inconsistency is to be resolved, and is thus likely to dampen investment.

Third, securing the full gains from a RIA may require considerable government commitment—for example, tackling the difficult issues of deep and wide integration—and membership of many RIAs may be a diversion from this.

These points are relevant considerations not only for a government considering membership of multiple RIAs, but also for incumbent members deciding on accession of additional countries. There is, in most cases, a tradeoff between the depth of integration that can be achieved and the size of the RIA. (This tradeoff has been evident in the different positions taken by EU member states in discussion of enlargement of the EU). The tradeoff can be shifted by requiring that new members accept the entire package of policies implemented by existing members (the *acquis communitaire* in EU parlance). While this may make it easier for incumbents to accept new members, it may reduce the desirability of membership for these new countries. In general then, we expect early members to have more say in setting the rules—and therefore receive larger benefits—than later members.

4.2 External Trade Policy: How Much Preference?

A FUNDAMENTAL ISSUE CONFRONTING ANY GOVERNMENT considering a regional integration agreement is the external trade policy that will prevail. There are two dimensions to this issue: first, the level of external protection that will apply after the agreement is made, and second, whether to set this external trade policy in a concerted manner.

Openness to the Outside World

Some of the costs and benefits of RIA membership depend directly on the external trade policy stance. This creates strong arguments for pursuing a policy of external openness in conjunction with regional integration.

First, trade diversion is both more likely—and more costly should it occur—the higher the external trade barriers. It is more likely, since the relative price differences created by preferential liberalization will be greater with a higher external tariff, inducing trade diversion in more sectors. It is also more costly, since a higher external tariff will provide greater incentives for inefficient sectors to expand. Producers are able to charge high prices (because the tariff protects them from world competition) and capture what was previously tariff revenue on internal trade. Fundamentally, the gains from competition with low-cost suppliers—gains to consumers, gains in developing an efficient industrial structure, and competition-induced efficiency gains at the firm level—may be forgone if competition from the lowest cost suppliers is inhibited. These are arguments both for low tariffs on average, and for tariff schedules that are relatively uniform, avoiding peaks. Very high rates in particular sectors are almost certain to produce diversion—such as in EU agriculture.

A further argument for low external tariffs relates to the likelihood of agglomeration occurring, and the RIA consequently causing divergence of economic structure. We argued in chapter 3 that one of the forces driving agglomeration is linkages between firms—the dependence of firms on other local firms for supplies, and on local firms and markets for their sales. The more closed is the RIA, the more inward-oriented will be its firms, increasing the strength of local linkages and making it more likely that the RIA will develop a monocentric economic structure. Research by Ades and Glaeser (1995) examined 85 countries, and showed that the population of the largest city is greater the higher are tariff barriers and the lower the share of imports in GNP. Krugman and Hanson (1993) have documented how Mexico's opening to trade (largely with the United States) brought a deconcentration of manufacturing from the congested Mexico City region.[1]

A counter argument to external openness might be that the RIA liberalization brings with it adjustment costs, and simultaneous external liberalization magnifies these to an unacceptable level. The problem with this argument is that adjustment costs are only worth paying, for an adjustment in the right direction. High-tariff peaks might induce costly economic changes that are moves away from economic efficiency. Simulation studies of regional integration involving developing countries and large, high-income nations or blocs (such as the EU) suggest that the adjustment costs associated with RIA implementation are as high as those that would arise if trade liberalization were implemented on a nondiscriminatory basis (Rutherford, Rutström, and Tarr 1999).

Customs Union or Free Trade Area?

In a free trade area (FTA), countries are free to set their own external trade policy, whereas in a customs union (CU) the RIA as a whole sets a common external policy. Of the 162 RIAs notified to the GATT/WTO by August 1998, 143 were FTAs and 19 were CUs.[2] A CU typically requires greater political commitment, because countries have to agree to a common external policy and set up budgetary mechanisms to distribute the tariff revenue between member countries. A central issue for countries planning to integrate their trade is whether to choose an FTA or CU.

The great advantage of a CU is that, because members have a common external tariff, it is possible to have much simpler internal border formalities—and possibly none at all. In contrast, an FTA leaves external trade policy to individual member governments, and faces a problem known as *trade deflection*; the redirection of imports from outside countries through the FTA member with the lowest external tariff, to exploit the tariff differential. If unconstrained, this reduces the effective tariff of every member to that of the lowest plus the transportation cost involved in indirect importing (which is a wasted real resource cost). The usual solution is *rules of origin*—the apparently reasonable requirement that goods qualifying for tariff-free trade should be produced in a member country, rather than just passing through it.

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

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

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

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

Thus, there are substantial benefits to going to a CU, yet, as we saw above, only a small minority of RIAs notified to the GATT/WTO are in fact CUs. What are the costs?

First, harmonization of external trade policy means a loss of national autonomy. Second, we saw in chapter 2 the potential for politically divisive redistributions due to a common external tariff—for example, in the antebellum United States. Political institutions need to be put in place to ensure that these tariffs are set in a consensual way. Furthermore, tariff revenues generated by the common external tariff have to be distributed between member countries, and this too can be divisive. In the EU these revenues are part of the central budget and are spent on agreed programs, yet the level of each member's net contribution or receipt from the budget remains contentious. In many developing country customs unions, difficulties of agreeing on a common external tariff and distribution of revenues have proven to be great. Thus, the GCC has to date not been able to achieve consensus on its common external tariff. Similarly, the implementation of a common external tariff by CARICOM, originally scheduled for 1981, was delayed until the 1990s; the original scheme, adopted in 1991, was subsequently revised, and

CARICOM members are in the process of implementing a new tariff structure (IDB 1998). In the case of the CACM, the common external tariff was rendered largely ineffective because of exemptions granted by some members for "necessary" imports (De la Torre and Kelley 1992).

The third problem with a common external trade policy is the additional adjustment costs—and lobby opposition—that may be encountered in moving to the common schedule. A good example is the difficulty that the EU had in harmonizing nontariff barriers. Despite being a customs union, for its first 30 years the EU allowed members to maintain their own quotas on certain third country imports (for instance, clothing, footwear, and steel) and prevented those goods from crossing internal borders (Winters 1992, 1993).

These three costs of forming a CU are minimized of member countries are more similar to each other, as in South-South RIAs rather than North-South RIAs. Schiff (2000) shows that the ratio of FTAs to CUs is 6 to 20 times higher for North-South RIAs then for South-South ones.

CUs, FTAs, and the External Tariff

There is a potentially important interaction between our first point—the desirability of open external trade—and the choice between an FTA and a CU, because FTAs and CUs create different incentives for setting external tariffs.

Several arguments suggest that an FTA may create downward pressure on external tariffs. First, trade diversion may become apparent; if a country sees itself importing a good from a partner country at a higher cost than similar goods from nonmembers, this may induce it to cut tariffs on these external imports. Second, if there is trade deflection, high-tariff countries lose tariff revenue, as imports come in through low tariff countries. This creates an incentive to cut tariffs to just below the level of their partners, and thereby capture the tariff revenue. Third, if duties on inputs used to make exports to other members cannot be rebated, high import tariffs render final goods uncompetitive to exporters. This concern was apparently behind Canada's decision to reduce 1,500 tariffs on inputs in 1995, shortly after NAFTA started.

The situation in CUs is quite different. Creating a customs union provides an (unavoidable!) opportunity to review the tariff structures and create new institutions for determining trade policy. National tariffs must be harmonized at some agreed level, and in the process, international obligations—notably those to the WTO—must be respected. Unfortunately, most of the arguments about the incentives for tariff setting in a CU do not lean toward external openness.

The first argument is that, by coordinating their trade policies, CU members may have a market power that individual countries lack. Import tariffs can improve a country's terms of trade, since by cutting the volume imported they reduce the world price of the product. This effect is going to be larger, the larger the country or bloc imposing the tariff. Furthermore, countries in a RIA may be able to increase their negotiating power against the rest of the world. If they are able to negotiate effectively as a bloc (which does not always happen) this additional power will change the outcome of trade negotiations. A related argument is that, in trade negotiations, a CU may be able to gain disproportionate power over certain issues by letting a particular member "lead" negotiations. If a more aggressive member leads negotiations with the rest of the world on an issue, the union may be able to extract a more favorable deal because threats to retaliate (with the whole of the union's resources) will be more credible.[3] Whether this leads to lower protection overall depends on whether a more aggressive union can achieve a more liberal outcome by virtue of its readiness to retaliate, or whether it actually needs to use its retaliatory muscle.

The internal process of decisionmaking within the CU may also place an upward pressure on tariffs. Consider a situation in which each member country has an interest in raising protection in one sector and reducing it in all others, and each country has a veto over reductions in protection. Unless there is effective intra-CU negotiation, this creates the possibility of a classic "prisoners' dilemma" outcome with high protection in all sectors, even though each country would be better off with low protection in all sectors. Although it might be hoped that negotiation within a CU could avoid prisoners' dilemmas, there are enough examples from the EU to not engender optimism. The EU allows countries disproportionate influence over policy—up to (and including) veto power—in areas in which they claim "vital interests." Winters (1994) shows that the prisoners' dilemma outcome is quite likely to arise in small groups of decisionmakers, and experience suggests the same outcome. Indeed, the unanimity with which trade policy decisions pass (in 1995 the EU Council of Ministers passed 92 of its 94 common trade policy decisions unanimously) suggests that countries were willing to acquiesce to perceived "vital interests" of particular members (Bilal 1998).

The CU will also change the power of lobbies. It is possible that lobbying pressure within a CU may be diluted, compared with national lobbying for protection within an FTA. There may be more opposition to overcome (Panagariya and Findlay 1994; de Melo, Panagariya, and Rodrik 1993) or more representatives to influence (Richardson 1994). Other arguments cut in the other direction. For example, each country might find that initially its industry and agriculture more or less cancelled each other out, but if integration lets agriculture lobbies cooperate (because they produce the same things) while the industry lobbies compete (because they produce different things) the CU may end up with agricultural protection. It is worth noting that there is a massive lobbying industry in Brussels, where the number of lobbying organizations grew from 300 in 1970 to some 3,000 in 1990. Expenditure on lobbying was estimated at $150 million in 1990, and increased rapidly. By 1998, there were 13,000 professional lobbyists in Brussels, approaching one for every European Commission staff member (*The Economist*, August 14, 1998).

4.3 How Deep?

THERE IS A LARGE MENU OF CHOICES CONCERNING THE DEPTH of integration that can be sought in a RIA. We argued in chapter 3 that the gains from competition and scale effects might not be achieved unless other policies causing segmentation of markets were removed, and firms in different countries were induced to compete head-on. Simple removal of tariffs while other obstacles remain in place may not be sufficient to achieve this. However, removing these obstacles is not without cost. For example, a CU is "deeper" than an FTA (it avoids the border costs associated with enforcement of rules of origin), but it brings with it other complexities related to choosing the common external tariff and distributing the revenue. In this section we look in detail at other policy measures that can be adopted to try and secure greater market integration.

Contingent Protection

Many RIAs retain contingent protection—restrictions on intrabloc trade that are applied in a more or less well-defined set of circumstances.

These include antidumping, countervailing duties (in response to foreign subsidies), and "emergency protection" to address balance of payments problems or to protect an industry from surges in imports. While contingent protection has been abolished within the EU, it remains applicable in all the EU's agreements with other countries except the European Economic Area. Within some RIAs contingent protection is widely used; in MERCOSUR, Argentina initiated 33 antidumping cases on imports from Brazil between 1992–96 (Tavares and Tineo 1998). Where these contingent protection measures have been left in place, countries recognize that they provide obstacles to trade, but have weighed the political and economic costs of their removal greater than the benefits. What are the benefits and costs of removing these measures, as has been done in the EU, the Canada-Chile FTA, and the Australia-New Zealand agreement?

Contingent protection provides a major barrier to trade, not only when actually applied to trade flows, but also by its mere existence, which has a "chilling" effect on trade. Just the surveillance of trade flows has been shown to have a negative impact on the volume of trade (Winters 1994). The threat of initiation of antidumping actions can lead to an immediate loss of markets for exporters, as importers seek to avoid the costs of posting the bonds required by customs authorities while the investigation is ongoing. Empirical estimates of the "chilling" effect on trade find that threatened exporters often agree to raise prices and maintain historical market shares, so contingent protection becomes an instrument facilitating collusion between domestic and foreign firms (Messerlin 1990; Staiger and Wolak 1989).

These are powerful arguments for abolition of contingent protection, but they encounter several counter-arguments. The first is that dumping can be predatory, when a foreign firm (or cartel) seeks to force domestic competitors out of the market by pricing below cost—with the intention of raising prices once the competition is gone. However, research suggests that predation is very much the exception, not the rule in antidumping cases, and that in over 90 percent of actual antidumping actions an antitrust authority would not have intervened on competition, let alone predation, grounds (Messerlin 1997; Schöne 1996). The consensus among most economists is that antidumping as it is practiced today has nothing to do with predation. Furthermore, if there is predation, national antitrust should be able to address the problem; and this can be done unilaterally—there is no need for international agreement or harmonizing competition regimes.

The second counter-argument is that if countervailing duties are to be suspended, then measures also need to be taken to restrain or coordinate industrial subsidies that may have a negative impact on domestic firms. When such subsidies are being used there are valid theoretical economic justifications for the use of countervailing duties (Dixit 1988). However, in general, contingent protection is an inefficient instrument to deal with the effects of foreign subsidies or industrial policies, because it imposes additional costs on domestic consumers without greatly increasing the incentives of the foreign government to change its policies. Small countries in particular are unlikely to have much success by pursuing retaliatory policies—all they will end up doing is adding an additional distortion to consumption. The appropriate policy is to draft rules that restrict the ability of RIA members to use industrial policies in ways that are detrimental to the welfare of other member countries. In practice, this may be difficult to achieve; only a limited number of RIAs have done much to discipline the ability of members to provide subsidies.

Finally, there may be strident opposition from lobby groups to the abolition of these measures. Antidumping cases are frequently initiated by producer lobbies, and these may be virulent opponents of their withdrawal. In practice the political power of these groups goes a long way toward explaining why contingent protection frequently remains in place in RIAs, despite the overall commitment to liberalize intrabloc trade flows. Continued access to such instruments may be required in order to "sell" the more general liberalization reform package.

Borders, Product Standards, and Red Tape

Trading across international borders encounters many real costs: delays, form-filling, recertification of products, and so on. Even if there are no duties, border formalities themselves create barriers and can be quite wasteful. For example, customs procedures can be duplicative or redundant, as when tax authorities in an exporting country require data similar to that demanded by the importer's customs officials—but in a different format. It has been estimated that border formalities on *intra*-EU trade in the early 1990s were equivalent to over 1.2 percent of the gross value of internally traded goods. The EU had already implemented procedures to cut these costs, and in many other RIAs the costs of border formalities are many times larger.[4]

Additional barriers to trade are created by variations in national product standards. Estimates from Egypt in the early 1990s, showed just how significant standards-related "red tape" in customs were; redundant testing and idiosyncratic standards alone imposed taxes equivalent to between 5 and 90 percent of the value of shipments (Hoekman and Konan 1999).

Barriers of this type prevent effective international competition. They provide opportunities for corruption. They are usually real resource costs—unlike tariffs, where revenue gets transferred to the government, the barriers use up administrative and technical time and effort. What can be done, within a RIA, to simplify them?

Border Formalities

Border formalities can be reduced by good customs administration and the use of standard practice on procedures. Much of this is possible independently of RIA membership, by adopting best practices in the area of customs administration and implementing the relevant international conventions aimed at trade facilitation. The World Customs Organization is the primary organization promoting the standardization and simplification of customs procedures around the world, in particular the Kyoto Convention of 1973, currently undergoing a major revision. Adopting the revised procedures has been argued to be the single most comprehensive prospect for true international trade facilitation (Staples 1998). Some of the needed measures are easier to implement within a RIA. One reason is simply the inherent simplicity of not collecting duties on internal trade. Another is that it may be easier to develop common approaches and institutions, such as the adoption of standard forms.

Product Standards

The issues raised by product standards are more complex, since countries can genuinely differ on what they regard as acceptable levels of standards. Countries seeking to reduce the barriers created by differing standards can follow two alternative routes—harmonization and mutual recognition.

The baseline principle governing treatment of imports in most trade agreements is "national treatment," which requires that governments treat foreign products or producers that enter their territory in the same way as domestic counterparts, in terms of internal taxes, health and safety standards, competition rules, and so on. The principle has always been a basic building block of international trade treaties, and ensures that liberalization commitments cannot be circumvented by discriminatory application of domestic policies—such as an excise tax that is higher for foreign than for domestic products. While national treatment is a powerful source of discipline on RIA members, problems arise if national product standards differ, requiring the sort of expensive retesting we saw above.[5]

These issues are nothing new. In the past they have often been resolved by harmonization around international standards. Between 1860 and 1914 more than 30 intergovernmental organizations emerged to harmonize product standards, particularly on infrastructure: for example, mail (1863), marine signaling (1864), technical railway standards (1883), ocean telegraphy (1897), and aerial navigation (1910) (Murphy 1994). International interconnection norms, agreed under auspices of the International Telecommunications Union, eliminated the need for telegrams to be printed at each border post, walked across, and retyped. The Radiotelegraph Union aimed to prevent a global radio monopoly by requiring interconnection across different technologies. Intergovernmental organizations proliferated after World War II, including such standards-setting bodies as the International Maritime Organization, the World Customs Organization, and the Bank for International Settlements. However, these bodies do not cover the great bulk of products that make up most of world trade.[6]

An alternative is to harmonize by unilaterally adopting the standards of another country or group of countries. In 1992 Canada adopted U.S. auto emission standards to ensure that its automakers could realize economies of scale by avoiding separate production lines for their home and U.S. markets. Switzerland, similarly, adopted the EU regime on technical regulations and industrial standards so Swiss goods can enter and circulate in the EU on the same basis as EU-produced goods (Messerlin 1998). Many developing countries use legal regimes developed in Europe or the United States, usually by maintaining systems inherited from a colonial past or military occupation. Others have deliberately adopted foreign norms. South Korea imported many West German and U.S. product standards in the 1950s as part of a strategy to upgrade the quality of industrial production and foster exports.

Despite these possibilities, most countries still maintain their own distinct product standards. Attempts to harmonize within a RIA require developing a set of RIA-specific common standards, set either by intergovernmental cooperation or by the cession of sovereignty to common or supranational institutions. In the EU, the European Commission has been delegated the power of proposing directives and regulations and the Court of Justice given the task of enforcement. EU experience suggests that this process is extremely slow and painful. Early efforts toward harmonization centered on food standards—the first "harmonization directive" issued in 1962 dealt with food coloring—and progress was very slow, in part because adoption of a Community-wide norm required unanimity. It took over a decade to reach agreement on the composition of fruit jams and mineral water, and only nine directives on foodstuffs were adopted between 1962 and 1979. Differences in national norms, reflecting national tastes, history, legal regimes—and producer lobbies seeking to restrict competition from imports—made it difficult to achieve the required consensus. For example, Germans set great store by their *Reinheitsgebot*, a standard established in 1516 specifying that beer may have only four ingredients (malted barley, hops, yeast, water). Other countries include preservatives or additives.

If harmonization is not pursued, the alternative route to settling standards issues is "mutual recognition," under which member countries simply accept that goods that are legally introduced into circulation in one member state cannot be barred from entering and being sold in another. This principle was incorporated into the Single Market program and has proved to be a powerful tool for increasing cross-border competition in European markets.[7]

However, mutual recognition raises two quite difficult issues. First, countries have to be able to agree on the minimum norms that should be met to safeguard public health and safety or maintain the integrity of public networks. Second, there has to be mutual trust in the competence and ability of the national institutions responsible for enforcing the relevant mandatory standards. Thus, even if all members accept the levels at which standards are set, it may require significant institutional strengthening for one country to accept that another's testing and certification procedures are adequate. One way of addressing this constraint is to rely on third party conformity assessment of goods and services, and seek agreement that certification by such specialized entities will be accepted by all members of a RIA. To date, however, this has been an option that has not been pursued vigorously in RIAs.

Discrimination in Public Procurement

If RIA membership is to secure effective competition, then competition should extend to government procurement—an area that often accounts for as much as 10 percent of GDP. Yet, in practice, governments frequently permit or require public entities to discriminate in favor of domestic firms when procuring goods and services. This can take the form of price preferences, local content rules, or residency requirements.

Progress in eliminating discrimination in public procurement can, in principle, be made independently of RIA membership, by consistent application of the national treatment principle and procedures outlined in the WTO Agreement on Government Procurement. In practice, progress at the multilateral level has been slow—virtually no developing countries have signed the voluntary WTO agreement (Hoekman and Mavroidis 1997). RIAs offer a potential avenue to make more rapid progress. However, only a limited number of RIAs have included liberalization of public procurement as an objective or made progress in forcing government entities to abide by the national treatment principle (EU, NAFTA). Progress in this area has proven to be difficult to achieve. A recent evaluation of the pattern of purchasing by European government entities found that public sector import penetration increased from an estimated 6 percent in 1987 to some 10 percent in 1994 (Gordon, Rimmer, and Arrowsmith 1998). Thus, on average, 90 percent of all purchases in the EU continue to be sourced from national firms, despite vigorous efforts by the EC Commission to eliminate discriminatory procurement practices.

4.4 How Wide?

POLICYMAKERS ALSO FACE CHOICES OVER THE RANGE OF activities to integrate. The discussion so far has focused on merchandise trade and integration of goods markets, but there are other aspects of cross-border economic interaction that may remain tightly regulated. The main examples concern trade in factors of production and trade in services. What are the costs and benefits of extending liberalization to these other cross-border interactions?

Investment Flows

At various points we have referred to the likely effects of FDI flows in a RIA. These may be flows from outside, or from partners within the RIA, as plants move to exploit the comparative advantage of different locations and to compete more directly with host country firms. In practice, there can be substantial barriers to such investment.[8] The barriers take many forms, including: absolute barriers to establishment in some sectors or activities; requirements that foreign equity not exceed a certain percentage of the total; domestic content requirements or export requirements, requirements that FDI projects meet targets not imposed on national firms; and obstacles to repatriation of profits.

Little progress has been made on liberalizing these restrictions on a multilateral basis. The OECD's proposed Multilateral Agreement on Investment sought to overcome some of these barriers, but agreement could not be reached. A WTO working group is studying the desirability of multilateral investment rules, but there are strong differences of opinion regarding the costs and benefits of a multilateral set of disciplines in this area. Within RIAs too, progress has often been slow, although individual member states of many RIAs have been unilaterally liberalizing FDI regimes. Argentina and Brazil still restrict FDI flows in a number of sectors, independent of whether or not the potential investor originates in MERCOSUR; CARICOM has only liberalized investment in banking; the CACM countries do not have a common investment regime. But many RIAs do include provisions to liberalize investment flows: such as NAFTA, the Group of Three, GCC, and SACU.

The case for liberalizing investment is strong. As we have seen at many points above, FDI is an important route through which developing countries can benefit from RIA membership. Agreeing to apply national treatment and the right of establishment for investors helps ensure that production choices are not distorted, and is important for governments seeking to use RIAs as "lock-in" or commitment devices. Leaving FDI off the table sends a strong signal to the international financial community that a government may wish to continue to restrict international transactions.

Services Liberalization

Service trade is inherently more complex than goods trade, for two reasons. First, in many service activities problems of asymmetric information are particularly acute; the purchaser does not know the quality of a professional service being purchased until after it has been paid for and consumed. And second, service trade frequently requires consumers and providers to be at the same place at the same time.

The first of these complexities creates a proper need for regulation of such service activities. Service suppliers must obtain certification or licensing in such fields as financial services, law, accountancy, and medicine. However, standards are often set by professional bodies that have an interest not only in creating a reputation for ensuring quality, but also in restricting entry and limiting competition. The second complexity—that services providers typically have to be established in the country they are supplying—is an inherent obstacle to international trade.

The combination of these two considerations has made services trade notoriously prone to trade restrictions, and hard to liberalize. We see existing services trade restrictions taking many forms. Many countries restrict the access of foreign services and service suppliers to domestic markets, and sometimes trade in services is simply prohibited.[9] Rights of supply may be restricted to domestic firms (such as in domestic transportation and basic telecommunication services), or to domestic residents (such as in legal, insurance, educational, surveying, or investment advisory services). Even if there are no formal prohibitions, there are often major barriers to entry. Professional standards are set in a way that requires foreigners to engage in costly recertification. Rights of access to telecommunications networks are often restricted: for example, where a dominant telecommunication carrier—public or private—imposes restrictions on the ability of new service providers to link to the network, or forces them to build infrastructure to reach interconnection points. Discrimination in ancillary services—not being listed in computer reservation systems—can substantially reduce the competitiveness of an airline. Limitations on advertising are a common way to limit the ability of foreign insurance firms to compete, and distribution arrangements can effectively bar market access for branded products.

This restrictive starting point, and the fact that most of the barriers are essentially quantity restrictions (prohibitions and regulations rather than tariffs) means that gains from opening up services trade to international competition are likely to be particularly large.[10] Indeed, from a starting point of prohibitive barriers, a preferential liberalization cannot be "trade diverting," so a major source of ambiguity about gains from preferential liberalization is absent. Furthermore, there will be no loss of tariff revenue for government, since rents created by the regulatory obstacles are typically collected by protected firms and workers. This does, of course, raise its own political economy difficulties in seeing through a liberalization.

In addition, the fact that the service sector is an input to so many other activities in the economy—production, commerce, trade, and education—makes it particularly important that the sector function efficiently. For example, the fact that services are an input to production means that failure to liberalize them faces local producers with higher costs than necessary, at a time when the RIA is possibly increasing competition and reducing the price of their output. This can give rise to the phenomenon of negative effective protection; output is not receiving tariff protection, but inputs are (implicitly, in the form of the barriers to service trade), so creating negative incentives for the development of activities that use these services. Estimates for Egypt suggest that trade barriers in services reduced effective rates of protection for manufacturing activities by some 30 percentage points (Djankov and Hoekman 1997). Since services are an input to trade, service sector inefficiencies can be damaging for many sectors of the economy. Agricultural output can be lost due to poor transportation and storage facilities, and substandard communication networks can raise the costs of doing business. Recent studies of Egypt drew attention to the fact maritime shipping was a monopoly—and fees were 25 percent higher than those in neighboring countries for equivalent routes. Fees charged by the public companies providing port services for handling and storage of goods were 30 percent higher (Mohieldin 1997). It has been estimated that a service liberalization that reduces average services prices by 15 percent could lead to estimated welfare gains for Egypt of some 5 to 10 percent of GDP (Hoekman and Konan 1999).

Most RIAs have not gone much beyond what was achieved in the General Agreement on Trade in Services (GATS). The main exceptions are the EU and NAFTA, although in all cases effective liberalization of services was not initiated until the 1990s. NAFTA has made substantial progress using a negative list system, so all service sectors are covered unless specifically exempted.[11] Other RIAs vary in their coverage of services. The Group of Three is similar to NAFTA, although sectoral coverage is narrower. In MERCOSUR, free circulation of services is a long-term objective to be achieved by 2007; progress has been slow, with members still negotiating a framework agreement. ASEAN members have agreed to full liberalization (on a preferential basis) in most services by 2020. The FTAs between the EU and Mediterranean countries do not include services, while those with the Central and Eastern European countries do. ANDEAN, CACM, and SADC have so far made little progress (Hoekman and Sauvé 1994; Page 1997).

If liberalization is to be pursued, it can proceed through various channels. GATS was negotiated at the WTO as part of the Uruguay Round, and WTO members have agreed to begin a new round of negotiations on services in the year 2000. This provides an opportunity to improve the structure of the rules and to achieve a higher level of liberalization commitments.

There are several reasons to think that RIAs may, for many countries, offer a more effective route to service liberalization. First, service liberalization may involve labor mobility—service providers need to become established locally, and this typically involves temporary if not permanent residence. Politically, this may be easier to achieve in a RIA than on a nondiscriminatory basis. Second, procedures are needed to make sure that quality standards are met. These issues are conceptually similar to those we saw with product standards—agreement on harmonization or, if mutually agreeable standards are in place, on mutual recognition. Achieving these within a RIA may be easier than establishing them for all comers.

However, service liberalization within a RIA is not something that is likely to be achieved easily. The very fact that these sectors are highly protected by nontariff instruments means that there are substantial vested interests, and considerable political effort will be needed to overcome them. Many RIAs have found it difficult to make much progress, and only now is the EU effectively securing market opening in these areas.

Further Areas

Investment and services are the two most important areas, beyond merchandise trade, where there are gains from widening the scope of integration. Of course, the scope can be set wider still—to include labor mobility, fiscal harmonization, and monetary union. We end this chapter by cautioning that extending the scope too broadly may detract from the economic benefits of integration. Some of the benefits from trade that arise out of differences between countries and the attempts to iron these out—by, for example, RIA-wide minimum wage legislation—will inhibit the very mechanisms by which countries can gain from integration.

4.5 Conclusion

One reasonably firm conclusion is that for most developing countries, and especially for the poorer ones, a North-South RIA with a large industrial country is likely to be superior to a South-South RIA with a developing country. The reasons are that:

- South-South RIAs are more likely to generate divergence, with the less developed member losing relative to the more developed one.
- South-South RIAs are more likely to generate trade diversion.
- North-South RIAs are more likely to generate useful transfers of technology.
- North-South RIAs are more likely to provide lock-in mechanisms in the area of politics (such as democracy) and economics (in terms of policy credibility).
- Given the industrial partner's superior institutions, a North-South RIA may provide more benefits from "deep integration" than a South-South RIA.
- Given a larger endowment difference between member countries in a North-South RIA than in a South-South one, a developing country may be able to better exploit its comparative advantage in a North-South RIA.
- The developing country partner is unlikely to capture most of the above-mentioned benefits of North-South integration unless it undertakes economic reforms.
- Though this chapter advocates forming or joining a RIA with a industrial country or region, whether and under what circumstances the latter will allow the developing country to join is unclear. This is examined in chapter 5.

Other conclusions include:

- For any RIA, lowering external trade barriers (up to the optimum level) is beneficial: it will increase the RIA's gains or reduce its losses.

- Though there are substantial benefits from a CU compared with an FTA in terms of simplicity of intrabloc trade regulations there are also costs in terms of loss of sovereignty, difficulty in setting the common external tariff and sharing the tariff revenues. Thus, most recent RIAs have been FTAs, and mostly North-South ones where these costs of forming a CU are likely to be high.
- For middle-income countries—such as the members of MERCOSUR or ASEAN—there may be sufficient gains from scale and competition effects to justify a RIA between them, but fully capturing these effects will require "deep integration" measures, and expansion and contraction of sectors and firms decided by the market.
- However, if a middle-income country is located close to a large industrial RIA—such as Mexico, and Eastern European and Mediterranean countries—then it is likely to best capture the benefits of enhanced scale and competition by joining that RIA.

Notes

1. For development of this argument see Fujita, Krugman, and Venables (1999) and Venables (1999).

2. Source: WTO. Of course, many RIAs contain other elements as well; this classification refers only to their policies on trade in goods.

3. Gatsios and Karp (1991, 1995).

4. In 1988 the EU had already adopted a Single Administrative Document and many members had simplified procedures to reduce customs burdens for large traders. The average customs clearance transaction in developing countries involves 25 to 30 different parties, 40 documents, 200 data elements, some 30 of which are requested at least 30 times, and 60 to 70 percent of which must be re-keyed at least once (Roy 1998).

5. Article 36 of the Treaty of Rome permits EU members to maintain domestic policies that restrict trade if this is needed to protect national health, security, morals, or the environment. Virtually all RIAs have similar provisions.

6. Neither do they usually include enforcement mechanisms. Resolving interstate conflicts has always figured on the agenda of international conferences and organizations, but has often been ineffective. Early in this century a number of proposals were made to develop international instruments to extend binding arbitration to intellectual property, the principle of equality of foreigners in taxation (national treatment), civil and commercial procedure, customs tariffs, the right of foreigners to hold property, the regulation of companies, and claims for damages. These were opposed by countries that sought to retain their national sovereignty (Murphy 1994). Most of the bodies mentioned earlier (except for the WTO) do not have binding dispute settlement mechanisms.

7. It originates from a landmark 1979 case, in which the European Court of Justice found that a German ban on the sale of a French Cassis de Dijon used to prepare an aperitif, kir, could not be justified on the basis of public safety or health. At the same time, procedures for harmonization were simplified by shifting to a majority voting rule for standards harmonization (Neven 1996). During 1986–97 some 250 harmonization directives were adopted

in the EU under majority voting rules, compared to a total of only 225 between 1958 and 1985, when the unanimity principle applied (Messerlin 1998).

8. We look only at long-term investment, not at the issue of regulation of short-run capital flows.

9. What follows draws on Hoekman and Braga (1997).

10. Typically a doubling of protective barriers more than doubles the real income cost of the barrier.

11. For example, a NAFTA Professional Services Annex sets out procedures for developing standards of professional practice, requires the abolition of citizenship and permanent residency requirements in licensing and certifying professional service providers, and establishes work programs to liberalize licensing for foreign legal consultants and engineers.