



WORLD TRADE
ORGANIZATION

Multilateralizing Regionalism Challenges for the Global Trading System

edited by Richard Baldwin and Patrick Low



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FOREWORD

Regionalism is much debated in contemporary trade policy discourse. This is hardly surprising, considering that well over 200 regional agreements with highly varied content and a rich array of geographical configurations are in existence, with dozens more agreements in the making. The phenomenon has accelerated notably in the last several years. The growth in the number of agreements reflects both a growing number of agreements per country and an increase in the number of countries emerging onto the trading scene.

A vast quantity of writing on the subject of regionalism now exists, and one might be tempted to ask what yet another conference volume on the subject can add. The chapters in this volume pose a number of questions that have not previously been addressed, notwithstanding the proliferation of scholarly literature. The focus here is not upon why so many regional agreements have sprung up – that question has dominated many a debate, and lots of interesting explanations have been offered of both an economic and a political nature. Rather, this volume looks ahead and asks how policymakers, traders and businesses view and react to the explosion of regionalism. It also ponders the nature of the relationship between the multilateral trading system and regional agreements.

Are we in a world in which regional agreements will continue to multiply, eventually reaching some critically high number that will place the trading system in a stable equilibrium, where hundreds of criss-crossing agreements coexist in some fashion with the WTO? My view is that most people think not. Proliferation is breeding concern – concern about incoherence, confusion, unnecessary business costs, instability, and unpredictability in trade relations.

This is not to argue that regionalism is all bad, nor that it will simply disappear in time. On the contrary, many regional initiatives have made important contributions to economic welfare, and doubtless to political stability as well. Governments will continue to sign such agreements. But we need to consider where this proliferation is leading us in terms of trade and

international economic relations, and perhaps revisit our approach to trade cooperation in a more general sense.

A key idea underlying most of the chapters in this volume is that the tangle of overlapping trade agreements will increasingly generate an interest in multilateralizing regional arrangements by joining them up into larger entities that bring us much closer to a multilateral system of trade arrangements. The question, then, is what forces and interests might push trade relations in a multilateralizing direction.

And what forces and interests might push in the contrary direction – where the discrimination inherent in regional arrangements is viewed favorably by interest groups that benefit from it? If the latter interests prevail, we may expect continuing pressure upon governments to go more regional and resist multilateralization, or at the very least to defend existing regional arrangements against greater inclusiveness. This volume throws new light on these fascinating and important issues.

As suggested above, the debate about whether regionalism is a good or a bad thing per se has long been sterile. It misses the point. We need to look at the manner in which regional agreements operate, and what effects they have on trade opening and on the creation of new economic opportunities. We also need to reflect on whether regionalism is causing harm to multilaterally based trading relationships. Many different kinds of agreements exist and much will depend on their design and intent. These self-same questions will also be relevant in considering the prospects for multilateralizing regionalism. Regionalism might be hurting multilateralism, either by bolstering discriminatory interests, or by fostering protection behind enlarged closed markets. Another concern is whether building on the stock of regional agreements distracts from multilateral processes.

But let us turn the question around and ask what the WTO might do to help avoid a situation in which negative aspects of regional agreements prevail, and ultimately to promote multilateralization. The first element here is that governments need to pay proper attention to their multilateral interests. We neglect the unique advantages of an inclusive, non-discriminatory multilateral trading system at our peril. It is these self-same governments that own the WTO and that enter into regional trading arrangements. It is for them to bring this debate home.

What the WTO can do for international trade in the first instance is to close the Doha Round quickly and successfully. Apart from the intrinsic benefits of completing the Round, this would help to refocus governments' attention on their broader global trade interests. It would also further reduce the scope for discriminatory trade policy in the future.

Second, the 2006 decision to fast-track the transparency mechanism negotiated in the Doha Round (Decision on Transparency Mechanism for Regional Trade Agreements), and make it operational on a provisional basis, is a significant potential contribution to helping us understand what is really going on in so many different regional trade agreements. In my view the decision to anticipate this outcome from the Doha Round reflects a growing level of concern regarding the consequences of a continuing regionalization of trade relations.

Third, an examination of the multilateral rules governing regionalism has long been on the GATT/WTO's negotiating agendas and work programs. Such efforts should continue. It would be useful to look systematically at the characteristics and design of regional agreements not only in terms of legal compliance questions, but also in terms of whether their architecture is more or less likely to foster multilateralization in the future. Perhaps we should think in terms of best practices in this regard.

I welcome the initiative behind this volume to explore the emerging relationship between regionalism and multilateral trade arrangements, and in particular the idea that governments could do more to multilateralize regional agreements for the broad benefit of the international trading community, as well as to explore new ways of ensuring that regional agreements are not designed so as to close off opportunities for more broadly based trade cooperation.

Pascal Lamy
Director-General, World Trade Organization



Introduction

RICHARD BALDWIN AND PATRICK LOW

The last two decades have seen an explosion of regional trade agreements, some of them involving several countries, many of them bilateral. Some have been local, within regions, others have stretched across regions. Some have involved deep integration, going beyond the WTO, while others have been quite light and superficial. All in all, some 350 of these agreements exist.

This proliferation of regional agreements has created a spaghetti bowl of criss-crossing arrangements, with little attention to coherence among agreements or to the implications of so many regimes for trade costs, efficiency, and the conditions of competition in global markets. The chapters in this volume, prepared for a conference held at the WTO in September 2007, are primarily focused on a core question concerning the prospects for gains in efficiency and coherence in international trade relations that might emerge from a process of multilateralizing regionalism. In thinking about this process of potential coalescence of dozens of regional agreements around the world into a more coherent whole, the conference did not attempt to analyze in any systematic way the economic, political, or political economy reasons why the incidence of regionalism has exploded in recent years. The reasons are many and plenty of analyses have been undertaken along these lines.

Against the background of proliferating regionalism and the assumption that today's international trading arrangements are far from optimal, it is as well to ask what is meant more precisely by the notion of multilateralizing regionalism. Most obviously, a process of multilateralization is promoted through the non-discriminatory extension of preferential trading arrangements to additional trading partners. Such extension can occur in two ways – either through the inclusion of new members in existing agreements, or by replacing existing agreements with new ones that extend to new members. There is no a priori way of judging the relative merits of these two approaches. Much depends on the preexisting architecture of the preferential arrangements and the

economics and politics that might drive an interest in “taming the tangle” of multiple overlapping agreements.

Major elements of the underlying analytical framework for looking at the multilateralization builds on recent work by Richard Baldwin.¹ The starting point of Baldwin’s analysis is that a good deal of trade liberalization has occurred in recent years in most parts of the world. This liberalization has been multilateral, regional, and unilateral. More open trading arrangements have fed on themselves through political economy forces increasingly disposed to further trade opening – Baldwin’s so-called juggernaut effect – and countries have participated in more open trade arrangements, in part so as to avoid being left behind – the domino effect.

A key component of the analysis rests on the growing phenomenon of production sharing – also referred to as unbundling, off-shoring, or fragmentation. This is a world in which production processes are spread through multiple jurisdictions across the world. The political economy effects of this fragmentation have been significant – blunting the old distinctions between “us” and “them” that used to drive trade policy. Producer interests that previously sought to protect their local markets from outsiders now worry about market access conditions and trade costs in a range of other markets as well. Hence the growing political economy forces that favor more open markets. But in the last few years trade policy has been dominated by regional initiatives, with their discriminatory and potentially distorting side-effects. Higher trade costs have also accompanied regionalism – in the Baldwin analysis this is in large measure a rules-of-origin story.

The basic proposition emerging from this analysis is that against a background of diminishing trade protection, brought about in part through an “untamed tangle” of criss-crossing preferential trade agreements and their associated higher trade costs, an interest is emerging in multilateralization – that is, in a process that would rationalize trade relations on a more global basis. The argument is not that regionalism will go away. Rather, it is the more modest but nevertheless important proposition that there may be growing interest in moving away from the spaghetti bowl.

In considering this, it is natural to ask not only how regionalism itself might evolve into something different, but also what role the WTO might play in promoting a more inclusive and coherent trading system,

¹ The most complete summary available of this work is to be found in Baldwin (2006).

freer of economic distortions. Whatever else the GATT/WTO has achieved over the six decades of its existence – and many would agree that these achievements have been significant – the fact remains that to all intents and purposes, the WTO has been something of a passive observer as regionalism has exploded. So while at least some governments have shown growing signs of asking where all this regionalism is taking us, a key question is what the WTO might do in the new and complex world of international trade relations. What should its role be? Regionalism is not going to just disappear, but along with all the other things the WTO does, can it contribute to making regionalism more multilateral-friendly? Several of the chapters and commentaries in the volume have touched on this question.²

The conference volume is divided into four main sections, dealing respectively with the evolution of regionalism, prospects and past experiences with multilateralization, sectors and themes relevant to multilateralization, and regional perspectives on the issues.

In the introductory section of the volume (Part I), Carpenter takes a historical perspective on regionalism, tracing the growth over time of the attractiveness of this brand of trade cooperation. She identifies three main phases of regionalism in the postwar period, and emphasizes the variety of motivations for regional trade agreements. This is followed by a chapter by Fiorentino, Crawford, and Toqueboeuf analyzing the current landscape of regional agreements. This chapter shows in stark fashion just how pervasive regionalism has become and emphasizes some of the trends in recent years, notably a strong preference for free trade areas over customs unions, agreements among countries that are not contiguous, a strong preference for bilateral agreements, significant geographical overlap with countries belonging to several different agreements, and considerable diversity in the scope and coverage of different agreements.

The chapter by Fiorentino *et al.* also examines the GATT/WTO's role in the surveillance of regional agreements, making the point that the multilateral trading system has proved ineffectual in this role. The chapter notes an important new departure in the WTO's approach to regional agreements, however, with the introduction of a new transparency mechanism as a provisional "early harvest" outcome of the

² In addition, Richard Baldwin and Philip Thornton recently published a short monograph (Baldwin and Thornton, 2008), based on the conference, which focuses particularly on the question of a possible WTO contribution to the multilateralization process.

Doha Round. The new mechanism emphasizes a non-litigious approach to establishing a uniform and complete information base that will allow the WTO membership to acquire an improved understanding of regional trade agreements. This exercise is not intended to undermine the WTO's legal basis for dealing with preferential trade agreements, but rather to strengthen it.

The first chapter in Part II – on prospects and past experience with multilateralization – is by Baldwin, Evenett, and Low. The chapter considers how far the logic of multilateralization – driven in Baldwin's earlier analysis by political economy forces, trade costs, and the unbundling of production across nations – extends to non-tariff measures. The focus is on trade in services, government procurement, competition policy, investment, technical barriers to trade, and trade remedies. The fundamental question is what determines the balance of interests that gives rise either to a spaghetti bowl phenomenon or a relative lack of discrimination. The overall conclusion of the chapter is that the spaghetti bowl is often not as apparent where non-tariff measures are concerned as it is in the case of tariff regimes supported by rules of origin. A determining factor is how far discriminatory outcomes are the result of intentional as opposed to incidental protection. The degree of success of multilateralization initiatives in the areas examined depends on the domestic balance of interests, and non-discrimination often requires reciprocity from RTA partners.

The chapter finds that outcomes in some areas benefit from an “MFN [most favored nation] dividend,” where regulatory reform undertaken at the regional level applies to all trade, either by design or because it is simply inefficient to seek to discriminate among alternative trade or investment sources in the relevant policy domains. In other areas, however, where reciprocity is important, the question arises whether a plurilateral or “club” approach might be required in the context of multilateralization. This clearly raises a systemic issue for the multilateral trading system, although in some cases – such as the mutual recognition of professional qualifications or conformity assessment in relation to product standards – the WTO already has to deal with the reality that governments will not enter into such arrangements on a fully non-discriminatory basis. This calls for a nuanced approach to non-discrimination, where a distinction is necessary between opportunity (the absence of *ex ante* exclusion) and outcome (the possibility of *ex post* exclusion). Overall, the authors emphasize the tentative nature of their analysis and the need for further research involving a broader range of

actors in the trading system, particularly to determine the intensity of the spaghetti bowl effect in different policy areas.

The chapter by Gasiorek recounts the context in which the Pan-European Cumulation System (PECS) came into existence in 1997, and explains how, by allowing “cumulation” among many countries in the determination of origin, a spaghetti bowl of hub-and-spoke arrangements was rendered down into a more integrated and less discriminatory set of market arrangements. The answer to the question whether this experience could be generalized as a means of multilateralizing fractured regional arrangements is not entirely encouraging. The reason for this is that cumulation has to be based on a set of shared FTAs with identical rules of origin, or the arrangements would require a value-added origin rule where tariffs are charged only on those components that do not originate in the qualifying region. These requirements are rather stringent in the complex world of multiple and laboriously negotiated rules of origin. An additional point is that even if this were possible, it would amount to partial multilateralization, possibly with additional discriminatory implications for third parties.

The chapter by Mann and Xuepeng Liu is not much more sanguine regarding the idea that another documented multilateralization episode – the establishment of the Information Technology Agreement in the aftermath of the WTO’s first Ministerial Conference in 1996 – could serve as a model for moves towards multilateralizing regional approaches to trade policy. The authors argue that the IT sector was something of a special case, as was the timing of the ITA initiative. Information technology and the products associated with it are the bread and butter of innovation, productivity growth, diversification and development. Widespread interest in acquiring high-quality IT at low prices provided a significant incentive for governments to agree to a duty-free, open-ended sectoral deal, albeit one that required a high degree of reciprocity. Moreover, according to the authors, the political incentive to move in this direction was bolstered by the “hype” attached to IT in the early 1990s.

Part III examines a number of sectors and themes relating to the multilateralization question. The first chapter, by Fink and Jansen, is a detailed consideration of how far the notion of multilateralizing regionalism might be applicable in the field of trade in services. Service transactions are more complex than those involving goods and they tend to be heavily regulated in order to deal with market failures associated with information asymmetries, economies of scale and scope,

and network externalities. In some service sectors distributional issues may also arise. The core issue is how far these policy interventions in RTAs are discriminatory. The authors argue that rules of origin tend to be relatively liberal in most cases, except in respect of Mode 4 dealing with the movement of natural persons. In the case of Mode 3 transactions involving commercial presence, however, the use of quotas on market access gives first-comers an advantage that renders rules of origin irrelevant. A particular feature of some RTAs with provisions on services is the so-called non-party MFN clause, which guarantees all preferential service suppliers the same conditions of access under different RTAs. This arrangement automatically fosters multilateralization. Similarly, as noted earlier, certain regulations by their nature automatically apply on a non-discriminatory basis, thus imparting a kind of MFN dividend. One area where discrimination is likely to be inherent, however, is that of mutual recognition agreements. Here a question is whether multilateral surveillance might mitigate the negative effects of discrimination. Overall, the authors argue that in many instances RTAs involving service trade are likely to be mildly discriminatory, although there are exceptions to this and more research is required in this area.

The chapter by Esteveordal, Harris, and Suominen on multilateralizing preferential rules of origin notes that rules of origin can inhibit trading opportunities for third parties, limit trading opportunities within RTAs by choking off access to competitive inputs, and increase transaction costs for countries and companies seeking to trade across more than one RTA. In this sense, both restrictiveness and divergence in rules of origin matter. Rules of origin may be expressed in terms of wholly obtained or produced products, a change in tariff classification, exceptions and additions to a change in a tariff classification, value content or technical requirements, and practices with respect to these different approaches vary widely among RTAs and across regions. The authors report on the relative restrictiveness of different sets of rules of origin, showing quite a bit of variation. They also note that the greater the degree of restrictiveness, the more divergence matters. At the limit, divergence does not matter if rules of origin are non-binding, but the costs of divergence occur both in relation to customs procedures and corporate practices. The chapter identifies a number of strategic options for lessening the negative impacts associated with rules of origin, including multilateralization, regional convergence, and bilateral reform. They conclude that multilateral guidelines for rules of origin are desirable, that fully harmonized rules are neither

practical nor desirable, that some regional convergence (the authors call this “lasagna noodles”) could simplify multilateral negotiations, and, of course, that all the problems would go away if MFN tariffs were reduced to zero.

Pauwelyn examines legal avenues towards multilateralizing regionalism. Starting from the observation that Article XXIV of the GATT and Article V of GATS are largely inoperative, the author argues for the application of the principles of general international law. The core proposition of the chapter is that there should be no assumption of hierarchy between WTO law and law established in RTA agreements – in other words, we should move away from notions of hierarchy towards mutual accommodation. Without mutual accommodation, problems inevitably arise as a result of overlapping and sometimes contradictory laws, differing obligations among parties, and competing fora for settling disputes. The author develops eight basic rules of interpretation and practice. These include the notion that all treaties are in principle equal and binding only on those agreeing to them, a presumption against conflict, the possibility that treaties can explicitly regulate against overlap, that treaties are valid unless declared otherwise, that treaties most recent in time prevail over earlier ones, that the most specific treaty prevails and that WTO and RTA panels can consider both WTO and RTA law. The chapter then examines a range of particular legal situations to demonstrate how these principles would operate in practice.

Turning to the regionally based chapters – Part IV of the volume – Draper and Qobo discuss African regionalism and argue that prospects are poor for any multilateralization of regionalism in terms of the Baldwin framework. The impetus simply does not exist for the juggernaut and domino effects to take hold, and much of Africa is excluded from unbundling or production sharing. On the contrary, many African governments feel defensive and vulnerable when it comes to trade policy, owing in part to structural imbalances and inequitable rules governing agricultural trade. Unilateral trade policy reforms are not widely embraced, regional agreements are often partial and shallow, and the general posture on the international scene is preoccupied with preference erosion, residual interest in import substitution, policy space and special and differential treatment, and the need for external resource flows. Problems besetting the continent include supply-side capacity limitations, economic sparseness, challenges of governance and very high trade costs. The economic logic of what Africa needs – improved infrastructure, further liberalization in some areas, investor protection, trade

facilitation, rationalized regional arrangements, competition policy, stronger institutions, and “aid for trade” – does not always sit comfortably with prevailing policy postures. These are among the challenges that must be met before the multilateralization of regionalism could become a reality.

The chapter by Estevadeordal, Shearer, and Suominen on multilateralizing RTAs in the Americas notes that, by 2013, the spaghetti bowl of the Americas should have rendered 80 percent of trade free of duties. But the spaghetti bowl is large, dense, and complex, and considerable architectural heterogeneity exists among agreements. Moreover, there are exceptions to the general state of openness within the region, such as tariff rate quotas in agriculture and restrictions on textiles and apparel, food, chemicals, and footwear. Restrictive rules of origin also dampen the trade effects of RTAs. Many RTAs in the region have fairly comprehensive provisions in various other areas, such as services and investment. A possible move towards multilateralization could be transcontinental free trade in the Americas (FTAA), but this seems unlikely in the near future. Other approaches could include policies towards convergence within the region, bearing in mind the short-term risk of polarizing the region with respect to the rest of the world. Case-by-case liberalization of individual RTAs may be a possibility, for example through enlarging cumulation zones, selectively relaxing rules of origin, and further liberalizing products where these have already been liberalized within RTAs to major exporters.

The chapter by Kawai and Wignaraja argues that the proliferation of RTAs in Asia is a defensive response to regionalism elsewhere, as well as a reflection of slow progress in global trade talks. Other factors include the IT revolution and the growth of production sharing. The authors argue that RTA formation in Asia can be complementary to the WTO process and benefits the region in a number of ways. These benefits will tend to be higher with elements of WTO-plus in the RTAs. The focus of the chapter is on an ASEAN+3 configuration (with China, Japan, and the Republic of Korea) and an ASEAN+6 bloc (with India, Australia, and New Zealand added). The larger configuration, which moves towards an East Asian FTA, is more likely to mitigate “noodle bowl” effects and yield the largest gains for the region. This approach will encourage the participation of low-income countries in freer trade arrangements, reduce trade-related business costs, and promote trade and investment. The authors also argue that commercial relations with the United States and

the EU are important, and an East Asia–North America FTA and an East Asia–EU FTA could be on a future agenda.

Hufbauer and Schott also look at Asia-Pacific regionalism and argue that, notwithstanding fears in certain quarters that rapid growth in regionalism is eroding the WTO system, there are ways in which current and future Asia-Pacific FTAs could complement the WTO. Among the ways that this could happen are the various Asia-Pacific Economic Cooperation (APEC) initiatives aimed at developing best practices in regional agreements and through a proposal to harmonize MFN tariffs to the lowest rates of FTA partners. For its part, the best thing that the WTO could do would be to continue to lower MFN tariffs. One approach to this could be to harmonize MFN tariffs down to the lowest level prevailing among members of a regional agreement. WTO members seem to have little appetite for modifying the deliberately fuzzy multilateral rules on RTAs, although the new transparency mechanism is a timid step in the right direction. The best idea in the mechanism is the requirement to notify all changes to FTAs. In short, this chapter sees perhaps some prospect of a move towards multilateralization within the region, should a free trade area in Asia and the Pacific (FTAAP) emerge, although variance among RTAs in the region raises questions about how probable this is.

The chapter by Hoekman and Winters looks at “deep” regional integration questions from a developing country perspective. The authors are not very optimistic about overall prospects for the multilateralization of developing country RTAs – which they suggest has not really happened and in some cases might not in any event be a good idea. Nor do they see regional agreements offering an effective path to deep integration in developing countries. However, as far as the temporary movement of labor is concerned – a central focus of the chapter – it is clear that bilateral progress dominates multilateral action. Among the reasons for this are linkages between trade and migration, a lack of symmetry in the market for reciprocity, the binding nature of multilateral commitments, the need for mutual trust, and the role of culture in a globalized world. Further progress might be forthcoming with more explicit cooperation between origin and destination countries and more technical and adjustment assistance for developing countries.

The chapter by Rollo also has a regional flavor in that it considers the challenges facing developing countries in negotiating RTAs, given the second-best nature of such arrangements. Developing countries with

resource constraints are likely to be at a particular disadvantage in assessing the costs and benefits of RTA proposals. The Sussex Framework is a relatively low-cost but robust analytical tool for making such assessments. The chapter argues there is a case for public or low-cost provision of such analytical tools, and that the WTO might in principle provide such services. But the author goes on to argue that perhaps this could cause a conflict of interest for the WTO and that there may therefore be a case for establishing an Advisory Centre on RTAs, modeled along the lines of the Advisory Centre.

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