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## **Regional representation in the WTO**

## **A new role for regional trade clubs?**

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### *Abstract*

This paper analyses the crisis of decision making in the WTO from the perspective of collective action and public goods theory. At the heart of the current policy paralysis is the inability of WTO members to collectively provide the global public good of a multilateral trade regime that benefits all. The rise of regionalism is explained by governments 'voting with their feet' and moving away from multilateralism. As the EC experience shows, regions not only achieve more 'deep integration', they also provide regional public goods. Regional preferences are more homogeneous, values are more similar and socio-cultural ties closer than at the global level, which facilitates regional collective action. The paper proposes the creation of a 'Club of Regions' in the WTO as a means to recreate incentives for collective action at the global level. It would provide a remedy for the present policy paralysis associated with consensus and the single undertaking by providing a more flexible institutional framework and allow regional actors to play a more positive role at the multilateral level.

Keywords: collective action; public goods; club goods; multilateralism, regionalism

The so-called 'Green Room' process is at the core of the controversy about the way in which decision making by consensus has become distorted in the World Trade Organisation (WTO).<sup>1</sup> Developing countries have increasingly protested at the paradoxical situation in which WTO decisions are formally taken by consensus and, although the overwhelming majority of its members are developing countries, yet the decisions are invariably against the interests of the South. The Sutherland Commission (2005), tasked with providing recommendations for the future reform of the WTO, has proposed, *inter alia*, the idea of 'regional representation' in the Green Room. But what exactly is meant by 'regional representation' and what model does it have in mind?

The European Community is the best example of a regional trade club in the WTO. The Community has become a very visible actor as it has been 'the single voice' of the Member States in the GATT since the early 1960s.<sup>2</sup> And it is the Community that is invoked as a party in trade disputes, not the Member States. Today the Community is

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<sup>1</sup> The Green Room process refers to the informal type of decision making, which is dominated by a small group of powerful countries, that has become part of the WTO practice over the years. See Jones (2006) for a full discussion of the issue.

<sup>2</sup> Since the European Community established a customs union from the very beginning, it required having a common external tariff. The founding EC treaty provided the institutional means for a common external commercial policy.

the world's largest exporter of goods and services and the world's largest market. It has become a key player in international trade negotiations as the national preferences of its member states are aggregated into a common policy. This gives significant leverage and influence in the negotiations and by acting collectively, the Community can achieve far more influence than if each country were to negotiate individually. So, does the experience of the EC suggest that the re-grouping of WTO members into regional groups could create the conditions necessary to revitalise collective action at the global level?

The WTO uses the term regional trade agreements in a very general way to include bilateral free trade agreements (FTAs) customs unions and economic partnership agreements as well as regional economic blocks like the EC. In this paper, regional trade groups will be used in a more restrictive way, as it excludes bilateral FTAS and only includes regional groups of countries that are involved in a longer term process of region building. Those regions are composed of countries that are geographically close together, that have shared common historical experiences, and face common problems today. The depth of market integration may vary from 'shallow' to 'deep' integration and so too, the robustness of the institutional integration may vary from 'soft' political consensus to 'hard' legal integration. Be that as it may, the determining factor is that 'regions' are involved in a dynamic process of integration which goes beyond a mere static, one-off free trade agreement.

The evidence of new dynamism in regional economic integration is now a truly global phenomenon. While the EC used to be exceptional in the level of its trade integration and intensity, other regions are now catching up fast. Intra-regional trade in East Asia is now equivalent to that of Europe in the early 1990s, which has now surpassed that of the North American Free Trade Area (NAFTA). In South America, MERCOSUR is emerging as the most important regional economic block and in Sub Saharan Africa regional trade groups are in a process of consolidating their South-South regionalism as a mechanism for development and a stepping stone to fuller integration into the global economy.

With the rise of new regionalism, academic debate has begun to focus more on the institutional arrangements of the WTO as opposed to the traditional concern with analysis of trade policy from the perspective of how liberal or protectionist it is. In the past, mainstream trade economics considered institutions important only with respect to how they could allow producer groups to achieve protectionism.<sup>3</sup> However, the neglect of the more general role of institutions in favour of a technocratic approach to trade policy making has led to widespread failure of trade liberalisation in many developing countries.<sup>4</sup>

The central question posed with regard to the multilateral trade system today is how to provide new incentives for international co-operation to accommodate increasing openness and diversity in the global economy (Lawrence, 2004). The institutional structure of the WTO has become increasingly subject to stress, as it has grown from a relatively small homogeneous group of countries to become a large heterogeneous organisation of 151 members. Increasing diversity in levels of economic development has made decision increasingly unwieldy and difficult..

Against this background, the decline of multilateralism and the rise of regionalism are viewed as related phenomena (Fratianni and Pattisson, 2001). If RTAs are growing faster because they are smaller, more efficient and more easy to manage, then there is need for a new multilateral structure which creates incentives for regions to cooperate at the global level, they argue. Lawrence (2005) presents analysis along the same lines. Viewed from this perspective, the WTO could play the role of the overarching global club that co-ordinates the growing number of regional trade clubs. In summary, this structure would be composed of interacting regional and global trade clubs

The objective of this paper is to analyse how regional representation could contribute to resolving the problems of collective action in the WTO. The paper is organised in three

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<sup>3</sup> The political economy of protectionism explained the phenomenon of protectionism in terms of the ability of relatively small groups like producers' groups to organise politically and effectively lobby their governments, while widely dispersed consumer groups did not have the same advantage.

<sup>4</sup> There is renewed interest in the study of institutions today and there has been a number of important theoretical developments in this field. See the recent edited volume by Ha-Joon Chang (2007) for a comprehensive analysis of this emerging new field.

parts. Part one presents the theoretical framework of analysis. Part two examines the EC as the most established regional trade club and part three explores how a global 'club of regions' might be created and operate in the WTO.

## I: The WTO as a mechanism for global collective action

The creation of the World Trade Organisation (WTO) in 1994 was hailed as a major step forward in providing a strong institutional framework for the governance of global trade. The mission of the WTO is to improve global economic welfare by reducing barriers to trade, by eliminating all forms of discrimination and by enhancing development through trade. Critics of the multilateral trade system like Stiglitz (1998) and Rodrik (2001), claim that the WTO has confused ends and means by putting primary emphasis on trade liberalisation *per se* to the detriment of its final goal. The ultimate *raison d'être* of the WTO is to provide the global public good of global economic welfare that is shared by all, and not just some, of its members (Mendoza, 2003).

The WTO has been increasingly contested for its failure to provide the mechanism for achieving this global public good. The outcome of the Uruguay Round has been criticised for its 'unbalanced outcome' that has imposed disproportionate costs on developing countries (Finger and Schuler, 2002). The first Ministerial Meeting in Singapore ran into trouble when it proposed a 'new trade agenda' that was spearheaded by industrial countries but rejected by developing countries. The so-called 'Singapore issues', as they have been known since then, envisaged the WTO extending its remit into new areas of investment, competition, public procurement and trade facilitation. Developing countries insisted that this should only happen as a result of an 'explicit consensus' to be taken at a later date. The Seattle Ministerial Meeting of 1999 broke down as developing countries refused to accept the inclusion of non-trade issues such as labour and environmental standards into the WTO.<sup>5</sup>

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<sup>5</sup> Developing countries fear that environmental and labour standards could be used as a form of 'disguised protectionism' against them. This fear is not completely unfounded after their experience of how industrial countries have used the anti-dumping rules of the WTO in a protectionist way against the South.

The subsequent Doha 'Development' Round, which was launched in 2001 against the background of the Millennium Development Goals (MDG), reflected the emergence of a new international consensus on the importance of trade for development. However, the Doha Round has encountered increasing problems and growing conflict came to a head at the Cancun Ministerial meeting in 2003. In response to developing countries' open rejection of the Singapore issues, United States Trade Representative Zoellick (2003) expressed his country's intention to pursue them outside of the WTO with like-minded countries. The European Union has since then followed suit. Compounded by lack of agreement on the liberalisation of agriculture, the Doha Round has been suspended and its successful conclusion is in doubt. The failure of the WTO challenges the traditional analysis of trade liberalisation.

Traditional analysis of the multilateral trade system has been dominated by neo classical trade theory which focuses on how to maximise the gains from trade in order to increase global economic welfare. Any country that unilaterally liberalises trade will experience beneficial effect through gains in efficiency by removing the production and consumption distortions created by protectionism. Additional gains may be derived from economies of scale as fragmented national markets become more integrated into the international economy. Furthermore trade liberalisation is conducive to learning, innovation and technical progress. But the gains from trade will be far greater if all countries engage in collective, multilateral liberalisation. This is the basic rationale of the multilateral trade system, which has been further reinforced by game theory models that demonstrate while protection may be in the interest of any one individual country, the best outcome will be achieved when all countries liberalise together.

But the current WTO paralysis can best be explained as a classic demonstration of the dilemma derived from 'the logic of collective action' (Olson, 1965, Hardin, 1971). While the WTO as a group is committed to multilateral trade liberalisation not each and every member is equally committed to the same goal. This is reflected in the increasingly acrimonious debate in trade policy circles about how the benefits and costs resulting from trade liberalisation are distributed among WTO members. 'Free riding'

frequently undermines collective action as some members or sub-groups are able to extract benefits from the system without paying their share of the costs. The perceived imbalance between benefits and costs in the WTO is what prevents the emergence of a 'global preference' that is essential precondition to build a global consensus on which to move forward the negotiations.

- *Collective action and the multilateral trade system*

Cooperation required for successful multilateral trade liberalisation depends on the collective action of governments to provide the public good of a multilateral trade system. The success of the post war General Agreement on Tariffs and Trade (GATT) was its ability to successfully harness collective effort in the pursuit of multilateral tariff reduction. The GATT succeeded in transforming the negative externalities of the tariff wars during the 1930s into the positive externalities of cooperative action by governments to move collectively to free trade. Through successive rounds of multilateral tariff reduction, the GATT further facilitated trade by reducing uncertainty, by making the behaviour of its members more predictable, by increasing transparency for economic decision-makers, by reducing transaction costs through multilateral rather than bilateral bargaining and by increasing the credibility of members' commitments through legally bound tariffs and a dispute settlement mechanism in the event of conflict. The GATT presided over a period of global economic growth and a 'golden age' of development in one region of the world - in East Asia.

Because tariff liberalisation was not always Pareto optimal, the GATT was unable to prevent the efforts of 'special interest groups' to get effectively organised and receive protection. This was reflected in a number of 'exemptions' from the rules in GATT granted over the years, first of all in agriculture and later in textiles and clothing under the Multifibre Arrangement (MFA). From the 1970s on, developing countries were exempted from reciprocity and received unilateral tariff preferences under the Special and Differential provisions. Neither did they join the Tokyo Round Codes negotiated in

the 1970s.<sup>6</sup> Thus, there was a certain amount of 'free riding' but it was sufficiently contained so that it did not undermine the basic global consensus underlying the collective action.

- *The multilateral system. What kind of public good?*

Since the work of Samuelson (1954) public goods are identified by two essential characteristics. The first is non-rivalry in consumption, in other words, once they have been made available to one person, they can be consumed by others without additional marginal cost. The second feature is that they are non-excludable, that is, once a public good has been supplied for one it is impossible to exclude anybody from consuming it. It is the function of states to produce public goods (Baumol, 1952); they have to be produced by governments because there is no incentive for private industry to supply them. Moreover, governments can overcome the free rider problem by using the coercive powers of the state to make citizens pay taxes to finance public goods.

But not all collectively provided goods are pure public goods in Samuelson's sense. In his theory of 'club goods', Buchanan (1965) provides a middle way between pure public and private goods. A club is a voluntary group of members who join together to provide a collective club good and who are willing to share the costs and benefits. A club good is a particular case of a pure public good, characterised by excludability and non-rivalry. A club good is excludable and that is its main characteristic. Non-rivalry is also mitigated, however, as the number of members of a club increase, rivalry and congestion will also increase. This may alter the perceptions of the members about the costs-benefits balance of membership in this club.

Thiebout (1956) provided an important contribution to understanding the optimal size of clubs.<sup>7</sup> Where externalities exist and economics of scale can be exploited, the

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<sup>6</sup> This analysis does not argue that similar principles apply to the type of trade protectionism that was practiced by industrial countries under the GATT and the special and differential treatment granted to developing countries, which neo-liberal economists have frequently implied. The objective here is rather to indicate that although the GATT functioned successfully in general terms, it had a number of failures in collective action.

<sup>7</sup> Thiebout's theory was originally conceptualised to deal with the organisation of fiscal policy in federal states and the distribution of power between central and local jurisdictions. Today it has become generalised to all areas of economic

optimal provision will be the relatively larger, centralised club, which would be the global trade club. But, in the presence of information asymmetries and divergence of preferences among members, there will be a strong tendency towards relatively smaller, decentralised clubs, which is regional trade clubs. The regulating mechanism for determining which club is preferred comes automatically from members 'voting with their feet'. The rise of regionalism over the past decade has shown governments voting with their feet and moving away from the global trade club to smaller regional trade clubs.

- *Governance and the provision of public goods*

Can 'global governance', which has been described as the absence of global government provide global public goods? As Kindleberger (1986) argued, the creation of multilateral institutions has been a necessary but not sufficient condition for the provision of global public goods. In addition to the multilateral institutional framework for cooperation, the stabilising power of a single hegemon is needed.<sup>8</sup> The United States was the dominant provider of cooperation in the GATT contributing to the success of its first four decades. As the largest producer in the world economy, the US needed export markets and was, consequently, willing to bear a disproportionate share of the costs. As the theory of the single hegemon creates within itself the seeds of its own decay, the hegemonic role of the United States inevitably began to wane. With the rise of economic power in other regions, notably in Europe and East Asia, the declining commitment of the United States became increasingly apparent which has led to growing problems since the creation of the WTO. Why is it so difficult?

The success of the original GATT was confined to a very narrow area of border tariffs on manufacturing goods. The creation of the WTO extended the remit of trade liberalisation into the new areas of services, investment and intellectual property rights.

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regulation, and especially in areas that are directly linked to regulatory barriers that are of special importance for addressing the competition oriented obstacles to market openness and global competition

<sup>8</sup> Kindleberger's work on the role of the hegemon was strongly influenced by his historical study of the role of the lender of last resort in financial markets. The hegemonic theory has now been generalised by club theory to trade clubs.

Moreover, the outcome of the UR had to be accepted as a 'Single Undertaking'.<sup>9</sup> It also provided for a tougher dispute settlement and greater potential for sanctions and retaliation. Decision making by consensus became, for the first time, a legal procedure rather than just a practice.

Since the creation of the WTO, it has been increasingly difficult to achieve cooperation in the WTO. The propensity to cooperate is determined by interaction between the degree of congruence between Members' preferences and the robustness of the institutional framework. Decreasing congruence of the preferences of Member countries has become more obvious and entrenched. While industrial countries display their marked preference for 'deep integration', this is not shared by developing countries.<sup>10</sup> A similar situation exists with regard to non-trade issues such as environmental and labour standards. And while developing countries insist on expanding special and differential provisions, many industrial countries are strongly opposed to it. Given those factors, the creation of a powerful institutional framework that constrains options available to developing countries, the resulting outcome has turned into a situation of policy paralysis.

The extension of the WTO into the new fields has impaired the ability of governments to continue providing public goods that they have traditionally done. A series of financial crises, the worst of which was in East Asia in 1997-98, has shown how financial liberalisation advanced by the multilateral institutions has undermined financial stability in a number of developing countries. The trade-related intellectual property rights (TRIPs) impinges on governments ability to provide public health in many developing countries. The provision of consumer and environmental protection has been made more complicated in industrialised countries.<sup>11</sup>

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<sup>9</sup> The Single Undertaking obliged developing countries to accept the whole package of the Uruguay Round, including the Tokyo round Codes in which they were not involved in negotiating, and the TRIPs agreement which were not in the interest of development.

<sup>10</sup> Deep integration includes the Singapore issues as well as services and intellectual property rights.

<sup>11</sup> The example of genetically modified foods in Europe demonstrates how revealed preferences of consumers can be interpreted as protectionism under trade rules.

- *The WTO: what kind of global trade club?*

Club theory provides a conceptual framework for re-thinking the WTO's role as a global trade club. Lawrence (2005) has proposed that it should operate as 'a club of clubs' organised to achieve the common goal of multilateral trade liberalisation. The fundamentals of multilateralism remain intact. All members share the values of multilateralism and are willing to accept the rights and obligations that are derived from membership. The club exists to provide club goods and will be able to prevent free riding by its ability to exclude. However, a number of smaller clubs would be allowed in order to accommodate the diversity of its members' development and preferences. The notion of smaller 'clubs' existing inside the global trade club is not entirely unprecedented as the plurilateral Codes that were negotiated during the Tokyo Round satisfied many of the characteristics of clubs outlined above.<sup>12</sup> Those Codes were successful, in that while membership was open to all members, no countries were forced to join. How might this idea be extended to the notion of regional clubs?

## **II. The EC: a regional trade club in the WTO**

The EC regional trade club has much in common with the WTO global trade club. Both are based on the principles of free trade and both share the common aims of progressive liberalisation through the removal of barriers, elimination of discrimination and the abolition of unfair trade practices. Furthermore, both systems allow for general exception from free trade under certain conditions, for example, for protection of the environment (Weiler, 2000). But in contrast to the decline of multilateralism, the regional EC system has experienced increasing returns in the liberalisation of the new trade areas of services, investment and capital mobility.

From the original customs union of the 1960s, the EC has evolved into a fully fledged internal market. Cross border trade has been expanded beyond traditional goods to

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<sup>12</sup> Plurilateral trade agreements were negotiated by groups of like-minded countries during the Tokyo Round of the 1970s, thus leaving the opt out possibility for members who did not want to join. Developing countries chose to remain outside of those agreements.

include free movement of services, capital and labour. Furthermore, positive integration has been enhanced by the adoption of a new approach towards harmonisation of standards and regulatory barriers which address behind-the border barriers that act as obstacles to trade. So why has the regional trade club got ahead of the global trade club?

- Regional trade liberalisation

The EC regional model, which combines economic and political integration, provides some compensating by products that facilitate a more compatible costs/benefits balance for the member states (Wyplosz, 2002). Economic integration has been an integral part of providing peace and security in Europe since the end of World War Two.<sup>13</sup> This political gain provides an incentive for Member States to accept the political cost of upsetting domestic special interest groups which otherwise would oppose trade liberalisation. Such benefits, which are outside of the realm of trade theory and traditional economics, have contributes to successful integration in Europe. From a purely economic perspective, however, the EC model has derived much strength from its ability both to shape and adapt to the dynamic changes in the global economy.

Old and new regionalism theories reflect the changing structure of global production and trade in the post war period. Old regionalism was based on the concepts of trade creation and trade diversion derived from the welfare effects of tariff elimination (Viner, 1950). Trade creation has predominated in the industrial sector leading to an outcome of ever more intensive regional trade. Intra-regional trade now accounts for over two thirds of total EC trade - which surpasses all other regions in the world. A major defect of the static customs union approach is the failure to take into consideration the dynamic effects of regional trade liberalisation, which are the most important in the long run. A larger regional market allows small to medium sized countries to expand their market, it offers economies of scale and stimulates enhanced competition.

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<sup>13</sup> The Schuman Plan was designed to make war materially impossible between France and Germany again by integrating the war making industries under a supranational institutional framework.

New regionalism theory integrates the dynamic effects of economic integration, the interaction between trade and investment and the role of institutional arrangements in providing incentives for deep economic integration (Ethier, 2001). As tariff barriers have been successively reduced and new information technologies have become widely available, foreign direct investment (FDI) has become relatively more important in European trade. As investment costs have been rapidly declining, the emergence of a large regional market has favoured regionalised production. This has been accompanied by regional clustering of production and the creation of regional value chains - all of which have an important impact on trade liberalisation strategies. From a political economy perspective, regionalism provides a trade off in favour of negotiations among a smaller number of countries desiring deep integration, as opposed to the larger group involved in multilateral trade negotiations with heterogeneous preferences.

- Deep integration and regional public goods

The EC internal market launched a process of deep integration that was accompanied by increasing centralisation of economic competences at the regional level.<sup>14</sup> Deep integration is more closely associated with 'regulatory competition' than with the price competition of traditional trade. But regulatory competition brings conflict between national regulations that have been put in place by governments -- many of which were originally designed to provide national public goods. How to achieve a balance between creating a regional market and providing regional public goods is a crucial element for success.

Regional trade clubs may, however, enjoy comparative advantage in the provision of public goods as the preferences of neighbouring countries are more homogeneous, their values are more similar and their socio-cultural ties closer, than at the global level. Thus regional systems have an inbuilt advantage over the global system regarding their propensity to cooperate and provide collective goods. But cooperation can never be

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<sup>14</sup> The major institutional innovation of the internal market was the introduction of majority voting for all sectors that were essential for the completion of the internal market.

taken for granted which serves to reinforce the need for appropriate institutional arrangements.

Towards this end the EC has been obliged to embrace the principle of 'variable geometry' that allows for varying degrees of flexibility in decision making. Qualified majority voting is used in core economic policies that are essential to the internal market, but unanimity has been maintained for the more politically sensitive sectors such as social policy. The open method of coordination, where there is no real decision making, only pressure to accept best practices, is applied to labour market issues where the least of all integration has occurred.

Thus, institutional innovation and a more flexible, modulated approach to decision making has made possible the provision of essential regional public goods such as environmental protection and social policy. In addition to institutional flexibility, the provision of European financial transfers for structural adjustment has modified the costs of comprehensive trade liberalisation for the poorest countries in the region.<sup>15</sup>

- *How regional clubs negotiate externally*

The common external trade policy of the EU is of special relevance for the topic of regional representation in the WTO. Of special interest here is not how liberal or protectionist that trade policy may be, but rather how collective action takes place between 27 countries that is, how national preferences are aggregated into a common policy. Although the founding EC assigned exclusive competence to the Commission for shaping a common commercial policy (CCP), cooperation in this field has become increasingly complex and difficult over the years.

Member governments preferences are defined as preferred policy options for realising specific national interests. Those preferences are the outcome of a complex process of interaction between governments and non-governmental actors' interests that are

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<sup>15</sup> The EU has its own form of internal development aid, known as the structural funds, through which financial aid and technical assistance is channelled from the richer to poorer countries in the region.

mediated through domestic political institutions. Those preferences are not stable and can change in relation to changing conditions (Young, 1998). How does the EC achieve a common policy when the MS have different economic interests. During the 1990s the different interests became visible in a number of sectors, notably agriculture, services and investment.

Part of the explanation lies in the linkage between the internal market and external trade policy. The internal market, which is based on 'hard' legal integration<sup>16</sup>, increases the likelihood of cooperation in external trade policy through three mechanisms. One, the EC can constrain members preferences in ways that were not possible prior to the EC. Two, the EC institutions increase the costs of non-cooperation. Three, institutionalisation of cooperation in some areas increases the appropriateness of cooperation in other areas and causes governments to think about their long-term interests compared to short-term considerations (Young, 2001) Those factors seem to have worked in practice as the EC has a track record of repeated cooperation in the GATT/WTO despite the fact that the MS have different economic interests.

In contrast to the 'hard' legal integration of the internal market, the common commercial policy has evolved through 'soft integration' by adopting non-legally binding modes of cooperation. In external trade policy, the member states have shown their preference for political pragmatism and have relied on various forms of cooperation that are much less constraining than a legally mandated common policy.

But this policy has become increasingly difficult to sustain since the creation of the WTO. Member States have been unwilling to grant exclusive competence to the Commission in the new areas of services, investment and intellectual property rights (IPRs). Thus, congruence of preferences and compatibility of interests among the member States has become more complex. This suggests that regional representation in the WTO may not necessarily facilitate consensus building in the future.

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<sup>16</sup> The liberalisation programme of the Internal market has been paralleled by expanding community competences and the extension of legally binding rules at the European level.. the robustness of the institutional framework of the IM has been a major contributing factor to its successful trade creation.

### **III. Towards a Club of Regions in the WTO?**

Regional trade clubs are currently subject to very little regulation in the WTO and operate in an increasingly autonomous manner outside of its purview.<sup>17</sup> A new role for regional trade clubs is now warranted, especially as they are growing so fast that they may overtake multilateralism. Regional trade clubs have become an integral part of global trade as over 50 per cent of global trade takes place within regions. The empirical evidence shows that intra-regional trade is growing relatively fast due to the influence of multiple factors that favour it such as economic geography and regional clustering of production, lower transportation costs and regional similarities in tastes etc.

All of this suggests that regions around the world are, to a greater or lesser degree, replicating the EC regional trade club. The European aspiration of political integration is not an essential precondition for building regional institutions to foster deeper economic integration, as shown by the diverse conditions of region building around the world. Decision-making between a smaller group of neighbouring countries has become easier than in the WTO with its large and heterogeneous membership. So liberalisation and rule making in the new areas of trade can be greater at the regional level than at the multilateral level.

- *Why governments are voting with their feet*

Viewed from the public goods perspective, the rapid rise of regionalism over the past decade suggests that governments are 'voting with their feet' and moving away from multilateralism. The global (centralised) jurisdiction was optimal for the GATT's mission of post war tariff reduction. By acting collectively countries were able to

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<sup>17</sup> RTAs are negotiated outside of the WTO but they must be subject to certain rules, notably Article XXIV governing trade in goods and Article V of the GATS governing trade in services. They must be notified to the WTO and assessed for conformity by the Committee in Regional Trade Agreements that was established in 1996. There is however general recognition that the Committee does not have either the power or the resources to carry out its functions in an effective manner.

exploit economies of scale through multilateral tariff negotiations and create positive externalities for the multilateral trade regime.

The mission of the WTO is formally similar to that of the GATT but its substantive policies have gone beyond the narrow field of tariffs to include services, investment, intellectual property rights. Consequently, the regional (decentralised) jurisdiction may turn out to be a more appropriate location for trade liberalisation and rule-making in many of the new trade areas as preferences are more homogeneous and informational asymmetries between neighbouring countries are smaller.<sup>18</sup>

That is not to say, however, that the problems of collective action at the global level can be solved at the regional level. The absence of global collective preferences in the WTO, which is the major factor contributing to the present paralysis of decision making by consensus, can not be substituted by regional preferences. So, there is need for a new mechanism that would recreate the incentives for collective action at the global level. This paper argues that a 'Club of Regions' within the WTO would be the most appropriate means towards achieving that goal.<sup>19</sup>

- *What a club of regions could do*

A Club of regions could provide remedial action for two major problems that have become intertwined in the breakdown of the current WTO decision making, namely consensus and the Single Undertaking. In the current situation, countries are increasingly forming coalitions to augment their bargaining power and also to strengthen their ability to thwart the whole final package of the Round's negotiations, by refusing to join the consensus. The major advantage of the Club system, is that it would offer an alternative means of decision making that would provide for greater flexibility to accommodate the diverse preferences of its members.

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<sup>18</sup> The intentional trade system seems to be evolving towards a 'multi-level governance' system that could, in the future be based on the principle of subsidiarity. The latter implies that trade regulation should be made at the level which ensures that its provision and implementation is most efficient and effective.

The essential elements of the Protocol for a Club of Regions would state clearly that membership is strictly voluntary and all negotiations concluded between the members of the Club would not be part of any future Single Undertaking in a new round. The ultimate aim of a Club of Regions would be to strengthen the WTO's mission, means and legitimacy, by providing a forum for negotiations relating to the specific issues of regionalism.

A Club of RTAs would have to possess adequate expertise, resources and authority to carry out its tasks and to achieve its stated mission. The already existing Committee on RTAs in the WTO would provide a starting point but would need to be strengthened. Regions and their member states would be responsible for implementing new rules and for monitoring them. To ensure legitimacy, there should be widespread agreement that this issue should be treated in the WTO while at the same time minimising the constraints on regional autonomy.

Regionalism is currently been driven by short term motives that may not be in the long term interest of the WTO. Countries fear that being left out of a growing web of RTAs could have a negative effect on market access opportunities for their exports. Many small countries see regional liberalisation as a catalyst for locking in their domestic economic reforms into the larger regional unit. Some countries want to use RTAS as part of a underlying strategy to achieve geo-political goals. Companies are concerned about competitiveness and prefer the faster liberalisation results at the regional level to the slow pace of achieving results at the multilateral level to accommodate the shortening product cycles and accelerating product obsolescence.

The current trend of RTAs present risks for the multilateral system to the extent that they go beyond existing multilateral trade rules and diverge from WTO rules and practices. To the extent this results in increasing fragmentation of trade rules the results

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<sup>19</sup> The following section draws on and builds upon the ideas presented by Robert Lawrence (2005), on the WTO as 'a club of clubs'.

will be increasing transaction costs for traders and increasing uncertainty about future trade rules.

Potentially even more harmful is the fact that the North-South divide in the WTO has now been transferred to the regional level. Diverging preferences in North-South RTAs have become increasingly apparent. While developing countries want to get greater market access to industrial countries, the latter are using RTAs to advance the deep integration agenda that was rejected at the multilateral level. In this context, the legitimacy of the WTO may be further tarnished as the powerful countries of the North used their economic and negotiating power to impose disproportionate trade liberalisation on developing partners in the South.

## **Conclusions**

This paper has analysed the crisis of decision making in the WTO from the perspective of collective action and public goods theory. At the heart of the current policy paralysis is the inability of WTO members to collectively provide the global public good of a multilateral trade regime that benefits all.

Since the creation of the WTO, it has become increasingly difficult to achieve consensus due to diverging preferences between industrial and developing countries. While the North wants to move ahead with the new trade agenda of deep integration, the South rejects those issues at the multilateral level.

In this context, the rapid rise of regionalism over the past decade demonstrates why governments are 'voting with their feet' and moving away from multilateralism. As the EC experience shows, regions are able to achieve more trade liberalisation, including in the new areas, and also enjoy comparative advantage in the provision of regional public goods. Regional members' preferences are more homogeneous, values are more similar and socio-cultural ties closer than at the global level, which facilitates regional collective action.

The paper concludes that the creation of a 'Club of Regions' in the WTO could recreate the incentives necessary for collective action at the global level. It would provide a remedy for the present policy paralysis associated with consensus and the single undertaking by providing a more flexible institutional framework and allow regional actors to play a more positive role at the multilateral level.

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