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The Regional and Multilateral Dilemma: Institutions Do Matter

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THE REGIONAL AND MULTILATERAL DILEMMA:

INSTITUTIONS DO MATTER

« The market mechanism, which arouses passion in favor as well as against, is a basic arrangement through which people can interact with each other and undertake mutually advantageous activities... The overall achievements of the market are deeply contingent on political and social arrangements.. In the context of developing countries in general, the need for public policy initiatives in creating social opportunities is crucially important »,
A. Sen, 1999, p. 142-143.

Abstract:

The world trade has been politically framed towards liberalism and « openness ». It is evident that this openness has its own grades and interests that command it. Developing countries have been directed, and pushed towards a playing ground they fear and ignore. But some would argue that even developed countries have to go through such stages. The whole difference here is the gap between where the latter stood when they decided to move toward openness and where developing countries do stand today.

A simple and obvious proof of that is the increasing number of regional trade agreements (RTAs in following papers for convenience) that most countries have adopted. If we agree that regional networking should serve coordinating interests, RTAs came to answer a multilateral dilemma: multilateral negotiations are asking different and diversified countries, economies and cultures, to melt into a single frame defined by the « Triade »¹, the world powers.

In this paper we will examine the regional trade in the context of world trade (part 1) and contrast regionalism and multilateralism. My conclusion that regional agreements hinder the progress of a fair and dynamic multilateral governance and reduce its institutional progress.

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Keywords: Regionalism, Multilateral Negotiations, Trade.

¹ This Triade includes the European Union, the United States of America and Japan.

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1. World trade and intra-regional shares

Regional agreements have been an ongoing trend in the past decade. We may consider here bilateral or multilateral agreements, even though,

« Bilateral agreements may include more than two countries when one of them is an RTA itself (e.g. EC (15)- Turkey (1) is an RTA comprising 16 countries). A plurilateral agreement refers to a RTA in which the constituent parties exceed two countries (e.g. EFTA, CAN, MERCOSUR, etc.). WTO Secretariat, 2003.

Bilateral agreements account for nearly 80% of regional agreements implemented and some 90% of those under negotiation. More complex are, multilateral agreements where one of the contracting parties is itself a regional agreement such is the case of the European Union. This type represents some 20% in 2002 of the regional agreements under process. The WTO estimated the number of RAs to approach 300 by 2005.

The EU is indeed a study case: under the principles of the « *acquis communautaires* »², the enlargement to EC (25) in May 2004 which in addition to adding ten new members to the EC, will result in a consolidation of over 60 RTAs which will cease to exist once the acceding members become party to the EC's existing RTA network.

What explanations can we give to interpret this trend? The WTO has some:

« A major explanation for the expansion in the number of RTAs in the 1990s was the collapse of the COMECON (the preferential arrangement involving the old Soviet Union and Eastern European countries) and the alignment of the Central and Eastern European countries to the European Union », WTO report, 2003, p.46.

Where do developing countries stand in this background?

« Regional agreements among developing countries account for 30-40 per cent of all RTAs currently in force, including those not notified to the WTO. In Africa alone, there are about eighteen

² according to which, new Member States agree, at entrance, to adapt to the context, rules, norms and laws implemented by the EU.

trading agreements. Typically, they seek to reach beyond free trade agreements (FTAs in this paper for convenience) and establish customs unions or common markets. They tend to encompass a large number of countries and may have extended transition periods, often 20 or 30 years. These long transition periods suggest that some recent RTAs are more a declaration of intent than agreements promising a significant impact on trade flows »», WTO Secretariat, 2003, p.46.

Indeed, developing countries have been eager to consolidate proximity and cultural affinities with neighbors or allied countries. Table 1 shows that developing countries have been very active in this trend. More than 149 agreements negotiated or under negotiation by May 2003.

table 1: Regional agreements applying or under negotiations (by May 2003)

	Notified to WTO	Concluded but not notified to WTO	under negotiation	Total developing countries	share (in percentage)
Total of agreements by developing country, where	76	34	39	149	100
USA is a member	3	2	4	9	6
Canada is a member	4	0	3	7	5
EU of EFTA is a member	24	5	5	34	23
Japan is a member	1	0	1	2	1
Ex-Soviet-Union and other countries in transition are members	16	0	0	16	11
Intra-developing countries	27	26	23	76	51
TOTAL of agreements by developed and developing countries	155	83	46	283	

Source: WTO, www.wto.org/english/tratop_e/region_e/region_e.htm, borrowed from Schott, 2003.

notes: EFTA : European Free Trade Agreement.

- a) *Agreements are only accounted once, even if notified under the GATT's articles XXIV and V. Nevertheless, NAFTA (which includes USA, Canada and Mexico) were counted twice, as USA/ NAFTA and as Canada/ NAFTA agreements.*
- b) *Agreements that were under negotiations at that time concerning the American Free Trade Agreement- AFTA) were counted twice: as USA/ Developing countries and Canada/ developing countries, same as Canada/ EFTA was considered under Canada and under EFTA.*

As striking as it may be, « One-third of the FTAs currently under negotiation are among countries that belong to different geographical areas. All major countries are involved in cross-regional FTAs. The

EU has concluded FTAs with Mexico, Chile, South Africa and numerous other African and Middle Eastern countries and in the process of negotiating RAs with ACP³ countries under the framework of the Cotonou Agreement. The EU is also negotiating an agreement with MERCOSUR », WTO report, 2003, p.51.

Trade has been a major, not the only, component of this evolution. Cultural exchanges, migrations and delocalization have also their places in such process. Let us take a look at world merchandise trade by region shows the tremendous increase in imports in value. A growth where Asian countries can be considered as the main vector. Africa and the Middle East have been quite close in last figures of 1993 to 2002, noting a great decline for Africa in imports.

Concerning exports, Western Europe as maintained a steady trend, as well as Asia with a better increase, especially for the six East Asian traders.

table 2: World merchandise trade by region and selected economy, 1948, 1953, 1960, 1973, 1983, 1993, 1999 and 2002 (Billion dollars and percentage)

	1948	1953	1863	1873	1983	1993	1999	2002
Exports								
Value								
World	58.0	84.0	157.0	579.0	1835.0	3671.0	5473.0	6272.0
share								
World	100	100	100	100	100	100	100	100
North America	27.3	24.2	19.3	16.9	15.4	16.6	17.1	15.1
Latin America	12.3	10.5	7.0	4.7	0.0	4.4	5.4	5.6
Western Europe	31.5	34.9	41.4	45.4	38.9	44.0	43.0	42.4
C./E. Europe, Baltic States/ CIS (a)	6.0	8.1	11.0	9.1	9.5	2.9	3.9	5.0
Africa	7.3	6.5	5.7	4.8	4.4	2.5	2.0	2.2
Middle East	2.0	2.7	3.2	4.1	6.8	3.4	3.1	3.9

³ Pays de la zone Afrique Caraïbes Pacifique.

Asia	13.6	13.1	12.4	14.9	19.1	26.1	25.5	25.8
Japan	0.4	1.5	3.5	6.4	8.0	9.9	7.7	6.6
China	0.9	1.2	1.3	1.0	1.2	2.5	3.6	5.2
Australia and New Zealand	3.7	3.2	2.4	2.1	1.4	1.5	1.3	1.3
Six East Asian traders	3.0	2.7	2.4	3.4	5.8	9.7	10	9.6
Memorandum item : GATT/ WTO								
members (b)	60.4	68.7	72.8	81.8	76.0	89.5	89.7	94.6
Imports								
Value								
World	66.0	84.0	163.0	589.0	1881.0	3768.0	5729.0	6510.0
Share								
World	100	100	100	100	100	100	100	100
North America	19.8	19.7	15.5	16.7	17.8	19.7	22.3	22.0
Latin America	10.6	9.3	6.8	5.1	4.5	5.1	5.8	5.4
Western Europe	40.4	39.4	45.4	47.4	40.0	43.0	42.2	40.8
C./E. Europe, Baltic States/ CIS (a)	5.8	7.6	10.3	8.9	8.4	2.9	3.7	4.6
Africa	7.6	7.0	5.5	4.0	4.6	2.6	2.3	2.1
Middle East	1.7	2.0	2.3	2.8	6.3	3.3	2.6	2.7
Asia	14.2	15.1	14.2	15.1	18.5	23.3	20.9	22.4
Japan	1.0	2.9	4.1	6.5	6.7	6.4	5.4	5.2
China	1.1	1.7	0.9	0.9	1.1	2.8	2.9	4.5
Australia and New Zealand	2.6	2.4	2.3	1.6	1.4	1.5	1.5	1.3
Six East Asian traders	3.0	3.4	3.1	3.7	6.1	9.9	8.5	8.4
Memorandum item : GATT/ WTO								
members (b)	52.9	66.0	74.2	89.1	83.9	88.7	91.6	91.6

Source: WTO, World Trade Statistics, 2003 (for 1999 data, World Trade statistics 2000).

a: numbers are influenced by 1.changes in the components of the region by country and by an important adjustment of conversion rates of exchanges between 1983 and 1993; 2. the consideration of mutual exchanges between Baltic states and Community of Independent States between 1993 and 1999.
[0]b: membership as of year stated.

Overall, factors determining such paths would need more than the space allowed in our seminar. Nevertheless, we can obviously shape up the effects of globalization from the late figures. One can wonder what happened when countries started implementing their agreements.

In general, and according to table 3, RTAs have helped empower trade between members of one agreement. Meanwhile, no clear relation or correlation between trade evolution and the RTAs trend can be defined. Shares of intra-regional export have increased significantly for MERCOSUR countries and less ambitiously for NAFTA and CARICOM members a little after implementation of the RTAs. The European Union has again maintained a steady trend.

table 3: Intra-regional export shares 1970- 2001

	1970	1980	1985	1990	1995	2000	2001	date of implementation
European Union								
CEFTA	--	--	--	--	14,6	11,5	12,4	1993
UE	59,5	60,8	59,2	65,9	62,4	62,1	61,2	1957
NAFTA	36	33,6	43,9	41,4	46,2	55,7	54,8	1994
Latin America								
CACM	26	24,4	14,4	15,4	21,7	13,7	15	1961
« Andean group »	1,8	3,8	3,2	4,2	12,2	8,8	11,2	1988
CARICOM	4,2	5,3	6,3	8,1	12,1	14,6	13,4	1973
MERCOSUR	9,4	11,6	5,5	8,9	20,3	20,7	20,8	1991
Africa								
CEMAC	4,8	1,6	1,9	2,3	2,2	1,2	1,3	1999
COMESA (a)	7,4	5,7	4,4	6,3	6	4,8	5,2	1994
ECCAS	9,8	1,4	1,7	1,4	1,5	0,9	1,1	1983 c

ECOWAS	2,9	9,6	5,1	8	9	9,6	9,8	1975 c
SADC (b)	4,2	0,4	1,4	3,1	10,6	11,9	10,9	1992 c
UEMOA	6,2	9,9	8,7	12,1	10,3	13	13,5	2000
Moyen-Orient								
ASEAN/ AFTA	22,4	17,4	18,6	19	24,6	23	22,4	1992
GCC	4,6	3	4,9	8	6,8	5	5,1	1981 c
SAARC	3,2	4,8	4,5	3,2	4,4	4,3	4,9	1985 c

sources: WTO, 2003, p.56. Citing CNUCED, Handbook of Statistics 2002;

WTO: International Trade Statistics 2002.

a before 2000, information not available for Namibia and Swaziland.

b before 2000, information not available for Botswana, Lesotho and Swaziland.

c year of foundation.

As it was noted by the WTO report (2003):

« It is true that the share of intra-regional exports as a percentage of regional bloc exports has been increasing since 1970 in most of the major regional trade blocs. Over 60% of EU exports are to other EU partners and over half of NAFTA exports are to other NAFTA partners. However, intra-regional export shares within the EU have remained nearly constant and those for NAFTA have shown an upward trend since 1970, well before NAFTA entered into force in 1994.⁴ Similar patterns can be identified for other major RTAs. MERCOSUR is an exception, where data show a sharp increase in intra-regional export shares after the agreement entered into force. », p. 55.

Indeed, structural facts have cristalized cooperation and enhanced trade between members of RTAs. As Crawford and Laird put it:

« Nevertheless, the fact is that trade within RTAs has been generally growing much faster than trade from non-members. An analysis of seven regional integration agreements (APEC, the European Union, NAFTA, ASEAN, CEFTA, MERCOSUR and the Andean Community) shows that, on average, imports from other members of these arrangements increased on (import-weighted) average at some 7 per cent a year in the period 1990-98, while imports from non-members increased at 5.5 per cent.

However⁵, while the growth in imports from non-members was on average lower than from members (the exception is the EU whose imports from non-members grew at the same rate as from members), this is similar to the average rate of growth of 6 per cent in world imports, including those by the selected integration arrangements, in the same period. », p. 6.

Economic effects of RTAs were tooled by the works of J. Viner (Viner J., 1950, *The Customs Union Issue*, Carnegie Endowment, New York) cited by Lloyd and MacLaren (2003):

« ...Where the trade-diverting effect is predominant, one at least of the member countries is bound to be injured, the two combined will suffer a net injury, and there will be injury to the outside world and to the world at large»,p.4.

Lloyd and MacLaren use a model to show that liberalization of trade induce gains for world economy and that countries excluded from RAs lose an opportunity. But how can we measure such proposal? Viner initiated, followed by others, the concept of trade diversion or trade creation. As the WTO has studied the concepts, it defines both as:

« Trade creation takes place when, as a result of the preferential rate established by a RTA, domestic production of a product is displaced by imports from a member country, where the good is produced at a lower cost. Trade diversion occurs when as a result of regional preferences, imports from a low cost country outside the regional trade agreement are displaced by imports from a higher cost partner country », WTO report, 2003, p.58.

WTO report states that trade diversion occurs when the difference in production costs between the lowest-cost member and the lowest-cost non-member is lower than the tariff rate faced by non-member countries (p.58).

But it remains difficult to isolate effects of RTAs on trade:

⁴ *Some of the empirical literature finds a significant positive impact of the formation of the EU on intra-regional trade. Results are sharper when estimations are conducted on disaggregated data or focused on growth in trade flows (Frankel, 1997 and Bayoumi and Eichengreen, 1998).*

⁵ "In the period 1990-97, imports from other members of these arrangements increased on average at some 15 per cent a year, while imports from non-members increased at 10 per cent. Thus, the decline in trade following the financial crisis had a similar effect overall on members and non-members."

« Since it is empirically difficult to isolate the trade creation effects of RTAs, proxies are often used. But even the most widely used proxies, such as intra-regional trade shares or concentration ratios⁶, will tend to give an over-estimate of the trade creation effects, since the increase in trade among partners may just reflect trade diversion. However, even with the use of these imperfect indicators, the data do not show that trade is increasingly becoming concentrated within RTAs. », WTO report, 2003, p.55.

We can see that, in practice, Trade creation is a mixed blessing for a negotiating government: it generates surplus for consumers at home and for exporters in the partner country, but reduces then for domestic import-competing producers; trade diversion, on the other hand, generates no such reduction in profits, and although it correspondingly generates no (or fewer) consumer gains that matters less to governments. If two such governments can swap trade diverting concessions, trade diversion is good politics even if it is bad economics (Winters,p.28). Winters points out that agreements between countries that are opened to trade mmimizes diversion effects of RTAs.

« Krugman (1993) disaggregates the causes of the welfare losses from regionalism and finds that they owe far more to trade diversion than to increases in the optimum tariff... regionalism with a fixed external tariff may or may not harm multilateralism *ceteris paribus* –see figure A.1—but the act of raising the external tariff certainly does. », Winters,p.8.

We thus argue that RTAs have a growing part in world trade. In fact, they allow a certain context for cooperation and, by a certain “natural law” consolidate similarities. In the mean time, problem is often seen when member states of an RA have to much similarities, same products to export and can not play that role of complimentarity. It is essential for RAs to be able to identify points of cooperation for their alliance to work out. Next part can put a light on this matter.

2. Regionalism and multilateralism

Concerning the WTO, the phenomenon of RAs is a dangerous path. The organization attempted to limit its expansion (some how in order to eliminate any institutional competition), WTO does advice

⁶ For a detailed analysis, WTO Report, p.56- 57.

Member States not to enter this kind of agreements, explaining that it represents an overlap of norms, standards and rules of origin, which slows international trade. Moreover,

« RTAs can pose threats to a coherent and active multilateral trading system. A proliferation of ill-considered and partial RTAs could turn fears of shortcomings in the multilateral framework into a self-fulfilling reality. The existence of numerous overlapping arrangements can distort trade, raise transactions costs, and undermine the systemic integrity of multilateralism. Regional trading agreements can strengthen vested interests hostile to non-discriminatory outcomes. They can weaken resolve to make multilateralism work by draining away scarce negotiating resources and reducing the effectiveness of pro-liberalization forces in the domestic economy », WTO report, 2003, p.66. It advises, in order to consolidate the advantages of regionalism and increase the efficiency of multilateralism:

« Two ground rules of policy behavior could help consolidate and build upon the benefits of regionalism and promote a more effective multilateral trading system. The first rule would be to refrain from engaging in regional commitments which governments would be unwilling, sooner or later, to extend to a multilateral setting.⁷ The second would be to consolidate the first rule by agreeing to a consultative system that would map and monitor the timing and conditions attached to the non-discriminatory, multilateral application of commitments made in RAs. Such agreements might provide a more effective link between regionalism and multilateralism than exists today. », p.66.

As we pointed out, WTO seeks to schedule negotiations on RAs in the multilateral frame as well as a panel system on these agreements. It has already started with the creation of a Committee for Regional Trade Agreements. Established in 1996, it has the task of examining the systemic consequences of RTAs on the multilateral system.

At that point, one may wonder if regionalism is an answer to a difficult globalization. Is it a barrier to the implementation of multilateral objectives?

Baldwin (1995, 1997) inquired this aspect of regionalism. He sees that the latter is a « complement to multilateralism » (1997). Baldwin explains that NAFTA has induced incentives for this kind of agreements, as a domino game, perhaps an imitative process. We can agree with this view as shows the

EU example. Its enlargement is the result of a political will on behalf of the EU members, but also a demand from the ten new comers which entered in May 2004. Meanwhile, as Winters points out, the cost for countries out of the agreement bloc increases (Winters,p.30).

Bhagwati has also studied the regionalism phenomenon. He claims that regionalism is a danger to multilateralism and to the world trade system. The author is sceptic and worries about the diversion effect of regionalism on the multilateral process. Bhagwati claims that there is no need for an alternative system to multilateralism and rejects the argument of regionalism as a promoter of economic liberalization nor as a complement to multilateralism as Baldwin believed.

Winters (1996) is more realistic on this issue. He just answers: « We don't know yet! »,p.1. For Winters, this opposition between regionalism and multilateralism takes us from the issue of the immediate effects of regionalism on welfare to the question of whether regionalism directs us to a more free trade or not. Considering the EU case, Winters argues:

« The EU allows one convincingly to reject the hypothesis that one act of regionalism necessarily leads to the collapse of the multilateral system. But it is difficult to go further: the *anti-monde* to EU creation is unknown and one does not know to what extent the EU is special. Thus any discussion of the evidence is necessarily judgmental. The majority view is, I think, that the advent of the EU aided multilateralism », pp.1-2.

What results can we compare between regionalism and multilateral system? The WTO, citing the OECD has come out with some answers:

« A recent study by the OECD (2002) focused on tariffs (including rules of origin), services, labor mobility, trade facilitation, special and differential treatment and environmental provisions in APEC, NAFTA, EFTA and the EU. The conclusion was that in many respects RTAs have not progressed too much beyond the GATT/WTO agreements, and that it was very difficult to determine whether RTAs represented an improvement in terms of the liberalization of trade », Rapport OMC (2003),p.54.

It is noteworthy to note the dynamic aspect of such bargain between regionalism and multilateralism. If we consider multilateralism as an intermediate phase of real globalization, than, as Winters shows:

⁷ “This assumes that the multilateral framework covers the relevant areas of the rules. Rules on labour rights in a RAs, for example, could not be incorporated within the framework of WTO obligations. Regional tariff reductions, on the other hand,

« In assessing regionalism we need also to recognize another complication. Shifting one partner into a FTA has a direct impact on our measure of multilateralism, but, far more importantly, it also potentially initiates a whole series of accommodating adjustments, as the integrating partners and countries in the rest of the world (RoW) adjust their policies to the new circumstances. We must consider multilateralism at the end of this process not just at the beginning. Moreover, in some circumstances, the final outcome will not be determinate; rather, regionalism might affect the probabilities with which different outcomes occur. », p. 4.

We agree on this dynamic frame vision of the regional versus multilateral debate. First, it is a solution for many countries today that are in the multilateral system but out of it because of their capacity to negotiate or simply because of a low economic power: « Multilateralism is sometimes referred to as a process whereby countries solve problems in an interactive and cooperative fashion », Winters, p.4.

Second, the late period has been a transitional path for developing countries toward liberalization of their economies in a unilateral level. Indeed, in the context of RAs, the NAFTA members have pursued their liberal path on individual basis (Lloyd and MacLaren, p.18).

This trend towards liberalism has been largely argued and consolidated in the Uruguay Round, when countries which feared to be out of trend went for the multilateral « credo ». As Crawford and Laird note, this context of individual and multilateral liberalization can not be considered as a trade destructive fact:

«and in practice, as Baldwin (1997) points out « almost all empirical studies of European and North American arrangements find positive impacts on member's living standards »⁸, Crawford and Laird, p.5.

Conclusion

As it was put by the WTO: « there will always be a drive towards regional arrangements no matter how well the multilateral trading system functions. Regionalism can serve as a catalyst for further liberalization at the multilateral level. », (2003, p. 64).

Has proximity gained reason over multilateral benefits? I guess not, as globalization has decreased the power of distances. Meanwhile, coping with multilateral « desirata » has become a factor of poverty and

could be replicated in the WTO.”

increasing misery, within and between nations. Regionalism can thus be considered as a short term window, not to escape from multilateralism, but to continue surviving for a large number of countries.

The several last failures in Doha or Cancun for example have shown that the spirit of the international institutions behind today's globalization is not welcomed by the actors concerned. Instead of suffering in silence, one positive thing was born: cooperation, be it through NGOs or other institutions, it is the one sound that decision-takers didn't yet hear very well.

More important, is to acknowledge the two levels of difficulty that we tried to enhance in this paper: an inner level where political and social will is necessary for real growth and sustainable development. In this respect, Institutional Economics and the transaction Cost Theory have brought a lot to this analysis (North, 1990, 2004; Williamson, 1998). A second level, the outside context, where multilateral forces find their justification in the markets logic.

Regional agreements in general also were shown to protect dissemination of identities and cultures, by consolidating affinities between close entities. It slows down aggregation of living manners, but unfortunately, it does not enhance living standards. Furthermore, local cultures can facilitate, and stimulate localized innovation networks (Pilon and DeBresson, p.15)

International institutions have been the architects of today's helpless frame under the auspices of liberalism and market hegemony. There are also the ones who, as Omamo and Farrington (2004) point it, converted the role of the state into that of facilitator and regulator of the private sector, « ignoring » local individualities and markets imperfections.

In the terms used by A. Sen (1999), capabilities must be able to flourish to produce development and wealth, and in that perspective: « There must be broad participation that goes well beyond the experts and politicians. Developing countries must take charge of their own futures », Stiglitz, p.252. That is a open way for new contributions in the search of welfare for developing countries.

⁸ “an exception is in South Africa, where Evans (1999) finds that there are winners and losers among the participants in the SADC FTA, due to be implemented in 2000.”

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Appendix: Regional Trade acronyms used in table 3.

CEFTA : Central European Free Trade Agreement
NAFTA : North American Free Trade Agreement
ASEAN : Association of South East Asian Nations
ECCAS : Economic Community of Central African States
SADC : South African Development Community
CEMAC : Communauté Economique et Monétaire de l'Afrique Centrale- EMAC (UDEAC)
ECOWAS: Economic Community of West African States
GCC : Gulf Cooperation Council
CACM : Central America Common Market
CARICOM : Caribbean Common Market.
MERCOSUR : South Common Market includes Argentina, Brazil, Uruguay and Paraguay.
SAARC : South Asian Association for Regional Cooperation
UEMOA : Economic and Monetary West African Union. Union.