CHAPTER 9

Preferential Trade Agreements and the Global Trade Regime

The major trading nations supported multilateral trade liberalization when they signed the General Agreement on Tariffs and Trade (GATT) in 1947, but a number of **preferential trade agreements** (**PTAs**) were also created. PTAs can be defined as trade agreements among a limited group of countries that provide trade preferences to the members. Most PTAs originally included countries within a particular region, such as the European Community and the Central American Common Market. However, about one half of PTAs in force today are *transregional agreements* that involve connections among regions and transcend regional boundaries.[1] To include transregional as well as regional trade agreements we use the term PTAs, even though the WTO and some authors use the term regional trade agreements (RTAs) when referring to all of these agreements. Mainly because of the growing diversity of WTO members and the inability to conclude the WTO Doha Round agreement, the value of intra-PTA trade increased from about 28 percent of world trade in 1990 to 50 percent in 2008.[2] The first part of this chapter examines why PTAs are formed and how they affect the global trade regime; the second part focuses on some specific PTAs. One difference between transregional and regional PTAs is that some regional PTAs, such as the EU and Mercosur in South America, are at higher levels of integration. The stages or levels of integration include the following (see Figure 9.1):

1 **Free trade area** (**FTA**). Member states eliminate tariffs and other restrictions on substantially all trade with one another, but each member can retain its own trade policies toward non-member states. Thus, an FTA poses less of a threat to national sovereignty and is more acceptable to states with politically sensitive relationships. More than 90 percent of PTAs are FTAs. The **North American Free Trade Agreement** (**NAFTA**)

	Free trade area (FTA)	Customs union (CU)	Common market	Economic union	Political union
Removal of tariffs among members	X	X	X	X	X
Common external tariff		X	X	X	X
Free movement of labor and capital			X	X	X
Harmonized economic policies				X	X
Political unification					X

FIGURE 9.1
Stages of Regional Economic Integration

and the free trade agreement of the ***Association of Southeast Asian Nations*** *(ASEAN)* are examples.

2 **Customs union** (**CU**). A CU has the characteristics of an FTA plus a *common external tariff* (*CET*) toward outside states. A CU has institutions to administer the CET, and the members have less ability to make independent decisions. When six states (France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg) formed the **European Community** (**EC**) as a CU in 1957, the UK was not included because it wanted to retain its Commonwealth preference system. To join the EC, the UK would have to raise its tariffs with Commonwealth countries to the same levels as the CET. Instead, the UK formed the **European Free Trade Association** (**EFTA**) with Austria, Denmark, Norway, Portugal, Sweden, and Switzerland in 1960 and retained its Commonwealth preferences. However, the UK's trade with EC members gradually increased, and in 1973 it joined the EC and phased out its Commonwealth preferences. There are only a small number of CUs, and the **European Union** (**EU**) is the most important of them. (We use the term EC from 1957 to 1992, and EU after 1992 to reflect the name change in 1993.)

3 **Common market**. A common market has the characteristics of a CU *plus* the free mobility of factors of production (labor and capital) among members. The increased labor mobility induces members to establish similar health, safety, educational, and social security standards so that no country's workers have a competitive advantage. Successful common markets are rare because they require high levels of integration; the EU is a common market.

4 **Economic union**. An economic union has the characteristics of a common market, and it harmonizes members' industrial, regional, transport, fiscal, and monetary policies. A full economic union includes a monetary union with a common currency. As discussed, 19 of the 28 EU members have adopted the euro as their common currency.

5 **Political union**. A political union has the characteristics of an economic union and also harmonizes members' foreign and defense policies. A fully

developed political union is more like a federal political system than an agreement among sovereign states.

It is important to note that these stages of integration are models that do not fully describe reality. NAFTA, for example, is an FTA (stage 1); but its provisions also require more openness toward foreign investment identified with stage 3 (a common market). Furthermore, some PTAs in the South described as CUs and common markets have not actually reached those levels. Although these stages are only models, they provide general guidance to the process by which states become more integrated.

PTAS AND THE GPE THEORETICAL PERSPECTIVES

In some cases WTO multilateralism and PTAs are competing approaches to trade. Whereas multilateralism contributes to global trade liberalization, PTAs may divide the world into competing trade blocs. However, open PTAs can break down national trade barriers and serve as a stepping stone rather than an obstacle to global free trade. PTAs following open principles abolish barriers on substantially all trade among members and lower trade barriers to outsiders. MNCs often use open regionalism and multilateralism as complementary strategies to promote market forces and increase their competitiveness in the global economy.

Liberal economists see multilateralism as the best route to freer trade because it breaks down preferential as well as national trade barriers. Some liberals who are highly committed to multilateralism focus on "the damage" PTAs "impose on the multilateral trading system."[3] For example, they view the recent trend toward forming numerous bilateral FTAs as producing overlapping FTAs that undermine "transparency and predictability in international trade relations."[4] Other liberals take a more nuanced approach. They consider closed PTAs as a threat to global free trade, but they support open PTAs as a "second-best" route to trade liberalization when global trade negotiations fail. Although they acknowledge that open PTAs may harm some groups such as displaced workers, they believe that the efficiency gains outweigh the costs incurred. They do not view power disparities as a problem for smaller states in PTAs because they assume that all states benefit from open PTAs. Indeed, they argue that small states benefit more than large states because of economies of scale and increased demand for their exports. Neomercantilists and Marxists by contrast believe that PTAs have important distributional effects, with some states benefiting at the expense of others. Neomercantilists argue that larger PTA members expect "side payments" from smaller members that exceed any economic benefits the smaller members receive from gains in market access and economies of scale. For example, Canada and Mexico sought free trade with the United States to gain more assured access to the large U.S. market. The United States, however, expected side payments in foreign investment, services trade, and access to natural resources—especially energy.[5] Thus, neomercantilists expect the distribution of benefits in PTAs to reflect the asymmetries of power, wealth, and technology among member states. Marxists see MNCs and transnational capital as the main beneficiaries of PTAs, and the working class and poorest states as the main losers. MNCs locate their production in states with the lowest wages, environmental standards, and taxes and export freely to other states in the PTA.

PTAS AND GLOBALIZATION

As discussed, the WTO uses the term regional trade agreements for transregional or cross-regional agreements as well as regional agreements. For example, the EU has bilateral FTAs with Mexico, Chile, and South Africa; and the United States has bilateral FTAs with Singapore, Chile, Israel, and Jordan. We therefore use the term *preferential trade agreements* because it better captures these agreements among states in different geographic regions.

In some respects, globalization is necessary to deal with current world problems. As interdependence increases, financial crises, trade wars, and environmental degradation require management at the global level. The WTO, IMF, and World Bank are better equipped than preferential agreements to deal with these problems. Globalization also promotes linkages among states in different PTAs, and in this sense it can undermine PTA cohesiveness. However, globalization may also stimulate the growth of PTAs. States often rely on institutions above the national level to deal with global interdependence issues, but IOs with large, diverse memberships may be unable to identify common interests and sanction defectors.[6] Thus, PTAs composed of like-minded states may be more effective than larger multilateral institutions in dealing with cross-national problems. Globalization also contributes to increased competition, and states and MNCs can often improve their global competitiveness by organizing regionally or transregionally. For example, European MNCs have improved their global competitiveness by using the EU as a regional platform, and U.S. MNCs have benefited from the existence of NAFTA. Furthermore, globalization is associated with neoliberalism, which favors a shift in authority from the state to the market. Market pressures weaken state barriers and contribute to the growth of private and public linkages at both the PTA and global levels. Thus, PTAs and globalization can be both conflictual and complementary.[7]

A HISTORICAL OVERVIEW OF PTAS

Trade regionalism and transregionalism extend back to ancient times. The Roman Empire fostered trade transregionalism from the first to fifth centuries CE, and the spread of Roman law and Latin in major outposts provided stability for this trade. Thus, Egypt imported metals, wine, and olive oil from Italy and other parts of Europe, and exported grain and flax. British Imperialism also used transregional trade. When Great Britain imposed a 10 percent tariff on most imports in response to the Great Depression, it adopted an imperial preference system with the dominions at a 1932 Ottawa conference. This formed the basis for the British Commonwealth preference system as decolonization proceeded.[8] Examples of early regional integration efforts were an 1826 CU between England and Ireland; an 1833 treaty establishing a Zollverein or CU among German states; and an 1854 Canada–U.S. Reciprocity Treaty removing all tariffs on natural products. Examples in the South included a 1910 South African Customs Union among the Union of South Africa, Bechuanaland, Basutoland, and Swaziland; and a 1917 CU among the British colonies of Kenya, Uganda, and Tanganyika.[9] Regional integration in its modern form developed after World War II with the creation of the EC. This chapter deals with the two major waves of PTAs during the postwar period.

The First Wave of PTAs

In 1949 the Soviet Union signed a treaty with Bulgaria, Czechoslovakia, Hungary, Poland, and Romania establishing the *Council for Mutual Economic Assistance* (*CMEA*). Although CMEA members engaged in technical cooperation and joint planning, state-centered central planning precluded any moves toward regional economic integration.[10] Thus, most writers view the first wave of PTAs as beginning with the formation of the EC in 1957 and EFTA in 1960.[11] PTAs then spread to Latin America and Africa during the 1960s. However, PTAs in the South were designed mainly to provide larger markets and economies of scale for LDC production of industrial goods through import substitution policies. The first wave of PTAs was largely unsuccessful outside Europe, because the South's attempts to promote import substitution at the regional level led to numerous problems. Only a limited number of industries were willing to locate in Southern PTAs, and they were concentrated in the larger, more advanced LDCs. This unequal distribution of benefits led to disputes among member states; in the East African Common Services Union, for example, Tanzania and Uganda were resentful that most industries located in Kenya. Some Southern PTAs tried to allocate industries among members by bureaucratic means, but this led to economic inefficiencies and further conflict.

PTAs in the first wave (the 1950s to 1960s) also had some other characteristics. First, all PTA members were from the same geographic region. Second, the PTAs were *plurilateral* rather than bilateral; that is, they were formed among at least three states. Third, the PTAs were either among DCs (North–North) or among LDCs (South–South). For example, six European states formed the EC, and four Central American states formed the Central American Common Market. Fourth, the United States as global hegemon firmly supported multilateral trade, generally opposed PTAs, and would not join them. The United States made an exception in supporting the EC to promote an economically strong Western Europe in the Cold War struggle with the Soviet Union.[12]

The Second Wave of PTAs

The second wave of PTAs, which began in the 1980s, is much more widespread and durable than the first wave. The most notable part of the second wave has been the proliferation of PTAs since the creation of the WTO. GATT/WTO members are to notify the organization of all PTAs in which they participate. Notifications refer to both the creation of new PTAs and the accession of new states to a PTA (e.g., the 2007 accession of Romania and Bulgaria to the EU). From 1948 to 1994 the GATT received 124 notifications of PTAs covering trade in goods, and from 1995 to 2015 the WTO received over 400 additional notifications of PTAs covering trade in goods or services.[13] Furthermore, a number of PTAs today have not been notified to the WTO.[14] Many states view PTAs as the centerpiece of their commercial policy, and for some WTO members preferential trade now accounts for more than 90 percent of their total trade.[15] A second notable feature of the second wave is that many of the PTAs are transregional; for example, Chile has a number of transregional bilateral trade agreements.

What accounts for the importance of the second wave? First, the EU has broadened and deepened the integration process. Table 9.1 shows that there were 28 EU members in 2015; 19 of these members (with an asterisk *) have adopted the euro as a common currency. Second, the United States reversed its policy and has formed FTAs with a growing number of countries. Third, NAFTA was the first reciprocal PTA between DCs (the United States and Canada) and an LDC (Mexico). This marked a change from the PTAs in the first wave which were only North–North or South–South. Fourth, the second wave is marked by a proliferation of bilateral PTAs, unlike the plurilateral PTAs of the first wave. Fifth, LDCs are joining in a growing number of PTAs, which are no longer based on import substitution policies and are more open to global market forces. Finally, there are attempts to form larger cross-regional PTAs such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP).[16]

EXPLANATIONS FOR THE RISE OF REGIONAL INTEGRATION

As discussed, transregional PTAs generally do not lead to integration about the FTA level. We therefore focus our discussion of integration mainly on the regional level. Neomercantilists, liberals, and Marxists emphasize different factors in explaining the rise of regional integration. Whereas neomercantilists look to security and power relationships, liberals focus on the growth of interdependence, and Marxists emphasize the role of transnational capital.

Neomercantilist Explanations

Some neomercantilists see regional integration as a response to security and power relationships. For example, the U.S.–Soviet bipolar system after World War II helped spark European integration for several reasons. First, most EC members were also members of the NATO alliance, and “tariff cuts are more likely between allies than between states belonging to different military

TABLE 9.1

Expanding Membership of the European Union

Member Year	Members	Population % Added	GDP (PPP) % Addition	GDP per Capita as % of EU Average
1957	France*, West Germany, Italy*, Belgium*, Netherlands*, Luxembourg*	100	N/A	100
1973	United Kingdom, Denmark, Ireland*	33.4	31.9	96.4
1981	Greece*	3.7	1.8	48.4
1986	Spain*, Portugal*	17.8	11	62.2
1990	Germany unified*	5.9	3.8	
1995	Austria*, Finland*, Sweden	6.3	6.5	103.5
2004	Cyprus*, Czech Republic, Estonia*, Hungary, Latvia*, Lithuania*, Malta*, Poland, Slovakia*, Slovenia*	19.6	8.9	45.4
2007	Bulgaria, Romania	6.5	2	17.7
2013	Croatia	0.8	0.7	38.8

Notes: * = eurozone members

Sources: The World Bank—GDP per Capita (current US$).
Eurostat—Tables, Graphs, and Maps—Population by Country by Year 2003–2014.
http://data.worldbank.org/indicator/NY.GDP.PCAP.CD/countries?page=1
http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tps00001&language=en

coalitions."[17] Second, the U.S. and Soviet superpowers assumed the main security responsibilities under the bipolar system, and this enabled Western Europe to focus on regional economic integration.[18] Third, the emergence of the United States and Soviet Union as superpowers gave Europeans an incentive to form the EC. With European states facing the loss of their colonies, integration was necessary if they were to retain some influence in the bipolar world. Fourth, although the United States generally opposed PTAs during the 1950s–1960s, it supported the EC because Western Europe's economic recovery was viewed as essential to meeting the Soviet security threat. Indeed, U.S. insistence that Europeans jointly administer U.S. Marshall Plan aid resulted in the formation of the **Organisation for European Economic Co-operation** (**OEEC**) in 1948. The OEEC also oversaw moves toward the convertibility of European currencies and the integration of West Germany in Western Europe; this laid the foundations for the formation of the EC.[19]

When the Soviet Union collapsed and the Cold War ended in the early 1990s, the neomercantilist John Mearsheimer argued that the EU would no longer be necessary to counter the Soviet threat. Thus, EU integration would decline and each EU member would begin to focus on its relative gains vis-à-vis the other members. However, the formation of the eurozone and the expansion of the EU to 28 members indicated that other factors also had to be considered (see discussion in this chapter).[20] Furthermore, neomercantilists looking at some other states and regions in the 1980s–1990s predicted that regional integration would increase. After World War II, the United States as global hegemon used its power and resources to support the GATT-based multilateral trade regime. As U.S. economic hegemony declined, it was less willing to continue providing this support, and it sought to regain its economic leverage by joining PTAs such as NAFTA. U.S. participation in PTAs was a major factor contributing to the rise of regional integration in the second wave.[21] Some neomercantilists also point to security considerations in explaining the formation of some North–South bilateral FTAs. For example, Singapore and South Korea sought bilateral FTAs with the United States partly to maintain a continued U.S. presence in East Asia as a counterbalance to China, Japan, and North Korea.[22]

Liberal Explanations

Liberals have been the main contributors to regional integration theory. We discuss liberal theory on the deepening of integration from an FTA to a CU, common market, and economic union in the section of this chapter on Europe. Liberal views concerning the reasons states form PTAs include the following:

- Global and regional institutions are created to support a liberal economic order. Liberalism in the postwar era was closely linked with the creation of the IMF, World Bank, GATT, and PTAs.
- PTAs are created to promote regional peace. For example, France, West Germany, Italy, the Netherlands, Belgium, and Luxembourg formed the **European Coal and Steel Community** (**ECSC**) in 1951 to integrate France and West Germany's coal and steel resources and prevent them from renewing their age-old conflicts. (The six ECSC members formed the EC in 1957.) These views draw on David Mitrany's theory of functionalism, which states that "international economic and social cooperation is a major prerequisite for the ultimate solution of political conflicts and the elimination of war."[23]
- PTAs are formed to provide a larger market for members' goods. The EC agreement was based partly on an understanding that it would provide a regional market for France's agricultural goods and West Germany's industrial products. A major attraction of NAFTA for the two smaller partners (Canada and Mexico) was free trade access to the much larger U.S. market for their exports.
- PTAs are formed to increase foreign investment. For example, Mexico joined NAFTA partly to attract more foreign investment from the United States; and the United States supported NAFTA partly to liberalize regional foreign investment flows.

- PTA negotiations are often a more achievable route to freer trade than GATT/WTO negotiations because they involve smaller groups of like-minded states. Thus, the number of PTAs increased rapidly as a result of problems with the Uruguay and Doha Rounds. Furthermore, states may seek PTAs to provide a positive demonstration effect for the GATT/WTO; for example, the 1988 Canada–U.S. Free Trade Agreement (CUSFTA) included provisions on trade in services and agriculture before GATT addressed these issues.[24]
- PTAs are formed because of pressure from domestic groups. With globalization, many private firms have become more dependent on trade and have shifted their operations from the national to the multinational level. These internationalist firms pressure for regional and transregional as well as global trade agreements. Regionalism improves the competitiveness of international firms, because they benefit from "the larger regional markets as their base rather than just the home market."[25]
- PTAs are formed as part of a "two-level game," in which political leaders use the PTA regulations to bring about domestic changes. For example, Canada sought the CUSFTA partly because "more open borders would expose Canadian firms to greater international competition and encourage them to restructure and modernize."[26]

Marxist Explanations

Marxists, like liberals, see MNCs as having a central role in the creation of PTAs (see Chapter 10). Unlike liberals, however, Marxists believe that PTAs permit MNCs to locate their production facilities in states with the lowest taxes, wages, and environmental standards and then export freely within the PTA. Whereas the capitalist class benefits from the growth of PTAs, domestic labor suffers because capital can move more easily to low-wage regions and states. Marxists also attribute the development of PTAs to the desire of powerful states to seek regional hegemony. As its global economic hegemony declined, the United States sought to recoup its losses by establishing its hegemony more firmly on a regional basis. Thus, some critics charge that NAFTA was "designed to fit Canada and Mexico into the American model of development, on terms amenable to American corporations."[27]

THE GATT/WTO AND PTAS

Governments and private actors have focused increasingly on PTAs to achieve their objectives because of their disappointment with the WTO's limitations. As discussed in Chapter 8, the U.S. and EU have concluded *TRIPS-plus* agreements that go beyond the WTO's *Trade Related Aspects of Intellectual Property* (*TRIPS*) agreement. The U.S. pharmaceutical industry is one example of private efforts to support TRIPS-plus provisions partly to maintain their monopolies, keep prices high, and limit the use of generic drugs. The U.S. has PTAs with many countries that have TRIPS-plus provisions, and LDCs often accept them in return for U.S. foreign investment and more access to the U.S. market for their exports. The EU also provides technical assistance, financial aid, and market access in exchange for TRIPS-plus agreements.[28] A second objective in forming PTAs is to include *investor-state dispute settlement* (*ISDS*) provisions. Only states have direct access to WTO dispute settlement. The North American Free Trade Agreement (NAFTA) by contrast was the first PTA to also give private investors access to dispute settlement through international tribunals related to a government's investment measures. MNCs view the ISDS provisions in PTAs as protecting them from discrimination by states, but neomercantilists see them as "a vehicle for investors to harass governments whose policies they dislike."[29] A third reason for forming PTAs relates to export promotion. The Asian "tigers"—Hong Kong, Singapore, South Korea, and Taiwan—are highly export oriented. Exports are worth about 45 percent of GDP in South Korea, 65 percent in Taiwan, and almost 200 percent in Hong Kong and Singapore. The four tigers were members of only five PTAs before 2000, but they have joined 49 more, largely to promote their exports. North–South PTAs also enable MNCs to export products and components duty-free among the members, and to use LDCs with cheaper labor costs as *export platforms* to DC markets. For example, an electronics firm can lower production costs by locating assembly operations in low-wage LDCs, chip production in higher-income countries such as Singapore, and high-end R&D operations in California. In sum, there are many reasons why PTAs can provide benefits to governments and firms beyond those provided by the WTO.[30]

The United States, as the postwar global hegemon, opposed preferential agreements that would interfere with an open multilateral trade regime. However, Britain wanted to preserve its discriminatory imperial preferences, and a number of states wanted to establish PTAs. The U.S. views largely prevailed, and GATT Article 1 calls for unconditional MFN treatment. However, **GATT Article 24** permits countries to form FTAs and CUs that do not adhere to MFN treatment, as long as these agreements meet specific conditions.[31] Article 24's acceptance of CUs and FTAs stems from the liberal view that open PTAs offer a second-best route to freer trade; thus, Article 24 seeks to ensure that the PTAs are more trade-creating than trade-diverting. Before discussing Article 24, it is necessary to describe the ways in which PTAs are trade-creating and trade-diverting.

Trade Diversion

PTAs can be trade-diverting because the elimination of intra-PTA trade barriers shifts some imports from more efficient outside suppliers to less efficient PTA suppliers. Furthermore, the freeing of trade within a PTA increases competition in member countries' markets. Inefficient industries may lobby for increased external trade barriers to shift the adjustment burden onto countries outside the PTA. Thus, trade diversion can result when PTAs raise protectionist barriers against outsiders. Investment diversion may also occur when MNCs put branch plants inside a PTA to take advantage of the tariff-free zone instead of producing in the least-cost location and shipping goods to the PTA countries. A CU is more trade-diverting in some respects than an FTA. Even if external tariffs do not increase when a CU is formed, protectionism may increase if the CU imposes antidumping and countervailing duties in response to pressure from import-competing industries. These duties limit imports to the entire CU area because of the common external tariff. Antidumping and countervailing duties pose less of a problem for outsiders in an FTA because each FTA member levies its own tariffs, and industries cannot pressure for area-wide protection. However, FTAs are more trade-diverting than CUs in terms of **rules of origin**, because each FTA member has its own external tariffs. FTAs require rules of origin to prevent importers from bringing goods in through the lowest duty member and then shipping them duty-free to other FTA members. The rules of origin determine whether products have undergone enough processing within the FTA to qualify for the trade preferences. It is difficult to formulate these rules because many goods are manufactured with components from a number of countries. Domestic firms often pressure FTAs for stiffer rules of origin which are more protectionist against outsiders. Rules of origin are a less significant issue for CUs because of the common external tariff.[32] Trade diversion depends on external as well as internal factors. When a PTA is formed, non-member states have an incentive to establish their own PTAs to "better defend themselves against the discriminatory effects of other … [PTA] groups."[33] Furthermore, regional trade blocs such as the EU become larger when pressure from non-member firms triggers "membership requests from countries that were previously happy to be non-members."[34] This proliferation of PTAs fragments the global trade regime.

Trade Creation

The main source of trade creation is the increased trade among PTA members, which shifts demand from less efficient domestic suppliers to more efficient PTA suppliers. When firms become more competitive as a result of the PTA, they are also more likely to support global as well as preferential free trade. Furthermore, PTAs often achieve a deeper level of integration than multilateral trade agreements because negotiations occur among a smaller number of like-minded partners. PTAs may therefore have a positive demonstration effect on multilateral trade negotiations. For example, the inclusion of agriculture, services, and intellectual property in the NAFTA provided a stimulus for negotiating these issues in the GATT Uruguay Round.

GATT Article 24 and PTAs

GATT Article 24 seeks to ensure that PTAs result in more trade creation than trade diversion. To increase trade creation, Article 24 stipulates that FTAs and CUs are to eliminate tariffs on "substantially all" trade among the members within a "reasonable" time period. (GATT granted waivers from the substantially all trade requirement for the ECSC in 1952 and the Canada–U.S. Auto

Pact in 1965.) This requirement limits preferential agreements with only partial trade liberalization such as those that contributed to protectionism during the 1930s. PTAs that remove all internal trade barriers are more likely to serve as stepping stones to multilateral free trade. To decrease trade diversion, Article 24 stipulates that a PTA should not raise tariffs on the average to countries outside the agreement. Whereas individual members of an FTA are not to raise their average level of duties, the common external tariff of a CU may not "on the whole" be higher than the member states' duties before the CU was established. These provisions are designed to limit reductions in imports from non-members as a result of the PTA.[35] However, GATT Article 24 has been more effective in theory than in practice.

The Effectiveness of GATT Article 24

When countries formed a PTA, GATT established a working party to determine whether it met the Article 24 conditions; but these working parties had only limited influence. GATT's regulations for PTAs were drafted with smaller agreements in mind, such as the Benelux customs union negotiated by Belgium, the Netherlands, and Luxembourg in 1944. In 1957 the EC members were unwilling to wait for GATT approval before proceeding with economic integration because of the size and importance of the EC. Negotiating the Treaty of Rome had been a difficult process, and EC members would not readjust the treaty to satisfy GATT.[36] In the end, GATT acceded to the EC demands and never finished examining the Treaty of Rome, even though it had reached no consensus on the treaty's consistency with Article 24. GATT's acquiescence in this case limited its authority over subsequent PTAs, and its working parties could do little to change PTAs after member states had negotiated them. Whereas GATT was notified about early agreements such as the EC before they entered into force, some later agreements such as NAFTA entered into force before a working party was even formed to examine them.[37]

It is not surprising that GATT had little influence over PTAs after they were negotiated. Governments had already engaged in extensive bargaining and were reluctant to reopen negotiations in response to outside criticism. GATT working parties could only try to embarrass PTA members with allegations of noncompliance and encourage them to comply with the guidelines in the future. However, GATT did influence decision-making at earlier stages by setting broad parameters for conducting the PTA negotiations. For example, the diplomats negotiating PTAs often operated

> under instructions to make maximum efforts to comply with GATT rules, and the actual results of these negotiations testify that a quite important degree of GATT compliance was achieved. Except for agriculture … and except for the EC's relationship with former colonies, the … developed-country agreements … were essentially GATT-conforming. To be sure, GATT was unable to do anything further once the agreements were signed and deposited in Geneva.[38]

Some analysts note that GATT was less effective because Article 24 requirements that PTAs should cover "substantially all" trade, not be more restrictive "on average" to outsiders, and be implemented in a "reasonable length of time" are ambiguous. In view of the imprecise wording, working parties were reluctant to give PTAs unqualified approval. By 1994, only six of 69 working parties had reached a consensus that particular PTAs conformed to Article 24, and only two of these six PTAs are still operative. In most cases, working parties simply noted that members had divergent views regarding the PTA's conformity with GATT. However, GATT never explicitly concluded that a PTA did *not* meet the legal requirements![39] To improve the regulation of PTAs, the GATT Uruguay Round agreement included an Understanding on the Interpretation of Article 24 and a GATS article on regional trade in services (Article 5). Recall that the GATS is an agreement for trade in services established under the WTO. The GATS, and the TRIPS for intellectual property rights, were created to supplement the GATT for trade in goods, or General Agreement on Tariffs and Trade, to extend it to services. Furthermore, the WTO replaced the working parties with a single *Committee on Regional Trade Agreements* (*CRTA*) to determine whether PTAs conform with the WTO. (As discussed, the WTO uses the term regional trade agreements for transregional as well as regional agreements.)[40] Although the Uruguay Round and CRTA have dealt with some GATT Article 24 shortcomings, many problems remain. For example, divisions persist on the interpretation of the "substantially all trade" requirement (many PTAs exclude agriculture), and the Uruguay Round negotiators did not decide how to deal with restrictive rules of origin in FTAs. In 2006 a negotiating group agreed on a mechanism to ensure that the WTO receives early notification of new PTAs; but this mechanism may not become permanent because of the breakdown of the Doha Round.

Special Treatment for LDCs

Although GATT Article 24 was to apply to all PTAs, LDCs receive special treatment. This is evident from the GATT/WTO's treatment of PTAs among LDCs and from its response to the EU association agreements with LDCs.

PTAs among LDCs The GATT/WTO takes a more lenient approach to PTAs among LDCs. For example, GATT accepted the formation of the Latin American Free Trade Association in 1960, even though it "did not even approach the requirements of total integration."[41] After Part IV on trade and development was added to GATT in 1965, LDCs sometimes invoked it to justify forming PTAs that did not meet Article 24's requirement to include substantially all trade. When the 1979 enabling clause was enacted, it became the main legal basis for LDCs forming questionable PTAs. The enabling clause permits LDCs to form PTAs that include a limited range of products and decrease rather than eliminate tariffs. PTAs are eligible for special treatment under the enabling clause if they do not include any DC members. For example, *Mercosur* (discussed later) was notified to GATT under the enabling clause, not Article 24.[42] Despite the GATT/WTO's permissiveness, recent LDC moves toward freer trade have inevitably affected their PTAs. The negative experience of LDCs with protectionist import substitution policies, and IMF and World Bank pressure on LDC debtors to liberalize their trade policies, have caused PTAs among LDCs to become more outward-looking.

EU Association Agreements with LDCs As discussed in Chapter 8, DCs unilaterally established a generalized system of preferences (GSP) for LDCs. EU association agreements with LDCs by contrast are jointly negotiated preferential agreements. When the EC was formed in 1957, the Treaty of Rome provided associate status to France's African Overseas Territories.[43] The EC's enlargement when the UK, Denmark, and Ireland joined in 1973 (see Table 9.1) necessitated a change because of Britain's relationship with Commonwealth LDCs. In 1975, the nine EC members concluded the first **Lomé Convention** (Lomé I) with 46 African, Caribbean, and Pacific (ACP) countries; three more Lomé Conventions followed in 1979, 1984, and 1989 (eventually with 71 ACP states). The Lomé Conventions offered preferential access for ACP goods to the EC market without requiring reciprocity. Critics argued that the Lomé system was not a genuine FTA because it was nonreciprocal; GATT Article 24 provides an exception to MFN treatment only for PTAs that follow the reciprocity principle. Furthermore, the 1979 enabling clause permits DCs to provide trade preferences only if they are offered to *all* LDCs. The enabling clause does not sanction EU discrimination in favor of its ex-colonies at the expense of other LDCs.

The EU argued that the nonreciprocal association agreements were justified because they contributed to LDC economic development; but external events increased the pressures for change. In 1994 Mexico formed the NAFTA with the United States and Canada, showing that LDCs could join in reciprocal FTAs with DCs.[44] Analysts also began to question the value of the Lomé Conventions to the ACP states, because their share of the EU market fell from 6.7 percent in 1976 to 3 percent in 1998; more than 60 percent of the ACP exports were composed of only 10 primary products. Marxists described EU nonreciprocal preferences "as a form of neocolonialism that perpetuates the production of … products not compatible" with the long-term interests of the ACP states.[45] Thus, the EU and ACP states negotiated the more WTO-compatible **Cotonou Agreement** (or *New Partnership Agreement*) in 2000. This agreement stipulates that, beginning in 2008, ACP–EU reciprocal "economic partnership" agreements will gradually replace the nonreciprocal preferences over a 10- to 12-year period. Although supporters of the Cotonou Agreement believe that the ACP states will benefit by liberalizing their trade policies, critics argue that EU–ACP nonreciprocal relations must continue because the ACPs have a lower level of development.[46]

The following sections focus on the EU, NAFTA, Mercosur, and two attempts to form large transregional PTAs in view of the protracted Doha Round negotiations: the Trans-Pacific Partnership and the Trans-Atlantic Trade and

Investment Partnership. Thus, the term "EC" is used when discussing events from 1957 to 1992, and "EU" is used for events from 1993 to the present.

THE EUROPEAN UNION

Europe has led the way in postwar regional integration, with European states as parties to 76 of the 109 PTAs formed from 1948 to 1994.[47] In 1951, six states (Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands) formed the ECSC and then established the EC and the *European Atomic Energy Community* (*Euratom*) in 1957 (see Table 9.2). In 1959, seven states (Austria, Britain, Denmark, Norway, Portugal, Sweden, and Switzerland) formed the EFTA instead of joining the EC, because the EC's customs union threatened Britain's Commonwealth preference system and the nonaligned policies of states such as Sweden and Switzerland. In 1993 the EC's name was changed to the EU to symbolize the extension of the community from trade and economic matters to a much broader range of activities under the Maastricht Treaty.

As discussed, the EU is an economic union, and 19 of the 28 members have discarded their national currencies and adopted the euro (see Table 9.1). The EU's institutional structure differentiates it from PTAs at lower levels of integration. The *European Commission* represents general EU interests rather than those of individual member states, and the powers of the *European Court of Justice* (*ECJ*) are greater than those of other international courts. The EU is therefore a "supranational" organization that operates above the level of the nation-state in some areas. However, the *Council of Ministers* (or *Council of the European Union*) is the most powerful EU institution in day-to-day politics. The fact that the Council of Ministers is composed of foreign ministers representing their governments is a reminder that the EU (despite its supranationality) is still beholden to its member states. Other important EU institutions are the *European Parliament* and *European Council* (of Heads of State and Government). In sum, the EU's unique institutional structure gives it more authority than other IOs, but the EU remains subject to a considerable amount of control by its member states.[48]

The Deepening of European Integration

European integration has been an uneven process, sometimes marked by obstacles and conflict, and other times by optimism and growth. For example, the EC began its operations with considerable enthusiasm in 1957, but the 1970s were marked by "Eurosclerosis" (i.e., stagnation) and a loss of faith in the EC's vitality. Divisions within the EC as a result of differential taxation, border inspections, domestic subsidies, and limits to market access were a major source of the problem. Thus, the EC sought to create a unified European market with more competitive firms based on specialization and economies of scale. The 1986 *Single European Act* (*SEA*) was designed to abolish nontariff barriers, liberalize trade in services, and facilitate the movement of capital and labor by 1992, and it also included a commitment to form an **economic and monetary union** (**EMU**).

TABLE 9.2

The Deepening of European Integration

Year	Event	Description
1951	European Coal and Steel Community (ECSC)	• 6 states integrate their coal and steel resources
1957	Treaty of Rome	• Establishes the European Economic Community (EC) and Euratom
1986	Single European Act (SEA)	• To free the movement of goods, services, and labor • Commitment to form a monetary union (EMU)
1992	Maastricht Treaty (or Treaty on European Union)	• Commitment to form a monetary union, and common foreign, security, and social policies • Renames the EC the European Union (EU)
1999	Creation of the euro	• 11 EU states adopt the euro as a common currency. The eurozone members increase to 19 by 2015
2009	Lisbon Treaty	• Establishes an EU high representative • Gives new powers to European Commission, Parliament, and Court of Justice • Removes national vetoes in some areas • Redistributes voting weights among member states

Source: Authors

Monetary union was to occur in a three-stage process, and negotiations resulted in the Treaty on European Union or **Maastricht Treaty** in 1992 (see Table 9.2).

The Maastricht Treaty changed the name of the EC to the EU because the economic pillar—the EC—was joined by two new pillars: for a common foreign and security policy, and a common social policy. Whereas the EC sometimes uses supranational decision-making, intergovernmental decision-making is the norm for foreign/security and social policy. The Maastricht Treaty also outlined a timetable for setting up the EMU, criteria for joining the EMU (e.g., a budget deficit of less than 3 percent of GDP, and public debt of no more than 60 percent of GDP), and functions the EMU would perform (e.g., the role of the European Central Bank).[49] As discussed in Chapter 6, 11 EU members formed the eurozone in 1999 and agreed to adopt the euro in place of their national currencies. Eight more EU members joined later, and the eurozone now has 19 members. The European sovereign debt crisis has resulted in serious problems for the eurozone, and for the EU in general. A major source of the problem has been the decision to establish a monetary union without political or at least fiscal unity among those countries adopting the euro. The transfer of tax authority to the EU continues to be limited, exemplifying "the failure of political and fiscal integration."[50]

Another aspect of the deepening of European integration relates to cross-border migration. The **Schengen Agreement** calling for the gradual abolition of border checks between countries was originally signed in 1985 by France, Germany, Belgium, the Netherlands, and Luxembourg outside the auspices of the EU. The agreement was incorporated into the EU framework as part of the 1997 Amsterdam Treaty, and today the Schengen Agreement has 26 member countries. Twenty-two of the Schengen members are EU countries, and four members are not in the EU: Iceland, Liechtenstein, Norway, and Switzerland. Two EU members—the United Kingdom and Ireland—opted out of joining the Schengen Agreement. The United Kingdom wanted to control its own borders, and Ireland gave priority to its Common Travel Area with the United Kingdom over free travel within the Schengen area. The "Arab Spring" uprisings began to create problems in the Schengen area when France shut its borders to trains carrying African migrants from Italy in April 2011, and the problems increased with the large movement of migrants from Syria, Iraq, and elsewhere to Europe in 2015. Many of the migrants are refugees seeking to escape areas of serious conflict, and major disagreements among EU countries as to how to deal with this issue raise questions about the viability of the Schengen Agreement over the long term (see Chapter 12). In sum, European integration has deepened over the years. However, eurozone problems, the Schengen agreement, and Brexit pose major challenges for the future of the integration project.

The Widening of European Integration

As Table 9.1 shows, the EU expanded from six to 28 members in several enlargements. Whereas the deepening of integration has often been a response to economic conditions, the recent widening was "thrust on the EU by the failure of communism in Europe."[51] This section focuses on the accession of Central and Eastern European countries (CEECs) to the EU.

When the EC was formed in 1957, the Soviet Union insisted that the Council for Mutual Economic Assistance (CMEA) be the vehicle for EC economic contacts with Eastern Europe. However, the EC preferred to negotiate bilateral agreements with Eastern European states and some of them broke ranks with the Soviet position. For example, the EC granted the GSP to Romania in 1972, and signed a trade and cooperation agreement with Romania in 1980. As economic conditions in the East worsened, the Soviets softened their position on economic linkages with the West; thus, a 1988 EC–CMEA agreement sanctioned EC negotiations with individual Eastern European states. After the breakup of the Soviet bloc, the EU negotiated a number of "Europe agreements" with Eastern European states. However, the EU offered them only limited trade concessions, and they began to apply for full EU membership.[52]

The wide disparity in economic development between most EU members and the CEECs posed an obstacle to their admission. Ten CEECs that signed Europe agreements with the EU had only one-fourth of the purchasing power of the EU average, and about 20 percent of their workers had agricultural jobs compared with only 6 percent of EU workers.[53] Thus, an EU Commission report warned that admission of the CEECs would cause migration to Western Europe, an eastward movement of firms because of lower labor costs in Eastern Europe, and a sharp increase in the population eligible for EU social and economic development funds. However, official EU statements described enlargement as "a political necessity and a historic opportunity."[54] Both the CEECs and the EU saw some advantages from enlargement. The CEECs felt that EU and NATO membership would give them security vis-à-vis Russia and that access to EU capital, technology, and markets would help close the economic gap with the West. EU members believed that stable CEECs would provide a buffer against political instability, the CEECs would provide the EU with cheaper workers and investment opportunities, and enlargement would enhance the EU's external influence.

Ten CEECs were admitted to the EU in May 2004. As Table 9.1 shows, the per capita GDP of these 10 countries was only 45.4 percent of the EU average. Although these CEECs added 19.6 percent to the EU population, they added only 8.9 percent to the EU's GDP. Table 9.1 shows that the per capita GDP of Bulgaria and Romania were only 17.7 percent of the EU average when they joined in 2007 and that Croatia's per capita GDP was only 38.8 percent of the EU average when it joined in 2013. Widening need not hinder the deepening of integration, and sometimes they occur together. However, the large number of states involved in the CEEC enlargements and their lower level of economic development contributed to a diversity of interests that was "harder to contain within a single framework."[55] Many European leaders believed that the EU enlargement necessitated major institutional reforms. To this end, a Convention in Brussels produced a draft Constitution for Europe that was signed in October 2004. This Constitutional Treaty did not receive final approval from voters in several states, but a less ambitious *Lisbon Treaty* did receive final acceptance in 2009. The provisions of the Lisbon Treaty are designed to facilitate internal and external policymaking by the EU with its enlarged membership. As Table 9.2 shows, the Lisbon Treaty establishes a new high representative position to give the EU more influence in international forums; gives new powers to the European Commission, Parliament, and Court of Justice; removes national vetoes in some areas; and redistributes voting power among the member states.

Despite the approval of the Lisbon Treaty, many uncertainties remain. First, the treaty is complex and difficult to read, and its effects remain to be seen. Second, Ireland was the only EU country to hold a referendum on the treaty. EU leaders in other states circumvented ambivalent attitudes by arguing that there was no need for referenda because Lisbon simply amended earlier treaties. Third, both the deepening and widening of EU integration have been deeply shaken by "the internal crisis over the euro."[56] As discussed, the EU sovereign debt crisis has widened divisions among member states and raised questions about the future of the eurozone (see Chapter 7). The economic problems have contributed to strong populist fears that the migration of labor from poorer to richer EU states is contributing to unemployment problems and adding to pressure on social welfare systems. These populist fears were a major factor contributing to Brexit. As for external pressures, shortly after Croatia joined the EU in 2013, Russia took actions to prevent Armenia and Ukraine from signing EU association agreements; and the EU has had difficulty in responding to Russia's strong pressures on Ukraine. Whereas the EU views Russia's actions as aggression, Russia argues that it is defending its own vital interests. It remains to be seen whether "Russian pressure in the east" will drive EU members "together or apart."[57] Adding to the external pressures, the large influx of migrants into Europe is putting new strains on the Schengen Agreement.

BREXIT

The UK joined the EC in 1973, but its identification with Europe was limited, and it supported *differentiated integration*. For example, the UK did not join the Schengen free-travel agreement, and did not replace the pound sterling with the euro. EU citizens can move freely, and have social and economic rights, including the right to work in any member state. Immigration to the UK resulting from the EU's Eastern enlargement and the 2008 financial crisis increased Euroscepticism, and under pressure from the UK Independence Party (UKIP) and Eurosceptics in his Conservative party British Prime Minister David Cameron promised a referendum on withdrawal from the EU if his party won the 2015 election. Postfunctionalists point out that Cameron changed UK policy to *differentiated disintegration*; i.e., "the selective reduction of a state's level and scope of integration."[58] Cameron first tried to negotiate reduced UK commitments as an EU member (*internal differentiated disintegration*), but he did not achieve some key objectives. In the June 23, 2016 referendum the electorate voted by 51.9 percent to leave the EU (i.e., **Brexit**), so the UK now sought *external differentiated disintegration*; i.e., withdrawal from the EU, and participation in some EU policies as a nonmember.[59] The Brexit vote shocked many, because the UK was known for its outward-oriented foreign policy, tolerant population, and strong institutions. Several factors were central to the leave campaign. First, they opposed the jurisdiction of the *Court of Justice of the EU* (*CJEU*) and the primacy of European law over British law. Second, they wanted to limit immigration from other EU countries. At the same time they wanted to maintain access to the common market for trade in goods, services, and capital. However, the Maastricht Treaty established a common market for labor, and other EU members would not let the UK selectively withdraw from the labor/migration market and maintain access in the other three markets.[60]

Major geographical differences were evident in the voting patterns. London, Scotland, and Northern Ireland voted to remain in the EU by sizable majorities; but in England outside London the leave vote was decisive. The voting patterns resulted partly from contrasting economic fortunes. UK competitiveness for manufactures had fallen sharply, with trade surpluses initially in the postwar period followed by regular trade deficits from the early 1980s. Northern England was strongly affected by this deindustrialization, with declining manufacturing employment. Lower-income, less educated, socially conservative, rural, and older people feared that immigration, trade, and technological advances were threatening their livelihoods. Older people also had positive memories of when the UK was a major power. Many of those voting for Brexit were susceptible to populism. They trusted the views of ordinary people over the "corrupt" establishment, and wanted to uphold the "native" population's prerogatives and limit immigration from Eastern Europe. The referendum was a means of going to the people who "counted," and they largely ignored the views of minorities. London by contrast has prospered as a pre-eminent financial center, and this was a major factor in its opposition to Brexit. In 2015 over 30 percent of London's financial services exports went to the EU, and the contrasting views of people in London and northern England were sharpened by major increases in income inequality. Scotland and Northern Ireland also had less prosperity, but a majority in these areas opposed Brexit for other reasons. With the UK and Ireland in the EU, both are in the customs union and have a common labor market. In 1993 regular customs checks between Northern Ireland and Ireland were abolished, and this facilitated the signing of the Good Friday peace agreement in 1998. Brexit could revive the border controls, and this would endanger the peace agreement and renew calls for Irish unification. With only 5.3 million people and some aspirations to become an independent state, Scotland wants to stay in the EU and benefit from access to its large market.[61]

After the referendum the main question was whether the UK would seek a "soft" Brexit that would keep it in the customs union and perhaps the internal market, or a "hard" Brexit involving only free trade. The UK chose not to remain in the internal market and it also wanted to withdraw from the customs union so it could make its own trade agreements. If the UK left the customs union, there would be a hard border between Ireland and Northern Ireland. This was unacceptable to Ireland, and the UK had to accept an "Irish backstop" agreement; i.e., the UK could not leave the customs union until a solution to the Irish border issue was found. The EU and UK reached a withdrawal agreement under Prime Minister Theresa May, but the UK Parliament rejected it and she was forced to resign. The Parliament also at first rejected the agreement negotiated by Prime Minister Boris Johnson. However, Johnson has had Parliament's support to "get Brexit done" since his decisive election victory on December 12, 2019, and the UK is now negotiating the terms of its withdrawal from the EU. Negotiating the terms of the UK–EU relationship will be a long, difficult process. Brexit could have serious drawbacks for the UK because its interdependence with the EU is highly asymmetrical. For example, the EU accounts for about 44 percent of UK goods and services exports and 53 percent of UK imports. The UK by contrast accounts for only 6.5 percent of EU exports and 4.5 percent of EU imports. In areas such as commercial services Brexit will undercut the UK's strong trade position. A large share of UK trade with the EU is in intermediate goods, and a number of EU managers are planning to remove some of their supply chains from the UK. The EU is also the UK's largest foreign investment partner, accounting for 41 percent of UK outward foreign direct investment (FDI) and 43 percent of UK inward FDI. Brexit could also threaten UK unity, with support for a new independence referendum in Scotland, and increased pressure for a reunified Ireland.[62] Although EU–UK interdependence is highly asymmetrical, Brexit will also hurt the EU. Losing a large, powerful, financially important DC will weaken the EU's momentum and diplomatic influence.[63]

Theoretical Perspectives and EU Integration

Scholars have applied a wide range of theories to European integration. We first focus on three well-known theoretical approaches: *neofunctionalism,* *liberal intergovernmentalism*, and *constructivism*. We then discuss the need to supplement these theories with two others: postfunctionalism and plutocracy.

Neofunctionalism Theorists often ask why European states have pooled substantial elements of their sovereignty in the EU. Neofunctionalism describes integration in one economic sector as creating pressures for further integration. For example, the six ECSC members found that integrating their coal and steel resources would have more benefits if they also integrated their transportation systems for moving the coal and steel. Thus, regional integration has an expansive logic, in which integration in one economic sector creates pressures for *spillover* into related sectors. Spillover can also contribute to the deepening of integration from an FTA to a CU, common market, and economic union. Whereas functionalists see spillover as an automatic process, neofunctionalists see political activism by interest-driven actors as also necessary. First, integration in one sector engenders increased transactions and new organizations representing business, labor, and consumer interests at the regional level. These regional interests exert political pressure for deeper integration. Second, the supranational bureaucracy (the European Commission in the EU) has a vested interest in expanding its authority through deepening integration over a wider range of sectors. Thus, Ernst Haas describes integration as "the process whereby political actors in several distinct national settings are persuaded to shift their loyalties, expectations and political activities toward a new center, whose institutions possess or demand jurisdiction over the pre-existing national states."[64] Neofunctionalism had considerable influence on the study of regional integration, but its influence varied over the years. The expansion of integration from the ECSC to the EC seemed to support neofunctionalism, but problems such as Eurosclerosis in the 1970s raised questions about the expansive logic of the theory. Neofunctionalist ideas such as "spillover" had somewhat of a revival in the 1990s with the SEA, the Maastricht Treaty, and the creation of the EMU, but the newer neofunctionalists viewed it as a less ambitious theory that explained only some aspects of the integration process. Few scholars call themselves neofunctionalists today because the theory has been subject to numerous criticisms. First, the tortuous path of European integration demonstrates conflicting pressures for integration and diversity, and there is no certainty that spillover will occur. Second, neofunctionalists tended to ignore the fact that the average citizen has been more skeptical of European integration than the elites. Contrary to what Haas predicted, citizens have *not* shifted their "loyalties, expectations and political activities toward a new center." Third, critics argue that the member states, rather than interest groups and the EU institutions, have the main power in the EU. States resist further integration when it does not serve their national objectives.[65]

Liberal Intergovernmentalism Whereas neofunctionalists focus on societal interests and supranational institutions, liberal intergovernmentalists assert that member states (central governments) remain free to choose how the EU functions. Andrew Moravcsik is the founder of liberal intergovernmentalism, which is "liberal" in its view of governments as bringing together domestic interest groups within a state, and "intergovernmentalist" in its emphasis on the central role of states (which also shows the influence of neomercantilism). Moravcsik argues that the EU rests on a series of bargains between member states, which are self-interested and rational in pursuing outcomes that serve their economic interests. Major policy decisions reflect the preferences of national governments rather than supranational institutions, and each state's preferences reflect the balance of its domestic economic interests. Conflict may arise among states with different preferences, and the status quo changes only when the largest states accept compromise agreements. Intergovernmentalists seek to explain how national interests are reconciled in intergovernmental bargains, and they see the EU as occupying "a permanent position at the heart of the European landscape" only because of decisions by member states.[66] European integration is reversible, because member states support the EU supranational institutions as a means of enforcing intergovernmental bargains. Whereas neofunctionalists are criticized for underemphasizing the role of governments, liberal intergovernmentalists are criticized for overemphasizing their role. Moravcsik focuses on a series of "grand bargains" among governments, but devotes less attention to the EU's day-to-day politics. Because governments cannot monitor daily activities, institutions such as the EU Commission have considerable discretion in making decisions. Furthermore, neofunctional theorists argue that state bargains may have "unintended consequences" in giving more discretion than states anticipate to supranational institutions.

Constructivism Neofunctionalists and liberal intergovernmentalists emphasize the role of material factors such as interests in the integration process. Constructivists by contrast focus on the role of ideas, norms, and identity. In studying European integration, we need to understand not only the EU's interactions with member states and interest groups, but also the effects of national self-image, identity, and views of the integration process. For example, compliance with EU principles and rules often depends less on EU sanctions and rewards than on whether a country sees itself as law-abiding. Some EU states are noted for implementing EU laws even when there is strong domestic opposition to them. Compliance with EU rules also depends on the development of a European identity within societies, and this can only occur if there is some compatibility between the EU and the core elements of national identity. Furthermore, assessments of the integration process require some understanding of the developing European identity. If various European groups do not view some states, such as Turkey, as being "European," they may oppose their joining the EU even if they meet the objective criteria for membership. Although constructivists correctly alert us to the importance of ideas, norms, and identities, critics argue that they have not yet developed shared theoretical principles and research strategies for studying the integration process.[67]

Postfunctionalism Neofunctionalists and liberal intergovernmentalists both view preferences as largely economic and emphasize bargaining among interest groups. Whereas intergovernmentalists examine the role of interest groups at the national level, neofunctionalists focus on groups at the supranational as well as national level. Neofunctionalists sometimes refer to the concept of *spillback*, when states withdraw from certain obligations to European integration. Nevertheless, neofunctionalists and liberal intergovernmentalists generally assume "that the EU cannot or can hardly *dis*integrate."[68] Liesbet Hooghe and Gary Marks by contrast argue that we must go beyond assessing the economic preferences of interest groups today because European integration has become more politicized and affected by mass publics. Whereas neofunctionalists felt that politicization would generally result in further integration, *postfunctionalists* argue that politicization is making integration more contentious; for example, including Eastern Europeans increased the divergence of interests among EU states. The elite must now take more account of public concerns that integration is threatening national sovereignty, increasing immigration, intensifying economic competition, and redistributing income. Thus, European integration has become the focus of contentious elections, party competition, and referenda.[69] As Brexit, discussed earlier in this chapter, shows, postfunctionalists point out that politicization in the UK *can* lead to disintegration. Postfunctionalists also raise the possibility of further disintegration in the EU, with divisions among countries exacerbated by the European debt crisis (discussed in Chapter 6) and the refugee crisis that began in 2015. These crises have contributed to the rise of Euroscepticism and populist parties. However, Euroscepticism has been stronger in the UK than in other EU countries, so for other countries partial exit from some obligations is more likely than a full exit from the EU.[70]

Plutocracy Integration theory has been so fixated on the EU that it has not focused on other forms of governance. For example, a study by Kathleen Hancock focuses on plutocracy, in which "smaller member states delegate policymaking to the wealthiest state in the integration accord."[71] The Eurasian Customs Union formed by Russia, Belarus, and Kazakhstan in 2007, which became the **Eurasian Economic Union** in 2015 (also including Armenia and Kyrgyzstan), has some characteristics of a plutocracy.

THE NORTH AMERICAN FREE TRADE AGREEMENT

Regionalism in the Western Hemisphere is more heterogeneous than in Europe. Efforts to form a Free Trade Area of the Americas for the entire hemisphere failed, and the most important PTAs are NAFTA and Mercosur. As discussed, the United States would not participate in comprehensive PTAs from the 1940s to the early 1970s, and it focused instead on GATT-based multilateral trade. However, a reversal of U.S. policies combined with greater openness to free trade in Canada and Mexico resulted in the **Canada–U.S. Free Trade Agreement** (**CUSFTA**) in 1988 and the North American Free Trade Agreement (NAFTA) in 1994.

The Formation of NAFTA

A noted Canadian historian has observed that one economic issue in Canada "comes close to rivalling the linguistic and race question for both longevity and vehemence, and this is, of course, the question of free trade with the United States."[72] In 1854, the two countries concluded a Reciprocity Treaty providing for free trade in natural products such as grains, meat, dairy products, and fish. However, the United States abrogated the treaty in 1866 because of its negative trade balance with Canada, increased Canadian duties on U.S. manufactures, and the British role in the U.S. Civil War. Efforts to revive free trade in 1911 and 1948 were unsuccessful, but the 1965 Canada–U.S. Auto Agreement provided for free trade in automobiles and parts (GATT provided a waiver from the Article 24 provision that FTAs should cover substantially all trade). In 1988 the two states established a comprehensive FTA, the CUSFTA; when Mexico, the United States, and Canada signed NAFTA in 1992, it superseded CUSFTA.

The question arises why these FTAs were formed after so many years. The United States reversed its policy on PTAs with the 1974 U.S. Trade Act, which permitted the president to "initiate negotiations for a trade agreement with Canada to establish a free trade area."[73] However, Canadian and Mexican requests initiated the negotiations for CUSFTA and NAFTA. Both countries had become more dependent on trade with the United States and cross-border production with U.S. companies, and they viewed freer trade as a means of increasing their competitiveness. When the United States responded to its balance-of-payments deficits in the mid-1980s with increased protectionism, Canada viewed an FTA as necessary to gain more assured access to the U.S. market. Mexico was concerned about Canada's favored position as a U.S. trader in the Canada–U.S. FTA, and as an LDC Mexico viewed an FTA as essential for attracting more U.S. foreign investment. The United States as a major economic power was more concerned about global trade linkages, and it concluded the CUSFTA and NAFTA largely because of frustration with the slow pace of the GATT Uruguay Round. Negotiating PTAs, in the U.S. view, would induce the EU and Japan to offer concessions in the GATT negotiations. PTAs also tend to breed more PTAs, and the EU's enlargement gave the United States another reason to join PTAs. Furthermore, the United States became less committed to multilateralism as the sole option as its trade hegemony declined. The United States also wanted Canada and Mexico to ease their regulations on foreign investment and natural resources, and it was willing to open its market to Canadian and Mexican goods in return. Cross-border intraindustry trade and gains from economies of scale also induced producers in key sectors such as computers, automobiles, electronics, and machinery to pressure for a PTA.[74]

Assessing NAFTA as a Free Trade Agreement

Unlike the EU, NAFTA has remained a free trade agreement. All three countries have been skeptical of EU-type supranational institutions that would infringe national sovereignty, and the U.S. Congress has resisted agreements that interfere with U.S. trade policy. However, Mexico and Canada as the two smaller NAFTA members realized that some integration was necessary to protect their interests, even if it impinged on their sovereignty. For example, Canada views U.S. antidumping and countervailing duty laws as protectionist, and favors either their elimination among NAFTA members or a common code to define which subsidies are permissible. However, the United States sees the use of ADDs and CVDs as its sovereign prerogative, and NAFTA dispute settlement panels can only decide whether a country's decision to levy a CVD is made in accordance with its own law; the panels cannot assess the fairness of each country's laws. When Vicente Fox became Mexico's president in 2000, he proposed that NAFTA extend to the free movement of labor as well as goods and services, and that a development fund be established to upgrade North American infrastructure. However, the United States and Canada did not support these proposals, and the NAFTA approach depends on the market to facilitate integration and decrease inequalities.[75] Although NAFTA includes some innovative features in services, agricultural trade, investment, and dispute settlement, it remains an FTA with a minimal degree of institutionalization.

How successful has NAFTA been as an FTA? NAFTA was contentious from the time it was formed, with supporters overestimating its possible benefits, and opponents overestimating its drawbacks. Thus, authors of a 2014 assessment write that "in truth the claims on both sides of the NAFTA issue 20 years ago were overblown."[76] The contentiousness over NAFTA continued, and it was invoked by both sides in the debate over whether the United States should participate in a much larger *Trans-Pacific Partnership* (*TPP*) agreement (the TPP is discussed later). The controversy over NAFTA in all three member countries is reflected in divisions among and within the GPE theoretical perspectives.

Liberalism Liberal economists often see NAFTA as an open FTA that serves as a stepping stone to multilateral free trade. NAFTA had a positive demonstration effect on the WTO in services trade, investment, and intellectual property rights, and it goes beyond the WTO in these areas. For example, NAFTA follows a "negative list" approach to national treatment for trade in services, which puts the onus on each member to list the services it wants to exclude from national treatment; all services a country does not list are automatically included. The General Agreement on Trade in Services (GATS), by contrast, takes a "positive list" approach; that is, national treatment applies only to sectors included in a member's list of commitments. Although liberals acknowledge that NAFTA has produced both winners and losers, they believe that the rewards greatly exceed the costs, and they place particular emphasis on private enterprise.[77] For example, the U.S. Department of Commerce finds "overwhelming evidence across the United States that NAFTA-related trade and investment liberalization has allowed U.S. firms to maximize efficiencies, remain globally competitive, and increase sales and exports as a result."[78] Liberals also point to the positive effects of NAFTA on foreign investment, noting that "in 1993, Mexico's inward stock of FDI was just $52 billion, about 7 percent of GDP. By 2012, the stock reached $315 billion, some 27 percent of GDP."[79] Overall, liberals laud NAFTA for increasing interdependence among the three countries.

Despite this generally positive assessment, liberals also point to NAFTA problems. For example, liberals criticize restrictions that continue to limit trade and investment. One study notes that "while CUSFTA and NAFTA both contained services chapters … regulatory barriers to cross-border trade in services were not much reduced."[80] Liberals also consider rules of origin to be a protectionist device in FTAs and they note that NAFTA has highly restrictive rules of origin for automobiles, textiles and apparel, and color televisions. Recognizing that interdependence requires more policy coordination, many liberals favor a deepening of integration; for example, some liberals propose that NAFTA should become a customs union.[81] Differences, of course, exist among liberals. *Orthodox liberals* often praise NAFTA for its market orientation and for being the first North–South FTA that does not give special treatment to LDC members (Mexico). *Interventionist liberals* by contrast argue that some measures should be taken to deal with the wide disparity between incomes, wages, and standards in NAFTA; and *institutional liberals* call for more institutions to address NAFTA's internal and external shortcomings. Orthodox liberals also view NAFTA's environmental and labor side agreements as nontrade issues that can be used to impose protectionist trade barriers, whereas interventionist liberals see these agreements as necessary to correct market imperfections. Finally, some liberals such as Jagdish Bhagwati are more critical of the proliferation of PTAs than others. Despite these differences, most liberals generally favor NAFTA as an open PTA. For example, one liberal study concludes that "NAFTA remains vital to maintaining trade and investment in the three countries and helps anchor the economic health of the North American marketplace."[82]

Neomercantilism Neomercantilists emphasize NAFTA's asymmetries in power and levels of economic development. They reject the liberal view that smaller states often benefit from FTAs more than larger states because of increased exports and economies of scale. As the larger partner, the United States expects its benefits from free trade to outweigh those of the smaller partners. For example, Canada sought free trade with the United States to gain more assured access to the U.S. market; but the United States expected side payments in return such as less regulation of U.S. foreign investment, greater U.S. access to Canadian energy, and a services trade agreement. The United States also expected Mexico to grant access to its market for U.S. agricultural goods and to give up claims as an LDC to special treatment. Neomercantilists also see NAFTA as a threat to national sovereignty. For example, they are highly critical of NAFTA's Chapter 11, which gives private investors access to binding international arbitration in disputes over a host government's investment measures. (This contrasts with WTO dispute settlement cases where only states are directly involved in dispute settlement.) Chapter 11 has resulted in some high-profile investor suits against government efforts to implement environmental and health regulations. Whereas liberals view NAFTA's Chapter 11 as an innovative mechanism that permits foreign enterprises to prevent states from discriminating against them, neomercantilists see it as "a vehicle for investors to harass governments whose policies they dislike."[83] Neomercantilists also argue that the benefits of NAFTA are overrated, because PTAs are "no substitute for a coherent national development strategy."[84]

Marxists argue that NAFTA is shifting power to the capitalist class and against labor groups. For example, NAFTA enables MNCs to avoid labor and environmental standards in Canada and the United States by relocating production in Mexico. As capital leaves the United States and Canada, wages and employment in these countries decline. Some Marxists use the terms *core* and *periphery* to designate social position and class rather than geographic location, arguing that NAFTA has relegated many U.S. and Canadian workers to peripheral status. For example, one study concludes that Mexico's emergence as a clothing exporter "to the United States as a result of NAFTA has been accompanied by dramatic growth of garment maquiladora employment south of the border and a dramatic decline in the garment industry north of the border, especially among manual, direct production workers."[85] The losses for U.S. and Canadian workers, according to Marxists, do not result in comparable gains for Mexican workers. For example, NAFTA is destroying the livelihoods of Mexican peasants because U.S. corn, which benefits from government subsidies, is being freely exported to Mexico. Marxists therefore argue that NAFTA is increasing poverty and inequality between the rich and poor in all three states. A 2014 study concludes that NAFTA has "contributed to mass job losses, soaring income inequality, agricultural instability, corporate attacks on domestic health and environmental safeguards, and mass displacement and volatility in Mexico."[86] Some Gramscian theorists assert that a coalition of labor, environmental, consumer, and women's groups should form a counterhegemonic bloc against the domination of corporate capital in NAFTA. This bloc would replace the corporate view of liberalization in North America with a more democratic, participatory model.[87]

Environmentalism NAFTA was the first significant trade agreement to include an environmental side agreement and establish institutions for monitoring and finance. During the NAFTA negotiations, there were serious disagreements over the environmental provisions. The greens such as Greenpeace, Public Citizen, and the Sierra Club argued that the NAFTA provisions favored corporate interests and trade liberalization over environmental concerns. For example, they charged that NAFTA's Chapter 11 opened a new legal channel for private investors to contest a state's environmental policies, and they dismissed the environmental side agreement as ineffective and unenforceable. In contrast, some business groups argued that the environmental side agreement would interfere with free trade and result in costly new regulations. Liberal environmental groups such as the World Wildlife Fund, Environmental Defense, and the National Resources Defense Council took a position between these extremes. Although they wanted the side agreement to put more emphasis on the upward harmonization of environmental standards, they favored trade liberalization and generally supported the efforts to include environmental provisions in NAFTA.

The NAFTA environmental provisions in fact have been mixed and in need of improvement. One study concludes that "Mexico's environmental laws have improved since NAFTA came into force," but that "Canada's post-NAFTA record has been less impressive."[88] Another study by contrast argues that Mexico's governments have lacked commitment to environmental protection in the post-NAFTA era, and spending and inspection levels have declined. Whereas many greens see NAFTA as beyond repair, interventionist liberals believe that the NAFTA environmental provisions can be upgraded by adopting stronger provisions. For example, some interventionists argue that the environmental provisions should be subjected to the same enforcement and dispute resolution provisions as the commercial parts of NAFTA.[89] In the view of two noted liberals,

> it makes more sense to tackle the shortcomings than to lament the existence of an FTA, as many environmentalists do, or to overlook the problems, as a very few diehard free trade advocates might. With the necessary tuning, NAFTA can become a trade agreement that both environmentalists and free traders appreciate.[90]

In sum, NAFTA has been highly contentious in all three member states. A major problem is that NAFTA supporters and opponents have focused on different aspects of the agreement. Whereas supporters have lauded NAFTA "for enhancing economic linkages between countries, creating more efficient production processes [and] increasing the availability of lower-priced consumer goods," opponents have blamed NAFTA "for disappointing employment trends, a decline in U.S. wages, and for not having done enough to improve labor standards and environmental conditions."[91]

The Renegotiation of NAFTA: The United States–Mexico–Canada (USMCA) Agreement

The election of Donald Trump in 2016 signaled a wave of anti-globalization sentiment. During the campaign, Trump has singled out trade agreements and practices, particularly those of China, as creating a "bad deal" for American workers, especially those in manufacturing, where thousands of jobs have been lost over the past two decades. Trump attributed continued trade deficits to unfair trade practices. Once in office, Trump pulled out of the Trans Pacific Partnership and began to use tariffs and renegotiations to attempt to change the terms of trade and "bring jobs back" to the U.S. In 2017, he placed tariffs on solar panels, washing machines, steel and aluminum, affecting multiple trade partners. His administration also banned American firms from using Huawei technology or selling to them, citing security and intellectual property concerns. Trump's use of tariffs is unprecedented in modern times, and his citation of national security concerns around certain imports, of steel from Canada, for example, are abuses of safeguard provisions established under the GATT/WTO.

As discussed in Chapter 1, the NAFTA was renegotiated in 2019. The Trump administration's new trade agreement with Mexico and Canada, the **United States–Mexico–Canada Agreement** (**USMCA**), met with the approval by the Democratic-controlled U.S. House of Representatives in early 2020, after a few amendments, including setting benchmarks for Mexican labor enforcement. The administration's trade deal had provisions that Democrats had long supported, such as measures to strengthen Mexican labor unions, downgrade NAFTA's Chapter 11 which gives private investors access to binding international arbitration in disputes over government investment measures, and encourage auto companies to make more of a car's parts in North America. In the new agreement, at least 70 percent of an automakers steel and aluminum must be bought in North America, and 40–45 percent of an auto's content must be made by workers that earn an average wage of at least $16 an hour. Automakers will therefore have to either raise wages in Mexico or hire more workers in the United States and Canada. The agreement also gives U.S. dairy producers greater access to the Canadian market. In other areas, particularly dispute settlement and cultural industries, Canadian negotiators were able to hold the line on concessions. Preliminary estimates of the impact of the new deal were modest,[92] with the U.S. International Trade Commission[93] estimating that it would increase gross domestic product by 0.35 percent after inflation, or $68.2 billion, and create 175,700 jobs.

Despite the Democrats' support for various aspects of the agreement, they viewed some provisions as not going far enough, and they opposed others. They argued that the labor and environmental provisions were too weak and lacked adequate enforcement mechanisms. They also opposed a provision to increase intellectual property protection to 10 years for some advanced drugs, because it would raise drug prices. After months of negotiations, key Democrats and Republicans agreed to strengthen the labor, environmental, and enforcement provisions, and to downgrade the intellectual property protection for some advanced drugs. As a result, the U.S. Congress gave final approval to the revised USMCA in January 2020. Nine Democrats voted against the agreement, mainly because it lacked provisions to deal with climate change.[94]

MERCOSUR

PTAs in Latin America during the 1960s–1970s were inward-looking, but there was a revival of Latin American regionalism in the mid-1980s on a more open basis. The largest of these newer PTAs is **Mercosur** (Mercosul in Portuguese), or the *Common Market of the Southern Cone*. In 1991 Argentina, Brazil, Paraguay, and Uruguay signed the Treaty of Asunción (TOA) to establish Mercosur, and Venezuela joined as a full member in 2012, but was suspended in 2016 for alleged violations of Mercosur's democratic principles. The TOA timetable included the formation of an FTA from 1991 to 1994, a CU in 1995, and eventually a common market; this schedule was unusual for Latin America, where most integration plans included only vague promises. Mercosur's significance also stemmed from the importance of its two largest members, Brazil and Argentina. Many observers were skeptical about Mercosur because of Latin America's history of inward-looking development policies and the long-term enmity between Brazil and Argentina. However, most Latin American LDCs were active participants in the GATT Uruguay Round, and the Argentine and Brazilian presidents supported integration because of their neoliberal economic strategies and their belief that integration would strengthen their position vis-à-vis the United States and the EU.[95]

The integration process was quite dynamic from 1991 to 1995 as tariffs were gradually eliminated and some business firms began to organize their production and sales on a regional basis. However, Brazil and Argentina introduced new tariffs and NTBs after 1995, and intra-Mercosur exports as a share of total exports declined. During the 1990s regional trade had risen from 10 to 25 percent of total trade, but from 1999 to 2003 it fell back to about 10 percent. From 1999 to 2002 the devaluation of the Brazilian currency and the subsequent crisis in Argentina put Mercosur in serious jeopardy. Beginning in 2003, the member states have taken steps to revive Mercosur with political and social as well as economic agreements. For example, a Mercosur Parliament (which only makes political recommendations) was formed in 2005. However, political and economic problems remain; one example was the suspension of Paraguay from Mercosur in June 2012. Although most merchandise trade within Mercosur is now duty-free, rules do not extend to services trade, government purchases, and many NTBs and administrative barriers. Mercosur has also not yet established a CU with a common external tariff. To maintain a CET, no member state can negotiate bilaterally with outside states.[96]

International, regional, and national factors account for Mercosur's problems. First, Mercosur members as LDCs are highly vulnerable to international developments. For example, the Mexican and East Asian financial crises in the 1990s contributed to the loss of markets for Latin American exports and a marked decrease in the prices of primary commodities. Second, in 2005 intra-Mercosur trade accounted for only 13 percent of the members' total trade. Only about 10 percent of Brazil's trade was with other Mercosur members in 2012. The dependence on trade with external actors such as the United States and the EU limits Mercosur's importance. Third, there is a high level of asymmetry, with Brazil accounting for about 70 percent of Mercosur's GDP. To ensure that Mercosur does not infringe its sovereignty, Brazil has opposed a strong dispute-settlement body.[97] Fourth, Mercosur has done little to harmonize the members' macroeconomic policies. In 1991 Argentina pegged its peso to the U.S. dollar, whereas Brazil adjusted its exchange rate. After Brazil devalued its currency in 1999, Argentina's trade balance with Brazil sharply deteriorated and many companies moved from Argentina to Brazil. By 2001, Argentina had a massive foreign debt and defaulted on its loans partly because its peso was pegged to the U.S. dollar. This provided the setting for the 1999–2002 crisis in Mercosur, which ultimately resulted in an Argentinian devaluation.[98] As Mercosur economies recovered amid higher commodity prices, driven primarily by Chinese demand, there appeared to be a new window for cooperation in the bloc. A "pink tide" of center-left governments including Evo Morales in Bolivia, Lula in Brazil, Kirchner in Argentina, and Bachelet in Chile seemed to open the way for expansion towards left socialist governments such as that of Chávez in Venezuela and Correa in Ecuador. However, disputes over Chávez's handling of political opposition derailed the project, and Venezuela was suspended. Following the global financial crisis in 2008, commodity prices have fallen off, and with them the fortunes of the Mercosur economies. The pink tide was reversed and continuing politico-economic crisis in Argentina has been matched by parallel crises in the other Mercosur states (other than Uruguay), preventing further advances in the bloc.

The one shining achievement has been the agreement to an EU-Mercosur trade deal in 2019. The agreement reflects the different trade and investment profiles of the Mercosur countries from those in North America, such as Mexico, who are largely dependent on the U.S. The South American countries, by contrast, have always had a more balanced mix of trade and investment partners with the U.S. and the EU, and more recently with China. The failure of the FTAA (Free Trade Agreement of the Americas) pushed Mercosur to start negotiating an alternative agreement with the EU as far back as 1999. The deal centers on the removal of some tariffs for South American agriculture in return for greater opening for EU manufactures and specialized food products, intellectual property rights, and an opening-up of government procurement. The agreement has not yet been ratified but is being met with opposition by indigenous rights groups and environmentalists who fear further Amazon destruction and by European farmers who fear greater competition. There are further concerns about how to ensure health and phytosanitary regulations meeting EU standards are met in Mercosur production.[99]

Neomercantilists see Mercosur as contributing to security as well as economic ties; Argentina and Brazil have upgraded their military cooperation, with joint military exercises and annual meetings between their joint chiefs of staff. Neomercantilists also argue that Mercosur strengthens its members' bargaining power vis-à-vis the United States and the EU. Liberals favor widening the scope of Mercosur's trade liberalization and predict that domestic business groups will continue to see Mercosur as a means of attracting foreign investment. Marxists argue that Mercosur resulted from IMF pressure on Latin Americans to liberalize their policies and that Mercosur incorporates its members "within the world capitalist system while preserving their subordinate status in the system."[100] Constructivists have asked whether efforts to extend Mercosur to social and political areas since 2003 have helped in establishing a feeling of collective identity. It remains to be seen how the balance between the forces of regionalism and nationalism affects the future of Mercosur as a PTA. In the end, Mercosur has to be judged in light of the regional context. The member countries have much to gain from trade and shared investment, including the potential to negotiate better collective deals with other regions such as the EU. However, internal problems in Brazil and Argentina, the two giants of the region, have prevented regional institutions such as the Parlasur (the regional parliament), modeled after the EU, from having anything but formal trappings.[101]

THE TRANS-PACIFIC PARTNERSHIP AND ITS SUCCESSOR AGREEMENT

Difficulties with completing the WTO Doha Round, and with the "spaghetti bowl" of smaller bilateral FTAs that often have conflicting provisions, have sparked an effort to negotiate several much larger transregional and regional PTAs. In 2008, President George W. Bush indicated that the United States would begin trade talks with a small group of Pacific Rim countries that had signed a trade agreement, and the group gradually increased to 12 countries. President Barack Obama continued the talks, and the ***Trans-Pacific Partnership*** (**TPP**) was signed in 2012 by the 12 countries which accounted for about 40 percent of world GDP: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States, and Vietnam. The TPP was designed to promote trade liberalization well beyond what was achieved in the WTO, and would involve difficult reforms for the member countries' economies. In geopolitical terms, the Obama administration viewed the TPP as important in countering China's growing influence in Asia. China would not consider joining it because of the trade liberalization required. U.S. proponents also viewed the TPP as crucial because an alternative agreement was being negotiated. China is closely involved with a proposed *Regional Comprehensive Economic Partnership* (*RCEP*). In 2013, the RCEP idea was announced, which would include China, the 10 members of ASEAN, and five other countries in the region. The RCEP would be much less ambitious than the TPP in terms of depth and scope of liberalization. Since the RCEP is limited to Asia-Pacific countries, it would marginalize the United States.

The TPP proved to be highly controversial during the 2016 Presidential campaign, with both Republican and Democratic candidates criticizing it. Opponents argued that it would increase the U.S. trade deficit, push U.S. manufacturing jobs elsewhere, and not deal with currency manipulation by some other traders. When President Trump took office in January 2017, one of his first actions was to pull the United States out of the TPP. After some delay, the other 11 countries decided to renegotiate the agreement without the United States, and in March 2018 they signed a revamped ***Comprehensive and Progressive Agreement for Trans-Pacific Partnership*** (**CPTPP**). The CPTPP entered into force in December 2018 after the first six countries ratified it.

This action shows that the other 11 countries in the proposed TPP were willing to move ahead without the United States, but the CPTPP is a much less significant agreement than the TPP would have been. The RCEP has not yet entered into force, but with trade tensions between the Trump administration and major trading partners, Asian countries are looking to the RCEP as a possible outlet for their exports. It has therefore become more likely that the RCEP will be approved and ratified. With China and India as members, the RCEP would account for almost half of the world's population, and for about 30 percent of global GDP. RCEP would provide China with an important new pivot to the Asia Pacific.[102]

Do PTAs Create or Divert Trade?

During the postwar period there have been two major waves of PTAs, the first in the 1950s and 1960s, and the second since the mid-1980s. Globalization has provided a stimulus to the second wave, which has been more enduring. As we have discussed, trade theorists have focused primarily on North–North PTAs, but the second wave of EU enlargement, Lomé Conventions, and NAFTA represent North–South agreements. A third category is South–South agreements. There has been a steady proliferation of agreements in this category beyond Mercosur from ASEAN to CAFTA (Central American Free Trade Agreement) to CARICOM (Caribbean Community and Common Market), to the more recent wave of intra-African agreements such as the SADC (Southern African Development Community), and the AfCFTA (Africa Continental Free Trade Area). The South–South agreements are designed to expand consumer markets and improve the global competitiveness of Southern companies. The effects of each trade agreement and its compatibility with multilateral efforts has to be analyzed separately over time, but the general debate around PTAs vs. multilateralism is worth considering.

A contentious issue among economic liberals in the current wave is whether PTAs serve as stepping stones or obstacles to global free trade; thus, some major debates in GPE are among theorists within the same perspective. Liberals generally agree that multilateralism is the best route to trade liberalization and that open PTAs are a second-best option because they divert some imports from more efficient outside suppliers to less efficient regional suppliers. However, some liberals see PTAs today as a serious threat to an open multilateral trade regime, whereas others believe that PTAs can coexist beneficially with multilateralism.

A notable theorist taking the first position is Jagdish Bhagwati, who describes PTAs as "termites" that are "eating away at the multilateral trading system."[103] Bhagwati and others in the first group present several arguments to show that PTAs pose a threat to the global trade regime: PTAs are discriminatory and therefore incompatible with MFN treatment, a basic trade regime principle; LDCs have a special exemption for PTAs under the enabling clause, which allows them to engage in discrimination without any discipline; the recent proliferation of bilateral FTAs is bringing chaos to the global trade regime, with different rules and tariff rates for each FTA; PTAs are creating a "spaghetti-bowl" of different rules and procedures; FTA rules of origin are often used as a disguised form of protectionism; many bilateral FTAs between rich and poor countries permit "the exercise of virtually unconstrained political and economic power by the United States and EU to secure concessions";[104] and PTAs divert valuable resources away from multilateral negotiations. The second group of liberals agree that PTAs can create problems such as trade diversion. However, they see some plurilateral FTAs such as NAFTA as more trade-creating than diverting, and they believe that PTAs can coexist with global trade liberalization. When NAFTA was formed, Gary Clyde Hufbauer and Jeffrey J. Schott predicted (in 1993) that "on balance ... the trade created by growth in the NAFTA region should more than offset the trade diverted in particular sectors."[105] In a 2005 study, Hufbauer and Schott referred to empirical studies which "on balance ... find that NAFTA tends to promote trade creation more than trade diversion." Although the authors criticize NAFTA for its restrictive rules of origin, they rate the agreement as a "success."[106] Liberals in the second group also support the large transregional CPTPP, which they view as a possible stepping stone to global trade liberalization. Arguments of theorists in the second group include the following: FTAs contribute to economies of scale and a division of labor based on comparative advantage; trade creation is likely to be greater than trade diversion if the FTA members are already major trading partners; PTAs allow members to overcome disagreements, which helps reduce the complexity of the WTO negotiations; and by promoting deeper integration at the regional and transregional levels, PTAs can lead the way for multilateral trade negotiations. For example, NAFTA liberalized trade in services and agriculture before the GATT/WTO.[107]

Although liberal theorists often base their findings on empirical studies, "different studies come out with different trade effects for the same PTAs. This is due to the use of different estimation methods, different databases and time periods to measure these trade effects."[108] In the first group, Bhagwati uses historical analysis to show that political factors resulted in the exceptions the GATT/WTO provides to PTAs, and he views these exceptions as mainly trade-diverting. In the second group, many analysts focus on specific PTAs for which they have a strong affinity. For example, Hufbauer and Schott want NAFTA to establish a common external tariff, strengthen its institutions, and promote closer monetary cooperation. Thus, the diversity of findings does not result only from different methodologies; nonmaterial factors such as the assumptions and values of the theorists also affect their findings.

Chapters 8 and 9 have focused on trade, but the relationship between trade and investment is extremely close; for example, PTAs affect regional production, intraindustry specialization, and the location of firms. A former WTO director-general notes that "businesses now trade to invest and invest to trade—to the point where both activities are increasingly part of a single strategy to deliver products across borders."[109] The next chapter deals with the issue of MNCs and foreign investment.

QUESTIONS

1. What are the differences between an FTA, CU, common market, and economic union? Do any PTAs fit completely within one of these models of integration? Why do you think it is often difficult for trading partners to increase their level of integration? Consider the challenges of each step.
2. How do neomercantilists, liberals, and Marxists explain the rise and consequences of regional integration?
3. In what ways can PTAs be trade-diverting and trade-creating? Do you think that PTAs are stepping stones or obstacles to global trade liberalization, and why do you think liberal theorists cannot agree on this issue?
4. What conditions does GATT Article 24 impose on PTAs? How successful has the GATT/WTO been in regulating PTAs?
5. In what ways do LDCs receive special treatment as members and associate members of PTAs? Does Mexico receive special treatment in NAFTA?

6 In what ways is the EU a unique PTA? What are the neofunctionalist, liberal intergovernmentalist, constructivist, and postfunctionalist theoretical approaches to economic integration, and why are they applied mainly to Europe? What is plutocratic theory (or plutocracy), and how does it differ from the major theoretical approaches to European integration?
7 What are the major changes to NAFTA under the new USMCA? What is the reasoning behind them and whom do they benefit?
8 What was the TPP and what were the factors in its demise? Why did the CPTPP replace it? Consider applying the two-level game framework discussed in Chapter 4 in your analysis.

KEY TERMS

Association of Southeast Asian Nations
Brexit
Canada–U.S. Free Trade Agreement (CUSFTA)
common market
Comprehensive and Progressive Trans-Pacific Partnership (CPTPP)
Cotonou Agreement
customs union (CU)
economic and monetary union (EMU)
economic union
Eurasian Economic Union
European Coal and Steel Community (ECSC)
European Community (EC)
European Free Trade Association (EFTA)
European Union (EU)
free trade area (FTA)
GATT Article 24
liberal intergovernmentalism
Lomé Convention
Maastricht Treaty
Mercosur
neofunctionalism
North American Free Trade Agreement (NAFTA)
Organisation for European Economic Co-operation (OEEC)
plutocracy
political union
postfunctionalism
preferential trade agreements (PTAs)
rules of origin
Schengen Agreement
Trans-Pacific Partnership (TPP)
U.S.–Mexico–Canada Trade Agreement (USMCA)

NOTES

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