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Dealing with PTAs in the WTO: Falling through the Cracks between 'Judicialization' and 'Legalization'

PETROS C. MAVROIDIS*

Columbia Law School and European University Institute

Abstract: Preferential trade agreements (PTAs) have to be consistent with the WTO. Their monitoring at the multilateral level has failed so far for various reasons. The question arises what to do? Completion of the contract ('legalization') has failed repeatedly, and, in light of vested interests and incentives, there is no reason to believe it can succeed now. Judicialization can be discarded as well, since the incentives to enforce the WTO contract in this respect are lacking. The good arguments thus lie in favour of building bridges between the WTO and PTAs, and the weaker arguments with an effort to enhance enforcement against PTAs through either judicialization or legalization of the monitoring process.

1. Monitoring PTAs at the WTO level: the facts

1.1 The rationale for centralized evaluation of consistency

Preferential Trade Agreements (PTAs) must observe the statutory conditions for compliance spelled out in Art. XXIV GATT 1994, and Art. V GATS. Since members of PTAs might have an incentive to always take the view that their PTA is WTO-consistent, self-assessment is not an option in the WTO regime. A centralized system of monitoring is put into place where an evaluation of compliance of notified schemes with the multilateral rules will take place. The multilateral review was designed as an institution akin to a modern merger authority. PTAs would not be consummated unless cleared through the process established.

To this effect, the WTO must be notified of all PTAs (Art. XXIV GATT).[1] The Committee on Regional Trade Agreements (CRTA) is the organ routinely notified of PTAs. It is the successor to the Art. XXIV Working Parties.

* Email: Petros.Mavroidis@unine.ch

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1 In this paper, we do not deal with PTAs notified under the *Enabling Clause*, or under GATS (although much of the analysis is relevant to those schemes as well).

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The CRTA is composed by delegates of all WTO Members and has been always decided by consensus.[2] In principle, the CRTA has wide powers. Art. XXIV:7 GATT relevantly provides that it has the power: 'to make such reports and recommendations to contracting parties as they may deem appropriate'. One cannot thus exclude the possibility that the CRTA concludes that a notified PTA is GATT inconsistent.

1.2 *From enforcement to transparency*

The approach we discussed supra was followed until 2006. As of 2006, the CRTA continues to be notified of PTAs, but it is no longer expected to come up with a 'thumbs up' or 'thumbs down' judgment. We explain. On 14 December 2006, the General Council of the WTO adopted a decision concerning the 'Transparency Mechanism for Regional Trade Agreements'.[3] The 'Transparency Mechanism' was supposed to complement the existing legal regime.[4] De facto, the 'Transparency Mechanism' did not *complement*, but *substituted* the previous arsenal: the multilateral review was narrowed down to a mere exercise in transparency. Indeed, all reports issued after the entry into force of the Transparency Mechanism contain no discussion regarding the substantive consistency of the notified PTA with the relevant multilateral rules. They are limited to a detailed description of the PTA, and aim to shed as much light as possible on its various aspects. The CRTA will typically circulate two documents, a factual abstract (an executive summary of the discussions held in the CRTA), and a factual presentation (the final report, which will provide factual information on various aspects of the notified PTA).[5]

Once the factual presentation of a notified PTA has been distributed, WTO Members send in questions to which responses must be provided by the parties and circulated three working days before the meeting of the CRTA.

There is also a written record of each agreement considered by the CRTA. The WTO Members' questions and the parties' responses as well as a record of the

2 In theory, if a consensus decision cannot be reached, the matter can referred to the higher organs which can decide by majority voting. This has neither happened, nor threatened to happen. There is no study to our knowledge measuring the impact of this threat, which, intuitively speaking, should be low in light of the collective preference, explained *infra*, for not enforcing this provision.

3 See WTO Doc. WT/L/671 of 18 December 2006. The WTO continues to use the term *Regional Trade Agreements* (RTA), against mounting evidence that there is often not much *regional* about new notifications, by passing thus the quintessence of such schemes, that is, their *preferential* character.

4 Indeed, the preamble and the text of the Decision adopting this mechanism leave no doubt that this were indeed the case: it points to the increasing number of PTAs; it is meant to *enhance* the existing transparency (judged implicitly insufficient); nowhere does it put directly (stating, for example, that A certain proviso of Art. XXIV GATT is hereby deleted or substituted) or even indirectly into question the existing framework (Art. XXIV GATT) to which it repeatedly refers and leaves the overall impression that this was an additional instrument in the fight against PTAs, see WTO Doc. WT/L/671, of 18 December 2006.

5 For a typical illustration, see the CRTA report on the FTA between Thailand and New Zealand; WTO Doc. WT/REG207/3 of 3 January 2007.

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discussion are available on the WTO RTA database.[6] There is, however, no longer review of the consistency (from a legal perspective) of the notified PTA with the WTO rules. The exercise is meant to increase transparency and stop short of going any further.

Information regarding PTAs can be obtained through other multilateral means. The TPR (Trade Policy Review) is one channel of information, as are the various WTO committees where communications regarding trade policy are routinely being made.

There are limits with respect to both. One limit is common: neither TPR reports, nor communications to the WTO are equipped to deal with the question of consistency of PTAs with the WTO. At best, they can provide some information regarding the workings of PTAs. They are avenues for increasing transparency. At best, they might be used as input when enforcing the WTO contract on PTAs, but are not enforcement mechanisms per se.

Worse, there are good reasons to believe that the information supplied is suboptimal. Hoekman and Mavroidis (2000) have criticized the TPR for adopting the wrong periodicity: we know about countries that are relatively more transparent than about countries that are less so. As a result, unless concluded with a main hub, PTAs might pass the watchful eye of investigators by stealth.

Collins-Williams and Wolfe (2010) conclude that it is essentially incentives that will determine whether transparency will be served through communications to WTO Committees. It would be quite odd to expect that incriminating information will be revealed to the WTO by trading nations through unilateral communications.

1.3 The outcome (so far)

As of March 2014, over 500 PTAs in total had been notified to the WTO, 345 under Art. XXIV GATT, almost two-thirds of which are now in force. Schott (1989) identifies four cases where PTAs were judged 'broadly' consistent with the GATT. Since his study there has been one case where there has been a definitive and unambiguous acceptance at the CRTA level that the notified PTA was GATT consistent: the custom union (CU) between the Czech and the Slovak republics.

We are simply in the dark as to the GATT consistency of the remaining PTA currently in place. The inescapable conclusion is that the multilateral review has not delivered on its institutional promise to ensure that PTAs will be GATT consistent before they can be 'consumed'.

Hudec (1972) noted:

> The seeming collapse of the MFN rules is probably the single most important cause of the present day pessimism about the GATT substantive rules.

6 http://rtais.wto.org/.

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Hudec, more than 20 years later (1993), remarks:

> the GATT's somewhat benign attitude toward RAs is merely one part of this larger tolerance toward departures from MFN in general.

Roessler (1993) is in agreement:

> The record under the current procedures is not encouraging. During the past three decades about 50 working parties have been established to examine RIAs. None of them was able to reach a unanimous conclusion on the GATT-consistency of the agreement examined.

The unanimous view is that the system of multilateral enforcement has failed. Should we fix it? And, if so, how? Before we jump to this question and enter the heart of the 'judicialization *v.* legalization' debate, we need to first form a view on the size of the problem. If nuisance is small, why bother?

2. The size of the problem

2.1 Less of a problem now (in trade diversion terms)

Recent empirical studies provide us with mixed evidence regarding the extent of trade diversion resulting from the formation of PTAs. We lack a comprehensive calculation of trade diversion for all PTAs (indeed one might wonder if one is feasible), but the on-going tariff liberalization of tariffs at the most favoured nation (MFN) level would strongly argue in favour of the thesis that the problem is not of the magnitude that it used to be.[7]

Scholarship points to the (missing) incentives to agree on MFN tariff cuts following establishment of a PTA.

Bhagwati (2002), Krishna (1998), and Limão (2006) all have contributed in making the point that, besides trade diversion created through the establishment of PTAs, members of PTAs behave as enemies of non-discriminatory trade liberalization since they are unwilling to cut tariffs on an MFN basis for fear of eroding the margin of preference that they have granted to their PTA partners. They thus become *stumbling* (as opposed to *building*) blocks obstructing MFN trade liberalization, and frustrating the achievement of the basic WTO objective.

The fear was probably legitimate at some point, but the question is: How relevant is it today? On the one hand studies like Karacaovali and Limão (2008) looking at the EU and Limão (2006) looking at the US have provided empirical

7 Irwin (1998) provides a very persuasive narrative of tariff reductions since the inception of the GATT. Tariffs have been drastically reduced since 1948, the advent of the GATT. The potential for trade diversion was much higher in the 1940s when MFN rates were floating around 40% than nowadays when average rates are below 5%. In similar vein, the 2011 WTO World Trade Report, based on Freund and Ornelas (2010), notes that 'several studies have tested the traditional theories on trade creation and trade diversion. While this literature is not conclusive, it suggests that trade diversion may play a role in some agreements and in some sectors, but it does not emerge as a key effect of preferential agreements.'

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evidence that PTAs have constituted stumbling blocks. They ask the question whether MFN tariff cuts during the Uruguay Round are related to their preferential tariffs.

The stumbling-block thesis would suggest that trading nations would have cut tariffs less in areas where they had preferential tariffs, and indeed this is what the authors mentioned so far have found to be the case.

Other studies, however, have found the opposite. Estevadeordal *et al.* (2008) examine the Latin experience with PTAs and find that Latin nations cut their MFN rates most in products where they had preferences in place.[8]

In concurring vein, Baldwin and Seghezza (2010) use tariff data for 23 large trading nations and find that MFN cuts and preferences are complements not substitutes. Margins of preferences in the real world tend be zero or close to zero where nations have high MFN tariffs. Intuitively, one would associate the stumbling-block thesis with large preferences in cases of high MFN tariffs, but the authors show that this is not the case in practice. The authors thus discard the stumbling-block thesis without supporting the building-block thesis.

Acharya *et al.* (2011) find that the impact of plurilateral PTAs on extra PTA imports and exports is large and positive. If at all, recent empirical evidence hardly supports the uni-dimensional conclusion that PTAs are stumbling blocks per se.

2.2 *Clubs are inevitable*

Trade diversion can also result from NTBs (about which there is nothing wrong, legally, if not wrong altogether, provided that non-discrimination is respected), just as it can result say from the increased use of anti-dumping (AD) proceedings against non-PTA partners, that Prusa and Teh (2010) document. Once again though, nothing much can be done about it: the burden associated with proving that under similar circumstances PTA partners privileged AD proceedings against a sub-set of the WTO membership (namely, outsiders to their PTA) is quite high.

Intuitively, the stumbling-block thesis makes good sense; empirically as well, at least as far as some PTAs are concerned. The success GATT has had in 'taming' tariff protection has shifted the attention of trade negotiators to negotiation of regulatory barriers, non-tariff barriers (NTBs) as they are often referred to in the literature. The term has no pejorative connotation. It simply refers to policies that segment national markets for either good or bad reasons. The quest for negotiators is to distinguish wheat from chaff.

What is clear though is that these instruments have to be applied in a non-discriminatory manner and cannot be applied preferentially since they were not

8 And, of course, the value of a tariff reduction to PTA partners enhances the bargaining power of that same tariff cut in broader negotiations with non-PTA partners worried about market access.

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meant to 'protect' in the first place.[9] Preferences can be given through PTAs only with respect to instruments designed to protect, e.g. tariffs. This observation leads to a two-fold conclusion: first, low tariffs mean that the potential for trade diversion is now much less than before the successful conclusion of the Uruguay Round; second, trade diversion in the classic sense of the term is less of a driver for PTAs when it is NTBs that are largely the subject matter of negotiation.

Sapir (2000) has perceptively observed that there is fast growth in the number of PTAs at the moment, when tariffs have been reduced to an all time low. He participated in Horn et al. (2010), a paper that shows that most of the negotiating items qualify as NTBs. The two studies together reflect an intuitively plausible explanation for the growth of PTAs: negotiations on regulatory cooperation are more likely to succeed across like-minded countries. This brings us squarely to the discussion on 'clubs'.

Negotiation on NTBs has occurred in the GATT and the preferred instrument is non-discrimination (in the form of national treatment and most favoured nation). Early on, during negotiations of the GATT, non-discrimination was imposed on domestic policies in order to ensure that the value of tariff concessions would not be eroded. The accent was on high tariffs for good reasons as they blurred the 'bite' of NTBs. Baldwin (1971) provided the definitive account in this respect.

Non-discrimination is effective in eliminating the risk of concession erosion. It is no guarantee for market access. Goods face a binary option: either they meet the standards of the importing state and access to that market, or they do not, and they do not enter.

Later some steps were taken (especially in the context of the TBT and SPS Agreements) to introduce the possibility for effective instruments of integration, like recognition and/or harmonization. This is an option though, not a legal compulsion.

Similar instruments are used between 'like-minded' partners. Costinot (2008) provided the theoretical rationale why this has been the case as far recognition is concerned. This instrument is forward looking, and unless trading nations 'trust' each other's regulatory process, this instrument will not be contracted in integration schemes. Non-discrimination, on the other hand, is the insurance policy that trading nations with a high level of protection (public health etc.) need in order to ensure that their markets will not be inundated with goods of inferior quality.

This is where 'clubs' matter. Lawrence (2006) first took up this discussion within the WTO context, arguing that variable geometry is inevitable as we move from 'shallow' (tariff liberalization) to 'deep' (NTB) integration.

9 The texts of Arts. XXIV.5 and XXIV.8 GATT do not contain explicit references to instruments disciplined. They do nevertheless mention 'duties' and 'other restrictive regulations of commerce'. In the original setting, domestic policies (instruments) coming under the purview of Art. III GATT were not meant to restrict trade, but simply to serve the value of tariff bindings.

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The 'natural' place for deep integration is 'clubs' and PTAs are the club par excellence in practice. It is not, of course, the case that all PTAs are natural candidates for deep integration. Some, however, like the Trans-Atlantic Trade and Investment Partnership (TTIP), or EC–Canada (CETA) etc., definitely are.

There is some empirical evidence to the effect that deep integration instruments are contracted between like-minded countries in the context of PTAs. Horn et al. (2010) examine the subject matter of PTAs, concluded between 1992 and 2008, of the two main hubs (EU, US) with various spokes, and divide then into WTO+ (say tariff cuts beyond the MFN level), and WTOx (issues that do not come under the mandate of the WTO, say positive integration in fields such as environmental policy, fight against corruption, etc.). The WTOx part of the PTAs is quite substantial.

All of WTOx and the better part of WTO+ subject matter concerns negotiation on regulatory barriers. PTA partners do not always opt for deep integration. However, even when they do not, they establish some form of 'regulatory cooperation'.

Marchetti and Mavroidis (2012) inquired into the identity of WTO Members that integrate their services market above and beyond the existing multilateral disciplines. Their study is of particular interest to the discussion here since services markets are segmented only through regulatory and not through tariff barriers. They focus on (mutual) recognition, and establish a series of criteria (e.g. GDP per capita, language, geographic proximity, religion, etc.). The more of these proxies two (or more) WTO Members tick, the likelier it is that they have introduced recognition between them.

Deep integration is both too costly for poorer countries (they will be asked to invest in order to increase their level of protection of various product markets in order to compete with the best for the lucrative export markets) and unrealistic (instruments like recognition are forward-looking and some notion of trust between regulators is a necessary input in this endeavour).

Lawrence (2006) first asked the question whether the WTO should abandon the single undertaking and move to variable geometry in light of what is at stake in terms of future integration. Hufbauer and Schott (2013) have added their voice to this argument, claiming that a return to the Tokyo Round codes system is imperative. They point to the fact that a series of codes that were signed as club agreements became multilateral, and the same could happen again.

Hoekman and Mavroidis (2014) have explained why, in a world where tariffs become gradually obsolete and where markets are being segmented through non-tariff barriers (NTBs), it is unrealistic (to put it mildly) to expect that deep integration will occur at the WTO level, across 160 highly diverse partners. In parallel with the other authors, they argue that club agreements are not only inevitable, but appropriate as well. Integration of markets between like-minded countries will offer opportunities to indirect participants who have joined global value chains. Importantly for this paper, they explain why, unless the WTO finds a modus vivendi with clubs which exist and continue to proliferate, its own relevance might be eviscerated. We will return to this point infra.

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2.3 *Could they be termites after all? From trade to forum diversion*

The preceding analysis leads us to conclude that the WTO is the victim of its own success: by effectively addressing tariffs, it paved the way for negotiation on regulatory barriers. Alas, this negotiation is best suited to like-minded countries. This to some extent explains the quest for PTAs.

It is not that there is no appetite for trade deals. The sheer number of PTAs proves the opposite. It is that there is no appetite for deals at the WTO level. As the trade agenda is being shaped at the PTA level, one increasingly gets the feeling that PTAs are the runaway bride: they have hijacked the trade agenda.

PTAs risk becoming the 'termites' of the world trading system not because of the trade diversion that they have provoked,[10] but because of the forum diversion they represent. PTAs, or at least some of them (but increasingly more), probably because they are by definition more flexible instruments than the WTO and also because there is no need to work out compromises that will satisfy 160 odd countries, have managed to better respond to the needs of the business community worldwide than the WTO does.

2.4 *Something needs to be done, but what?*

The sheer number of PTAs proves that they constitute a successful model in the eyes of trading nations. Yes, they can and do negatively prejudice the welfare of outsiders, but one would be hard-pressed to look for cosmopolitanism and altruistic behaviour among rational egoists. The question that the WTO needs to address quite urgently is what its role is next, for the over 500 PTAs that continue to be negotiated, while all it can show following 13 years of negotiation is an agreement to fight corruption in countries proposing transitional periods of 15 and 20 years for its entry into force.[11] A change in attitude is required.

Hawks willing to discipline PTAs more are essentially preaching for an agenda that has already proved obsolete. This brings us squarely into the 'legalization *v.* judicialization' debate. For the reasons we explain infra, neither of the two approaches provides an adequate response to the key issue here, namely the forum shifting from Geneva to national capitals. To the contrary, the better arguments are in favour of a less drastic and yet more effective approach: increase the transparency of PTAs at the WTO level. Here is why.

10 Bhagwati (2008) made similar arguments. He is definitely correct when it comes to evaluating the pre-Uruguay Round situation.

11 The Agreement on Trade Facilitation was in principle agreed in Bali, along with some Declarations on various issues. The original exuberance gave way to skepticism when India blocked its adoption, since it had not been satisfied with the progress of discussions on 'food security'. At the time of writing, the future of the Agreement on Trade Facilitation is uncertain, although some steps have been taken towards reconciling the opposite camps and allowing for its entry into force.

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3. Legalization *v.* judicialization

3.1 Definitions

By legalization, we understand a process whereby the original contract is 'completed' with additional information. The working hypothesis here is that lack of enforcement is probably due to contract incompleteness, and the ensuing disincentive to complete it through adjudication. Judicialization has a different perspective. It assumes that contract incompleteness is no impediment to enforcing the contract. What matters is that parties litigate more, and the system should adjust this way.

3.2 Legalization

3.2.1 Contract incompleteness

Even the briefest of perusals can persuade the reader that the legal benchmark for evaluating the consistency of PTAs with the WTO is anything but clear. 'Substantially all trade' is one of the two key requirements (the other being the external protection requirements) that PTAs have to meet to be WTO-consistent. While we are clear on its rationale,[12] we are unclear as to what it precisely covers.

This term can be (and has been) interpreted in practice in so many different ways, that it is impossible at this stage to state with clarity what exactly it means. Mavroidis (2012) cites excerpts from official GATT reports where this term has been interpreted to mean a specific percentage of the trade involved, and a 'qualitative' threshold that does not need to be quantified.

Lack of clarity as to what was meant is due to many factors. This provision was added at the end of GATT negotiations, and its extension to free trade areas was agreed even later. Trading nations stayed idle until 1995, and did not amend/modify the provision at all. They did adopt an Understanding on the interpretation of Article XXIV during the Uruguay Round, but it deals only with external protection, and not with the term 'substantially all trade'.

3.2.2 No reason to be optimistic now

There have not been serious attempts to specify the meaning of 'substantially all trade'. Mavroidis (2012) mentions that only one proposal to amend the contract in this respect was seriously discussed by the WTO membership. Australia proposed a quantitative threshold at the six-digit level that should be agreed by all trading nations to satisfy this requirement. In the ensuing discussions, Australia did not manage to sensitize almost anyone to this effect.

Twenty years later since Australia first submitted its proposal, no move in this or similar direction is recorded. The last bastion of MFN trade, Mongolia, is busy at

12 Grossman and Helpman (1995) explain that, absent this requirement, PTAs could legitimately occur even if only one product market were liberalized. Similar understanding of PTAs would almost totally eviscerate the relevance of MFN, the cornerstone of the GATT.

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the time of writing, negotiating a PTA with Japan. It is speculative indeed, but highly plausible to contemplate that, since all WTO Members are engaged in PTAs, it is in their common interest to avoid specifying the legal test of consistency.

No proposal to this effect has been submitted during the Doha Round either, and, under the circumstances, it seems quite unrealistic to lay hopes on the legalization front.

3.3 Judicialization

3.3.1 In theory an option

Those unhappy with the outcome of the exercise before the CRTA can of course always litigate. There should have never been any doubt to this effect, and yet this issue was raised in *Turkey–Textiles*.

India had argued that its MFN rights had been impaired, proved its claim, and the ball shifted to Turkey's camp to justify its measures. Turkey invoked its CU with the EU (European Union), and also argued that this provision (Art. XXIV GATT) was not justifiable, as Panels lacked the authority to decide what should be best left to the discretion of the CRTA. Turkey was effectively claiming that the institutional balance struck between WTO Committees and WTO panels would be dealt a blow if the Panel decided to move, and decide if the requirements spelled out in Art. XXIV GATT had been met. The Panel had, therefore, first to address whether it was competent to discuss the consistency of a PTA with the GATT.

It held the view that WTO adjudicating bodies are competent to examine PTA-related issues, but should stop short from providing an overall assessment of the consistency of a PTA with the WTO contract.[13] In the Panel's view, for reasons having to do more with the administrative burden, the CRTA is the more appropriate forum to review consistency of notified PTAs.

The Panel report was appealed. The AB (Appellate Body) report held for a different proposition. The Article XXIV GATT defence, in the AB's view, holds only if two conditions are met:

> First, the party claiming the benefit of this defence must demonstrate that the measure at issue is introduced upon the formation of a customs union that fully meets the requirements of sub- paragraphs 8(a) and 5(a) of Article XXIV. And second, that party must demonstrate that the formation of that customs union would be prevented if it were not allowed to introduce the measure at issue … We would expect a panel, when examining such a measure, to require a party to establish that both of these conditions have been fulfilled. It may not always be possible to determine whether the second of the two conditions has been fulfilled without initially determining whether the first condition has been fulfilled.[14]

13 Paras. 9.52 and 9.53.
14 Paras. 58–59.

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It follows that the AB went further than the Panel, arguing that those carrying the burden of proof had an obligation to prove that its requirements had been met in their totality.

3.3.2 *In practice, a mirage*

Not much litigation has happened. Only a handful of disputes since the inception of the GATT (1947) has arisen where the consistency of a PTA with the GATT was the main or ancillary component. Turkey–Textiles emerges as the only genuine case in the WTO era where a PTA defence was raised and thoroughly discussed.[15]

3.3.3 *A mirage yes, but for some (good) reasons*

In Mavroidis (2005), we identified a number of reasons why litigation has only seldomly occurred. It is, of course, a quixotic test to draw an exhaustive list of explanatory variables since most explanations are idiosyncratic, and we are often facing private information that there is no incentive to reveal. Some explanations, however, do seem to matter for many cases.

Collective action is one, since trading nations might incur the full cost (economic and political) of litigation, while profiting only in small part in cases where they have been successful.

Non-enforcement might leave outsiders better off (because of the reduced trade diversion), unless of course we talk of 'complementary' goods, a rather infrequent occurrence.

Strategic reasons might argue in favour of staying idle, since, except for Mongolia (soon to join the club), all WTO Members already participate in PTAs, and they would have little incentive to undermine their options in this area by streamlining the various obligations embedded in GATT. Think of it this way: PTAs are formed for various reasons. The collective interest of those embarking on this exercise would be to avoid too much scrutiny at the multilateral level, which could lead to all of them having one option less, an unwanted outcome if we go by revealed preferences of the trading nations.

The institutional design of WTO panels should play a role: Why trust amateur judges with interpretations of loaded terms, such as 'substantially all trade', that the trading nations have failed to clarify?[16]

Finger (1993) points to yet another reason explaining scarce litigation against PTAs. Maybe GATT contracting parties having committed the original sin

15 Schott (1989) and Mavroidis (2005) provide an exhaustive list of all relevant GATT/WTO cases.

16 The sheer amount of authorized retaliation and the difficulty in calculating it might also provide those interested in enforcing Art. XXIV GATT before a GATT Panel with a disincentive to do so: the WTO Arbitrator would have to calculate the total amount of trade lost (a fairly straight-forward exercise depending on the assumptions made), and then apportion the amount of trade lost by the complainant and use the outcome of this latter calculation as basis for authorized retaliation.

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(by demonstrating benign attitude towards the European integration) refrained from changing their attitude subsequently for fear of being inconsistent.

Moreover, if the European integration process provides the benchmark, then few if any PTAs would meet this standard. The European Union evolved into the deepest integration process we know as of today. Trading nations might thus feel reluctant to undo serious policy choices with a trade component (like the original European Coal and Steel Community), which might lead to genuine FTAs/CUs in the future.

3.3.4 End game

Judicialization does not look promising either. Indeed, one might ask what else the WTO can do to incite litigation: it is the only international regime where courts are established without consensus by the defending party, solely at the wish of the complainant; Turkey–Textiles reduced the original burden of persuasion for the complainant to a demonstration of violation of the MFN, an obvious point. And still, litigation is missing.

Litigation is, however, missing for good reason. It is not an incentive-compatible structure as argued in the preceding sections. It is hard to see how these incentives can be addressed; as PTAs move towards an exclusively regulatory content, it is also hard to see what litigation can bring to outsiders. As argued above, regulatory policies must be applied on an MFN basis even if contracted within PTAs. The problem is that outsiders often cannot meet the regulatory standards of PTA partners.

To recap:

(a) we are moving to a world where regulatory barriers (only, or in large part) segment markets;

(b) non-discrimination is ill-equipped to deal effectively with regulatory barriers in a near tariff-free world;

(c) instruments like recognition and harmonization are for good reasons contracted between like-minded countries, and PTAs offer a forum to this effect;

(d) the legalization and/or judicialization route cannot help outsiders to undo similar integration policies.

5. The t-word and its merits: transparency

So far this paper has tried to establish that neither legalization nor judicialization offer a promising avenue towards addressing PTAs. Something though should be done. PTAs are the 'runaway bride' eloping with the trade agenda away from

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the WTO. We suggest that the WTO should enhance the transparency agenda towards PTAs, and this in order to connect with the fora that have become the pole of attraction for trade negotiators and learn from their operation.[17]

The negotiating history of the PTA clause is unclear. True Chase (2006) explained in persuasive terms the extension of the provision to cover FTAs as well, but why have a provision on CUs in the first place? Was not the GATT conceived of as an instrument to establish non-discriminatory trade? The UK cared about preserving its imperial preferences, a far cry from a CU or an FTA. A review of the negotiating record leads to the following conclusions:

(a) The US delegation was instrumental in proposing the draft of what became Art. XXIV GATT. The US delegate (usually, Harry Hawkins) proposed the first comprehensive writing of the provision, and was the recipient of the many comments tabled.

(b) A number of trading nations were in favour of introducing a clause to this effect, albeit for different reasons. Some saw it as natural complement to the discipline on 'frontier traffic' (e.g. trade between adjacent countries, which is also regulated in Art. XXIV GATT[18]), others saw it as a necessary tool to 'legalize' pre-existing arrangements, whereas still others as tool for development, and some even took the view that similar schemes could function as an insurance policy in case the multilateral order broke down. Indeed, there was no guarantee at the time of inception of the GATT that the 23 original signatories would stick together in times of adversity, much less that others would join in. Even though the rationale for including customs unions (CUs) in the GATT was not the same across negotiators, they all agreed on a text that would be flexible enough to provide the 'roof' for divergent processes.

Probably neither of the above explanations matters today anymore. Horn *et al.* (2010) discuss PTAs formed by the US and the EU over the last 20 years, and conclude that their content is dramatically different from that of the WTO. Instead of continuing to ask the question whether they are building or stumbling blocks, a sterile question in light of the empirical proof we have discussed supra, the WTO could adopt a pro-active attitude and build bridges to PTAs, establish a link that will help it improve its own attractiveness to trading nations.

PTAs in a way are the hothouse where tomorrow's multilateral agenda is being tested. The WTO has every interest in keeping up with the Joneses instead of sitting

17 For a more detailed discussion on this, see Mavroidis (2011).

18 Art. XXIV.3 GATT regulates frontier traffic: it states that nothing in the Agreement should prevent countries from according advantages to adjacent states aiming to enable frontier traffic. In a second paragraph, it covers an issue of historical interest, namely trade between the Free Territory of Trieste and the adjacent to it countries.

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in its comfortable Geneva home pretending the work is done when the CRTA issues its reports is senseless at worst, and of extremely limited value at best.

Following the 'control' by the CRTA, PTAs live their life within the premises they have established. They are of course bound by the notification requirements established by the WTO. Similar requirements fall short of asking the most relevant (for WTO purposes) questions: Why discuss, for example, investment protection at the PTA and not the WTO level? What were the factors facilitating the standardization process at the PTA as opposed to the WTO level? What are the criteria used to choose new PTA partners? Under what conditions would PTA partners be willing to entertain a discussion on 'open regionalism'? The list is endless. This is an area where regulatory activity is indeed necessary in order for the WTO to continue to be afloat for developments occurring in the PTA world.

The WTO will in the short to medium run continue anyway to be a relevant forum. For one, it is the guardian of liberalization so far. Moreover, it provides a dispute settlement system that is by far more sophisticated than fora provided by other international organizations. The question it needs to ask at this stage is this: How can it continue to be policy relevant in the future as well?

In this paper, we have argued that variable geometry is inevitable in a trade contract between 160 highly asymmetric players, which are from now on called to address essentially regulatory barriers. Indeed, even the EU, an agreement between 28 far more (than the WTO) homogeneous players, has opted for similar arrangements, first through the establishment of its monetary union, and more recently by institutionalizing 'enhanced cooperation'. From a *Realpolitik* perspective, there could not be a more persuasive argument than the EU experience.

Connecting to PTAs, learning from their experience, and then armed with knowledge, the WTO could pick 'winners' and multilateralize agreements that are now being discussed away from its premises. Instead of demonizing them PTAs, the WTO would be doing itself a service by using them an as antechamber to multilateral agreements while keeping the umbilical cord tight through increased transparency.

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