

TERMITES IN THE TRADING SYSTEM: HOW PREFERENTIAL AGREEMENTS UNDERMINE FREE TRADE BY JAGDISH BHAGWATI (NEW YORK, US: OXFORD UNIVERSITY PRESS, 2008) 139 PAGES. PRICE AU\$45 (HARDBACK) ISBN 9780195331653.

This is a small book, but it is no less effective for being brief. It takes no intellectual prisoners and gives no quarter in argument. It is in every sense what in French is described as a *livre de combat*. Over a long and distinguished career, Professor Jagdish Bhagwati has written many weighty tomes and countless articles in learned journals in defence of his views on the advantages of the liberal trading order.¹ These works have been read with the respect they deserve by a learned and expert audience. But clearly Professor Bhagwati has decided that the time has come to reach out to a wider audience if the rot in the multilateral trading system is to be stopped.

Bhagwati is deeply concerned that the rush to conclude what are euphemistically known in the World Trade Organization parlance as ‘regional trade agreements’, but which he prefers to designate by the more accurate term of ‘preferential trade agreements’, is having a profoundly corrosive effect upon the maintenance of the integrity of the principles and practice of the multilateral trading system. He is unequivocal in his judgement that preferential trade agreements, which today number over 350, ‘have now turned into a pandemic and a pox on the world trading system’.² In his arguments against preferential trade agreements, no scorn is too withering, no refutation too blunt. Only one conclusion is possible: these agreements are a disaster.

The book opens with a chapter outlining the history behind the inclusion of art XXIV in the *General Agreement on Tariffs and Trade 1947* (‘GATT 1947’).³ It is known that Great Britain and France desired to preserve colonial and Commonwealth preferences against the wishes of the United States. India and Pakistan were granted the (as yet unrealised) right to maintain a preferential relationship and several other states sought the right to set up looser trade associations in the form of a new concept, the ‘free trade area’. But the dirty little secret behind art XXIV is that the decision to include it was much influenced by the fact that Canada and the US were secretly contemplating a bilateral trade agreement, which ultimately Canadian Prime Minister Mackenzie King decided would be politically unacceptable in Canada. In order to keep their options open, these two supposedly ardent free traders did not oppose the inclusion of art XXIV in the final version of the *GATT 1947*. Nor did they maintain the initial

¹ See, eg, Jagdish Bhagwati, ‘Departures from Multilateralism: Regionalism and Aggressive Unilateralism’ (1990) 100 *Economic Journal* 1304; Jagdish Bhagwati, *Free Trade Today* (2003); Jagdish Bhagwati, *The World Trading System at Risk* (1991); Jagdish Bhagwati and Arvind Panagariya, ‘The Theory of Preferential Trade Agreements: Historical Evolution and Current Trends’ (1996) 86 *American Economic Review* 82; Jagdish Bhagwati, David Greenaway and Arvind Panagariya, ‘Trading Preferentially: Theory and Policy’ (1998) 108 *Economic Journal* 1128.

² Jagdish Bhagwati, *Termites in the Trading System: How Preferential Agreements Undermine Free Trade* (2008) 15.

³ Opened for signature 30 October 1947, 55 UNTS 187 (entered into force 1 January 1948); *ibid* 7–11.

idea that art XXIV be limited to permitting customs unions. Had this happened, the current ‘pandemic’ would have been restricted to a minor illness, as it has proven infinitely harder to meet the high standards of a customs union than the much less rigorous requirements of a ‘free trade area’. Yet, as Bhagwati states, no one would have predicted the widespread use of the right to set up free trade areas, which now take the form of mainly bilateral agreements, often between two very distant and different countries.⁴ The number, variety and complexity of these agreements have reached a point where it has become almost impossible to follow and describe them all. Many are made by benevolent or less benevolent hegemony such as the US, the European Union and China. Many more are made by developed states, supposedly to assist developing nations, and a further extensive category are made between developing states, which by virtue of the 1979 *Enabling Clause*⁵ escape even the limited discipline of art XXIV.⁶

Bhagwati’s second chapter details the growth of the erroneous thesis that preferential free trade agreements are made of the same stuff as multilateral free trade. He decries the erosion of the weak disciplines of art XXIV of the *GATT 1947* and debunks the popular myth that preferential trade agreements can be seen as building blocks of free trade rather than as stumbling blocks, or that it is possible to ‘walk on two legs’ of regionalism and multilateralism, as was claimed by a former US Trade Representative.⁷ Rather, he sees in preferential trade agreements (masquerading as building blocks) the corruption of an ideal, which serves the interests of friendly or unfriendly hegemonic powers claiming to achieve multilateral goals by other means. Chapter 3 details the dangers of the ‘spaghetti bowl’ effect, an expression that he had previously coined,⁸ where an ever-increasingly complex web of preferential commitments and rules of origin adds to the costs of trade and weakens any sense of responsibility to a single multilateral order. Chapter 4 deals with the attempts that have been made to deal with the flood of preferential trade agreements in the WTO and elsewhere. None of these have been successful and none appear likely to stem the tide. He does not discuss the creation in 2006 of the *Transparency Mechanism*,⁹ doubtless because it is proving to be as futile as any previous solution. The only practical solution that would actually nullify the advantages of preferential trade agreements for any state would be the reduction of all tariffs to zero.¹⁰ The concluding appendix contains a ‘who’s who’ of leading economists who have debunked the shallow arguments used to defend preferential trade agreements.

Root and branch stuff from the most distinguished international economist of our time; from a man whose counsel has been valued by successive Directors General of the GATT and the WTO. Is there anything that can be said in defence of preferential trade agreements without incurring the scorn of the great man?

⁴ Bhagwati, *Termites in the Trading System*, above n 2, 11–14.

⁵ *Differential and More Favourable Treatment: Reciprocity and Fuller Participation of Developing Countries*, GATT BISD, 26th Supp, 203, GATT Doc L/4903 (3 December 1979) (Multilateral Trade Negotiations Decision, adopted on 28 November 1979).

⁶ *Ibid* 27.

⁷ *Ibid* 39.

⁸ *Ibid* 61–3.

⁹ *Transparency Mechanism for Regional Trade Agreements*, WTO Doc WT/L/671 (14 December 2006) (General Council Decision).

¹⁰ Bhagwati, *Termites in the Trading System*, above n 2, 91.

Perhaps not, but every reviewer must try. The EU is clearly a preferential trade agreement (and certainly guilty of trade diversion), but it is also one of the most hopeful and original creations of the modern international system; arguably it is the way forward from narrow nationalism towards a freer and more open international society. Surely Bhagwati would not argue against the existence of the EU, although he no doubt objects to many of its international policies.¹¹ He might answer that he has less objection to genuine customs unions than to free trade areas and the EU is entirely *sui generis*. But he has to contend with the existence of the EU. Second, and closely related, is the fact that the root of the EU, and possibly many other preferential trade agreements, lies in valid political and not economic objectives. This is true of the EU, whose real cause and real achievement is the elimination of war within its boundaries. But it is also true of many free trade agreements such as *NAFTA*,¹² *ANZCERTA*¹³ or *ASEAN*.¹⁴ The fact is that free trade agreements actually serve many different functions; economic, social and political. Recently, they have been used to bring together the different universes of investment protection and trade law.¹⁵ While many of the additional ‘non-trade’ provisions added to contemporary trade agreements can be decried by Bhagwati as extraneous and inappropriate or as being disguised forms of protectionism, can we really say that human rights, or environmental protection or fair labour standards and trade are unrelated? Surely this is too sweeping a claim.

In the final analysis, while preferential trade agreements may be doing little economic good and may be doing more economic harm, one can remind economists, even the greatest, that they give the world the theory of the second best. Or to put it in even more basic terms, in an imperfect world, the best is often the enemy of the good. But Bhagwati has issued a clarion call and we would be foolish not to heed it.

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¹¹ Ibid 14, 31–2, 35–6, 91.

¹² *North American Free Trade Agreement*, opened for signature 17 December 1992, 32 ILM 289 (1993) (entered into force 1 January 1994) (‘*NAFTA*’).

¹³ *Australia New Zealand Closer Economic Relations Trade Agreement*, [1983] ATS 2, (signed and entered into force 1 January 1983) (‘*ANZCERTA*’).

¹⁴ *Association of Southeast Asian Nations Declaration*, 6 ILM 1233 (1967) (signed and entered into force 8 August 1967) (‘*ASEAN*’).

¹⁵ See, eg, *US–Chile Free Trade Agreement*, signed 6 June 2003 (entered into force 1 January 2004) ch 10, which broadly defines investors and investment, government procurement and emphasises that investors receive equal treatment in the host country. *Japan–Malaysia Free Trade Agreement*, signed 13 December 2005 (entered into force 13 July 2006) arts 75–6; *Korea–Singapore Free Trade Agreement*, signed 4 August 2005 (entered into force 2 March 2006) art 10.4; *Singapore–Australia Free Trade Agreement*, signed 17 February 2003, [2003] ATS 16 (entered into force 28 July 2003) ch 8 art 3; *Agreement between New Zealand and Singapore on a Closer Economic Partnership*, signed 14 November 2000 (entered into force 1 January 2001) arts 28–9 <http://www.fta.gov.sg/sg_fta.asp>. See also David Gantz, ‘The Evolution of FTA Investment Provisions: From NAFTA to the United States–Chile Free Trade Agreement’ (2004) 19 *American University International Law Review* 679, 690–1.

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