One Trading World, or Many: The Issue of Regional Trading Blocs

Over the past several decades, more and more countries have entered into preferential trading arrangements, provoking concern that the benefits of free trade are being sacrificed to growing discrimination. Just how widespread is this discrimination in international trade, and is it "legitimate" under the codes of international behavior to which countries generally subscribe? What does economic theory tell us about the likely consequences of such discrimination, and why do so many nations engage in it? Are patterns of trade being seriously distorted by the emergence of discriminatory "trading blocs"? The answers offer little indication that the sky is falling, but neither do they provide grounds for complacency.

The Prevalence of Preferential Trading

To our knowledge, no comprehensive compilation of preferential trading arrangements has previously been published. And the listing in Table 1 may be less than complete, although we invested much research in its preparation. The list is formidable. Included in the 23 arrangements identified are 119 countries, accounting for some 82 percent of the world's international trade in goods. No region is free from such arrangements; indeed, one would be hard-pressed to find even one country that does not receive from, or grant to, other countries some form of explicit preferential treatment in international trade, although that treatment might take some mode other than participation in a multilateral arrangement such as those included in the table.

Preferential trading arrangements take several forms, but all favor the trade of the participants over that of nonparticipating countries. In the most casual arrangement, the trade preference association, each member establishes lower governmental barriers against imports of goods from other members than against comparable imports from

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Table 1
Preferential Trading Arrangements, by Geographic Region and Year Launched

Region, Title and Membership	Year Launched	Type of Trade Arrangement
Africa:		
Communauté Economique de l'Afrique de l'Ouest (CEAO), or West African Economic Community: Benin, Burkina Faso, Côte d'Ivoire, Mali, Mauritania, Niger, Senegal	1959	Customs union
Union Douanière et Economique de l'Afrique Centrale (UDEAC), or Economic and Customs Union of Central Africa: Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon	1964	Customs union
Southern African Customs Union (SACU): Bophuthatswana, Botswana, Ciskei, Lesotho, Namibia, South Africa, Swaziland, Transkei, Venda	1969	Customs union
Mano River Union (MRU): Guinea, Liberia, Sierra Leone	1973	Customs union
Economic Community of West African States (ECOWAS): Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, The Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo	1975	Common market
Preferential Trade Area for Eastern and Southern African States (PTA): Burundi, Comoros, Djibouti, Ethiopia, Kenya, Lesotho, Malawi, Mauritius, Mozambique, Rwanda, Somalia, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe	1981	Trade preference association
Communauté Economique des Etats de l'Afrique Centrale (CEEAC), or Economic Community of Central African States: Burundi, Cameroon, Central African Republic, Chad, Congo, Equatorial Guinea, Gabon, Rwanda, Sao Tome and Principe, Zaire	1981	Common market
Arab Maghreb Union (AMU): Algeria, Libya, Mauritania, Morocco, Tunisia	1989	Common market
Asia:		
Association of Southeast Asian Nations (ASEAN): Brunei, Indonesia, Malaysia, Philippines, Singapore, Thailand	1967	Free trade area
Bangkok Agreement: Bangladesh, India, Laos, South Korea, Sri Lanka	1976	Trade preference association
Europe:		
European Community (EC): Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, United Kingdom	1957	Common market
European Free Trade Association (EFTA): Austria, Finland, Iceland, Liechtenstein, Norway, Sweden, Switzerland	1960	Free trade area
European Community and European Free Trade Association: Member countries of the EC and EFTA	1972	Industrial free trade area
Latin America:		
Central American Common Market (CACM): Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua	1960	Customs union
Andean Common Market (ANCOM): Bolivia, Colombia, Ecuador, Peru, Venezuela	1969	Common market
Caribbean Common Market (CARICOM): Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, St. Kitts-Nevis, St. Lucia, St. Vincent and the Grenadines, Trinidad and Tobago	1973	Common market

Table 1 *continued*

Region, Title and Membership	Year Launched	Type of Trade Arrangement
Latin American Integration Association (LAIA): Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela	1980	Trade preference association
Organization of Eastern Caribbean States (OECS): Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts-Nevis, St. Lucia, St. Vincent and Grenadines, Virgin Islands U.K.	1981	Customs union
Southern Cone Common Market (MERCOSUL or MERCOSUR): Argentina, Brazil, Paraguay, Uruguay	1991	Common market
Middle East:		
Gulf Cooperation Council (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates	1981	Common market
Middle East and Africa:		
Arab Common Market (ACM): Egypt, Iraq, Jordan, Lebanon, Libya, Mauritania, Syria	1964	Common market
North America:		
Canada-United States Free Trade Agreement: Canada, United States	1989	Free trade area
Oceania:		
Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERT): Australia, New Zealand	1983	Free trade area
Other: Other preferential arrangements include various bilateral free trade agreements, such as between Israel and the EC, Israel and the United States, and Chile and Mexico, and also preferential treatment for imports from less developed countries by many countries, including the EC and the United States.		

Source: See the Appendix.

nonmember countries. In the free trade area, members go a step further and completely eliminate governmental barriers against goods imports from other members, but, as in the trade preference association, maintain their individual barriers against imports from nonmembers. Establishment of a customs union requires that members not only eliminate government barriers against merchandise imports from one another, but also establish identical barriers—in particular, a common tariff barrier shared by all—against imports from nonmembers. Finally, the customs union becomes a common market with the removal of artificial or governmental impediments to all transactions between members, including transfers of labor, capital, and services as well as goods.

Is It Legal?

A code of law for international trade is set forth in the General Agreement on Tariffs and Trade (GATT), which is applied as a treaty obligation among countries that subscribe, or "contract," to the Agreement. In addition, GATT entails an organization, or forum, in which countries discuss and negotiate issues of international trade, such as the multilateral liberalizations under consideration in the current Uruguay Round. GATT entered into force in 1948, with 23 original contracting parties, a number that had grown to 103 by November 1991, with an additional 29 countries applying the agreement de facto (GATT 1980, 1992).

The very first paragraph of the very first article of the General Agreement lays down a broad prohibition against the use of preferential tariff rates: "With respect to customs dues . . . any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties." (GATT 1969, p. 2) This language gives expression to the unconditional most-favored-nation (MFN) principle, the principle that each contracting party must grant to every other contracting party treatment as favorable as it grants to any country. Long before the GATT, this principle of nondiscrimination had been generally observed by many nations.

However, the very second paragraph of this same first article allows an exception to this principle, permitting the continued application of many preferential tariff rates that were in effect at the time the GATT was adopted. And a much more significant exception is to be found in Article XXIV, which spells out the conditions under which GATT signatories may form customs unions and free trade areas (and interim arrangements leading to them). The formation of such preferential trading arrangements is allowed as long as the following conditions are met: (1) trade barriers are eliminated on substantially all trade among members; (2) the trade barriers remaining against nonmembers are not higher or more restrictive than those previously in effect (in the case of a customs union, not "on the whole" higher or more restrictive); and (3) interim arrangements leading to the free trade area or customs union are employed for only a reasonable length of time.

No region is free from preferential trading arrangements, favoring the trade of the participants over that of nonparticipating countries.

Provided these three rather ambiguous conditions are satisfied, arrangements such as those listed in Table 1 do not violate the legal obligations assumed by members of the GATT. Nonmembers are free to discriminate without satisfying any such conditions (unless they have limited that freedom through other treaty obligations), according to the prevailing interpretation of international law (Jackson 1989, p. 134). Of the countries participating in the discriminatory arrangements identified in the table, only 18 neither belong to GATT nor apply its provisions de facto.

Under GATT it has been possible to rationalize, if not justify, the proliferation of preferential trading arrangements because of the ambiguous language used in specifying the three conditions that these arrangements must meet. Phrases such as "substantially all trade," "not on the whole higher or more restrictive," and "reasonable length of time" have allowed much latitude for interpretation. This latitude has been exploited. The GATT has been notified of more than 70 preferential trading arrangements—some establishing very loose preferences as "interim agreements" with no date for completing a free trade area—but GATT has never formally disapproved any of them (OECD 1990, p. 18; Jackson 1989, p. 141).

Although preferential arrangements of the sort indicated in Table 1 are the subject of this article, it should be noted that they are by no means the only mode of discrimination in international trade. One variant close to the types listed in the table is the granting of preferences to imports from less developed countries under schemes such as the Generalized System of Preferences (GSP), which was sanctioned by a waiver of the GATT most-favored-nation principle from 1971 to 1981 and thereafter by an international agreement (Jackson 1989, p. 141; Carl 1986, pp. 7–8). Another prominent form of discrimination is the widespread use of so-called "voluntary" export restraints, under which a country agrees under pressure to limit its exports of a certain good to a particular importing country or countries. The restraints imposed by Japan over its automobile exports to the United States are a well-known example. Other forms of significant discrimination could be adduced. All in all, more than one-fourth of world trade fails to observe the MFN principle, according to one recent estimate (Kostecke 1987, pp. 425 ff.).

Does It Matter?

Few words arouse more revulsion than "discrimination." But is discrimination in international trade a harmful practice? And if so, why is it so prevalent?

Perhaps the strongest case ever made against discrimination in international trade is Jacob Viner's classic work, *The Customs Union Issue* (1950), in which Viner focused on the effect of customs unions. His conclusion was that, "with respect to most customs union projects the protectionist is right and the free trader is wrong in regarding the project as something, given his premises, which he can logically support" (p. 41). Viner based this conclusion on the belief that formation of a preferential trading area such as a customs union would usually shift purchases of traded goods primarily from lower to higher money cost sources (excluding tariffs), rather than from higher to lower cost sources.

In briefest outline, the underlying reasoning is as follows. Once the customs union has been completed, members will import from one another some commodities that previously they did not import at all because of their tariffs (now eliminated on trade among the members). This "trade creation" is efficient and desirable, as it entails a shift from a higher cost (domestic) source to a lower cost (foreign) source. But because the union maintains a tariff barrier against imports from nonmembers, the members will also now import from one another some commodities that previously they had imported from nonmembers who had supplied the items at the lowest cost including the tariffs then levied (at rates that were the same for both members and nonmembers). This "trade diversion" from a lower cost (nonmember) source to a higher cost (member) source is inefficient and undesirable. It was Viner's opinion that in the construction of the typical customs union high priority would be given to protecting domestic industries, so that trade diversion would outweigh trade creation. He believed this undesirable outcome would be even more likely in the case of preferential trading arrangements short of full customs union, on the grounds that the participants would select preferences that were predominantly protective of their own industries.

Viner believed that the formation of a preferential trading area would usually shift purchases of traded goods primarily from lower to higher money cost sources (excluding tariffs).

To this case against preferential trading arrangements, Viner recognized one significant qualification. Within the enlarged protected market formed by such an arrangement, the expansion of output in various industries might be accompanied by economies of scale, with lower costs per unit of output, and this gain in efficiency might offset the losses stemming from net trade diversion. This beneficial outcome he considered unlikely, arguing that in most industries plants can attain their most efficient scale even if the industry is not large.

Viner also appreciated that by adopting a common tariff against imports from nonmembers, and by negotiating as a unit on trade issues with the rest of the world, the countries forming a customs union could exercise greater economic leverage than if they acted individually. Thus, the union might find it possible to improve the terms on which it traded with other countries. Any such gain for the union would, of course, represent a loss for the rest of the world.

While a number of significant refinements have been made in Viner's analysis, the concepts of trade creation, trade diversion, and economies of scale have remained central to empirical studies of preferential trading arrangements.[1] Empirical studies are very important, because both Viner's and subsequent theorizing have made one thing clear, namely, it is not possible to say a priori that customs unions—or, more generally, preferential trading arrangements—will inevitably either enhance or diminish world efficiency or world welfare. Each case must be examined carefully on its own merits. This is not to argue that preferential trading arrangements may be more efficient than perfectly free trade among all countries. But given that trade is less than free, the formation of a preferential area may or may not represent an improvement.

Thus, it is not only the GATT, but economic theory as well, that is somewhat ambiguous on the issue of preferential trading areas. It would be wrong to conclude from this shared ambiguity that GATT was based on the theorizing outlined in this section, as that theory blossomed only after GATT was founded. In the drafting of the GATT, economic theory probably was less influential than the harsh lessons of the years between the world wars, a period that witnessed a proliferation of bilateral and other discriminatory arrangements inimical to world trade and responsible for worsening both the Great Depression and international relations. In terms of sub-

[1] For developments in theory following Viner's work, see Gunter (1989); Wonnacott and Lutz (1989); Kowalczyk (1990); and the references cited in these works.

sequent economic theorizing, the three conditions required of preferential trading areas under GATT Article XXIV can be viewed as tending to restrain the trade-diverting aspects of such schemes while encouraging their trade-creating aspects. Of course, as with any agreement, the GATT is no better than its interpretation and enforcement.

Empirical Analyses

Since empirical analysis is crucial to evaluation of a preferential trading area, what has been revealed by such studies? Are they helpful in resolving the ambiguity of theory?

In recent years surprisingly little of the empirical research on preferential trading areas has provided estimates of trade creation and diversion. What is not surprising is that such estimates have been chiefly for the European Community (EC), the major customs union to develop after World War II. These EC estimates generally agree that for manufactured products trade creation exceeded trade diversion. On the other hand, EC policy toward agriculture has been highly protectionist and has likely generated substantial trade diversion. Thus, one recent survey concludes, "it is not obvious from . . . the empirical studies whether the volume of trade created outweighed that of trade diverted, whether there was any *external* trade creation by which *non-members* benefited from the increased EC market size, or whether the customs union among the original EC members improved global allocative efficiency" (Pomfret 1988, p. 131, emphasis added).

Similar conclusions are drawn regarding research into two other effects noted by Viner, namely, effects on economies of scale and terms of trade: "the available evidence shows that increased scale economies have been realized in some EC sectors since the establishment of the customs union, but gives little indication of a causal relationship or of the magnitude of any allocative efficiency gains . . . . Finally, although it is widely agreed that the EC customs union has involved terms of trade effects, there are few estimates of their magnitude . . . . In sum, the EC customs union seems to have involved small (and perhaps even negative) static welfare gains, possible but unproven dynamic benefits, and a welfare transfer from non-members" (Pomfret 1988, pp. 133–135).

Thus, empirical analysis has done little to resolve the ambiguity of theory on the question of whether preferential trading areas such as the EC serve to enhance or diminish global efficiency and welfare. If in fact the benefits are so dubious, why are such arrangements so widespread? Before tackling this puzzle, we should note that by no means have all preferential trading arrangements turned out to be viable. Indeed, even some of those identified in Table 1 are, at this writing, more nearly nominal than functional. Because of this mixed record, much attention has been given to the question of what promotes the viability or demise of preferential arrangements, especially customs unions and free trading areas. A review of the conclusions is not only interesting in its own right but also sheds some light on the puzzle of why so many of these arrangements are launched.

This research on the viability of customs unions and free trade areas has yielded somewhat more definitive results than has research on trade creation and diversion and on welfare effects. The arrangements that endure and that seem to foster trade among the participants often display the following characteristics:[2]

(1) the member countries have relatively similar levels of per capita GNP and relatively similar economic structures;

(2) the member countries have compatible laws and policies governing international trade flows and adopt an across-the-board rather than product-by-product approach toward liberalizing trade among themselves;

(3) the member countries are not located vast distances apart.

It is one thing to observe these characteristics and another to explain why they seem to promote the success of a preferential arrangement. Presumably, similar levels of per capita GNP reduce the likelihood of disagreements over trade flow adjustments that generate unemployment or, more generally, that redistribute income. Firms in poorer countries fear the superior technology, managerial skills, and capitalization of firms in richer countries while workers in the richer countries fear the competition of lower-paid laborers in the poorer countries. These fears, and the disputes they provoke, may be less intense among countries with similar levels of development. It also happens that such countries commonly trade more heavily with each other, even in the absence of preferential understandings, than do countries of widely differing economic structure and per capita income.

[2] See Schott (1991, pp. 2–3); Wonnacott and Lutz (1989, pp. 74–83); Thoumi (1989); and Carl (1986, pp. 13–34).

In the realm of government policy, two points seem especially relevant. First, conflicting national laws and policies toward international commerce obviously inhibit its development. Second, barriers to trade between the members of a preferential arrangement are generally reduced more expeditiously if the successive reductions are applied to virtually all barriers, across the board, rather than if reductions of varying degrees are negotiated for different products. Successful opposition by affected interest groups is more likely to arise against reductions proposed product by product than those undertaken across the board.

With respect to the last of the characteristics common to successful preferential arrangements, the lesser is the distance between countries, the lower are the costs of transportation and communication that encumber their trade, other things equal. Other things are not always equal, of course, and geographic proximity is no guarantee of success. But customs unions or free trade areas are seldom, if ever, even attempted among nations that are poles apart.

The characteristics that make for success are clearly present in the case of the largest and longest-lived of the customs unions, the European Community (EC). Near the other extreme are the less successful Latin American Integration Association (LAIA)—and especially its predecessor, the Latin American Free Trade Area (LAFTA)—and the Economic Community of West African States (ECOWAS). Progress within ECOWAS has been impeded by the participation of its members in other preferential trading arrangements that impose obligations incompatible with those assumed under ECOWAS. The resulting inconsistency of the members' commercial policies has contributed to virtual paralysis in the mutual reduction of trade barriers (Agyemang 1990, esp. pp. 67 and 79). In the case of LAFTA, the product-by-product negotiating approach posed a formidable obstacle. The same approach has slowed the reduction of trade barriers within the Association of Southeast Asian Nations (ASEAN).[3] More generally, progress within a number of integration schemes launched by less developed countries, such as LAFTA, has been slowed by disagreements over how the perceived gains and losses might be distributed, and over compensation to be provided by countries that gain to poorer, losing countries.[4] These disagreements, of course, illustrate the likelihood of friction where per capita incomes and economic structures differ very much among the member countries.

Overall, preferential trading arrangements have a mixed record, with few approaching their announced goals; and even for the more successful arrangements it is hard to prove demonstrable benefits for the world at large or even for the members. Such being the case, why are these arrangements so common? A definitive answer is elusive, but the motivations behind many arrangements are fairly readily discerned.

Why So Many Preferential Trading Arrangements?

A Vinerian answer to this question might run along the following lines. Trade-diverting preferential arrangements are promoted by the producers who benefit, while the consumers who are injured offer little opposition. The explanation for this activism on the part of producers and passivity on the part of consumers is that the gains from diversion reaped by protected industries are concentrated enough to inspire them to lobby for preferential arrangements, while the injury done to consumers is spread too thinly among them to provoke their strong protestations.

> *Motives besides protectionism—some economic, others more nearly political—lie behind the formation of preferential trading arrangements.*

This rather traditional explanation of protectionist successes no doubt has some validity, but it is only part of the story. Other motives besides vulgar self-interested protectionism are also at work. Some are economic in nature, others more nearly political. A political motivation played an important role in the formation of the EC. It was hoped that economic integration would strengthen political ties among the West European countries and reduce the likelihood of

[3] See Carl (1986, pp. 15–17); Wonnacut and Lutz (1989, pp. 74–77); and Balasubramanyam (1989, pp. 173–74).

[4] See Carl (1986, pp. 16, 21–22, 28); Wonnacut and Lutz (1989, pp. 82–83); and Pomfret (1988, pp. 145–47).

[5] See, for example, MacBean and Snowden (1981, pp. 145–46).

conflicts among them, such as had led to World War II, while also providing a democratic bulwark against the Soviet communist bloc.[5] The prospective expansion of the EC to include some of the recently liberated countries of Central and Eastern Europe is similarly justified on the grounds that their inclusion will enhance the stability of their struggling new market economies and democratic institutions.

Another motivation at least partly political in nature is frustration with the slow advance of trade liberalization under GATT-sponsored negotiations. A highly influential example of this glacial pace is the current Uruguay Round—negotiations that were launched by more than 70 nations in September 1986 and that, at this writing, have yet to produce an overall agreement. One reason for this lack of progress is that trade negotiations these days are tackling more complex issues, such as intellectual property rights, dispute settlement techniques, nontariff barriers, and trade in services. Not surprisingly, agreements on matters of this nature are more readily reached among relatively few countries whose relevant policies are already fairly similar, a fact that inclines countries to strike a (preferential) bargain with just a few other countries rather than endure the lengthy and dubious multilateral GATT negotiations.

Still another reason that some countries opt for preferential rather than MFN agreements conducted through GATT is to avoid giving a "free ride," in the form of liberalizing or market-opening measures, to countries that fail to reciprocate (Belous and Hartley 1990, p. 13). For example, several countries might agree to extend to each other's banking firms the right to open branches within each other's borders, but be reluctant to extend the same right to banks in another country that did not offer that right.

Among less developed countries an important goal of preferential trading arrangements may be to reduce dependence on industrial countries, especially as a source of manufactured goods, by fostering trade and integration among the parties to the arrangement. A closely related goal may be to enhance the bargaining power of the parties vis-à-vis the industrial countries (Agyemang 1990, pp. 57–58).

Finally, countries may seek inclusion in preferential trading arrangements not because they expect significant gains but to avoid losses from the trade diversion to which they would be exposed as outsiders. Even if a preferential arrangement creates more trade than it diverts, the nonmembers experience only diversion—a reduction in their exports to the members—unless, over the long run, the arrangement serves to accelerate the economic growth (and demand for imports) of the member countries. In the case of a customs union, such as the EC, another potential loss to be avoided through joining is the less favorable terms of international trade that the union, to its own advantage, may be able to impose upon the outside world. For these and other reasons, countries often fear the consequences of being "left out" of preferential arrangements. And countries that are left out may form their own arrangements, partly in "self-defense" and partly merely in imitation of other arrangements; the power of example can be powerful indeed.

Are Discriminatory Blocs Capturing and Transforming the World's Trade?

Table 2 reports, in order of magnitude, the percentage shares of world merchandise trade attributable to preferential trading groups identified in Table 1. As indicated in the first row of data, countries belonging to these arrangements account for more than 80 percent of all international trade. And, as noted at the bottom of Table 1 and elsewhere in this article, these arrangements by no means exhaust the catalog of preferential trading schemes in use.

The EC's share of world trade is much larger than that of any other trading group. Because the EC and EFTA have formed a free trade area for manufactured goods, the Canada-United States Free Trade Area is an even more distant second than indicated by the percentages reported. While some of the trading groups account for inconsequential shares of world trade, the aggregate for all the groups is most impressive.

But are these trading groups turning into trading blocs that promote trade among themselves at the expense of trade with the rest of the world? The mere finding that members of a group trade more intensively with each other than with other countries would not establish that the group had "turned inward." For one thing, the members are often closer geographically to one another than to nonmember countries and would be expected to trade more intensively, other things equal, if only because of lower transportation and communications costs. Moreover, if the members enjoy more rapid growth in production and overall trade than the rest of the world, trade among them would ordinarily be expected to grow more rapidly than their trade with the rest of the world.

Table 2
Preferential Trading Groups' Percentage Shares of World Merchandise Trade, 1989 and 1990

	Exports		Imports		Total Trade	
Trading Group	1989	1990	1989	1990	1989	1990
Total of countries in trading groups listed below	79.93	81.26	82.34	82.90	81.16	82.10
European Community (12)	38.99	40.96	38.89	41.04	38.94	41.00
Canada-United States Free Trade Area	16.63	15.70	20.44	18.54	18.56	17.14
European Free Trade Association	6.41	6.71	6.47	6.60	6.44	6.65
Association of Southeast Asian Nations	4.17	4.22	4.22	4.65	4.20	4.44
Latin American Integration Association	3.46	3.47	2.45	2.61	2.95	3.03
Bangkok Agreement	2.72	2.47	2.88	2.85	2.80	2.66
Gulf Cooperation Council	2.31	2.57	1.45	1.48	1.87	2.02
Australia-New Zealand Closer Economic Relations Trade Agreement	1.58	1.45	1.79	1.50	1.68	1.48
Southern Cone Common Market	1.54	1.42	.87	.85	1.20	1.13
Arab Common Market	.92	.95	.99	.95	.95	.95
Arab Maghreb Union	.79	.93	.83	.84	.81	.89
Andean Common Market	.85	.90	.59	.55	.72	.72
Southern African Customs Union[a]	.78	.76	.63	.53	.71	.65
Economic Community of West African States	.68	.68	.53	.58	.61	.63
Preferential Trade Area for Eastern and Southern African States	.24	.22	.35	.34	.30	.28
Caribbean Common Market	.15	.16	.25	.24	.20	.20
Economic Community of Central African States	.21	.22	.16	.16	.19	.19
West African Economic Community	.17	.16	.19	.18	.18	.17
Central American Common Market	.16	.14	.21	.20	.19	.17
Economic and Customs Union of Central Africa	.15	.18	.11	.11	.13	.14
Mano River Union	.10	.08	.12	.15	.11	.12
Organization of Eastern Caribbean States[b]	.01	.01	.03	.03	.02	.02

Note: The trade (exports, imports or total trade) for each group is the sum of the trade of the individual members of the group, including trade with countries both within and outside the group. Trading groups' shares of world trade do not sum to the total for all countries in the listed groups (first line), as some countries are members of more than one group and data for each country are counted only once in this total.
[a]Not including member territories that are not countries.
[b]Not including the British Virgin Islands.
Source: International Monetary Fund, *Direction of Trade Statistics Yearbook*, 1991.

This reasoning is applied in Table 3.[6] Assume (arbitrarily) that in 1948 the trade among the countries that were later to form the EC was fairly "neutral," or relatively free of government preferences that succeeded in fostering trade among them.[7] Then the trade share reported as neutral in column 5 is equivalent to the actual share recorded in column 4. For following years, the trade reported as neutral is that which would have taken place among EC members if the share of intra-EC trade in EC total trade had risen (or fallen) by the same percentage as the EC share of world trade. In fact, the share of intra-EC trade in the EC total has risen faster than the EC share of world trade, with the result that, by 1990, the share of EC trade taking place within the group was 23.5 percentage points greater than if that trade had increased neutrally, or free of any growing bias toward doing business within the group (59.2 − 35.7 = 23.5).

[6] Compare Frankel (1991, pp. 5–9).

[7] In fact, it is not crucial that trade have been free from such preferences in 1948, for we are interested in examining the *change* after 1948, or whether trade became *less* neutral as time passed.

Table 3
European Community (12) Trade with Selected Areas, 1948 to 1990

	In Billions of U.S. Dollars			As Percent of EC Total Trade			
Year	Total Trade (1)	Intra-EC Trade (2)	Trade with the United States (3)	Actual Intra-EC Trade (4)	Neutral Intra-EC Trade[a] (5)	Actual Trade with the United States (6)	EC Total Trade as Percent of World Trade (7)
1948	35.2	9.6	4.6	27.4	27.4	13.0	31.4
1949	37.5	11.5	4.4	30.6	31.6	11.8	36.3
1950	37.4	13.0	3.6	34.7	31.3	9.7	36.0
1951	50.8	16.4	5.3	32.3	29.8	10.4	34.3
1952	49.8	16.4	4.9	33.0	29.8	9.9	34.3
1953	49.8	17.4	4.2	35.0	30.4	8.5	34.9
1954	53.7	19.3	4.4	35.9	31.5	8.2	36.2
1955	61.2	22.4	5.8	36.7	30.1	9.5	34.6
1956	67.1	24.6	7.0	36.7	29.7	10.5	34.1
1957	73.4	26.6	8.1	36.2	29.9	11.1	34.4
1958	71.5	26.2	7.0	36.6	34.6	9.8	39.8
1959	76.9	29.6	8.0	38.4	34.8	10.4	40.0
1960	89.7	35.7	9.5	39.8	35.4	10.6	40.7
1961	95.8	40.5	9.6	42.3	35.9	10.0	41.2
1962	102.8	45.5	10.4	44.3	36.6	10.1	42.1
1963	113.5	52.1	11.2	45.9	37.0	9.9	42.5
1964	127.0	59.6	12.5	47.0	36.3	9.9	41.7
1965	139.4	66.4	13.9	47.6	36.6	10.0	42.1
1966	152.5	73.3	15.6	48.0	36.3	10.2	41.7
1967	158.7	76.7	16.0	48.3	35.7	10.1	41.1
1968	176.7	87.0	18.8	49.2	35.2	10.6	40.5
1969	208.4	106.8	20.3	51.2	36.5	9.7	41.9
1970	240.4	124.8	23.2	51.9	36.3	9.6	41.7
1971	272.1	144.3	24.7	53.0	37.1	9.1	42.7
1972	326.3	178.3	27.9	54.7	37.5	8.5	43.1
1973	451.8	247.5	36.9	54.8	37.3	8.2	42.9
1974	605.6	311.3	47.1	51.4	34.7	7.8	39.8
1975	634.3	326.1	45.7	51.4	35.0	7.2	40.2
1976	709.0	372.2	50.1	52.5	34.3	7.1	39.5
1977	809.3	424.8	56.2	52.5	34.3	6.9	39.4
1978	964.5	518.7	68.8	53.8	35.4	7.1	40.7
1979	1235.6	675.2	86.7	54.6	35.9	7.0	41.3
1980	1463.7	766.6	104.7	52.4	34.8	7.2	40.0
1981	1323.7	668.8	102.9	50.5	30.0	7.8	34.5
1982	1270.7	660.1	99.2	51.9	30.8	7.8	35.4
1983	1226.9	648.9	97.6	52.9	30.7	8.0	35.2
1984	1249.7	656.3	110.2	52.5	29.5	8.8	33.9
1985	1313.7	702.8	118.3	53.5	30.3	9.0	34.8
1986	1577.9	896.7	131.1	56.8	33.5	8.3	38.5
1987	1914.3	1114.0	149.6	58.2	34.6	7.8	39.8
1988	2147.4	1257.6	164.0	58.6	33.9	7.6	39.0
1989	2305.2	1346.5	176.9	58.4	33.7	7.7	38.7
1990	2784.0	1648.7	201.8	59.2	35.7	7.2	41.1

Note: Trade is defined as the sum of reported exports (fob) and imports (cif). The EC includes Belgium, Denmark, France, Germany (West), Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, and the United Kingdom.

[a]EC percent of world trade (col. 7) in current year multiplied by the ratio [(intra-EC trade as a percent of EC total trade (col. 4) in 1948)/(EC percent of world trade (col. 7) in 1948)].

Source: International Monetary Fund, Direction of Trade Statistics through U.S. Department of Commerce, Compro data retrieval system.

What is of interest in such data is not so much the position in any one year but the change that has occurred over the years, because what part of trade is truly neutral in any year is highly debatable. What is beyond debate is that the members of the EC have come to trade much more intensively with one another than would be expected from their trade with the entire world, a fact that is reflected in the widening gap between the shares reported for actual and neutral intra-EC trade. As the customs union was completed and its membership has expanded, the bias toward intra-group trade has grown. Thus, the EC has increasingly assumed at least this characteristic of a trading bloc.

Because the EC and EFTA now comprise a very sizable free trade area for manufactured products, that arrangement also merits special attention. As can be seen in Table 4, EC-EFTA, like the EC, has become much more inward-oriented in its trade. Three of the EFTA countries have applied for full membership in the EC, and their inclusion seems highly likely.

Comparable data for the Canada-United States Free Trade Area in Table 5 lend only weak support to the perception of a developing trade bloc. To be sure, the share of actual trade between the two nations exceeded the neutral share by about 10 percentage points in 1990, but that differential has not risen appreciably in years and, indeed, was notably smaller in 1990 than in the early 1970s. Data that could be obtained on this differential for other preferential trading arrangements may be found in Table 6.

Whether a particular arrangement has tended to become a trading bloc is clearer in some cases than in others. Our own assessment, based on Table 6 and presented in Table 7, is that most of them have shown this tendency in recent years. Those that have account for about two-thirds of the world's trade.

Not only the direction but the composition of trade flows is influenced by preferential trading arrangements. At any time a nation will have developed certain comparative, or relatively competitive, advantages and disadvantages in world markets that will be exhibited in the composition of its exports and imports if markets are relatively free and efficient. The nation's "revealed comparative advantage" may be measured by the ratio of the nation's net exports (exports minus imports) in each commodity category to the sum of the nation's total exports and imports in that category (Balassa and Noland 1989, p. 175). This ratio, or index, can take on any value between −1 and +1; the larger the algebraic value for a commodity category relative to the values for other categories, the greater is the country's revealed comparative advantage in the commodity category concerned. Thus, one can measure how the revealed comparative advantage of a country or of a preferential trading arrangement has changed over the years.

This analytic technique is applied here to the EC and the EFTA. It is well known that the EC has pursued a highly protectionist policy for its agriculture, so it might be expected that the EC's relative competitive position in agricultural commodities would have (artificially) improved over the years, as exports were promoted through subsidies and imports were impeded through the variable tariff levy and other devices. One might also wonder if a preferential trading area such as the EC would provide inducements that boosted net exports of sophisticated manufactures in an effort to stimulate technological advance within the member countries.

The members of the EC have come to trade much more intensively with one another than would be expected from their trade with the entire world, thereby assuming at least this characteristic of a trading bloc.

These hypotheses receive no support from the statistics in Table 8. The rankings for the commodity groups listed in this table are based on revealed comparative advantage ratios computed for the two-year periods 1962–63 (the earliest for which the desired data were readily available) and 1988–89. To be sure, the EC's greatest revealed comparative advantage in 1988–89 was in beverages and tobacco, and the comparative advantage of that category had improved markedly since 1962–63. But the ranking, or relative competitiveness, of food and live animals deteriorated over the same span of years, and the opposite would have happened if the EC had actually succeeded in strengthening its competitive position in these agricultural items. Similarly, the EC's revealed comparative advantage weakened in machines and transport equipment, the reverse of what would have occurred under policies successfully promoting these sophisticated manufactures in world markets.

Table 4
European Community (12) and European Free Trade Association (EC-EFTA) Trade with Selected Areas, 1948 to 1990

	In Billions of U.S. Dollars			As Percent of EC-EFTA Total Trade			
Year	Total Trade (1)	Intra-EC-EFTA Trade (2)	Trade with the United States (3)	Actual Intra-EC-EFTA Trade (4)	Neutral Intra-EC-EFTA Trade[a] (5)	Actual Trade with the United States (6)	Total EC-EFTA Trade as Percent of World Trade (7)
1948	42.6	16.8	5.7	39.4	39.4	13.4	38.0
1949	44.5	18.7	5.3	42.1	44.6	11.9	43.1
1950	44.2	20.5	4.4	46.4	44.0	9.9	42.6
1951	60.9	27.9	6.3	45.8	42.6	10.4	41.2
1952	59.6	27.7	6.0	46.5	42.4	10.0	41.0
1953	58.9	28.1	5.1	47.7	42.7	8.7	41.3
1954	63.9	31.6	5.3	49.4	44.5	8.2	43.1
1955	72.7	36.6	6.8	50.3	42.4	9.4	41.0
1956	80.1	40.4	8.3	50.4	42.1	10.3	40.7
1957	85.5	42.4	9.3	49.6	41.4	10.9	40.0
1958	82.9	41.6	8.0	50.1	47.7	9.6	46.1
1959	89.1	46.0	9.1	51.7	48.0	10.2	46.4
1960	106.3	57.0	11.0	53.7	49.9	10.3	48.3
1961	113.7	64.2	11.0	56.4	50.6	9.6	49.0
1962	122.0	70.9	11.8	58.2	51.7	9.7	50.0
1963	134.2	79.5	12.8	59.2	52.0	9.5	50.2
1964	150.4	90.5	14.3	60.2	51.1	9.5	49.4
1965	165.0	100.2	15.8	60.7	51.6	9.6	49.9
1966	180.1	109.1	17.8	60.6	50.9	9.9	49.2
1967	187.6	113.7	18.1	60.6	50.2	9.7	48.5
1968	207.8	126.6	21.2	60.9	49.3	10.2	47.6
1969	244.5	153.6	22.9	62.8	50.9	9.4	49.2
1970	283.5	180.5	26.1	63.7	50.9	9.2	49.2
1971	318.9	205.2	27.8	64.3	51.8	8.7	50.1
1972	381.6	251.2	31.5	65.8	52.2	8.2	50.4
1973	527.6	348.0	41.5	66.0	51.8	7.9	50.1
1974	708.1	440.2	53.1	62.2	48.2	7.5	46.6
1975	743.4	460.5	51.9	61.9	48.7	7.0	47.1
1976	829.6	519.8	56.7	62.7	47.8	6.8	46.2
1977	945.8	592.6	63.8	62.7	47.7	6.8	46.1
1978	1122.1	715.8	78.3	63.8	49.0	7.0	47.3
1979	1434.6	926.5	98.3	64.6	49.6	6.9	47.9
1980	1703.2	1071.2	118.3	62.9	48.1	6.9	46.5
1981	1539.7	935.9	116.7	60.8	41.5	7.6	40.1
1982	1476.0	915.2	112.2	62.0	42.6	7.6	41.2
1983	1428.5	903.7	111.6	63.3	42.5	7.8	41.0
1984	1456.5	918.0	125.8	63.0	40.9	8.6	39.5
1985	1532.7	981.7	134.5	64.0	42.0	8.8	40.6
1986	1847.5	1253.1	149.7	67.8	46.6	8.1	45.1
1987	2242.2	1552.0	171.2	69.2	48.2	7.6	46.6
1988	2508.3	1737.5	187.9	69.3	47.1	7.5	45.5
1989	2686.4	1850.4	203.4	68.9	46.7	7.6	45.1
1990	3234.8	2255.0	232.1	69.7	49.4	7.2	47.7

Note: Trade is defined as the sum of reported exports (fob) and imports (cif). EFTA is here defined to include Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

[a]EC-EFTA percent of world trade (col. 7) in current year multiplied by the ratio [(intra-group trade as a percent of EC-EFTA total trade (col. 4) in 1948)/(EC-EFTA percent of world trade (col. 7) in 1948)].

Source: International Monetary Fund, Direction of Trade Statistics through U.S. Department of Commerce, Compro data retrieval system.

Table 5
Canada-United States Free Trade Area (Can-US) Trade with Selected Areas, 1948–90

	In Billions of U.S. Dollars		As Percent of Can-US Trade with World		Can-US Total Trade as Percent of World Trade
Year	Total Trade with World (1)	Can-US Trade (2)	Actual Can-US Trade (3)	Neutral Can-US Trade[a] (4)	(5)
1948	26.4	7.3	27.8	27.8	23.6
1949	25.2	7.3	28.9	28.8	24.4
1950	25.7	8.2	31.7	29.2	24.8
1951	36.6	11.7	32.1	29.1	24.7
1952	35.5	11.3	31.9	28.8	24.5
1953	36.3	12.0	33.0	30.0	25.5
1954	34.5	11.3	32.8	27.4	23.2
1955	37.1	12.8	34.5	24.7	20.9
1956	43.9	14.9	34.0	26.3	22.3
1957	46.4	14.9	32.1	25.6	21.7
1958	43.4	13.9	32.0	28.4	24.1
1959	46.4	15.2	32.8	28.5	24.2
1960	48.8	14.5	29.8	26.1	22.2
1961	49.0	14.9	30.3	24.9	21.1
1962	51.8	16.0	30.8	25.0	21.2
1963	55.1	16.6	30.2	24.3	20.6
1964	62.2	18.9	30.5	24.1	20.4
1965	67.6	21.7	32.2	24.1	20.4
1966	78.5	26.4	33.6	25.3	21.5
1967	82.3	29.8	36.2	25.1	21.3
1968	95.4	35.4	37.1	25.8	21.9
1969	104.7	40.5	38.7	24.8	21.1
1970	116.7	41.7	35.7	23.9	20.2
1971	127.4	47.8	37.5	23.6	20.0
1972	149.5	56.6	37.9	23.3	19.8
1973	195.3	69.2	35.4	21.9	18.5
1974	276.0	89.2	32.3	21.4	18.2
1975	281.8	91.0	32.3	21.0	17.9
1976	325.7	106.7	32.8	21.4	18.1
1977	364.2	116.7	32.1	20.9	17.7
1978	419.3	129.6	30.9	20.8	17.7
1979	513.2	152.2	29.7	20.2	17.1
1980	612.6	163.8	26.7	19.7	16.7
1981	654.6	182.6	27.9	20.1	17.1
1982	600.8	169.4	28.2	19.7	16.8
1983	616.6	193.3	31.3	20.9	17.7
1984	732.9	237.6	32.4	23.4	19.9
1985	752.1	244.4	32.5	23.5	19.9
1986	785.7	242.4	30.9	22.6	19.2
1987	874.5	268.4	30.7	21.4	18.2
1988	1016.7	310.6	30.5	21.8	18.5
1989	1106.9	335.1	30.3	21.9	18.6
1990	1168.2	354.9	30.4	20.3	17.2

Note: Trade is defined as the sum of reported exports (fob) and imports (cif).
[a]Can-US percent of world trade (col. 5) in current year multiplied by the ratio [(Can-US trade as a percent of Can-US total trade with world (col. 3) in 1948)/(Can-US percent of world trade (col. 5) in 1948)].
Source: International Monetary Fund, Direction of Trade Statistics through U.S. Department of Commerce, Compro data retrieval system.

Table 6
Excess of Actual over Neutral Intragroup Trade, as Percentage of Group Total Trade, for Various Trading Groups

	Trading Arrangement and Percentage Excess[a]										
Year	ANZCERT	CACM	Can.-U.S. FTA	EC (12)	EC (12)-EFTA	EFTA	MERCOSUR	ANCOM	ASEAN	LAIA	GCC
1948	0	0	0	0	0	0					
1949	0	−.3	.1	−1.0	−2.5	−.6					
1950	−.2	−1.7	2.6	3.4	2.3	−.9					
1951	−.5	−1.0	3.0	2.4	3.2	−1.1					
1952	.3	−2.1	3.1	3.2	4.1	.1					
1953	1.0	−2.3	3.0	4.6	5.0	−.2					
1954	1.4	−2.2	5.5	4.4	4.9	−.2					
1955	1.6	−2.0	9.8	6.6	7.9	.2					
1956	2.5	−1.8	7.7	7.0	8.3	−.1					
1957	3.6	−1.6	6.5	6.3	8.2	1.9	0				
1958	3.9	−1.4	3.5	2.0	2.4	1.4	.5				
1959	2.7	1.2	4.4	3.6	3.7	1.5	−1.5				
1960	2.6	1.9	3.7	4.4	3.7	.2	−1.7				
1961	3.2	3.4	5.4	6.4	5.8	.7	−3.8				
1962	3.3	3.6	5.8	7.7	6.5	.9	−2.1				
1963	4.1	6.0	5.9	8.9	7.3	1.4	−.8				
1964	3.6	9.4	6.4	10.7	9.1	2.1	3.2				
1965	3.4	10.8	8.1	11.0	9.1	2.7	5.2				
1966	3.7	14.2	8.4	11.8	9.7	3.4	3.5				
1967	3.4	16.8	11.1	12.6	10.4	4.5	3.4				
1968	3.5	20.2	11.3	14.0	11.7	4.7	4.2				
1969	3.1	20.1	13.8	14.8	11.9	5.5	4.0				
1970	4.1	20.7	11.9	15.6	12.8	6.3	3.6				
1971	4.4	18.5	14.0	15.9	12.5	6.7	2.5				
1972	4.9	18.4	14.6	17.2	13.7	6.9	1.4	0	0	0	
1973	5.4	18.4	13.6	17.5	14.1	6.7	1.1	.7	−3.2	.8	
1974	5.3	17.5	10.9	16.7	14.0	7.4	−.2	.3	−7.1	−.6	
1975	4.7	16.6	11.3	16.5	13.2	7.4	−.4	1.2	−5.6	.4	
1976	4.9	16.2	11.4	18.1	14.9	6.7	1.4	1.9	−5.5	2.1	
1977	5.2	13.3	11.1	18.2	15.0	6.2	1.6	2.4	−6.2	3.2	
1978	5.2	16.4	10.1	18.4	14.8	4.9	2.1	1.1	−6.5	1.9	
1979	5.4	15.4	9.5	18.7	15.0	5.1	4.4	1.6	−6.3	2.5	0
1980	5.1	18.5	7.0	17.6	14.8	4.6	3.3	1.2	−9.0	.7	−1.1
1981	5.2	16.8	7.8	20.5	19.3	5.8	1.9	1.6	−9.4	.6	−.7
1982	4.9	16.4	8.4	21.1	19.4	5.7	2.3	2.3	−9.1	2.2	.1
1983	5.5	16.4	10.5	22.2	20.8	5.3	1.1	2.3	−9.3	1.2	.8
1984	5.9	14.0	9.0	23.0	22.1	5.5	2.1	1.8	−9.9	1.3	2.0
1985	5.4	11.0	9.0	23.2	22.0	5.3	1.8	1.9	−6.2	.7	3.4
1986	5.2	8.0	8.3	23.4	21.2	4.9	5.4	1.9	−4.6	4.3	4.6
1987	6.3	10.1	9.3	23.6	21.0	4.7	4.6	2.7	−5.4	4.1	4.5
1988	6.1	9.8	8.8	24.6	22.2	4.5	4.5	2.9	−8.7	3.8	4.8
1989	5.8	10.0	8.4	24.7	22.2	4.5	6.4	3.1	−11.6	4.7	5.3
1990	6.1	10.0	10.1	23.5	20.4	4.1	6.8	2.5	−13.2	3.6	4.9

[a]Minus sign indicates excess of neutral over actual intragroup trade.

Note: As available, data are shown beginning with 1948. Lesotho and Swaziland are not included in PTA, nor is SACU included in this table, because of lack of data.

Source: International Monetary Fund, Direction of Trade Statistics through U.S. Department of Commerce, Compro data retrieval system.

Table 6 *continued*

	Trading Arrangement and Percentage Excess[a]										
Year	ACM	AMU	Bangkok	CARICOM	CEAO	CEEAC	ECOWAS	MRU	OECS	PTA	UDEAC
1981	0	0	0	0	0	0	0	0	0	0	0
1982	−1.9	−.1	.1	1.0	1.3	−.6	1.7	.2	4.2	−.1	−1.1
1983	−2.3	−.1	.3	1.1	.4	−.9	2.3	.6	4.7	.3	−1.0
1984	−1.3	.4	.7	.5	−.6	−1.1	4.2	.2	4.1	.6	−1.5
1985	−.1	.6	−.1	1.8	0	−.7	3.3	.2	2.6	−.1	−.8
1986	.9	1.2	−.1	1.1	−.7	−.3	5.8	.2	1.3	.2	.1
1987	2.3	1.4	−.6	1.6	1.2	.7	5.3	.1	−.1	.7	1.2
1988	1.1	1.5	−.9	2.9	2.0	1.1	4.5	−.4	−.8	1.1	1.6
1989	1.8	2.0	−.8	4.4	3.3	.9	4.1	−.6	−1.4	1.1	1.7
1990	1.4	1.8	−.7	4.3	3.8	1.2	4.2	−.6	−.7	1.3	1.7

Table 7
Trends toward or away from Bloc Formation in International Trade by Preferential Trading Arrangements

Trade Becoming More Bloc-like	Trade Becoming Less Bloc-like	No Persistent Strong Tendency
AMU	ASEAN	ACM
ANCOM	CACM (since 1970)	Bangkok
ANZCERT	Can-US FTA (1972–80)	MRU
CACM (through 1970)	ECOWAS (since 1986)	
Can-US FTA (1948–72 and 1980–90)	EFTA (since 1975)	
CARICOM	OECS (since 1983)	
CEAO (since 1986)		
CEEAC (since 1984)		
EC		
ECOWAS (through 1986)		
EC-EFTA		
EFTA (through 1975)		
GCC		
LAIA (since 1985)		
MERCOSUR (since 1983)		
PTA (since 1985)		
UDEAC (since 1986)		

Source: Table 6.

Table 8
Ranking by Commodity Group of Revealed Comparative Advantage for EC (12) and EFTA Countries' Trade with the Rest of the World, 1962–63 and 1988–89

	EC (12)		EFTA	
Major SITC Commodity Group	1962–1963	1988–1989	1962–1963	1988–1989
Food and live animals	6	7	7	7
Beverages and tobacco	5	1	8	9
Crude materials excluding fuels	9	8	1	3
Mineral fuels, etc.	8	9	9	2
Animal, vegetable oil, fat	7	6	5	6
Chemicals	3	2	4	4
Basic manufactures	4	4	2	1
Machines, transport equipment	1	3	6	5
Misc. manufactured goods	2	5	3	8

Note: In the rankings 1 is most positive, 9 most negative. EFTA is here defined to include Austria, Finland, Iceland, Norway, Sweden, and Switzerland.

Source: U.S. Department of Commerce, Compro system, UN data base.

This is not to say that EC policies to protect agriculture or to promote sophisticated manufactures were without effect. Absent any policies of this nature, the deteriorations in rankings of food and live animals and of machines and transport equipment could have been even greater. What can be said here is that deteriorations did take place in spite of any such policies.

EFTA is much less tightly organized than the EC, especially with respect to agriculture. While the statistics in Table 8 would tend to support a hypothesis that EFTA has promoted certain categories of manufactures, further research beyond the scope of this article would be required to confirm that hypothesis.

Where Do We Go from Here?

In spite of Viner's classic critique, it would be hard to demonstrate that the preferential trading arrangements now in operation have had a significantly deleterious impact on the world economy. To demonstrate the opposite would be almost as difficult, however (because of the complexity of the question and the data required), and much concern has been voiced that the international economy is tending to fracture into estranged, if not hostile, discriminatory trading blocs. The EC constitutes one bloc, and is expanding, perhaps eventually to encompass virtually all of Europe. Another bloc may be forming around the free trade area formed by Canada and the United States, which are negotiating with Mexico to establish a North American Free Trade Area—which, in turn, could be extended to all of Latin America. Finally, some foresee the development of a third major bloc in East Asia centered about Japan, although countries in the region have shown no inclination for such an arrangement.

In any event, preferential liberalization of trade is clearly inferior to global liberalization. Although the global approach pursued under GATT may be complex and slow, any nation that undertakes to negotiate a series of preferential trade agreements—including a series of bilateral agreements eventually forming a free trade area—will find that this alternate approach is far from swift and simple. Under the preferential approach, each new agreement must take into account bargains struck in prior agreements, and prior agreements may well have to be renegotiated to accommodate the interests of all parties. And paradoxically, to negotiate liberalization across a broad range of trade may be more difficult for just a few countries than for many, because when many offer sweeping reductions in barriers the odds may be greater that each party will perceive some considerable gain. Partly for this reason, GATT negotiations are much more likely than bilateral negotiations to yield liberalization of the most pernicious and intractable nontariff barriers, especially within highly sensitive areas such as agriculture and textiles and apparel.

But if global negotiations fail, blocs that genuinely liberalized trade among themselves could improve the general welfare and set a good example. In particular, they should welcome new members, for the best free trade area is worldwide in scope. In this connection, some encouragement should be taken from the recent collapse of the most discriminatory trading bloc of them all—COMECON, the Council for Mutual Economic Assistance, whose membership was drawn from the former Soviet communist bloc.

Conclusion

A multiplicity of preferential arrangements has permeated the trading world. In recent years most of these arrangements, accounting for about two-thirds of world trade, have increasingly resembled "trading blocs," in that their trade has become oriented more inward, among bloc members, and less outward, with the rest of the world. This outcome is hardly surprising, since the essence of a preferential trading arrangement is to discriminate in favor of the trade of participants over that of nonparticipating countries.

Certain types of preferential arrangements are sanctioned by the international codes to which most countries subscribe. This law is rather vague and has been loosely interpreted or applied, so that governments have felt relatively free to discriminate in international trade without much risk of retaliation from the countries that are disadvantaged.

Like the law, the standard theory of international trade is somewhat ambiguous regarding preferential arrangements. To be sure, the theory asserts that free trade is more efficient than discriminatory trade. But theory also acknowledges that in a world with less than free trade a discriminatory (or preferential) reduction of trade barriers can enhance efficiency in certain circumstances. Unfortunately, because of the complexity of the issue, very little has been learned about the actual impact of preferential trading on world efficiency and welfare, although a number of empirical studies have been undertaken.

Not all preferential trading arrangements have endured. They seem more likely to flourish if the members are fairly similar in their economic structures, per capita incomes, and policies toward international trade, if they are fairly close geographically, and if they adopt an across-the-board rather than product-by-product approach toward liberalizing trade among themselves.

That so many preferential arrangements have been launched may seem puzzling, in view of their frequent failure to attain their goals and their dubious impact on world efficiency and welfare. More than one motivation has been at work. Producers who expect to gain greater protection may lobby for preferential arrangements, while the injured consumers may offer little resistance. Also, frustration with the slow progress of global trade liberalization and with the "free ride" taken by some countries that benefit but contribute little has inspired growing interest in preferential arrangements limited to "kindred souls," all of whom contribute. Or nations may join such arrangements to enhance their bargaining power vis-à-vis the rest of the world or to avoid being "left out" and becoming victims of increased discrimination. Sometimes the motivation is partly to form a more stable political area, as was the case for the E.C.

Over the long run, nondiscriminatory reductions in trade barriers are clearly preferable to discriminatory reductions. But should global negotiations fail, blocs that truly liberalized trade among themselves could improve the general welfare. To set the best example for the rest of the trading world, they should be receptive to new members, for the ideal free trade area is worldwide in scope.

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