Benefits Of Regional Trade Agreements

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Abstract

The last decade had seen escalation of regional and bilateral trade agreements. However, many policy makers would justify this striking proliferation to the reduced momentum of multilateral negotiations. Based on this logic, it makes sense to explore various viewpoints. The contrasting perspectives range from thinking of regionalism as a stumbling block to one that believe it as being a building block for quick growth in multilateralism. In the same vein would be the consideration whether regionalism is trade-creating or trade-diverting. The rapid build-up of the RTAs may have affected the negotiating dynamics of the Doha Round of negotiations under the World Trade Organization (WTO) and it is unclear whether the increase in bilateral deals is in response to the slow progress of Doha talks. Concerns over the RTA expansion played a role in the launch of the Round, and, after the failure of the Cancun ministerial, it has gathered momentum. The divide between the developed and the developing world is being driven by the inability to arrive at a consensus on issues relating to agriculture. The split has been seen in the nature of a North-South polarisation and the characteristic movement of regional and bilateral trading formats is being declared, or announced, virtually on a daily basis. In this Paper, an attempt is being made to understand the certain most important issues connected with benefits of Regional Trade Agreements.

Key Words: Regional Trade Agreements, World Trade Organization, Trade Diversion, Economic Benefits, Static and Dynamic Gains.

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1. CONCEPT OF REGIONAL TRADE AGREEMENTS

1.1 Introduction

The last decade had seen intensification of regional and bilateral trade agreements. It is realize that the “regionalism” as being a counter to the move to foster rapid multilateralism. However, many policy makers would justify this striking propagation to the reduced momentum of multilateral negotiations. Based on the above mentioned judgment, there is an urgent need to explore various viewpoints. The contrasting perspectives range from thinking of regionalism as a stumbling block to one that thinks it as being a building block for rapid growth in multilateralism. In the same vein would be the consideration whether regionalism is trade-creating or trade-diverting. The rapid build-up of the RTAs may have affected the negotiating dynamics of the Doha Round of negotiations under the World Trade Organisation (WTO) and it is unclear whether the increase in bilateral deals is in response to the
slow progress of Doha talks. Concerns over the RTAs expansion played a role in the launch of the Round, and, after the failure of the Cancun ministerial, it has gathered momentum. The divide between the developed and the developing world is being driven by the inability to arrive at a consensus on issues relating to agriculture. The split has been seen in the nature of a North-South polarisation and the characteristic movement of regional and bilateral trading formats is being declared, or announced, virtually on a daily basis. In this Paper, an attempt is being made to understand the certain key issues connected with benefits of Regional Trade Agreements.

1.2 Meaning of Regional Trade Arrangements

“Regionalism” is described in the Dictionary of Trade Policy Terms, as “actions by governments to liberalize or facilitate trade on a regional basis, sometimes through free-trade areas or customs unions”. The term Regional Trade Arrangements (RTAs) is used to characterize customs unions, free trade areas or other preferential arrangements countries enter into in order to create faster, broader and deeper liberalization or integration among members of regional group. According to WTO, RTAs are the agreements between the countries that may not belong to the same geographical region and may based on the specific conditions of preferential trade under the provisions of GATT Article XXIV and Article V of the GATS.

1.3 Recent Development in Regional Trade Agreements

In fact, in an RTA, a relatively small number of countries agree to mutually reduce their barriers on each other’s exports. At one time, RTAs were mostly established by geographic neighbors. Today, many RTAs encompass geographically distant countries, such as the US-Jordan and European Union (EU)-Mexico agreements, but the term ‘regionalism’ is still commonly used. Over the past decade, there has been a rapid increase in the formation of RTAs. As of 1st July 2016, some 635 notifications of RTAs had been received by the GATT/WTO. Of these, 435 notifications were made under Article XXIV of the GATT 1947 or GATT 1994; 43 under the Enabling Clause; and 157 under Article V of the GATS. Of these 635 RTAs, 423 were in force, which is double the level a decade earlier. Almost every country in the world has joined at least one RTA and some have entered even more than twenty. The overall number of RTAs in force has been increasing steadily. At present there are 90 per cent of Free Trade Agreements (FTAs) and partial scope agreements and 10 per cent of customs unions agreements of RTAs are under negotiations that further strengthen the world trade volume. Although regional integrations are discriminatory in nature, discrimination against non-parties can be minimized if the agreements are open and parties allow accession by third parties to existing agreements. Such amplification and consolidation of existing agreements is being proposed by new negotiations like Regional Closer Economic Partnership Agreement. To set superior standards for trade in goods and services, a group of 12 Pacific Rim nations led by the United States signed the mega Trans Pacific Partnership (TPP) regional trade agreement. In addition the two more big regional trade agreements Transatlantic Trade and Investment Partnership (TTIP) between the US and the European Union, and the Regional Comprehensive Economic Partnership (RCEP) between the Association of Southeast Asian Nations and its six partners, including China and India are also negotiated in year 2015. The trend depicts that newer trading agreements are more complex and comprehensive. The recent regional trading agreements are not limiting themselves to reduce trading barriers but broaden the horizon by including provisions on market opening in services, investment, competition policy, trade facilitation, government procurement, intellectual property, electronic commerce and even labor and the environment too. Majority of them are bilateral, giving rise to an increasingly intricate regime of varied trade regulations. Analysts argue that these overlapping regional trade regimes make international trade more complicated and dent WTO non-discrimination principles. The 10th Ministerial Conference reaffirmed the need to ensure that RTAs remain complementary and not a substitute for, the multilateral trading system. Ministers also agreed to work towards the transformation of the transparency mechanism into a permanent mechanism for RTAs.
1.4 Rational and philosophy Behind Regional Trade Agreements

Foremost is that a regional trade agreements is a stratagem to achieve comprehensive reforms with key trade partners. In the RTAs of the previous decade, members have sought to execute deep economic and institutional integration by signing agreements that address more than tariff reform. Many RTAs now deal with the reform or synchronization of regulatory practices, investment protection, labour issues, trade dispute resolution and the development of general positions in other trade negotiation platforms. Increasingly, RTAs are also viewed as a way of connecting developing and developed countries in a common platform of economic development. By encouraging investment and locking in unilateral economic reforms, RTAs can facilitate productivity gains in participating developing countries and accelerate their economic growth. Several developed countries offer non-reciprocal preferences as another way of promotion exports by developing countries. Non-reciprocal preferences are arrangements between developed and developing countries that reduce tariffs or even allow duty-free access for selected products from developing countries. However, these arrangements often exclude products that are of greatest importance to developing countries. Besides, non-reciprocal preferences do not require participating developing countries to espouse their own market access reforms. For these reasons, non-reciprocal preferences are now viewed by several as a less effective development tool, compared with regional trading agreements.

2. Gains From Regional Trade Agreements

The rationale for RTAs is drawn from the standard trade theory, i.e. David Ricardo, Adam Smith, Alfred Marshal and Haberlar’s, which states that free trade is superior to all other trade policies. In fact, the free trade views of these economists were very much criticised by trade protectionists i.e. Rowl Prebish, Singer, Gunnar Myrdal, Nurkse etc. So in the counter of these views the significance and benefits of regional trade agreements is drawn by policy makers of developing countries. In this paper economic theory and empirical evidence on RTAs tend to point towards static gains and dynamic gains as the potential economic gains members of RTAs stand to benefit (de Melo et al, 1993; de la Torre and Kelly, 1992; Langhammer and Hiemenz, 1990; Robson, 1987; Balassa, 1961). The static gains and dynamic gains are discussed below.

2.1 Static Trade Gains

The static gains lead to only one time expansion in allocation of economic resources such as land, labor, capital and natural resources. The magnitude of static trade gains depends on the volume of trade created and diversion of trade from home territory to a partner country. Viner (1950) shows that trade creation is welfare enhancing, providing gains on both the supply and the demand side. Supply side benefits ensue from the reallocation of resources away from protected industries to the firms producing goods and services for the regional market. While on the demand side, consumers get benefited by getting high quality products and services at lowest possible cost in the region. The trade diversion takes place when a partner country production displaces lower cost imports from the rest of the world. The loss from trade diversion curtail from the reduction in government revenue as imports from outside the region with high tariffs are replaced by imports from within the region with lesser tariffs. Even though there is an offsetting gain as consumers pay lower prices, a portion of the price they pay effectively subsidizes producers in other member countries, rather than accruing to the government for reallocation within their own country. This cross-border subsidy represents a decrease in aggregate economic welfare (Ohyama, 1972; Radelet 1999). At this juncture a key question arises that whether the benefits arise through free trade agreement facilitate to absorb the cost of trade diversion or not. Hence, a free trade arrangement is likely to be seen as beneficial if, on balance, it gives rise to greater trade creation than trade diversion. The situation may give rise to varied conditions, firstly it may possible imports displace domestic production i.e. results in trade creation; secondly, preferred imports
might displace intra RTA imports i.e. trade diversion, while the third chance may occur that no RTA partner country produce goods and services rather they import from member country i.e. neither trade creation nor diversion takes place.

2.2 Dynamic Gains: Economics of Scales

Most researchers of RTAs tend to argue that major benefits derived from RTAs by developing countries are dynamic gains rather static gains. The dynamic gains talks about stimulation of investment in production for export and linked industries. Radelet (1999) argues that the dynamic gains from RTAs stem from the impacts on productive capacity and potential output, and the resulting impact on income growth. The dynamic trades benefits arise through RTAs are summarized below:-

**Economies of Scale**

The regional trade agreement facilitates the member to enlarge and diversify the trading market. The RTA gives the platform to the domestic firms of a member country to explore untapped markets and reap the benefits of economies to scale, (Langhammer and Hiemenz, 1990; Robson, 1987). Viner in 1950 observed the first time about the benefit of economies of sale through creation of regional trade agreements. Later Corden in 1972 formalizes this theory in terms of the importance of economies of scale to trade and welfare under customs unions. Corden argues that reduce trade barriers through getting into regional trade agreement gives the opportunity to the member country firms and industry to operate at lesser cost. Thus cost reduction effect and enhanced intra-regional trade, leads to greater internal demand and reduced barriers to trade. This provide opportunities for firms or industries to attain greater economies of scale and reduce output prices as firms operating within RTA capture bigger markets for their products both domestically and overseas. Such trading situation may also results in reduction in overall cost of transportation and communication that may creates spillover effects like cheaper transfer of knowledge from producer to the user. Hence, RTA brings the countries to come together for the mutual gains like joint production of public goods of common interest like building transportation network.

**Enhance Market Competition**

The RTAs also results in increase in competition among producers in the member countries, which tend to lead to greater production and marketing efficiencies (Lyakurwa, 1997) and possibly gains from industry restructuring. The large scale producers who were earlier tries to monopolies the domestic market, tend to produce specialized product due to market pressure. It further results, sharpening entrepreneurial and managerial performance of big concern. In contrast it may possible RTAs lead to a lesser amount of competition. This may happen either because in some RTAs, member countries allocate control of different sectors to different member countries or through creation of cartel between the firms in a region. The increased completion through regional trade agreement may results in mushrooming of producers with identical goods and services. Such situation pressurizes the firms to focus over certain products or activities in which they are more efficient and develop expertise over it. The increased competition in supply side gives the customers wider choice, better products at reasonable price. The above discussion opposes the trade creation theory of static gains of RTAs as the latter argues that nations will benefit only if they export products that are not similar (Baldwin and Venables, 1995).

**Boost Investment**

It is also argued by the researchers that RTAs boost the investments within as well as outside the region that leads in growth acceleration (Baldwin, 1992). The reduction in barriers and enlargement of market increases the profits of the firm. The excess returns induce producers to invest accumulated capital stock in productive ventures that help the economy to move towards growth path (Amponsah, 2001). Furthermore, RTAs may stimulate investment by reducing uncertainty and enhancing policy credibility. In a nutshell, RTAs may attract foreign direct investment (FDI)
dependent on the degree to which trade barriers are reduced and on transportation costs (Stevens, 2002). The literature on economic geography tends to suggest that economies of scale and location specific costs can provide justification for regional integration (Baldwin, 1995). It is further argued that the size of the integrated countries and markets will influence the degree and speed of industrialization (Puga and Venables, 1997). The analysts also argued that the benefits of regional trade agreement could be large if RTAs are designed as intermediate steps towards global integration (Radelet, 1999). The RTA is a platform that exposes firms to global competition and enhances the ability of the firms to compete globally (Bhagwati and Panagariya, 1995; Bhagwati, 1992). The new firm or industry can move from being domestically competitive to regionally competitive to globally competitive. This argument assumes that extension of protection to a regional basis will have constructive impacts on marketing techniques, quality control and management capabilities (Langhammer and Hiemenz, 1990; Krugman, 1984). On the other hand, RTA may impede or slow further global integration of its member countries if the latter believe that the regional markets are sufficient to meet their firm goals or if under the influence of big firms ruling party of the country gets into RTAs a to grab the opportunities arise due to trade diversion. Thus, regional integration is viewed as establishing a long-term dynamic towards more complete global integration, and hence is likely to be beneficial in the long run (Summers, 1991). The regional trades agreements are easier to negotiate as compare to multilateral agreements due to fewer members are involved.

3. Non Economic Gains of Regional Trade Agreements

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RTAs may support policy credibility by “locking in” uniform trade and investment reforms (Whalley, 1996; Baldwin et al., 1997). Whereas individual member nations may do well in embarking on policy reforms, group action can persuade all members to abide by a common reform agenda. According to Langhammer and Hiemenz (1990), there are many non-economic benefits member countries may derive from RTAs that are discussed below:-

Collective Bargaining The regional trade agreements can improve the collective bargaining of member countries. Through collective efforts the members may be better able to demand access to markets and even withstand demands from non-members for access to the region. This ensures enhancement of their voting power in international forums.

Commitment of member countries to political goals The regional trade settlement may enhance the commitment of member countries to political goals of common interest. Through RTAs, the member countries could have better political relations, and may increase regional dialogue and discussion. The mutual collaboration help to prevent conflicts, political regional disputes among the member countries and reduce tensions and the possibility of war among potentially rival countries, since political support is essential for the creation of RTAs. Hence regional assimilation is viewed as an instrument for fostering diplomacy and regional stability (Mansfield, 1993).

Loss of sovereignty The membership in regional trade agreement entails some loss of sovereignty, which can be either positive or negative. Hence, RTAs can serve as a check on unpopular policy decisions of governments, particularly those in newly independent countries, which might not want to surrender any of their newly acquired power. For instance, member governments of RTA may be co-opted to committing to a schedule of tariff reductions, which might make them discard some of their national policy options to abide by the regional policy options. The Schiff and Winters (1998) present the premise that trade among neighboring countries provides security directly by raising the level of interaction and trust among the people of those countries, by increasing the stake that each country has
in the welfare of its neighbor, or by increasing the access to the neighbor’s strategic raw materials. Nevertheless, free trade does not guarantee peace. The justification of RTAs on political ground needs confidence that trade preferences would lead to valuable political rapprochement and that it would not take place if RTA is not established (African Development Bank, 2000).

**Nurture New Establishments** According to the economists, the traditional analysis of the impact of regional groupings is based on the concepts of trade diversion and trade creation. The principal rationale used to justify RTAs is the “infant industry.” Firms producing manufactured goods inside the regional integration will in the beginning have higher costs than the world market, but costs will reduce as they learn. The firms will be able to compete in world markets, giving the country an export capacity. The experience of the Asian tigers, among others, has shown that governmental promotion or subsidization of firms can produce dramatic and cumulative change in comparative advantage over several decades. It is experienced that firms learning curve move upwards during the subsidy period. This allow quick learner to compete later on world markets without subsidies. The provision of subsidy to the new entrants sometimes criticize by the researchers that growing in over protective environment or excessive favors sometimes averse the new establishments to take risk and rise. It is advised that the government should gradually reduce tariff protection to force such firms to become more efficient.

**Attract Foreign Investment** Another benefit that arises through regional assimilation could come from foreign investors who were initially unwilling to invest in the individual countries but are tempted by access to a larger regional market. The potential for attracting investment is determined by the certainty of the regional trade agreement environment. The foreign investor’s gets attracted to invest in the regional integrated countries if they find the regional trade understanding is not temporary for getting immediate gain but lasts for long. Such investment can fetch new technologies and other benefits to the region. Lacking it, companies that invested in one country with the expectation of serving the regional market could find themselves with closed borders and excess capacity.

**Peace and Stability** Apart from economic benefits the regional integration could reduce regional tensions by increasing interaction and understanding. They also may help promote good governance in individual members. In addition, they may help a country defuse conflicts between two other members of a regional grouping. Nevertheless, there are very great limits on the capacity of a regional grouping to enforce behavior on individual members.

4. **Conclusion**

The world trade remains capricious in the year previous year 2015 due to diverging outlooks for developed and developing economies, disturbed global financial markets and sharp increase in commodity prices and exchange rates. According to the recent report of WTO, the estimated growth in volume of merchandise trade is supposed to remain stagnant at 2.8 per cent. Despite of a number of positive benefits to the trade members and numerous encouraging developments took place nevertheless the global economic environment remains challenging and continued vigilance is required. In the middle of this ambiguity, WTO Members must individually and collectively resist protectionist pressures. The greatest safeguard against protectionism is to have strong multilateral trading system. According to the reports on recent trade developments “WTO members need to avoid putting up barriers and “get trade moving again” to enhance the overall world trade. However regional integration results in numerous economic and non-economic benefits but incaution decision of regional collaboration might results in unfavorable trading terms because of integration between rich and poor economies, and limits the global competitiveness up to the regionally collaborating countries only. To break the older practice of promoting discrimination through regional integration the WTO is working towards making such agreements not to lead fragmentation of global trading system.
8. References


