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CATPRN

Canadian Agricultural Trade Policy And Competitiveness Research Network

IS THE GROWTH OF REGIONALISM AS SIGNIFICANT AS THE HEADLINES SUGGEST? LESSONS FROM AGRICULTURAL TRADE

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1. Introduction

Regional trade agreements (RTAs) are not new, but many commentators agree that their importance in global trade is once again on the rise (Figure 1). As of May 15, 2011, the World Trade Organization (WTO) notifications show that it is monitoring some 489 RTAs with 297 agreements in operation. This is up from 180 agreements in 2003, less than 100 agreements in 1995, and just 23 agreements in 1990. Since the advent of the WTO in 1995, the WTO has received an average of 11 notifications per year - almost one per month – and many countries participate in multiple RTAs.

The term ‘regional trade agreement’ is often used to classify any arrangement that grants some form of preference beyond the WTO’s Most Favored Nation (MFN) status.¹ This terminology, however, can be misleading because it ignores considerable differences in the depth of economic integration RTAs pursue. At their simplest, RTAs extend tariff preferences to member countries. At their deepest, RTAs progress towards an economic union harmonizing domestic and non-tariff policies, investment procedures, migration, intellectual property, and the creation of shared political, fiscal, and monetary policy. While the reduction of trade barriers among member nations is a common goal of RTAs, lack of political will, divergent liberalization agendas, product exclusions (especially in agriculture), and excessively long transitional periods of trade liberalization might render an RTA large with respect to the number of countries and its share in global trade, but economically insignificant. A number of studies have shown the trade creating potential of RTAs, but an important policy question is: what factors are responsible for the impressive agricultural trade increases RTAs seem to generate? One key, although largely untested, factor is whether the depth of economic integration explains the success of these agreements. Drawing on the WTO’s database of RTA notifications permits us to group agreements into one of three depths of economic integration: “Deep” (i.e., customs unions, common markets and single economic unions), “Moderate” (i.e., free trade agreements), or “Shallow” (i.e., partial or limited scope) integration agreements (DIAs, MIAs, and SIAs, respectively). We then match these agreements to a global dataset of agricultural trade flows covering 44 years (1964-2008) and estimate a gravity equation to control for heterogeneity in the depth of regional integration.² To preview the results, we find that deep integration agreements are largely responsible for the sizeable agricultural trade flow increases reported in the literature, whereas moderate and shallow agreements are largely inconsequential, despite the fact that the latter two account for nearly 90 percent of RTAs notified to the WTO. With relatively modest, and oftentimes insignificant agricultural trade effects of MIAs and SIAs, the results cast doubt on the significance of regionalism and its threat to the multilateral system.

2. The Growth and Depth of Regionalism

The WTO recognizes three hierarchical categories of RTAs according to their trade liberalization ambition. At the lowest level, partial scope agreements (PSAs) offer preferential tariff rates to member nations but the agreement covers a limited set of products. The 2005 agreement between Chile and India (CHL-IND) is a useful example. India offered Chile preferential tariff rates ranging from ten to 50 percent for a total of 178 tariff lines but livestock and meat were the only beneficiaries in agriculture.³ Chile’s offer to India covers just seven agricultural tariff lines. The ASEAN-China agreement similarly includes only a handful of agricultural tariff lines. Other agricultural products are either excluded or are categorized on a sensitive products list. Because of the limited scope and coverage of these agreements, we shall refer to partial scope RTAs as “Shallow Integration Agreements” (SIAs).

¹ Use of the word “regional” is a bit of a misnomer. Many recent RTAs are not “regional” in the geographical sense of the word because they stretch across continental divides (i.e., EU-Chile, U.S.-Australia, U.S.-Morocco, etc.).

² A comprehensive discussion of the model specification, data and estimation procedures is contained in Grant (2012).

³ To put this into perspective, there are more than 5,000 tariff lines classified at the six digit level of the Harmonized System of Trade Classification (HTS or HS). Of this total, roughly 700 lines are classified as agricultural products.

At the next level of integration, FTAs reduce or eliminate trade barriers on “substantially all trade” within the agreement. However, the meaning and interpretation of the word “substantial” in GATT Article XXIV is not clear and has led to a number of systematic issues for the WTO’s Committee on Regional Trade Agreements (CRTA) (Crawford and Laird 2000; WTO 2000). Because of this ambiguity, most FTAs have exceptions. For example, contentious issues still remain in the North American Free Trade Agreement (NAFTA) in areas such as dairy, beef, sugar, tobacco, peanuts, poultry and eggs, lumber, and transportation and labor migration (Meilke, Rude and Zahnizer 2008, Vollrath 2004). For these reasons we shall refer to FTAs as “Moderate Integration Agreements” (MIAs).

Customs Unions, Common Markets, and Economic Unions are the deepest form of integration where members adopt a common external tariff (in the case of a customs union), permit the free movement of capital and labor as well as adopting a common currency (in the case of a common market) and unify their fiscal, monetary and political policies (in the case of an economic union). Krueger (1997) notes that in theory DIAs are *Pareto* superior to MIAs and SIAs because the latter allow member nations to set their own tariffs on products originating from non-member countries. DIAs, on the other hand, set a common external tariff and thus avoids complex Rules of Origin (ROO). Crawford and Fiorentino (2005) go as far to say that DIAs are “out of touch” with today’s trading climate because they eliminate a country’s ability to protect (see also Krueger 1999).

Counting RTAs, as has been popularized by the WTO, is often used to highlight the growth and significance of regionalism. Figure 1 illustrates this trend by tracing out the cumulative number of RTAs notified to the WTO over the period 1960-2010. Also illustrated is the number of DIAs, MIAs, and SIAs making up the total, and the number of bilateral RTAs in existence. The table embedded within Figure 1 provides summary totals at ten year intervals. At first glance, the growth of regionalism is striking. However, counting agreements to illustrate the growth of regionalism is not necessarily that illuminating because equal weight is assigned to each agreement and no attention is given to its economic significance. An alternative is to plot the share of world trade taking place within RTAs (Frankel, 1997), under the assumption that all trade is covered by the agreement. Figure 2 illustrates this share using an area graph decomposed by RTA type. The peak of the graph represents the share of world agricultural trade occurring within RTAs, which reached an unprecedented 60 percent in 2008 (the final year in our empirical sample). Deep integration agreements continue to account for the largest share in world agricultural trade, largely due to the expanding membership of the EU. However, does this mean that DIAs stimulate more intra-regional trade? Or, do DIAs, particularly the EU, encompass a much larger set of predominantly developed economies compared to MIAs and SIAs? This is the fundamental problem with trade shares – they do not control for the agreement’s size in world trade. By definition, adding more members will always increase the intra-regional trade share of RTAs.⁴

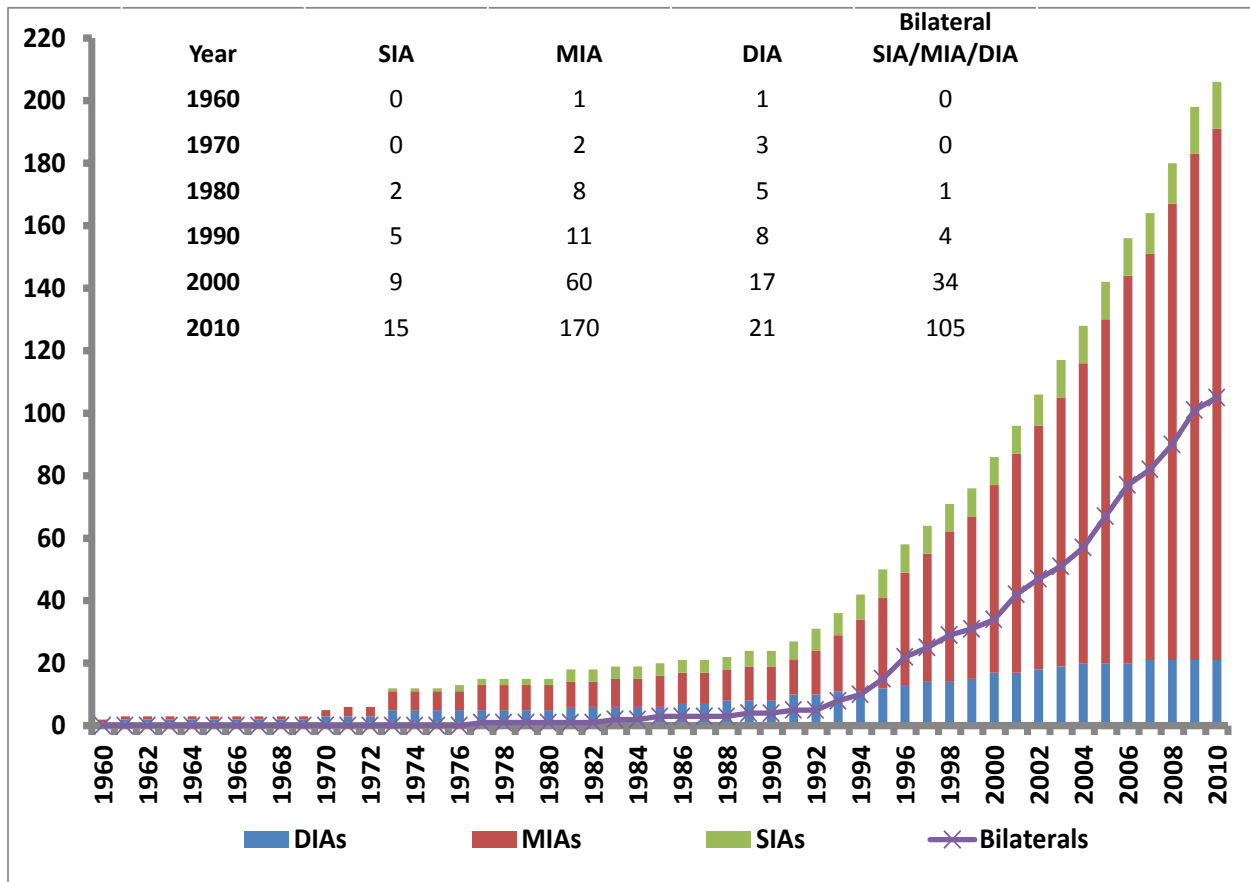
3. Results

We begin by investigating whether deeper integration explains the large agricultural trade flow effects of RTAs. In Grant (2012) results are presented for two scenarios: *Generic* and *Depth*. The *Generic* scenario restricts the trade flow effect of RTAs to be equal across all agreements, whereas the *Depth* scenario allows the RTA effects to vary depending on the depth of regional integration pursued.

Consistent with previous studies the results reveal that the average RTA significantly increases members’ agricultural trade (Grant and Lambert 2008; Vollrath and Hallahan 2011). Focusing on the *Generic* RTA effects, the results suggest that RTAs increase members’ agricultural trade by 51-114 percent depending on the exact specification of the empirical model.

⁴ Additional measures of regional integration are discussed in Grant (2012).

Figure 1. Regional Trade Agreement Notifications by Type of Agreement, 1960-2010

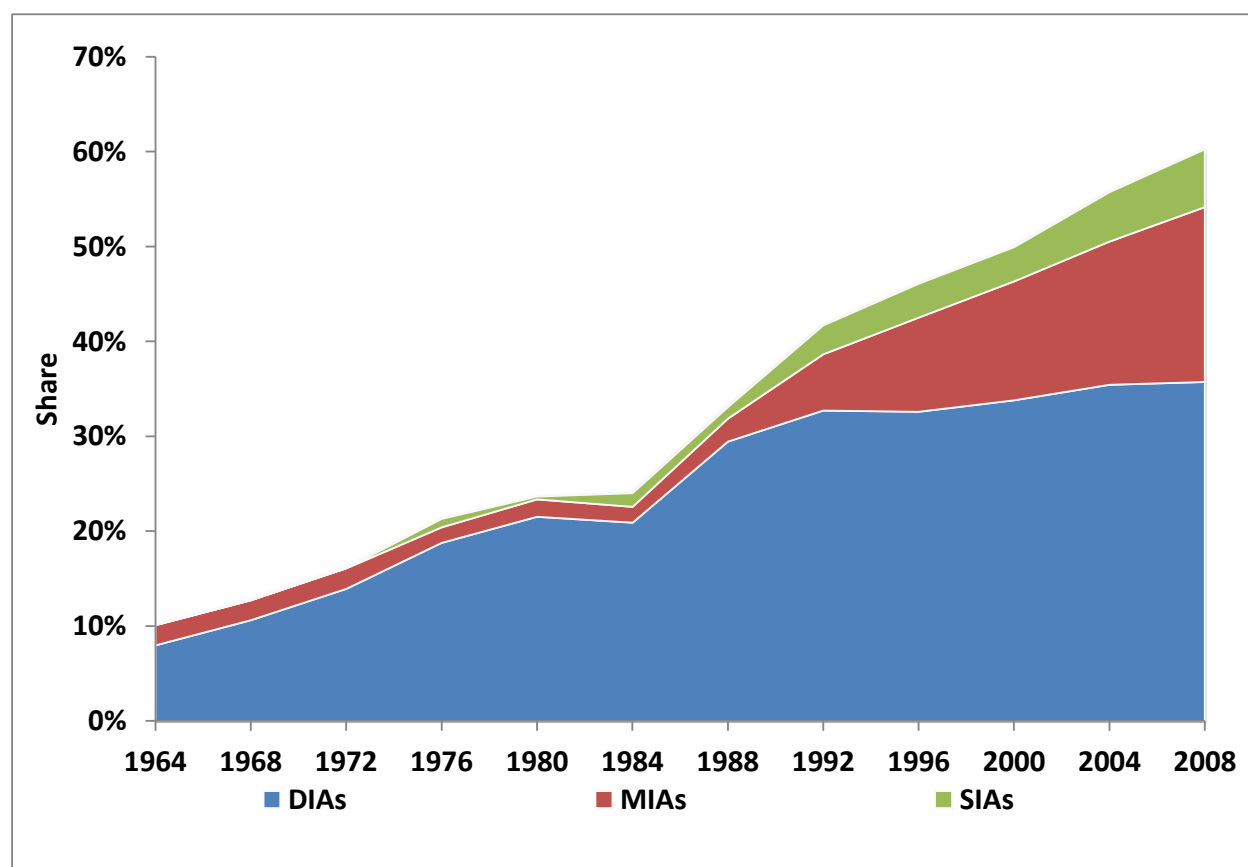


Notes: The figure and embedded table depicts cumulative RTAs entered into force by year and type of agreement. DIA denotes deep integration agreements (i.e., customs, common markets and economic unions); MIA denotes moderate integration agreements (i.e., free trade agreements); and SIA denotes shallow integration agreements (i.e., partial scope arrangements). Bilateral RTAs are defined as those agreements encompassing only two countries and are not in addition to the totals of the columns labeled DIA, MIA and SIAs.

Source: http://www.wto.org/english/tratop_e/region_e/region_e.htm

However, are all RTAs this successful with respect to their effect on members' agricultural trade? Or, do RTA trade increases depend on the depth of trade liberalization pursued by the agreement? The *Depth* scenarios shed considerable light and provide new insight on the factors that explain the success of regional integration. Using our preferred specification the results suggests that DIAs increase members' trade by a remarkable 127 percent. In other words, deep integration agreements more than doubles members' agricultural trade! By comparison, MIAs (i.e., FTAs) increased members' trade by 31 percent and the effect for SIAs (i.e., partial scope agreements) was economically small and statistically insignificant. In short, it appears that RTA trade increases are driven almost entirely by the formation of deep integration agreements.

Figure 2. Share of RTA Trade in World Agricultural Trade by Type of Agreement, 1964-2008



Source: Authors' calculation based on a new bilateral dataset of agricultural trade from 1964-2008, collected from the United Nation's Commodity Trade Statistics Database (Comtrade) using the Standard Industrial Trade Classification (SITC, revision 1)

3.1 *The Hierarchy of RTAs with Phase-Ins*

While illuminating, the results in the previous section may not reflect the cumulative effect of regional integration since almost all RTAs are phased-in over a 10-15 year time horizon. When phase-in periods are accounted for deep integration agreements have persistent effects on trade that are significant up to 12 years (or more) compared to moderate and shallow agreements. The cumulative effect of DIAs is to increase members' trade by 175 percent after four years, increasing to 210 percent after eight years and a remarkable 246 percent after 12 years. This compares to trade increases of 46 percent for MIAs after four years and increasing only slightly to 58 percent after 12 years. For MIAs and SIAs the lagged effects are small and often statistically insignificant.

4. Conclusions

The proliferation of regional trade agreements is not only viewed as one of the most important international economic developments since the post-war era but it has also intensified the debate on the desirability of these agreements vis-à-vis the multilateral system (Panagariya 2002; Baldwin and Thorton

2008). Counting RTAs, as has been popularized by the WTO, reveals that most countries, and all WTO Members, are party to at least one RTA and many belong to multiple alliances.

However, the trade liberalizing ambition of RTAs differs dramatically which leaves open the question of whether the world economy is actually becoming more regionalized? Focusing on agricultural trade, a sensitive sector both regionally and multilaterally, this article investigated the trade creating potential of three types of RTAs with varying levels of trade liberalization ambition: "shallow" (i.e., partial scope arrangements), "moderate" (i.e., free trade agreements), and "deep" (i.e., customs unions, common markets and single economic unions) integration agreements. Despite increased attention being paid to the growth of regionalism, the results reveal that while some agreements are important, others are largely inconsequential. Deep integration agreements, on the other hand, are largely responsible for the impressive agricultural trade increases reported in the literature. These agreements increased members' agricultural trade by 127 percent on average and by a remarkable 246 percent after 12 years of implementation and phase-in.

The implication is clear. Although partial scope and free trade agreements appear to be the trade policy instrument of choice, policy-makers would do well to reflect on the positive benefits of deeper integration. Moving beyond shallow and moderate integration generates sizeable trade flow gains and creates an atmosphere conducive to commercial exchange. This suggests that deepening free trade agreements such as NAFTA will offer important benefits for agricultural trade.

But there is perhaps a more important policy implication that has surfaced in this article. Much of the policy debate concerns the fact that regionalism is a force competing with, and potentially surpassing, the multilateral framework. Yet, tabulating the RTA statistics reveals that "shallow" and "moderate" integration agreements collectively account for 90 percent of RTAs currently in force (Figure 1). With relatively modest trade flow impacts, perhaps these agreements are being motivated for reasons other than agricultural trade liberalization. Such factors could include bargaining power whereby regional blocs are able to secure more in international negotiations than each country acting independently (Baldwin 2008), confronting cross-border problems such as national security, migration, or service sector liberalization. On the other hand, it is hard to escape the conclusion that the growth of regionalism may not be as significant as the headlines suggest, at least with respect to agricultural trade.

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