

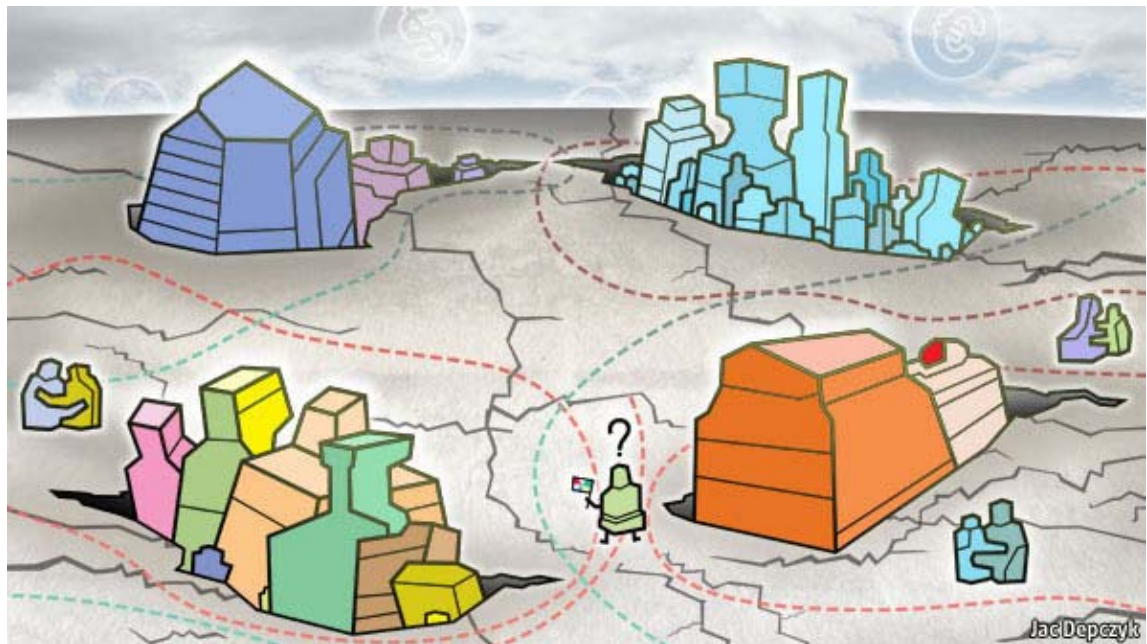
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## Free exchange Building blocks

**Regional deals are the only game in town for supporters of free trade. Are they any good?**

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THE Doha trade talks would be great if only they worked.



Multilateral deals mean common standards and lower barriers for all, but the Doha round, launched by the World Trade Organisation (WTO) in 2001, is dead in all but name. Instead, the cause of liberalisation is being advanced by regional trade agreements (RTAs). The number of RTAs has risen from around 70 in 1990 to over 300 today. The latest, between the European Union and Singapore, was announced on December 16th. Bigger deals are on the horizon. A free-trade deal between America and the EU could be struck in 2013, as could a Trans-Pacific Partnership (TPP) between America and countries in Asia and Latin America. How do these not-quite-global deals compare with the

real thing?

The simplest way to assess trade deals is to ask how good they are at lowering barriers like tariffs and subsidies. A 2011 OECD study looked at 55 RTAs, to see whether agricultural duties were lowered. It showed that deals between rich and emerging economies lifted the number of goods traded duty-free from 68% to 87% within ten years. In deals between emerging economies, the proportion rose from 28% to 92%. (Sectors like sugar and dairy proved resistant even in the best RTAs.) Three out of five deals banned export subsidies. It is clear that RTAs lower these sorts of barrier.

But tariffs are not the only measure of success. Technical and regulatory obstacles are often more important. When rules do not match, trade cannot take place at any price. Some differences reflect big issues—how medical trials for drugs should be run, for example. Others look more like a shelter for entrenched interests. Take alcohol labelling. Recent WTO meetings have dissected the definition of “liquor” versus “spirit”; whether “London Gin” must come from London; and whether Peruvian *pisco* is not, in fact, brandy. The evidence suggests that RTAs do target these non-tariff barriers as well. In a 2009 study Roberta Piermartini and Michele Budetta of the WTO found that 58 of the 70 RTAs they examined try to align rules or speed accreditation processes. The proposed transatlantic and TPP deals have similar aims.

The truest test of an RTA, however, is its trade impact. Calculating this can be hard because lots of things, including growth and exchange rates, affect trade. The United States Department of Agriculture (USDA) recently examined 11 big RTAs in operation between 1975 and 2005, focusing on the impact on foods, a particularly contentious area of trade. The RTAs included the EU and the NAFTA agreement between America, Canada and Mexico. The USDA estimated what trade patterns would have looked like in the absence of the relevant RTA, using factors like distance, common borders, language and macroeconomic variables. By stripping away the trading activity that can be explained by all these factors, the authors isolated the impact of the RTAs.

The USDA’s findings explain why RTAs are popular. Thanks to the RTAs, the trade of foods inside the region rose in ten of the 11 cases; in the EU and NAFTA the impact was a rise of at least 3% annually on average. In six of the 11 RTAs outside countries gained, too. Trade between NAFTA members and other countries in “commodity” foods like grains, fruit and vegetables rose by

2% a year. It may be that by gearing up for trade (investing in distribution networks, for example), firms within an RTA are able to exploit efficiencies that boost trade more widely.

Another way to isolate the impact of a trade deal is to study stockmarket reactions. If RTAs really do boost trade, the prospects for firms in an economy will improve when trade talks are announced, or are completed. Because investors look ahead when picking stocks, prices should rise as soon as news breaks.

To test the idea, Christoph Moser of the KOF Swiss Economic Institute, a think-tank, and Andrew Rose of the University of California, Berkeley, collected data on 1,001 announcements relating to 122 RTAs between 1988 and 2009. First, they establish the relationship between national and foreign stockmarkets, using this to strip out any changes in a country's stocks that are due to global shifts rather than local news. They then study stocks over a window starting the day before each trade announcement and lasting for ten days after it. The findings again support RTAs: they tend to boost markets, especially when member countries are poorer and already trade a lot (so there is more to gain).

### **Roadblocks and diversions**

Despite these benefits, two big concerns about RTAs remain. One is the fear that RTAs boost insiders at the expense of outsiders. Although the USDA research found that in most cases total trade rose following an RTA, it also found some evidence of "trade diversion". The EU looks especially clubby. It seems to have stripped 3% a year of trade away from America, and replaced it with intra-EU trade. The ASEAN club of Asian countries had a similar effect on manufactured food (things like breakfast cereal and soup): American firms again lost out. Unlike global deals, RTAs have the potential to shift activity away from efficient producers.

A second concern is that regional deals lack rules stating that all members are equal. Because bigger members are able to dictate terms, firms in smaller countries may have to cope with different regulations for different trading partners. This not only increases their costs. It also risks turning trade liberalisation into a hub-and-spoke model. If a few large blocks form, each with its own rules, it could be impossible to fit the various regional groups together. Trade could permanently segment. This is why big deals like the TPP

and the proposed US-EU agreement are especially vital. If they can start stitching big regional entities into a coherent whole, they will show how the new form of trade liberalisation can be made to work.

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