

Review of World Trade Report 2011

The rise in preferential trade agreements between countries (in the form of GATT's Article XXIV-sanctioned free trade agreements, customs unions and other arrangements involving developing countries, permitted by the GATT's Enabling Clause) stands as the dominant trend in the evolution of the international trade system in the recent two decades. Hundreds of preferential agreements have been negotiated during this period and with nearly every member country of the World Trade Organization (WTO) belonging to at least one PTA.

Alongside this evolution of the world trade system towards preferential trade, the academic and policy literature on the economics of trade preferences has explored a variety of questions regarding the merits of preferential trade, the political and economic determinants of preferential agreements and the interplay between the bilateral (preferential) and multilateral (non-preferential) approaches to achieving freer trade. On the one hand, it has sometimes been argued that the acceleration towards trade preferences reflects the deep frustration that countries felt with the "slow" pace of the multilateral process and that PTAs are a faster and more efficient way of achieving trade liberalization. On the other hand, it has been recognized that preferences in trade may result in welfare losses, as imports may be sourced from inefficient partner countries rather than more efficient outsiders because of the lower tariffs faced by the former. This diversion of trade is also potentially costly to outsiders who are relatively handicapped in member country markets and may incur terms of trade losses in their exports. It has also

been argued that preferential agreements are not to be seen as providing a simple monotonic path to multilateral free trade, warning that preferential agreements might create incentives within member countries against further multilateral liberalization.

For the year 2011, the World Trade Report (WTR) engages this question of preferential trade in depth. It starts by asking how much of merchandise trade is conducted on a preferential basis and points out that despite the proliferation of PTAs in recent years, the amount of liberalization that has been achieved through preferential agreements is actually quite limited. Specifically, only 16 percent of global merchandise trade (30 percent with intra-EU trade included) receives preferential treatment and less than 2 percent of world trade (4 percent when intra-EU trade is included) is eligible for preference margins greater than 10 percent. Furthermore, WTR 2011 reports that “sensitive sectors remain sensitive” in preferential agreements. That is, approximately “66 percent of tariff lines with MFN tariff rates above 15 percent have not been reduced in PTAs”. The exclusion of “sensitive sectors” from liberalization within preferential agreements also suggests that often the very same interest groups that object to multilateral or unilateral liberalizations will oppose liberalization in a preferential context as well. Taken together, the WTR analysis suggests that preferential agreements haven’t proven to be as effective in liberalizing trade as their proponents have hoped.

Having noted the (only) modest liberalization in trade achieved through PTAs, WTR 2011 focuses on two (recently popular and interrelated) arguments to explain the proliferation of preferential agreements and to speculate on the consequences. The first

argument is that the motivation for PTAs may have little to do with the lowering of trade barriers, as such, and that PTAs should be understood instead as vehicles for undertaking “deeper” forms of integration to achieve institutional harmonization with partner countries while the second argument is that the motivation for deep integration with partner countries comes from the increasingly fragmented pattern of global production, in which the different stages of production are unbundled and spread across different countries. Underlying these arguments appears to be the loosely articulated view that PTAs formed with the intention of achieving deep integration in the context of globally fragmented trade are superior in their motivation and design, having more likely been driven by trade fundamentals rather than protectionist impulses and characterized by institutional arrangements and rules that are often “non-discriminatory” in nature.

How much "deep" integration has been achieved in practice? The WTR data on the “anatomy of preferential agreements” suggests that institutional provisions that fall outside of the WTO mandates, but that covered by PTAs (and are also deemed legally enforceable by the text of the PTA) are quite few in number. For instance, only 4 percent of the PTAs include legally enforceable provisions on anti-corruption measures, 12 percent include provisions on labor regulation, and 11 percent include provisions on environmental regulations. Regulations on the movement of capital and the protection of intellectual property rights are more significant at 40 percent and 34 percent respectively, but many possible provisions are simply not referenced in the vast majority of PTAs. This, in itself, permits some skepticism on how much deeper PTAs, on average, have gone beyond the possibilities offered by the WTO.

Furthermore, as the WTR recognizes, it is, less than clear that the achievement of “deep integration” at a regional level is a desirable goal from either a regional or multilateral perspective. Common policies may benefit countries with common policy preferences, but may be costly if there are wide differences in the preferences of member countries (as is often the case with provisions involving environmental and labor standards, for instance). In the context of North-South agreements, there is an additional concern that the greater resources and organizational ability of government and sectoral lobbies in the North will shift policy in a direction that is closer to their own interests and away from the interests of the South. Furthermore, the establishment of policies and standards at a regional level may inhibit multilateral liberalization if the multilateral standards vary from regional ones and there are costs to switching standards. While some features of "deep" PTAs such as competition policy may be non-discriminatory, in general, the possibility of negative spillovers on non-member countries cannot be ignored.

Does fragmentation of global production trade provide a new basis for regionalization of trade? While this argument is gaining currency in some quarters, it would seem that production fragmentation should provide greater incentives instead for broader multilateral liberalization. After all, the most efficient producers of any given intermediate good need not lie within the jurisdictional boundaries of any specific preferential agreement and the identity and location of the efficient producers of intermediates may be expected to vary faster than any country's ability to sign new preferential agreements. As a practical matter, if PTAs were designed to support

fragmented production networks, we might expect to see greater geographic concentration of trade over time as many production networks are regional in nature. However, as the WTR notes, the share of intra-regional trade in Europe has remained roughly constant at around 73 percent between 1990 and 2009. While Asia's intra-regional trade seems to have risen from 42 to 52 percent during the same period, North America's intra-regional trade shares rose from 41 percent in 1990 to 56 percent in 2000 and fell back to 48 percent in 2009. Thus, no clear pattern linking trade preferences and production fragmentation can be discerned in the data.

Alongside these recently emerging hypotheses regarding the determinants and the “true” nature and motivation of preferential agreements and their putative impact on the world trade system, WTR 2011 uses new data and novel analysis of older data to assess several ongoing debates relating to the prevalence and merits of preferential trade. It also contains a number of very interesting case studies and analytical discussions that inform various economic, political and legal aspects of this complex question. This important and multidimensional contribution is essential reading for the expert and the novice alike.