

Regional Trade Agreements: Performance Evaluation and Research Agenda

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Abstract

This paper proposes a broad model for key success factors in Regional Trade Agreements (RTAs). Current literature is relatively limited in its focus on largely economic consequences of RTAs and the externalities are mostly ignored. This model incorporates five predictor dimensions forming the character of a RTA as follows: (1) Economic, (2) Socio-Cultural, (3) Negotiation, (4) Country Objectives and (5) Review process. It proposes a methodology for the empirical testing of the proposed model. The proposed model, potentially, facilitates the measurement of the character of a RTA and its association with various RTA objectives.

Introduction

Economic co-operation and integration have had a long history. Formal or informal trading agreements have existed wherever people traded with one another. Regional Trade Agreements (RTAs) are agreements between countries to reduce or eliminate trade barriers and are a form of economic co-operation and integration. The reasons for, and benefits of, forming RTAs have largely been defined in economic terms. Frankel (1997) identifies traditional gains from trade, strengthening domestic policy reform, increased multilateral bargaining power, guarantees of access, strategic linkages and multilateral and regional interplay. Other reasons for forming RTAs may include (1) the dissatisfaction with the multilateral approach, particularly the slow progress of the Doha Round, (2) the negotiating skills developed during the process by less experienced countries, (3) the 'bandwagon effect' of smaller countries following the policies of larger countries in joining RTAs (Bhagwati 1993), and (4) fear of being left out of major RTAs. There are also benefits of credibility, signalling, insurance, and as a mechanism for coordination (Fernandez 1997).

RTAs can fail in multiple dimensions. In economic terms, the negative results can include trade diversion, reduction of quality, increasing consumer prices and lowering global competitiveness for a country (Yeats, 1998). Investment, economic growth, government tax revenue and employment may also fall. In social terms, the flow on effects may be reduced wealth and income distribution, and living standards may fall (Woolcock, 2001). In the political sphere, stability and co-operation may decline, and conflict may increase (World Bank, 2000). In cultural terms, the homogenisation of culture may rapidly increase; changing the unique culture of smaller countries, and social cohesion may diminish. In terms of sustainability, it is not always coincident with economic expansion (Barbier, 2003).

Measurement of RTAs performance

The measurement of success or failure of RTAs has been examined in economic terms, mainly in the form of trade diversion or trade creation, but little work has been done examining the political, socio-cultural and other environmental dimensions (Woodcock, 2001). This paper outlines a broader model of assessment for RTAs, and suggests a strategy to test this model. A comprehensive measurement instrument of success is required, as the narrow economic definition of success fails to adequately capture externalities. These

externalities may have constructive or detrimental consequences to the citizens, whether planned, anticipated or accidental.

Not all RTAs have been successful, or endured. Some RTAs have expired, been superseded or disbanded, while others are not successful in meeting the anticipated economic outcomes. (E.g., BAFTA- Baltic Free trade Area ceased to exist when its members joined the EU.). However the rapid growth of RTAs continues, suggesting varying motives behind agreements that may not be immediately discernible.

Current situation

As at July 2007, there were more than 300 RTAs reported to the World Trade Organisation (WTO), with 205 of those currently in force (WTO n.d.). According to UNCTAD, (2008) world merchandise trade has grown twice as fast as world output over the past four years, both in terms of volume and in dollar values. Trade under RTAs accounts for more than 50 per cent of international trade. Unfortunately, RTAs are not classified under a performance ranking mechanism, making comparison of success problematic. Empirical work has progressed with the gravity model being the most standard measure currently employed. Results can change as there may be a lag before the outcomes of the RTA are realised. Externalities to the agreements can impact on their performance (E.g. High tariffs to non-member countries, complex bureaucracy making implementation of the agreement's aims difficult, and deterioration of the global economy).

In the gravity model, trade is seen as a function of Gross Domestic Product (GDP) and distance between countries. The inclusion of other explanatory variables such as common borders and language, and the use of dummy variables to capture the trade diverting or creating effect of the RTA, complete the model. Some of the results of RTAs as reported using the gravity model include: NAFTA, MERCOSUR and CACM (Central African Common Market) - trade diverting (Jugurnath, B. Stewart, M, and Brooks, 2007), Andean Community and SADC (Southern African Development Community) - trade diverting (Croce, Juan-Ramón, and Zhu, 2004), ASEAN and CER - trade creating (Jugurnath, Stewart, and Brooks, 2007).

A variety of determinants appear to be contributing to the performance of a Trading Bloc. These predictors can also act as a virtuous circle, being the outcomes of the successful RTA. (E.g. a degree of security and economic prosperity are both necessary conditions to the establishment, effectiveness and outcomes of a successful RTA). Yang and Gupta (2005), identify the level of economic integration required for an RTA as making conflict more economically costly, and therefore less likely, while also providing incentives for external intervention when problems arise. The positive effects on political stability are apparent from the formative years of the EU with regards to France and Germany. Economic integration results in more balanced economic and social development among member states.

RTAs can have a mediating effect on extreme political governments, as the European experience has also shown. RTAs can also provide access to a larger range of goods, services and technology.

Some of the indicators seen as negative predictors of performance include: economic disruption at a macro or micro level including unemployment, sectoral disruption and loss or reduction of particular sectors of the economy. There may be increased exposure of the economy to global fluctuations and skills shortages and loss of human capital as workers

migrate. Specialisation may deplete non-renewable resources and inflation may be imported, or result from the flow of resources away from domestic consumption goods and services, to export sectors. Development of RTAs may slow multilateral agreements as countries may benefit from maintaining an RTA, and drag-out multilateral negotiations, and tensions may rise (Yang and Gupta 2005).

More unusual outcomes can occur. Bolton, Roland and Spolaore, (1996) identify a curious outcome of RTAs; that due to the increased economic integration likely requiring greater political integration to operate efficiently, this simultaneously reduces the economic cost of separation and incentives towards political separation are increased. Alesina, Spolaore and Wacziarg, (2000) find the trade regime influences the history of nation-state creations and secessions, and that the economic benefits of country size are mediated by the degree of openness to trade.

Current Australian RTAs include a general list of objectives, and a renegotiation process. For example, the SAFTA's (Singapore-Australia Free Trade Agreement) objectives are outlined in Article 1, and include, strengthening bilateral relations, liberalising trade between them and building on commitments at the WTO, improving efficiency and competitiveness, establishing transparent trade rules and exploring newer areas of economic cooperation. (DFAT, n.d.) A renegotiation process is required because of the situational changes that may invalidate the original agreement. As the dynamic trading environment becomes more complex, the contents and procedures for the renegotiation process need to be articulated within agreements. E.g. SAFTA contains a schedule of review in Article 3: "In addition to the provisions for consultations elsewhere in this Agreement, Ministers in charge of trade negotiations of the Parties shall meet within a year of the date of entry into force of this Agreement and then biennially or otherwise as appropriate to review this Agreement." (DFAT, n.d.)

Limitations of existing literature

An existing limitation is the absence of a framework within current literature to identify the broader success or failure of a RTA. Arguably, articulated benchmarks could determine an expected level of performance and set the standard for measuring the success or failure of the agreement. A change of circumstances due to the dynamic environment, within which RTAs operate, may necessitate the renegotiation of agreements and re-signing of new objectives if required.

The likely causes of poor performance in RTAs are numerous, but may include the maintenance of high external tariffs (Tumbarello, 2007; Yeats, 1997). Problems with policy coordination are likely to be common. For example, the country of origin regulations restrict access to the EU market for developing countries in spite of the increased access given under a different rule (Brenton and Manchin, 2003; Francois, McQueen and Wignaraja, 2005). If a country enters a RTA with minor trading partners then the expectations must be low for success. Under-resourcing of the coordinating body will also detract from its performance as will the lack of political will (Yang and Gupta, 2005).

The ambiguity involved in RTAs performance evaluation and the importance of managing the conduct of a RTA to a successful outcome, leads to the proposed expanded model of RTAs incorporating the key contributing factors including economic, socio-cultural, negotiation, country objectives and review dimensions.

Proposed Model

Key Propositions

The Trading Bloc Character construct is an aggregation of various predictors, which synthesised together, yield a measurement of the likelihood of success for the RTA. The character of the trading bloc varies by the extent of the contribution of various factors (success factors). It is suggested that if a RTA is deficient in its aggregate strength due to shortcomings in one or several contributing factors, then the expectation of success must be moderated in view of the less than ideal circumstances. It is therefore posited that the character of the trading bloc influences the outcome of the RTA.

The purpose of the model (Figure 1), therefore, is to facilitate investigation into the relative importance of the individual contributors in forming the Trading Bloc Character. It will also demonstrate the associations between the trading bloc character and some specific performance indicators. Specifically, the propositions are as follows:

- The character of a trading bloc as it is formed by the various relevant factors contributing to the characteristics of each country, determines its success potentials.
- The character of a trading bloc associates positively with its performance indicators. The higher the magnitude of the RTA character, the higher the potential for success.
- The magnitude of association between the Trading Bloc Character would vary for different performance indicators, such as GDP and the level of infrastructure.

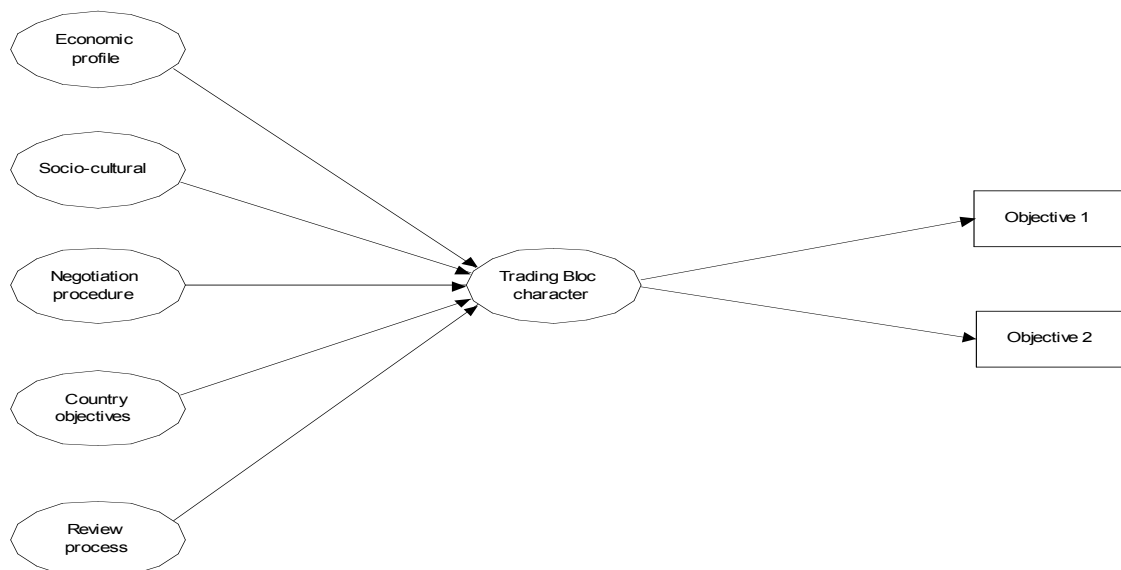


Figure 1 The model of Trading Bloc Character

The model represents the following key criteria for the participating countries, determined to be contributing to the Trading Bloc Character, and so to the performance outcomes of a trade agreement, based on the existing literature. A multitude of different performance indicators can be used, however, the indicators anticipated for this model are considered core. They are the signalling performance criteria (eg. GDP indicates tax revenue, economic development or growth and changes in exports and imports).

- The economic profile of each country is measured by key indicators, not limited to, but including, GDP, the level of economic development, volume and composition of trade with trading partners. These measurements indicate a range of other data such as relative economic size, natural resources, productive capacity, level of technology and infrastructure. A certain threshold is necessary in terms of key economic indicators for a successful RTA. Other economic moderating factors including high trading costs and external trade barriers, low resource complementarity, and a broad-based liberalisation are required (Yang and Gupta, 2005).
- Socio-cultural factors include social cohesion, cultural integrity, political stability, political system, judicial independence, corruption, operation of the public service, and human and social capital. (Eg. The Living Standards Measurement Survey for developing countries is used by the World Bank to aid understanding of the observed social sector outcomes.) A closer psychological distance is likely associated with a stronger performance.
- Negotiation includes the country's negotiating experience, relative bargaining power, and commitments to other RTAs, which combine to impact on its negotiating outcomes.
- Country objectives will vary but countries may use RTAs as a method of achieving politically sensitive microeconomic reform, to secure access to markets, or for fear of being left out of important RTAs.
- A review process is necessary to examine performance against key success criteria, to set renegotiation triggers, provisions for re-examination and renegotiation of new issues, problems. Scheduled review and renegotiation aimed at solving emerging problems and introducing corrective actions are advantageous.

Research agenda

To verify the model, the following research is suggested. To ensure the model's validity and reliability requires a research design including both qualitative and quantitative research. The establishment of the nature and relevance of the key predictors will be through interviews with (initially) Australian trade negotiators. These interviews should provide background to the negotiation process, and inform the development of a survey instrument. Current Australian RTAs appear to incorporate few success targets, with those present purely economic in nature. RTAs have mixed success, making it likely that some are used primarily to forge political alliances, rather than as tools of economic integration.

The interview results would be used to construct a research survey, which will allow for the necessary data collection to operationalise the model, covering all the predictors identified. The data collected will assist in measuring the magnitude of the character of the trading bloc and, potentially, facilitate the investigation into the identification of strengths and weaknesses as well as the likelihood of success. The effectiveness of the Trading Bloc Character will be ascertained by associating it with various objectives of the RTA.

Conclusion

This paper proposes a conceptual model and a research agenda for examining the performance of RTAs. The suggested model differs from current performance measurement methods that are narrowly economically based. The paper argues that the success of a RTA is dependent upon a more widely based criteria and that the aggregation of these predictors into a quantifiable measurement can act as a forecast of likely performance of the RTA.

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RESPONSE TO REVIEWERS' REPORTS

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Paper Number: 1304

We (the authors) would like to express our gratitude for the constructive comments we have received from the reviewers and wish to advise corrections made to the text of the original manuscript.

Reviewer comments, in total (sic.):

Reviewer 1581

The primary issue to be addressed is the lack of a conclusion to the paper.

The paper appears to outline a Master's or Doctoral study and concludes with a vague outline of the research agenda.

The paper needs a real conclusion that summarises the anticipated contributions of the study and includes a brief mention of the research to be undertaken.

Reviewer 1305

The manuscript is not formatted according to the ANZMAC 2008 guidelines. Please revise.

(Page 5) The use of "bullet/point formatting" in this section seems odd.

Reviewer 1581 comments, dealt with specifically:

Reviewer's Comments:

The primary issue to be addressed is the lack of a conclusion to the paper.

Authors' Response

The conclusion to the paper has been reviewed and is amended accordingly.

Reviewer's Comments:

The paper appears to outline a Master's or Doctoral study and concludes with a vague outline of the research agenda.

Authors' Response

This conceptual paper is a part of a larger research project. It is intended, as indicated in the paper, to conduct a more thorough investigation into the environmental factors that predict the outcome of a RTA.

We would like to add that the outline of the research agenda included in the paper was intended to present an approach rather than a detailed program.

Reviewer's Comments:

The paper needs a real conclusion that summarises the anticipated contributions of the study and includes a brief mention of the research to be undertaken.

Authors' Response

The conclusion to the paper has been reviewed and rewritten to clearly state the purpose and the argument presented to establish a need for testing the model of RTA that has been proposed

Reviewer 1305 comments, dealt with specifically:

Reviewer's Comments:

The manuscript is not formatted according to the ANZMAC 2008 guidelines. Please revise.

Authors' Response

The manuscript has been reformatted according to the ANZMAC 2008 guidelines.

Reviewer's Comments:

(Page 5) The use of “bullet/point formatting” in this section seems odd.

Authors' Response

The bullet point formatting (page 5) is used with the intention of providing a more clear classification of explanations provided. This format better demonstrates the various components of the model proposed and make the text easier to read.

(Page 5) The use of “bullet/point formatting” in this section seems odd.