

Economics and Trade in Goods

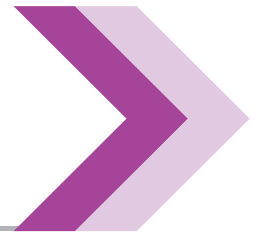
AN INTRODUCTION

An ADB–ITD Training Module
for the Greater Mekong Subregion

ADB

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Economics and Trade in Goods



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An ADB-ITD Training Module for the Greater Mekong
Subregion

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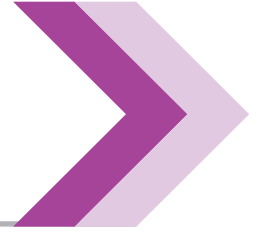
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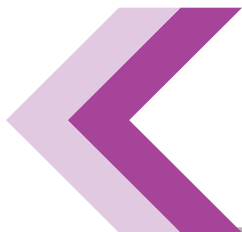
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Abbreviations



AQIS	–	Australian Quarantine and Inspection Service
ASEAN	–	Association of Southeast Asian Nations
EU	–	European Union
GATT	–	General Agreement on Tariffs and Trade
GMS	–	Greater Mekong Subregion
GSP	–	generalized system of preferences
IBD	–	infectious bursal disease
ITD	–	International Institute for Trade and Development
MFN	–	most favored nation
PRC	–	People's Republic of China
RTA	–	regional trade agreement
SPS	–	sanitary and phytosanitary measures
TBT	–	Technical Barriers to Trade (Agreement)
WTO	–	World Trade Organization



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Introduction



This training module consists of three papers that are directly relevant to the Greater Mekong Subregion (GMS). They were prepared in support of a course on economics and trade in goods that was presented several times during 2008 at the International Institute for Trade and Development (ITD), Bangkok, to government officials from the GMS. They do not constitute an account of everything a government official needs to know about the economics of international trade or trade in goods. Rather, they alleviate the paucity of GMS-specific material published on these two important trade policy-related topics. Indeed, they may well be of interest to trade policymakers in the GMS countries independent of the training program.

Box 1: Principal Learning Objectives of This Module

The purpose of this module is to strengthen officials' and experts' understanding of the types of

- trade barriers that affect trade in goods and the economic analysis thereof,
- proposals made in different forums to reform border policies affecting trade in goods and the analysis of those proposals, and
- the relevance of these matters to GMS countries.

The module emphasizes the practicalities of these policy questions, including negotiating tactics and economic analysis.

The first paper, drafted by Simon J. Evenett, provides a pragmatic and, one hopes, comprehensive account of the major policy options facing government decision makers who must determine their country's strategy toward regional trade agreements (RTAs).² The proliferation of RTAs in recent years puts good policy advice and frameworks at a premium for the many GMS countries that are actively negotiating such initiatives. In addition to integrating trade in the subregion through initiatives from the Association of Southeast Asian Nations (ASEAN), GMS countries have negotiated with a diverse set of trading partners

² A course on the economics of international trade and trade in goods covers trade reforms and measures associated with a broader set of matters than RTAs. There are two reasons for including a paper on trade strategies toward RTAs rather than on multilateral and unilateral trade reforms in this module, however. First, trade reforms in general are better covered by the existing available literature, especially as they relate to trade strategy formation, than RTAs are. Second, in the past year more information about the nontariff-related provisions of RTAs has become available, making this a good time to reflect upon the implications of negotiating these accords for national trade strategies.



outside of Southeast Asia in recent years, including the European Union (EU), the People's Republic of China (PRC), and the United States. The paper reflects on developments over the past 10 years and describes policy options in an area often plagued with highly wrought rhetoric and partisan commentary.

Evenett argues that, despite the focus in many economic papers on the effects of RTAs on international trade in goods, in fact these agreements increasingly relate to policies, including noneconomic policies, that tend not to introduce discrimination against foreign commerce at the border. The growing number of policies regulated by RTAs and the need for effective institutions (typically domestic ones) to implement them suggest that there are more potential trade-offs between negotiating parties, and therefore that the notion of reciprocity in trade negotiations needs to be expanded beyond the exchange of market access concessions. Evenett also discusses various rationales put forward for pursuing RTAs, and he identifies the circumstances under which it is wise for a nation to respond to the RTAs negotiated by others through launching an RTA negotiation of its own. This is important for GMS countries because the United States and others have engaged in rhetoric that suggests that if GMS nations do not engage in RTA negotiations they will “fall behind.” Evenett also draws out certain implications for the ongoing ASEAN–European Union trade negotiations, in which some GMS countries are involved.

Evenett's paper shows how economic tools can be used to inform the choice of negotiating partners for RTAs, identify priorities for RTA negotiations, and evaluate any proposed RTA. He provides examples of the ways in which other jurisdictions have allowed economic considerations to influence aspects of their RTA strategies and encourages GMS officials to give further thought to these factors.

One area where better facts and data can improve GMS decision making on trade policies is that of the tariff and nontariff barriers facing the subregion's exporters. Dr. Watcharas Leelawath's paper shows how data available from the World Trade Organization (WTO) and the United Nations Conference on Trade and Development can be used to assemble a comprehensive picture of the trade barriers faced by GMS exporters. Such a picture can be useful in identifying matters to be taken up in bilateral, regional, and multilateral trade negotiations and possibly in dispute settlement cases brought to the WTO. Watcharas also presents evidence concerning different degrees of diversification of the imports and exports of GMS countries with respect both to products and to trading partners. These differences may well account for certain similarities and differences in the trade policy priorities of GMS countries. For example, all GMS countries have a strong interest in barriers to foreign markets for textiles and clothing, but only Lao PDR



and Myanmar have more than 20% of their exports in food items and agricultural raw materials; therefore, they are more concerned than other GMS countries with trade barriers to these commodities. This paper also highlights the importance of rules of origin, technical barriers to trade, and sanitary and phytosanitary measures (SPS) as nontariff barriers facing exports from GMS countries. The legacy of the quotas imposed under the Multilateral Agreement on Textiles and Clothing, which were abolished in 2005, is also discussed.

SPS matters receive further attention in Dr. Somchin Suntavaruk's paper, which consists of a case study of Australia's regulations on the importation of chicken. For many years the Australian government has maintained a quarantine and inspection regime intended to ensure that imported food—including chicken—is healthy and does not pose a threat to Australian consumers or the country's agricultural sector. These public health objectives are, on the face of it, perfectly legitimate. However, the question that arises is whether the Australian government restricts imports further than its stated policy goals require. Somchin presents evidence concerning the formulation and revision of regulations governing the importation of chicken that suggests that considerations other than health may have influenced official decision making. Although these matters have been taken up by Australia's principal trading partners, the SPS regime persists unchanged. If indeed the Australian system is too restrictive, this fact raises the question of what position the GMS countries should take toward the strengthening of the provisions of the WTO's SPS agreement. This matter takes on particular importance given the comparative advantage that many developing countries have in agricultural production, animal rearing, and similar food production activities.

To summarize, the three papers contained in this module cover some of the important trade policy challenges facing the GMS countries in the area of trade in goods. Two present new information; the third discusses recent research on regional integration and its implications for policy making. Naturally, circumstances differ across the GMS and it should not be surprising that officials from this subregion may not all draw the same implications for their countries' trade strategies.



Strategies for Regional Trade Agreements: A Practical Introduction for Government Officials

Simon J. Evenett

Executive Summary

The subject of regional trade agreements (RTAs) has generated its own rhetoric among trade negotiators and led to strong divisions of expert opinion. Understanding this material can be a challenge for government officials newly appointed to trade ministries. The purpose of the first portion of this module is to provide GMS government officials with an accessible introduction to the scope, rationale, and potential effects of RTAs. The goal is not to provide an overview of the analysis of regional integration; that is well covered elsewhere.³ Indeed, given the widening scope of RTAs it is not clear that the traditional analysis of their effects captures the rich set of provisions included in some RTAs, especially relating to nontariff barriers and state policies and measures that seek to influence and regulate national business environments. The approach taken here is comprehensive, seeking to identify the important factors to take into account when advising senior policy makers.

In addition to introducing the key policy choices, the appendixes include pointers to useful instructional material, related writings, and the negotiated texts of RTAs. Finally, 20 exercises are included to strengthen the reader's understanding of the material, to encourage the reader to research different policy options, and, in some cases, to evaluate them. This module examines the principal characteristics of RTAs, the apparent rationales for negotiating RTAs, the identification of RTA partners, and the evaluation of RTAs (both first- and third-party) in some detail. The module does not reproduce the analytical material that can be readily found in good economics textbooks and survey articles; rather, it draws on recent analyses of the RTA strategies pursued by different countries and identifies a number of significant considerations that officials ought to consider. This module should be

³ See Appendix 1.



seen as a complement to a thorough analysis of RTAs, not a substitute for such an analysis. Where possible, examples from Southeast Asia and the Greater Mekong Subregion are used.

Introduction

The changes in the trade policy landscape facing government officials over the past 15 years have been so profound that it is difficult for government officials in both developing and industrialized countries to keep abreast of developments and think through what they mean for the commercial policy priorities of nations. The challenge is particularly acute for developing countries, whose trade ministries are often short on personnel and whose payoff for choosing the right trade policy can be significant development. In contrast (and sometimes apparently in response) to the stalled multilateral trade negotiations on the Doha Development Agenda, many nations are turning to unilateral trade reforms and to negotiating regional trade agreements (RTAs). Moreover, the rise of the PRC and India (to mention two of the most important emerging markets) and the attendant relocation of world manufacturing production and supply chains has altered the calculus perceived to underlie many trade policy options. For a newly appointed official in a trade ministry these developments may seem daunting and bewildering. This module offers some practical pointers to government officials on one of the most important developments identified above: the growing number of RTAs. The focus on RTAs is not meant to imply that the other developments in the world trading system are unimportant, or that they do not interact with RTAs. Nothing could be further from the truth.

Government officials should not be surprised that they encounter difficulties in trying to understand RTAs, the debates around them, and their implications for national commercial policy making and priorities. Much of what is written on RTAs is contentious, reflecting disagreement among economists and other experts about their merits. There is even disagreement about what they are, leading some analysts to object to the term RTA and to propose different terms and acronyms for the same phenomenon.⁴ Worse still, RTAs themselves have changed over

⁴ Some analysts think that RTAs should be referred to as “preferential trade agreements” because they are inherently discriminatory. Others prefer “free trade agreement” or “free trade areas” because the parties to an RTA need not be countries from the same region. Still others prefer the term “bilateral trade agreement” because regional trade agreements typically involve just two signatories. Finally, some prefer the term “regional integration agreements” because RTAs now involve so much more than provisions on trade in industrial goods. This module uses RTAs, which is the WTO’s nomenclature. The important matter of what constitutes an RTA is dealt with in the next section of this module.



time in terms of membership and, perhaps more importantly, content. Few RTAs with industrial country signatories confine themselves principally to provisions liberalizing trade in manufactured products. To address these complexities, the next section introduces a broad definition of an RTA and discusses some different types.

These complications matter because many countries are actively negotiating, seeking to negotiate, or have recently negotiated RTAs. It is difficult to obtain precise numbers for RTAs, not least because nations do not face strong incentives to report the RTAs they have entered into to the World Trade Organization (WTO). Even so, the WTO has been notified of over 300 RTAs (although the number in force is actually lower; with the expansion of the European Union to the east, many RTAs between Eastern European nations or between those nations and the European Union have lapsed). However, in a world with 152 WTO members and over 180 customs territories, 300 bilateral trading relations constitute a small fraction of those that could be affected by RTAs. Indeed, countries such as Singapore and Thailand that have been actively negotiating RTAs conduct a large proportion of trade on their terms.⁵ More generally, the active pursuit of RTAs by some countries in the Greater Mekong Subregion (GMS) and in Southeast Asia has raised their profile; naturally, senior policy makers and political leaders want to know how RTAs may influence their development policy goals. Government officials in trade ministries will want to have answers to their leaders' questions, not least because many external experts and nongovernmental organizations also tend to have strong views on RTAs.

Many of the countries in the GMS have another strong reason for understanding what RTAs can involve: the European Commission, on behalf of the member states of the European Union (EU), is seeking to negotiate a broad-ranging regional

⁵ Again, care is needed here. The best example is the EU, which to date has signed some form of RTA with all but nine WTO members. Those nine WTO members account for a third of all imports into the EU. This had led some observers to conclude that two thirds of imports into the EU enter on terms dictated by RTAs. This inference is incorrect because an additional one-third of all imports enters the EU at zero tariff rates, as specified in the EU's WTO commitments. This means that at most one third of imports enters into the EU on the terms specified in RTAs. Bureaucratic hurdles imposed at the EU's customs houses, including rules of origin, may reduce the profitability of a non-EU exporter that invokes better treatment under an RTA that its country has with the EU; to the extent this happens, less than a third of the EU's total imports pay tariffs at lower rates than specified in the EU's WTO commitments. There is nothing EU-specific about this example; the empirical magnitudes involved have been reported to the WTO in various trade policy reviews of the EU's commercial policies.



trade agreement with ASEAN. The European Commission has tended to negotiate RTAs with very broad provisions. The EU–Chile RTA, one of the last RTAs the EU negotiated with a middle-income developing country, contains many chapters on matters that on their face have little to do with trade, such as scientific collaboration and cultural exchange. Other provisions in EU RTAs refer to issues not associated with customs policy, such as intellectual property rights, government procurement, competition, and policies toward foreign direct investors. Moreover, the European Commission would like its RTA with ASEAN to strengthen the degree of regional integration between ASEAN members, a goal that may have direct consequences for ASEAN's own shared priorities and initiatives. Government officials in the GMS need to be able to give their policy makers advice on this particular negotiation; officials of GMS countries not involved in the negotiation will want to watch what their neighbors agree to or propose, not least because of the implications for trade within the subregion.

The remainder of this portion of the module examines the principal characteristics of RTAs, the rationales for negotiating RTAs, the identification of RTA partners, and the evaluation of RTAs (both first-party and third-party) in some detail. It does not reproduce material that can be readily found elsewhere; instead, it draws upon recent analyses of the RTA strategies pursued by different countries and identifies a number of significant considerations for officials. As such, the paper that constitutes this part of the module should be seen as a complement to, not a substitute for, a thorough analysis of RTAs. Indeed, the matters raised in this paper round out the discussion on RTAs that can be found in the teaching module on the economics of trade in goods prepared for an ADB-ITD course. Where possible, the paper uses examples from Southeast Asia and the GMS. Exercises for readers are provided at the end of every section of this paper. Readers are encouraged to answer the questions listed as they will deepen their understanding of the material covered in that section.

Exercise 1: What is a Regional Trade Agreement?

Please go to the World Trade Organization's website on RTAs: (www.wto.org/english/tratop_e/region_e/region_e.htm)

1. How does the WTO define regional trading agreements or arrangements?
2. How many RTAs has the government of your country signed? How many RTAs is your government currently negotiating?



Characterizing Regional Trade Agreements

Regional Trade Agreements Were Initially Vehicles to Liberalize Trade In Industrial Goods

Governments have a wide range of instruments to facilitate cooperation with other sovereign bodies. This point is worth bearing in mind because it raises the question of whether something called a “regional trade agreement” is the best, or indeed the only, instrument to promote cooperation in trade policy making. For trade in goods, both agricultural and industrial, members of the WTO—or its predecessor, the General Agreement on Tariffs and Trade (GATT)—needed some type of accepted legal instrument to codify departures from the principle of most-favored-nation (MFN) treatment (that is, setting zero or lower tariffs to liberalize goods trade). GATT article XXIV allowed deviations from MFN status, liberalizing trade in goods through a “regional trade agreement” that met certain conditions.⁶ Perhaps the best-known such condition is that the agreement must set zero tariffs on substantially all trade between the parties. Precisely what “substantially all trade” means has never been defined. Because “substantially all” is a weaker requirement than “all,” the question arises how many and which tariff lines are exempt from zero tariff treatment. Does “substantially all” mean 90% (or 95% or 99%) of all tariff lines in the parties’ tariff schedules? Does it apply to 90% (or 95% or 99%) of all trade between the parties? In practice, many of the exempted tariff lines have been in the agricultural goods category, because it appears to be much harder to liberalize trade in agricultural goods than in industrial goods in many countries. Much ink has been spilled on the meaning of “substantially all” and on the reform of article XXIV (as well as General Agreement on Trade in Services (GATS) Article V and the Enabling Clause) in general, but little has come of it. It seems that WTO members are not keen to have restraints imposed on the deviations from the WTO’s MFN rule that the creation of an RTA permits.

Initially, then, RTAs were vehicles for promoting one type of international cooperation on commercial policy: eliminating tariffs on “substantially all” trade in industrial goods between the parties to an RTA. Since tariffs were to be eliminated in principle, there was no need for rules to ensure that each party to an RTA offered every other party the same sub-MFN but positive tariff on each tariff line—

⁶ Article V of the General Agreement on Trade in Services (GATS) and the Enabling Clause agreed to by GATT members in 1979 provide further legal authority to form RTAs.



what might be considered a tariff-related “conditional MFN” requirement.⁷ But rules were needed to ensure that only firms shipping goods from a signatory of an RTA would receive the RTA’s beneficial tariff treatment. Because the parties to an RTA need not have the same MFN tariff rates on each product,⁸ firms in countries that are not parties to the RTA could ship goods to the RTA party with the lowest MFN tariff rate, pay that rate, and then try to get the goods into their target RTA party at the tariff rate prevailing between parties to the RTA. Rules of origin were created to prevent such transshipments, but their implementation raises the costs of exporting to parties to the RTA as well, diminishing those parties’ benefits.

Rules of Origin: What Is at Stake?

An example may help illuminate the matter at hand. Suppose there are three countries, A, B, and C. Countries A and B sign an RTA and set zero tariffs on the importation of mineral water from each other. Countries A and B maintain their own ad valorem MFN rates on mineral water of 10% and 20%, respectively. A mineral water exporter in country C could export its product to country B directly and pay a 20% duty. However, the same exporter could export the product to country A, pay the 10% tariff, and then attempt to take its product across the border to country B. If the exporter from C succeeds, then effectively its tariff rate on imports of mineral water into B is 10%, not the 20% that B imposes. For B, one solution is to require that any mineral water imported into B from A must be “made in country A” or “made with enough ingredients produced in country A” (for manufactured products, “made with enough parts or components produced in country A”). Exporters from country C, transshipping through country A, will not be able to meet this requirement, so will have to pay the 20% tariff. Such a requirement is known as a “rule of origin.” The reader may ask why country A

⁷ Such a requirement would stipulate that each party to an RTA treat every other party to that RTA equally. As will become apparent, once RTAs started to include provisions on nontariff matters, in particular on regulatory policies, parties to certain RTAs adopted conditional MFN requirements. These requirements held out the promise of equal treatment among signatories to an RTA, treatment that might be better than that offered to WTO members that were not signatories of the RTA.

⁸ An RTA in which all of the parties do agree to apply the same schedule of MFN tariffs on imports from nonparties is known as a customs union. The creation of a customs union requires the parties not only to agree to liberalize trade in goods among themselves but also to agree on a common schedule of MFN tariffs. The latter agreement requires a further pooling of sovereignty (a step many countries presently appear unwilling to take) and typically presages the creation of a supranational body to negotiate on behalf of the customs union. The EU is a customs union, and one of the first powers transferred by member states of the European Economic Community (the European Commission’s predecessor, the supranational body created by the Treaty of Rome) was the right to negotiate trade agreements on behalf of the member states.



would agree to the inclusion of a rule that increases the amount of paperwork for its exporters in an RTA. When the tariff benefit (here 20%) exceeds the cost of completing the paperwork, then country A's exporters have a cost advantage over exporters in country C seeking to supply similar goods to country B. In this case the rule of origin protects the export advantage the RTA provides to country A. However, if country B's rule of origin places a sufficiently high burden on country A's exporters (here greater than 20%), even they will find it cheaper to pay the MFN tariff rate. In this case the rule of origin eliminates the liberalizing benefit of the RTA.

For policy-making purposes, three points follow from this example. First, rules of origin are necessary if RTA parties do not have identical MFN tariff schedules. Second, the more onerous the rule of origin, the smaller the benefit that accrues to exporters in countries that are parties to an RTA. In consequence, rules of origin can be designed to limit the liberalizing effect of an RTA; no analyst should conclude that an RTA indicates liberalizing intent without carefully examining the restrictive impact of any accompanying rules of origin. Third, there is a limit to how much damage rules of origin can do. As soon as the cost of meeting a particular rule of origin exceeds that of paying the MFN duties, exporters from RTA countries pay the MFN rate instead. It follows that lowering MFN tariff rates, whether through unilateral or multilateral trade reform, effectively reduces the range of tariffs over which rules of origin can "bite." Thus an effective way to mitigate the impact of rules of origin is to encourage the party in question to lower its MFN tariff rates.

Third-Party Most Favored Nation clauses

Before turning to the manner in which many recent RTAs have expanded beyond liberalizing trade in industrial goods, it is worth noting the occurrence of third-party MFN clauses in RTAs. A third-party MFN clause between countries A and B in an RTA would provide that if A enters into another RTA with C, and A offers C more market access than B, then A is obligated to offer B the same market access as C.⁹ In view of these clauses, trade negotiators should be mindful of future market access negotiations when they are engaged in current RTA negotiations. Two strategic implications follow from the use of these clauses. First, a developing country may be more willing to sign an RTA with another country that offered little additional market access (or insisted on many exceptions from the RTA's zero

⁹ Third-party MFN clauses typically apply to trade in industrial goods, but there is no reason for such a limitation in principle. There have been examples of RTAs with third-party MFN clauses that applied to access to government procurement contracts.



tariff treatment) if it believed that the latter country was very likely to negotiate a later RTA with a third country that would demand substantial market access improvements in return to zero tariff access to its markets. In this case the third-party MFN clause enables the developing country to benefit from the third country's greater negotiating clout. Second, a developing country, having entered into an RTA containing a third-party MFN clause with another country, is now more reluctant to enter into another such RTA with a third country because it knows that it must match any market access commitments it gives to the third country. Recently, the Brazilian delegation to the WTO contended that the EU's Economic Partnership Agreement with the Caribbean nations, which contained such a third-party MFN clause, would effectively chill those nations' desire to negotiate RTAs with other countries. Officials of developing countries should be aware of current thinking about third-party MFN clauses, even though our understanding of their effects is incomplete.

Regional Trade Agreements Have Evolved and Now Are a Vehicle for Many Forms of Cooperation Between States

Over time, RTAs began to include provisions concerning a wide variety of matters other than trade in industrial goods. For example, the Treaty of Rome, signed in 1957, included provisions concerning competition law. There are five principal varieties of nontariff matters that have come to be included in RTAs:

- (i) government measures **implemented at national borders** that directly affect cross-border rather than domestic trade, such as rules on customs valuation; customs documentation; transshipment; and so-called trade defense instruments such as countervailing (anti-subsidy) rules, anti-dumping rules, and safeguard rules against surges in imports;
- (ii) government measures that **regulate all commerce, domestic and foreign, within a jurisdiction**, such as RTA provisions on government procurement policies, intellectual property rights, labor and environmental standards, competition law, investment policies, the regulation of sectors such as financial services and telecommunications, and the regulation of public and private monopolies;
- (iii) provisions concerning **government-owned or government-influenced entities**, such as state-owned energy suppliers, that engage in commercial operations and that, in principle, could influence the price and availability of goods and services to other firms operating in the jurisdiction;



- (iv) **dispute settlement provisions** that seek to encourage the faithful implementation of other RTA provisions, including through revocation of RTA benefits if a party does not comply with the rules; and
- (v) **provisions relating to cooperation and commitments** on matters unrelated to international commerce, such as scientific exchange, diplomatic meetings, and cultural exchange.

In addition to these five types of nontariff provisions, RTAs may have other collateral effects that may or may not be explicitly mentioned in the negotiating text, such as financial support (in particular aid flows) or foreign policy and military payoffs. Finally, it is worth recalling that the parties can agree to take further steps to review the operation of RTA provisions, or to withdraw or suspend RTA obligations.

What should government officials make of this tendency for RTAs to expand in scope? They should recognize that their opposite number may have a different conception of the appropriate scope of an RTA.¹⁰ That RTA concepts may differ has two important implications. First there is a conceptual question addressed at greater length below: what matters should, in principle, be addressed in a legally binding RTA rather than in some other cooperative instrument? Second there is a practical moral: government officials with responsibilities other than setting trade policy for goods need to be involved in the preparation for RTA negotiations, or even in certain elements of the negotiations themselves. This includes officials outside of trade or commerce ministries, whose level of expertise in trade policy matters is open to question.¹¹ One can also ask whether they view the form, costs, and benefits of international cooperation in the same way as the national trade ministry; often they do not. Trade and commerce ministries should understand the motives and interests of non-trade officials involved in consultations on national RTA strategy in order to assess how RTA provisions can be used to foster cooperation between states.¹²

¹⁰ A related observation is that in recent years the European Commission and the United States have insisted that their RTA partners accept a wider range of disciplines on measures that go well beyond liberalizing trade in industrial goods. The trend toward broader RTAs is well established and likely to continue.

¹¹ In fairness, one can also inquire about the expertise of trade officials negotiating on matters not involving trade in goods.

¹² National regulators, very possibly aided by legislators and influential private sector interests, may be more interested in defending their own powers and autonomy. Indeed, they may be completely unfamiliar with the logic of reciprocal trade liberalization..



The expansion of RTAs is arguably correlated with the degree to which a provision seeks to limit discrimination by each party against government or private sector entities located in other parties. Such discrimination can be explicit (*de jure*) or implicit (*de facto*); when explicit discrimination is not permitted, government officials can often discriminate *de facto* in the design and implementation of regulations. This is why rules to eliminate *de jure* discrimination are typically complemented by RTA provisions to make regulatory processes more transparent (often making it harder for regulations to be used in a discriminatory fashion), allow for mutual recognition of regulatory processes (enabling a firm in one implementing country to meet another implementing country's standards by meeting its own), and harmonize regulations (presumably in a way that limits discretion or at least allows each RTA party to resort to the same discretion).

The parties to the RTA could agree not to discriminate between one another but discriminate against nonparties. The discrimination that RTAs generate in trade in goods can have an analogue in their provisions on other border barriers and on state regulatory measures. This logical possibility cannot be discounted. However, one of the most interesting findings of research on RTAs in recent years is the number of instances (in different policy areas) where RTA provisions on nontariff matters have been used to limit, and even eliminate, discrimination against all trading partners.¹³ Sometimes the RTA provisions in question explicitly ban discrimination against all trading nations (for example, many RTAs with the United States ban the use of performance requirements for investors from any jurisdiction); in other cases the RTA provision in question calls for an improvement in regulatory policy that is eventually implemented on a MFN basis. For example, a government may find it too expensive to maintain one regulatory regime for financial sector firms from RTA partners and one for firms from other countries, and therefore may decide to improve its existing regulatory regime in response to RTA obligations. Analyses of service sector provisions and their implementation in RTAs have long identified this phenomenon.

A related consideration is that provisions on government measures in RTAs may cover matters for which there are no WTO rules or obligations. In such cases, there is no conflict between the RTA provision and the corpus of multilateral trade rules. However, by the same token there would be no multilateral disciplines or, perhaps more importantly, multilateral deliberations that could help identify policy options for a developing country. Some parties (specifically the United States and

¹³ For evidence on such matters in six areas of government policy, see the case studies presented in Baldwin, R., S. Evenett, and P. Low. 2007. *Beyond Tariffs: Multilateralising Deeper RTA Commitments*. Paper presented at WTO-HEI Conference. Geneva. 10–12 September.



the European Commission) have argued that in cases where RTA provisions fill a gap in the WTO disciplines, they can act as a template for future WTO rules. To be sure, there may be one or more templates of rules for a given area of state policy, but this has not proved to a serious problem, at least for middle-income developing countries. In such cases, officials from developing countries are encouraged to understand what each template consists of, what its adoption by a developing country would entail, what future options its adoption might foreclose (in terms of preventing other RTA negotiations), and how it relates to the country's developmental and overall priorities. In general, developing country officials should ask what are the costs and benefits of using RTAs that go beyond WTO rules to promote cooperation between states on a particular policy measure or to bring domestic enforcement of a state measure more into line with the country's own developmental needs.

Some RTA provisions relate to specific characteristics of state institutions (in particular their funding, staffing, independence, and oversight by courts), rather than to the measures taken by those institutions. Such provisions could involve steps to strengthen a state body (for example, by giving it an adequate budget), to constrain it, or to ensure its effective—typically legal—oversight. The purpose of RTAs has thus expanded from liberalization of trade to reforming state institutions.

To summarize, RTAs have expanded in scope beyond their original focus on liberalizing trade in industrialized products and have developed many new and different elements. This expansion implies a change in the rationale for RTAs (a point explored in the next section) and has direct consequences for the manner in which RTAs are negotiated. In particular, interagency coordination is essential, and negotiators must strive for a better understanding of state regulators' and other government ministries' motives and their desire for greater cooperation between states. RTAs have ceased to be purely liberalizing instruments and can now be employed to shape state institutions. Are they an appropriate vehicle for developing countries seeking to align their commercial policies and regulatory institutions better with their overall development objectives?



Exercise 2: Characterizing Regional Trade Agreements

1. Please go to the WTO website and look up Article XXIV of GATT and Article V of GATS, the multilateral rules on RTAs. What are the differences in the WTO rules on RTA provisions concerning goods and services, if any?
2. Having looked up the Enabling Clause, discuss what restrictions WTO rules place, if any, on the RTAs that GMS countries can enter into, bearing in mind that all of the GMS countries are designated as developing countries in the WTO.
3. What is the source of the disagreement between certain ASEAN nations and India over the rules of origin that might be contained in an RTA between these trading parties? What commercial interests are at stake in this disagreement?
4. Do any of the RTAs entered into by GMS countries include third-party MFN clauses? If so, why? If not, why not?
5. Please obtain copies of the Chile–PRC RTA and the Chile–European Commission RTA (you can download the text of these agreements from the Internet). Compare the tables of contents of these agreements. What can you learn about the differences in scope of these two RTAs? What questions does this raise about the motives for the two RTAs? A comparison of the preambles of both agreements may be useful in this regard.

The Rationales for Negotiating Regional Trade Agreements

Countries negotiate RTAs for many reasons, not all of which lend themselves to economic analysis. The desire for peace, or to minimize the likelihood of military conflict, has accounted for some RTAs between bordering states. The progressive pooling of sovereignty in Europe after the Second World War, the third major war on the continent of Europe in just 70 years, was motivated by the desire to prevent Franco–German conflict. The fact that the pooling of sovereignty began in the coal and steel industries and later expanded to include atomic power indicates that the desire to avoid future conflict was a leading, if not the paramount, concern at the beginning of European regional integration. American support for European integration was motivated by this concern as well as by the desire to strengthen Europe's economy as the Cold War developed.

RTAs can be used as instruments for dialogue between countries where explicit discussions on military and foreign policy–related matters may be impossible. Dialogue between states should not be trivialized. Neither should the need to keep



channels of communication open when difficult circumstances arise. However, any RTA motivated by the concern to maintain dialogue should be judged by different criteria from an RTA motivated by promoting cooperation between states on commercial policy matters.

History also heavily influences the view many policy makers in developing countries take of regional integration. The struggle for independence from colonial powers, often tough and violent, led to the birth of many new nations with leaders who cherished their autonomy. For those leaders, pooling sovereignty in supranational institutions soon after independence would have felt counterintuitive to say the least, as would entering into RTAs that “intruded” into the exercise of state functions. For this reason the scope of RTAs executed by recently independent developing countries is often narrower than those entered into by industrial countries. For example, the 2007 RTA between Chile and the PRC is narrower than the wide-ranging RTAs Chile was willing to enter into with the US and European Commission, revealing the PRC’s preference for a less expansive agreement. Government officials and analysts should recognize the shadow that history can cast over the likely form of an RTA and a country’s motives for entering into it.

Other rationales for RTAs are more economically oriented. The notion of reciprocity is especially important to bargaining on commercial matters between states, as is clear from the fact that an RTA has to be voluntarily agreed to by each party. The voluntary nature of RTAs does not mean that a party will necessarily get a “fair deal” or a large share of the commercial benefits of an RTA, just that it will get enough to make the deal worth entering into. It should always be remembered that an RTA negotiation need not lead to the conclusion of a final agreement and that the very possibility of ending an RTA negotiation can be used strategically to defend national interests.

The Various Notions of Reciprocity in Regional Trade Agreement Negotiations

Numerous trade-offs can arise in RTA negotiations because the parties have different notions of reciprocity. As argued in the next subsection, in the context of RTAs reciprocity has typically been seen in terms of market access—that is, access for each party’s firms to the other’s markets. However, at least three other notions of reciprocity can be identified. Government officials considering the range of bargains that can be struck in an RTA would do well to appreciate them, because they can shape the negotiating priorities of RTA negotiating partners.

First, some jurisdictions, such as the EU, see RTAs as a vehicle to encourage the spread of their values to trading partners; those values typically relate to



the treatment of workers, employee rights (including freedom of association in unions), social and political rights, and environmental protection. A trading partner that wants to disseminate its values may be willing to exchange better access to its markets for adherence to its rules by RTA parties. Second, in a related but distinct sense, an RTA party may accept another party's regulatory policies, such as those pertaining to intellectual property rights and competition law. In this sense, reciprocity may concern institutions and policies of the state that govern all commerce in a country, not just border-related measures. Some developing countries with histories of substantial shifts in economic policy between governments have used this form of reciprocity to lock in a set of regulatory policies and institutions, making it much more costly for successor governments to reverse them. The third form of reciprocity is associated with foreign direct investment. RTAs with some parties, such as the EU and the United States, are seen as being sufficiently tough that they lead multinationals to respond positively, anticipating improvements in the business climate. They constitute a "seal of approval."

It is worth pointing out that these different notions of reciprocity have different commercial costs and benefits, as developed below. Here, however, we consider the implications for devising a country's negotiating strategy. Before starting an RTA negotiation, trade officials should think through the various notions of reciprocity and what they mean in terms of negotiating proposals. Which ones best suit the needs of their country? Which are in principle acceptable to the country even if achieving reciprocity in this sense is not a priority? Which are superfluous to the country given its current and planned circumstances? Which are completely unacceptable? Engaging in this thought process helps officials better identify their country's priorities, the likely priorities of its trading partner, and the potential trade-offs involved. Furthermore, it shifts the discussion beyond a focus on reciprocal improvements in market access alone.

Indeed, it is often said that the trade policies of developing countries should be aligned with their development goals; in the context of preparation for RTA negotiations this maxim takes on particular significance, given that an RTA can implicate state regulations (which reflect government policies toward the business environment of a country, implicitly or explicitly) and labor, social, and environmental policies. Which of these policies is a developing country government prepared to alter in order to secure an RTA with a given trading partner, and to what extent? On the other hand, since an RTA can range beyond liberalizing trade in goods, developing countries formulating negotiating strategies should identify the regulatory policies of their industrialized negotiating partners that they might like to alter. For instance, both the PRC and India have called upon the United States to modify its rules that allow for the vetting of foreign purchases of American



companies on national security grounds. In principle, this change could be written into the provisions of an RTA. This is not to say that the United States would agree to such a change of policy, but that developing country signatories need not be the only ones who change policies affecting the business environment as a result of an RTA.

Discerning whether a potential negotiating proposal is necessary for a nation highlights one very important point: an RTA is just one of many vehicles for advancing reform in a country and for promoting cooperation between states. Proponents must make the case for including a certain provision in a binding RTA, instead of some alternative instrument or measure available to governments. Why not use a non-binding instrument outside of the context of an RTA (a so-called soft law)? If the binding character of the RTA provision is what is important, has it been reinforced by an effective dispute settlement mechanism? Alternatively, if a government had decided to change a given regulatory policy before an RTA negotiation, why not include it in the RTA in exchange for a concession, such as technical assistance to speed up the revision of the regulatory measures concerned and to strengthen the enforcing institution? Thinking through whether a potential negotiating proposal is superfluous thus forces some consideration of alternative reform trajectories, the potential scope of an RTA, and negotiating tactics (recognizing the potential quid pro quos in an RTA deal).

More generally, considering alternative reform trajectories may well call into question the merits of pursuing an RTA. Multilateral trade negotiations might provide a better vehicle for securing a nation's overseas commercial policy objectives (though the growing length of time it takes to conclude WTO negotiations may count against that particular negotiating trajectory). Unilateral reform measures may be more attractive because a government can determine the scope and pace of reforms by itself and can sidestep the difficulty of securing public approval for reciprocal trade agreements where opponents argue that the government "gave too much" or "got too little" for the RTA. The political viability of different types of reciprocity may differ within and across jurisdictions, and trade officials need to take these political factors into account. A technically superb RTA that is not politically viable to any negotiating partner simply will not be approved.

The Various Manifestations of the "Market Access" Motive for Regional Trade Agreements

Governments often seek RTAs to gain access to foreign markets for their firms (both those that are and, just as importantly, those that might become engaged in international commerce). Two particularly strong market access rationales for



seeking RTAs arise because RTAs allow a group of countries to eliminate tariffs on trade between parties but not third parties. The first, sometimes referred to as the offensive rationale, is to obtain a tariff advantage for a nation's exporters over competitors in countries that will not be parties to the RTA, increasing local firms' incentive to export. For example, suppose Thailand's biggest rival in exporting shrimp to the EU is Viet Nam, and that both Southeast Asian nations currently pay an MFN tariff rate of 20% when their shrimp enters the EU. An EU–Thailand RTA that eliminated tariffs on shrimp would be a considerable advantage to Thai shrimp exporters if it came into force before any EU–Viet Nam RTA. Without the 20% tariff, Thai shrimp exporters could lower their prices by up to 20%, expand their profit margins, or do both in any combination. Thai shrimp exporters would then be said to have preferential market access (over the MFN tariff rate of 20%) to the EU market. It is quite possible that the Thai share of the EU shrimp market would expand at the expense of other suppliers, including Viet Nameese exporters.

Notice that the commercial advantage created for exporters of a particular good when their country enters into an RTA is a function of the applied MFN tariff on the good in question, the size of the RTA partner's market in that good, and customer preference for lower-priced goods in RTA partners' markets. Aggregating across all of the goods a potential RTA party may export can indicate the ultimate possible export payoff from the tariff elimination elements of an RTA. In reality, the tariff elimination benefit is small for developing countries precisely because many industrialized countries charge very low applied MFN tariffs on average.¹⁴ Moreover, many industrialized countries offer nonreciprocal preference schemes (under the Generalized System of Preferences, or GSP) that allow most goods from the developing country to enter their markets without tariffs. In these circumstances, the export payoff of an RTA between an industrialized country and a developing country is merely to lock in the GSP-related zero-tariff treatment that the industrialized country could otherwise withdraw. This important limitation is often overlooked in the empirical analysis of the effects of RTAs on exports, but may take on new relevance now that some developing countries have implemented their own GSP regimes, particularly in favor of the least developed countries. Because many developing countries still have high applied MFN tariff rates (often on average above 10%), RTAs between developing countries (south-south RTAs) offer the largest tariff elimination–related payoff in the absence of a GSP regime.

¹⁴ However, note that many industrialized countries' tariff schedules include tariff peaks (high applied tariffs on a small number of tariff lines) that tend to apply to products for which developing country exporters are competitive in international markets. In principle, an RTA may end up eliminating such tariff peaks; however exceptions to tariff elimination frequently have been negotiated in RTAs.



The second market access rationale for a country to negotiate an RTA, often called the defensive rationale, is that their exporters' commercial opportunities are being eroded by the preferential market access given to exporters from RTA countries. A country seeks RTAs in this case, so the argument goes, to level the playing field (that is, to secure the same zero-tariff access to foreign markets as RTA countries' exporters), or to catch up (with what is rarely specified). In 2001 the United States used precisely this rationale to launch a new trade strategy aimed at entering into RTAs with trading partners. The United States is not alone in using such rhetoric to justify RTAs. Some trade officials, in developing as well as industrialized countries, seem to get nervous when other countries' trade negotiators enter into more RTAs. Emotion and fear, however, are not a sound basis for trade policy. Before getting worried, trade officials should seek evidence that their actual exports—or the profitability of their actual exports—have fallen in some foreign market because of an RTA between that market and another country or countries. This is not to suggest that RTAs never cause export losses to third parties; economists have studied the circumstances under which this happens. The suggestion is simply that trade officials contemplating an RTA to restore “lost” exports should ascertain the magnitude of those export losses. Indeed, even if there are losses from the extant RTA, the subject country would not necessarily recoup them through an RTA with one of the parties to the extant RTA. The economic analysis of RTAs gives us no reason to suppose that the exports lost because of an RTA will be recouped by another RTA. This warning is all the more pertinent given that some industrialized countries, notably the United States since 2001, have argued that developing countries that do not sign high quality RTAs (where “high quality” is almost always defined by the industrialized country) will be “left behind.”¹⁵ This scaremongering should be ignored. Policy should be based on estimates of what a country can expect to lose (in the first instance in exports, but ideally in terms of overall welfare) from not taking part in the “race” to enter into RTAs with industrialized nations. Economists in the trade ministries and universities of developing countries should have access to the tools for making these estimates.

To summarize, in this section we have scrutinized the two market access–based rationales for entering into RTAs. When a potential RTA partner already offers generous GSP treatment to a country's exporters, the offensive rationale does not promise a compelling export payoff. To be sure, an RTA may have greater product coverage than is available under the GSP regime, but that depends on

¹⁵ For a detailed account and analysis of this US trade policy of “competitive liberalization,” See Evenett, S. J., and Meier, M. 2008. An Interim Assessment of the US Trade Policy of “Competitive Liberalization.” *The World Economy*. 31 (1). pp. 31–66.



the RTA provisions the potential partner actually agrees to. These considerations seem particularly apt for the GMS countries that are negotiating an RTA with the European Commission. The defensive rationale could justify entering into an RTA, but the need for a defense against other countries' RTA activity should be demonstrated empirically and not merely asserted. We warned about the rhetoric of RTAs and how it can mislead senior trade policy officials and ministers. On this matter at least, the authorities can use the economic expertise at their disposal to help sift fact from fiction.

Box 2: Trade Facilitation Measures and the Greater Mekong Subregion

Even when tariffs are zero, clearing goods can be costly and time-consuming, as can moving goods when infrastructure is shoddy and when they must be transferred between transport modes. One study estimated that every day of delay in shipping goods had the same effect on international trade as a 0.8% tariff. Widespread recognition both inside and outside the GMS that these factors can increase the cost of exporting and importing has led to many initiatives for trade facilitation. For example some trade agreements, including RTAs, contain binding conditions on the nature, transparency, and procedures associated with customs rules and clearance. In other cases regional and subregional transportation infrastructure improvements have been made to speed up internal and cross-border movement of goods. By 2007 ADB had funded 26 projects to improve transportation infrastructure in the GMS. These and other initiatives will help develop three identified corridors (northern, east-west, and southern) for commerce within the GMS. In addition, governments in the subregion have signed the Cross-Border Transport Agreement, which covers customs inspection procedures, the movement of persons, traffic transit through countries, and design standards for roads and bridges. Certain ASEAN trade facilitation initiatives are relevant, too, highlighting the importance attached to this matter throughout Southeast Asia.

The notes of caution expressed above about the market-access motives for entering into RTAs shift the focus back to the other potential nontariff rationales. Many of these relate to state measures regulating commerce within borders, whether of foreign or domestic origin. Some refer to nontariff-related customs procedures that ultimately can have the same effect on imports as tariffs (Box B). Our discussion would be incomplete, however, without pointing out that there is a potential link between RTAs motivated by improving nontariff and inside-the-border government measures and those motivated by market-access issues. For decades now, trade analysts and negotiators have feared that lowering or eliminating tariff barriers to imports would trigger the imposition or strengthening of nontariff barriers or



other government measures that discourage sourcing goods and services from abroad.¹⁶ In this view, RTA provisions (and other trade agreements for that matter) are needed to “preserve the original market access bargain” brought about by tariff liberalization. They do this by adding legally binding provisions to (i) limit (and in the limit, ban) nontariff barriers, (ii) discourage the discriminatory application of government measures to regulate the national business environment, and (iii) promote transparency in national business regulation, allowing foreign and often domestic firms to better understand the “rules of the game” for doing business in the country in question and plan accordingly. Again, this rationale should be supported by evidence, ideally numerical evidence, so its significance can be compared to that of other negotiating priorities. Moreover, even if “preserving the original bargain” is a problem, it does not follow that RTA provisions can tackle it. This is not to say that the problem does not exist or should not be taken seriously, but that a nation’s RTA negotiating strategy based on “preserving the original bargain” must be based on evidence, both qualitative and quantitative.

Much has been written about the various ways in which state measures and private practices can reverse market access improvements wholly or in part. This is not the place to review that evidence and the steps that can be taken to rectify this problem. In this regard, however, a nation’s own exporters and related trade associations are potentially significant sources of information about foreign nontariff barriers. Consulting these firms and associations can be a useful starting point for identifying foreign barriers that meaningfully impede exports.¹⁷

We have discussed various rationales for RTA negotiations. We now turn to the important decision: An RTA with whom?

¹⁶ Baldwin, R. E. 1970. *Non-tariff Distortions of International Trade*. Washington, DC: Brookings Institution. This paper offers a now-vintage expression of this idea, which goes back even further.

¹⁷ In 2007 the author conducted such interviews of sectoral and national associations of exporters for the European Commission in preparation for its recent RTA initiatives. A report on those interviews is now public and part of a larger study available from the author upon request. Bourgeois, J., K. Dawar, and S. Evenett. 2007. *A Comparative Analysis of Selected Provisions in Free Trade Agreements*. Report prepared for the Directorate-General for Trade. European Commission. Brussels.



Exercise 3: Notions of Reciprocity

1. What trade-offs do you consider legitimate in bargaining over RTAs? Why?
2. Can you identify ways in which RTAs could be used to strengthen state institutions and private sector capacities in your country?
3. Have exporters in your country ever complained about losing sales to foreigners as a result of third parties negotiating and implementing an RTA among themselves?
4. Suppose that an important businessman in your country said he wanted the government to negotiate RTAs so as to attract foreign direct investment. Can you think of any alternative policy measures that might achieve the same effect more quickly or at lower cost? What does this imply about the validity of this stated rationale for negotiating RTAs?
5. In your opinion, should the continued relocation of manufacturing assembling capacity to the PRC, the development of supply chains for parts and components throughout Southeast Asia, and the growing scarcity of commodities affect the case for your country starting RTA negotiations with other trading partners?

Identification of Potential Regional Trade Agreement Partners

Although the discussion that follows emphasizes economic factors that are often quantifiable, there is no doubt that other factors have influenced the choice of RTA partners in Asia and the Pacific and elsewhere. It is said, for example, that Singapore chose New Zealand as its first RTA partner precisely because it had few tariffs on that country's exports; the slight expected economic impact of any RTA made New Zealand a good partner for Singapore to learn how to negotiate an RTA. United States officials have publicly stated that Australia became an RTA partner and New Zealand did not for quite a different reason: Australia supported the second invasion of Iraq, whereas New Zealand did not and had previously banned American warships from its harbors. This suggests that foreign policy considerations influence RTA partner choice. (New Zealand's substantial and internationally competitive dairy industry suggests still another reason: a reciprocal deal that opened North America to that industry might not be politically acceptable).

In recent years the degree of sophistication with which nations identify potential RTA partners has increased. Although much of what is known about such matters relates to the decision-making processes of the European Commission and the



US administration in this decade, there is no reason why developing countries in the GMS cannot apply similar empirically grounded approaches.¹⁸ An account of the European Commission's recent identification of new RTA partners follows.

In October 2006 the European Commission published a new policy statement (or "communication" as it is called in EU parlance) on its trade policy called Global Europe. One element of that new policy was to abandon a moratorium on the negotiation of new RTAs that had been in place since the end of the 1990s. The ASEAN group of nations, India, and the Republic of Korea were identified as priority countries for the negotiation of new RTAs, as were the Central American countries. Completion of long-standing and stalled RTA negotiations with the MERCOSUR group of nations and members of the Gulf Cooperation Council was seen as a priority. Negotiating a new bilateral economic pact with Russia was also said to be an objective, but only after that country had joined the WTO. Interestingly for our purposes, RTAs with many countries, including Australia, Canada, the PRC, Japan, New Zealand, and the United States, were ruled out. Three reasons, not necessarily applicable to each country, were given: (i) an RTA with the country in question (thought to be the PRC) could not win sufficient public support in Europe and from European governments; (ii) negotiating with a particular country (thought to be Japan and the United States) would call the viability of the multilateral trading system into question; and (iii) the country in question was likely to ask for reforms in particular EU sectors that were politically unpalatable in European capitals (the exclusion of Australia, Canada, and New Zealand was thought to be driven by the demands these countries were likely to have made about agricultural policy reform, a concern that could also have been raised about the United States). Thus, systemic concerns and worries about political viability appear to have played a role in the European Commission's RTA partner selection. Obviously, for the European Commission to have come to these judgments it must have identified what it expected a prospective RTA negotiating partner to demand in any negotiation. There is no reason why GMS countries could not undertake a similar analysis of the likely negotiating priorities of their potential RTA partners.¹⁹

¹⁸ Evenett, S., and Meier, M. 2008. An Interim Assessment of the US Trade Policy of "Competitive Liberalization." *The World Economy*. 31 (1). pp. 31–66 (US approach) and Evenett, S. 2007. "Global Europe:" An Initial Assessment of the European Commission's New Trade Policy. www.evenett.com/articles/ECNewTradePol.pdf (European Commission approach).

¹⁹ It is doubtful that the GMS countries other than the PRC need to give much weight to the consequences of their RTAs for the multilateral trading system. Hence this module focuses on the implications of the negotiating priorities and political viability of the GMS countries' potential RTA partners.



In a companion paper to the Global Europe policy statement, the European Commission published an analysis of the economic characteristics of its potential RTA partners. This analysis is particularly interesting for our present purposes because it can be replicated by trade ministries and researchers in the GMS countries. The first step the European Commission took was to calculate the long-term potential market size of an RTA partner, bearing in mind that the economies of many developing countries are growing quickly (so that current national income may give a misleading indication of future market size) and that an RTA could define trading relations with the potential partner for many years to come. Given trend rates of economic growth and information on the current size of a potential RTA partner's economy, it is possible to calculate the partner's average expected market size for a given time horizon (for example, 10 years). This calculation could be further refined by estimating the expected size of a nation's total imports of all goods or of merchandise products, using publicly available data;²⁰ import measures give a better indication of the total market available to foreign suppliers. A GMS country could repeat this exercise for all trading partners it does not have an RTA with, and rank those trading partners according to this measure of potential future market size. As with all projections, assumptions that past trends will continue into the future should be made with care, yet some assumptions are needed if any forward-looking measure of market size is to be calculated.

The second indicator the European Commission employed to rank potential RTA partners was the average MFN tariff rate applied by a potential RTA partner to manufactured and agricultural products.²¹ The higher the average MFN tariff rate, the more market opportunities the elimination of tariffs by a potential RTA partner will create for EU exporters, other things being equal. GMS countries can refine this procedure substantially. A GMS country may be interested in knowing the MFN tariff rate applied by a potential RTA partner to its top 5, or 10, or 20 exports. It could ascertain those tariffs and use a summary to compare potential RTA negotiating partners.²² Such quantitative information must then be combined with qualitative information about the nontariff barriers (including sanitary and phytosanitary measures and technical barriers to trade) faced by a GMS country's

²⁰ Annual data on total imports and on national incomes are available from the World Bank's World Development Indicators database. This database is available online and most universities subscribe to it.

²¹ The WTO publishes profiles of all of its members on its website, which include the member's average MFN tariff rate applied to imported manufactured goods and to agricultural goods. www.wto.org/english/res_e/reser_e/tariff_profiles_e.htm

²² The summary could be expressed in terms of the simple mean of the tariffs faced or the geometric mean (which gives higher applied tariffs more weight). An export-weighted average is probably not useful, precisely because high tariffs are likely to depress exports to a trading partner and, by implication, the weight they are given.



leading exporters. The higher the barriers, other things being equal, the larger the likely export impact of the preferential market access that results from an RTA.

The third measure developed by the European Commission sought to capture how much preferential market access a potential RTA negotiating partner already gave to third parties, and therefore the extent to which European Commission exporters are already at a disadvantage from the potential partner's existing RTAs. This measure can be developed with various degrees of sophistication, from the crude (simply counting the RTAs that a potential negotiating partner is already a party to) to the more statistical (estimating the extent to which the European Commission's exports have been reduced by the RTAs previously entered into with a potential negotiating partner). This evidence, especially the cruder evidence, needs to be interpreted with care in the light of comments made above. In particular, knowing how much a potential negotiating partner's existing RTAs have reduced a GMS country's exports reveals nothing about the extent to which an RTA between the GMS country and the potential partner would increase the GMS country's exports. These are two distinct matters.

In this section the goal was to identify the methods that have been used to assess and compare potential RTA negotiating partners. Although these techniques have tended to be used by the largest industrialized jurisdictions, there is no reason GMS nations could not apply similar methods systematically. This is not to say that these methods will automatically tell a GMS country which nations it might want to negotiate an RTA with; qualitative considerations also need to be taken into account. Still, there is a component of the assessment of potential partners that can be conducted objectively with publicly available data on imports, national income, and trade barriers; this analysis could usefully inform decision making by senior trade policy makers and ministers in the GMS.

Exercise 4: Factors Influencing the Identification of Potential Regional Trade Agreement Negotiating Partners

1. What factors have determined your government's previous choice of RTA negotiating partners? To what extent have those choices been influenced by foreign policy considerations and other noneconomic considerations?
2. In what ways would you adapt the method the European Commission used to assess and compare potential RTA negotiating partners to the circumstances of your GMS country?
3. Which of your country's Asian trading partners apply above-average levels of MFN tariffs at present and are expected to have above-average imports over the next 5 years?



Evaluation of Regional Trade Agreements

Government officials who follow ongoing RTA negotiations—whether those of their own country or of third parties—ought to develop a series of metrics to assess any proposed or agreed RTA texts. The purpose of this section is to point to a number of indicators that can be readily implemented and that shed light on what some refer to as the “level of ambition” of a proposed RTA text. These indicators are not a substitute for, but a more easily understood complement to, a full economic analysis that seeks to estimate the potential effects of an RTA on its signatories and on third parties, taking into account the expected reductions in tariff revenues and the losses in real income caused by trade diversion.

The following indicators of the extent of liberalization of trade in industrial goods by an RTA trading partner can be computed, taking account of the operation of any GSP-related or other development-related preferences offered by a trading partner:

- (i) the total number of tariff lines for which there is no reduction in tariffs after the RTA comes into force (expressed as a number of tariff lines, as a percentage of the total number of tariff lines, and as a percentage of the tariff lines for which there were positive levels of imports before the RTA came into force);
- (ii) the total number of tariff lines for which there is less than full elimination of tariffs when the RTA comes into force (expressed as a number of tariff lines, as a percentage of the total number of tariff lines, and as a percentage of the tariff lines for which there were positive levels of imports before the RTA came into force);
- (iii) the total number of tariff lines for which there is less than full elimination of tariffs after all of the tariff reductions envisaged in the RTA have come into force (expressed as a number of tariff lines, as a percentage of the total number of tariff lines, and as a percentage of the tariff lines for which there were positive levels of imports before the RTA came into force). It may also be revealing to calculate the average percentage reduction in tariffs for these tariff lines.

In principle, similar calculations could be made for the agricultural chapter of an RTA that has one.

It is important to check whether the RTA includes a third-party MFN clause, which will generate additional preferential market access if a trading partner offers more market access to another country than was offered to the signatories of



its previous RTAs. From the opposite point of view—that is, evaluating potential limitations on market access gains—it is important to identify and understand the circumstances under which tariff preferences granted under the RTA can be reduced or withdrawn entirely. Moreover, it will also be important for a GMS country to discount any gains in preferential market access from a new RTA by the likelihood that one of its new RTA partners will enter into another RTA with a third party, thereby increasing the competition faced by the GMS exporter in the trading partner in question. More generally, it is important to appreciate that every time a country's RTA partners enter into another RTA, the preferential market access enjoyed by the country's exporters may diminish. Next, the effects of any expected multilateral or unilateral MFN cuts should be taken into account, because such cuts reduce the degree of preferential market access created by an RTA. Finally, the risk of erosion of any preferential market gains through the application of more demanding customs rules and paperwork (including rules of origin), longer delays at the border (whether infrastructure- or security-related), more frequent use of trade defense instruments, and more stringent technical regulations (in particular those relating to product safety and sanitary and phytosanitary standards) should be considered, even if it cannot be quantified. Examining whether an RTA partner resorted to these methods to limit imports after implementing previous RTAs may help indicate the magnitude of this risk.

Given the availability of detailed tariff line data on applied tariffs (and in some jurisdictions on import volumes and values), and the much more limited data on nontariff barriers and the determination and application of laws affecting all commerce in a jurisdiction, it is not surprising that it is much harder to assess the impact of an RTA's nontariff provisions. Even so, a growing number of comparative analyses of nontariff RTA provision have been undertaken. They suggest that the following factors should be assessed provision by provision in the first evaluation:

- (i) whether the provisions only call for best efforts or commit a government to do or not to do something;
- (ii) whether the provisions are subject to the RTA's dispute settlement procedures or create rights of redress and compensation for aggrieved private actors;
- (iii) whether the provisions require any change in a state measure, in state enforcement practice, or in the resources and powers given to a state body;
- (iv) whether the provisions create, limit, or eliminate discrimination against third parties de facto or de jure; and



- (v) whether the provisions promote cooperation between the relevant government ministries or agencies.

The purpose of this section has been to identify the elements a government official should take into account when trying to fully assess the contents and potential effects of an RTA. As the scope of RTAs has broadened, any assessment is likely to become richer; this is inevitable. Moreover, many of the quantitative and qualitative factors identified in this section will enable better interpretation of the numerical estimates produced by economic analyses of RTAs—though one must bear in mind that economic analyses tend to aggregate across tariff lines when estimating the effects on trade and to provide only cursory (if any) treatment of the nontariff provisions found in many recent RTAs.

Exercise 5: Evaluating Regional Trade Agreements

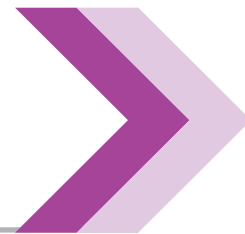
1. Please obtain a copy of the tariff schedules of the India–Singapore Regional Trade Agreement (RTA). On the basis of the criteria developed in the section above, how would you assess the extent of tariff cutting in this agreement? In your opinion, does this degree of tariff cutting meet the WTO standard of liberalizing “substantially all” trade in an RTA?
2. Please obtain a copy of the service sector schedules of the India–Singapore RTA. What is your assessment of the degree of liberalization contained in those schedules? Are there any exceptions or loopholes in these schedules that should worry either of the parties to this agreement?
3. Please obtain copies of several RTAs signed by Japan and by Thailand. On what basis would you compare the chapters on government procurement in these RTAs? In general, which country’s RTAs (Japan’s or Thailand’s) contain the most ambitious provisions for liberalizing government procurement markets and for improving the transparency of state purchasing practices?
4. Compare the competition policy chapters of the Singapore–United States RTA with the rest of Singapore’s RTAs. What can you learn from this comparison? If you had to put together an ambitious set of RTA provisions on competition law and policy, what provisions would you include? Why? Would your country benefit from signing such ambitious provisions in an RTA?
5. Consider any of the RTAs signed by nations in the GMS region. Can you find examples of RTA provisions that limit or eliminate discrimination against third parties? Can you find RTA provisions that were implemented on a nondiscriminatory basis? Finally, can you find RTA provisions that limit the ability of a signatory to use the WTO-permitted exceptions to the principle of nondiscrimination; for example, the use of trade defense instruments such as anti-dumping measures?



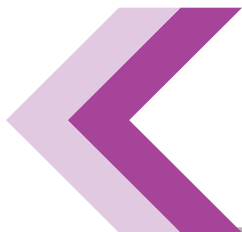
Concluding Remarks

Regional trade agreements are growing quickly in number and are here to stay. They represent an important column in the architectural edifice of international trade rules. RTAs have also grown in scope; they are no longer principally confined to the elimination of many tariffs on the industrial products traded between signatories. Moreover, contrary to much discussion of RTAs, these instruments for cooperation between states have also been used to limit and even eliminate discrimination against third parties and the exceptions to WTO rules on nondiscrimination. Given these developments, the purpose of this module has been to provide officials, including those new to trade ministries, with an overview of the key strategic decisions their country will likely take if RTAs are to form part of their national trade strategy.

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- Bourgeois, J., K. Dawar, and S. Evenett. 200. *A Comparative Analysis of Selected Provisions in Free Trade Agreements*. Report prepared for Directorate-General for Trade. European Commission. Brussels.
- European Commission. 2006a. *Global Europe Communication. Competing in the World: A Contribution to the EU's Growth*. Directorate-General for Trade. Brussels.
- . 2006b. Communication from the Commission of 6 December 2006. *Global Europe: Europe's Trade Defence Instruments in a Changing Global Economy—A Green Paper for Public Consultation*. Brussels.
- . 2007. Communication of 18 April from the Commission to the European Parliament, the Council, the European Economic and Social Committee, and the Committee of the Regions. *Global Europe: A Stronger Partnership to Deliver Market Access for European Exporters*. Brussels.
- Evenett, S. J. 2007. "Global Europe:" *An Initial Assessment of the European Commission's New Trade Policy*. 27 June 2008. www.evenett.com/articles/ECNewTradePol.pdf
- Evenett, S. J., and Meier, M. 2008. An Interim Assessment of the US Trade Policy of "Competitive Liberalization." *The World Economy*. 31 (1). pp. 31–66.



Appendix 1

Instructional Materials on the Economics of Regional Integration

Introductory Materials

Krugman, P., and M. Obstfeld 2006. *International Economics: Theory and Policy*. Addison-Wesley, Prentice Hall.

Advanced Materials

Krishna, P. 2005. The Economics of Preferential Trade Agreements. In Kwan, C. E., and J. C. Harrigan, eds. *Handbook of International Trade*, Vol. 2.

Panagariya, A. 2000. Preferential Trade Liberalization: The Traditional Theory and New Developments. *Journal of Economic Literature* 38. pp. 287–331.

Feenstra, R. 2003. *Advanced International Trade: Theory and Evidence*. Princeton, NJ: Princeton University Press.

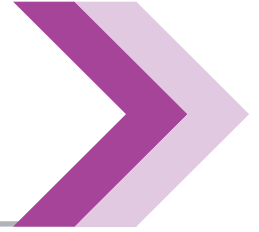
Other Materials of Potential Interest

Bhagwati, J. 2008. *Termites in the Trading System: How Preferential Agreements Undermine Free Trade*. Oxford University Press.

Balastèr, P., and C. Moser. 2008. *Sur la voie du bilatéralisme: enjeux et conséquence*. Berne: Secrétariat d'Etat à l'économie SECO.

Evenett, S. J. 2008. Regional Trade Agreements: Some Notes on a New Research Agenda. Note prepared for the Joint World Bank–DFID–BERR Steering Committee Meeting on the Global Trade and Financial Architecture Project. June.

Appendix 2



Websites Providing Texts of Regional Trade Agreements

ASEAN Secretariat.
www.aseansec.org

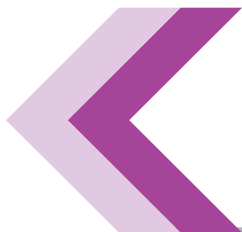
Dartmouth College, CIBER website of RTA texts.
mba.tuck.dartmouth.edu/cib/resources/trade_links.html

European Commission, Directorate General for Trade.
ec.europa.eu/trade

Office of the United States Trade Representative.
www.ustr.gov

World Trade Organization website on the Interim Transparency Mechanism.
www.wto.org/english/tratop_e/region_e/trans_mecha_e.htm

World Trade Organization website on RTAs.
www.wto.org/english/tratop_e/region_e/region_e.htm



Appendix 3

Comparative Analyses of Specific Provisions or Chapters of Regional Trade Agreements

- Anderson, R. D., and S. J. Evenett. 2006. *Incorporating Competition Elements into Regional Trade Agreements: Characterization and Empirical Analysis*. 27 June. www.evenett.com/working/CompPrinInRTAs.pdf
- Baldwin, R., S. J. Evenett, and P. Low. 2007. *Beyond Tariffs: Multilaterising Deeper RTA Commitment*. Paper presented at WTO-HEI Conference. Geneva. 10–12 September.
- Bourgeois, J., K. Dawar, and S. Evenett. 2007. *A Comparative Analysis of Selected Provisions In Free Trade Agreements*. Report prepared for Directorate-General for Trade. European Commission. Brussels.
- Dawar, K., and S. J. Evenett. 2008. *The CARIFORUM-EC EPA: An Analysis of its Government Procurement and Competition Law-Related Provisions*. Report prepared for Deutsche Gesellschaft für Technische Zusammenarbeit. June.
- Fink, C., and M. Molinuevo. 2007. *East Asian Free Trade Agreements in Services: Roaring Tigers or Timid Pandas?* 27 June 2008. World Bank. East Asia and Pacific Region Report No. 40175. go.worldbank.org/5YFZ3TK4E0
- Houde, M., A. Kolse-Patil, and S. Miroudot. 2007. *The Interaction Between Investment and Services Chapters in Selected Regional Trade Agreements*. OECD Trade Policy Working Paper No. 55. OECD Publishing.
- Solano, O., and A. Sennekamp. 2005. *Competition Provisions in Regional Trade Agreements*. OECD Trade Policy Working Paper No. 31.
- Teh, R. 2008. *Competition Provisions in Regional Trading Agreements*. Mimeo. World Trade Organization. April.
- Teh, R., T. J. Prusa, and M. Budetta. 2007. *Trade Remedy Provisions in Regional Trade Agreements*. WTO Staff Working Paper No. ERSD-2007-03.

An Overview of Tariff and Nontariff Barriers Faced by the Greater Mekong Subregion Countries



Watcharas Leelawath

The Greater Mekong Subregion (GMS) economies have grown impressively during the past decade. Every GMS country except Thailand posted GDP growth rates greater than 4% between 1992 and 2007. Total exports of GMS countries increased more than 300% over the same period. Intraregional trade soared even higher; that trade is 11 times greater than in 1992. Foreign direct investment in the subregion has almost doubled from 1992 to 2007. All six GMS countries have engaged themselves increasingly in the global market. However, these countries face both tariff and nontariff challenges that have prevented them from reaping the full benefits of international trade.

This section of the module provides an overview of trade barriers faced by the GMS countries. Part A reports information regarding the export product diversification and market diversification of these economies. Part B sets forth the tariff rates imposed by major export destinations for each GMS country. Part C provides an account of the types of nontariff barriers faced by countries in the subregion.

Product and Market Diversification of Greater Mekong Subregion Countries

Generally speaking, the exports of GMS countries are concentrated in a few product lines. Textiles and clothing are significant export products of all six countries, especially for Cambodia, for which textiles and clothing were 71.82% of total exports in 2006 (Table 1). In contrast, food items and agricultural raw materials, certainly important export categories, constituted only about 1% each of Cambodia's exports in 2006. Other products, such as metal ores, fuel, nonferrous metals, chemical products, machines and equipment, and iron and steel, taken together, constituted less than 0.6% of Cambodia's total export trade in 2006. North America (the NAFTA countries of Canada, Mexico, and the United States) is the major destination of Cambodian exports, accounting for more than 50% (Figure 1). In particular, because of a 1997 bilateral agreement, Cambodia exports more than 70% of its textiles and clothing to the NAFTA countries; the rest goes to the European Union.

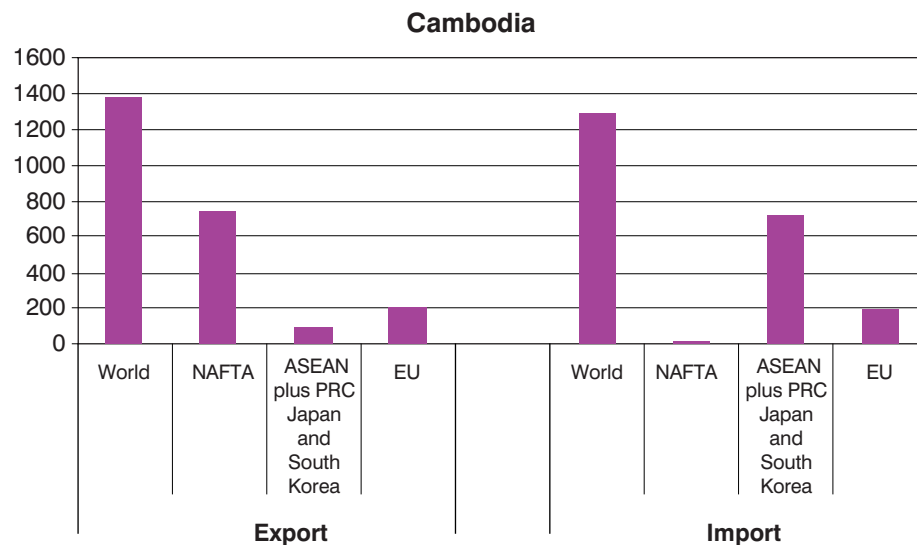


Table 1: Export Structure of Greater Mekong Subregion Countries 2006 (%)

Product	Cambodia	PRC	Lao PDR	Myanmar	Thailand	Viet Nam
Food items	1.08	3.23	7.06	17.8	11.64	16.81
Agricultural raw materials	1.76	0.53	38.09	21.94	4.53	1.75
Metal ores	0.007	1.79	1.01	2.36	1.24	0.85
Fuel	0.001	2.31	0.7	31.73	4.32	21.43
Nonferrous metals	0.004	1.43	0.003	1.64	0.69	0.14
Chemical products	0.11	4.69	0.581	0.12	8.09	1.22
Machines and equipment	0.47	46.23	2.18	0.47	44.67	9.36
Iron and steel	0.001	2.53	0.53	0.67	1.49	0.23
Textiles and clothing	71.82	15.27	43.58	20.28	6.65	18.66

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

Figure 1: Major Export Destinations and Major Sources of Imports for Cambodia (\$US millions)

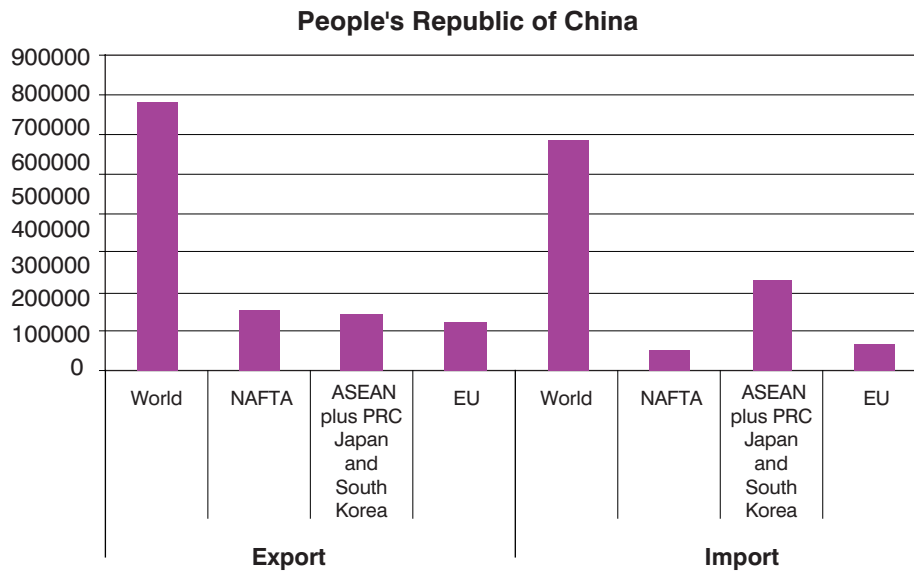


ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People's Republic of China.

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.



Figure 2: Major Export Destinations and Major Sources of Imports for the People's Republic of China (\$US millions)



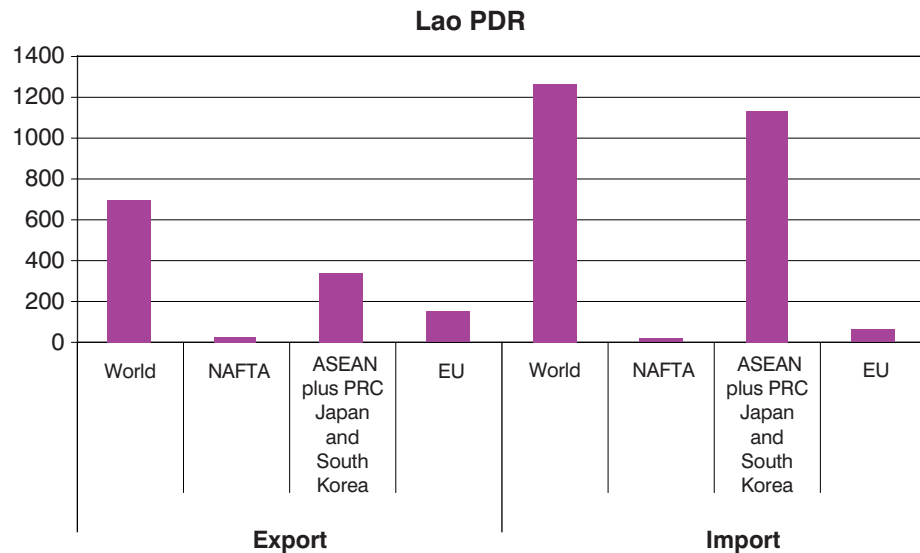
ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People's Republic of China.

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

The structure of the PRC's exports is more diversified than Cambodia's. As shown in Table 1, the country's major export is machines and equipment, which represented 46.23% of its total exports. The second most significant export, textiles and clothing, had a much lower share of 15.27%. The other categories of export products—food items, agricultural raw materials, ores and metals, fuel, nonferrous metals, chemical products, and iron and steel—are much less important. The PRC's export markets are diversified, with roughly equal exports to the ASEAN nations, the EU, Japan, the Republic of Korea, and the NAFTA countries. The PRC's import sources are less diversified: approximately 50% of the PRC's imports come from ASEAN.



Figure 3: Major Export Destinations and Major Sources of Imports for the Lao People’s Democratic Republic (\$US millions)



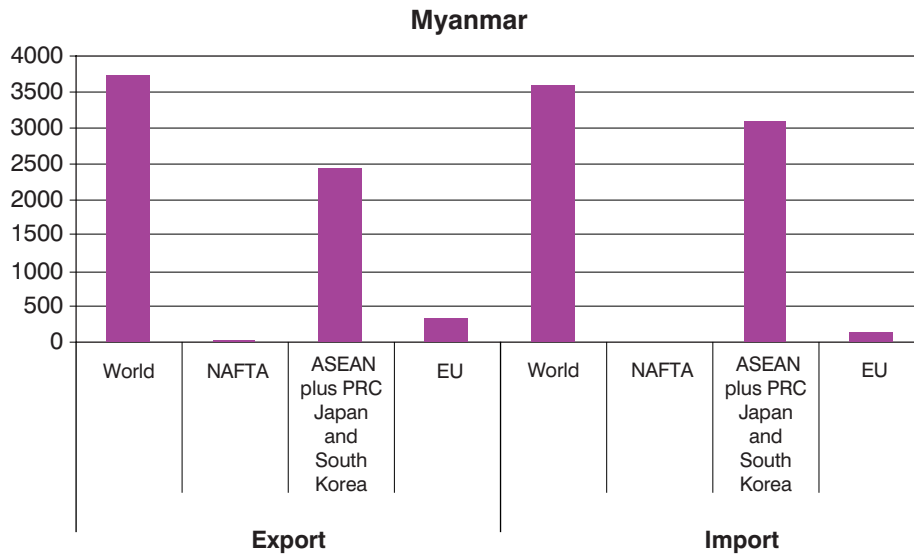
ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People’s Republic of China.

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

Textiles and clothing and agricultural raw materials are the Lao PDR’s primary exports to neighboring countries; Thailand and Singapore represent 43.58% and 38.09%, respectively, of its total exports. Because of the Lao PDR’s low labor costs and lack of well-trained workers, the Laotian textile and clothing industries predominantly produce low-value-added products. Locally owned factories in the Lao PDR rely on imported raw materials and work on a CMT (cut, make, and trim) basis. The finished products are exported, mostly to Thailand. Other exported products are of very little importance. Food items and machines and equipment constituted just 7.06% and 2.18%, respectively, of total exports in 2006. The remaining product categories, including ores and metals, fuel, and chemical products, constitute at most 1.01% of total exports (ores and metals). As shown in Figure 3, more than 50% of the Lao PDR’s total exports go to ASEAN member countries, particularly Thailand.



Figure 4: Major Export Destinations and Major Sources of Imports for Myanmar (\$US millions)



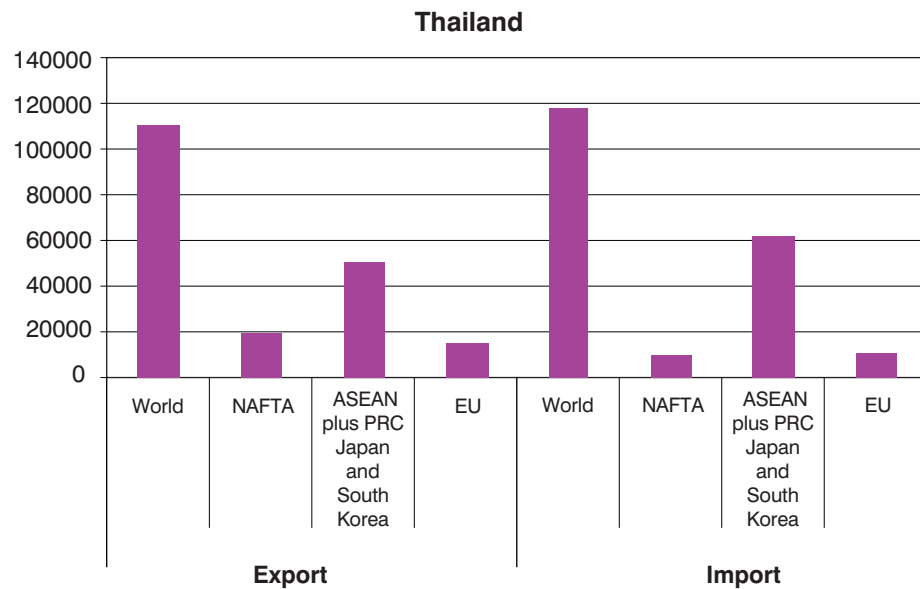
ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People's Republic of China.

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

According to Table 1, Myanmar's exports are better diversified than those of Cambodia and the Lao PDR. Four primary product groups—fuel, agricultural raw materials, textiles and clothing, and food items—constitute more than 91% of those exports. The biggest single export was fuel, at 31.73% in 2006, followed by agricultural raw materials (21.94%), textiles and clothing (20.28%), and food at (17.8%). Myanmar's export destinations are not well diversified; as illustrated in Figure 4, exports to ASEAN member countries represented 57% of Myanmar's total exports in 2006. The data also show that Thailand has always been Myanmar's biggest trading partner, while its export and import volumes with NAFTA countries was very small.



Figure 5: Major Export Destinations and Major Sources of Imports for Thailand (\$US millions)

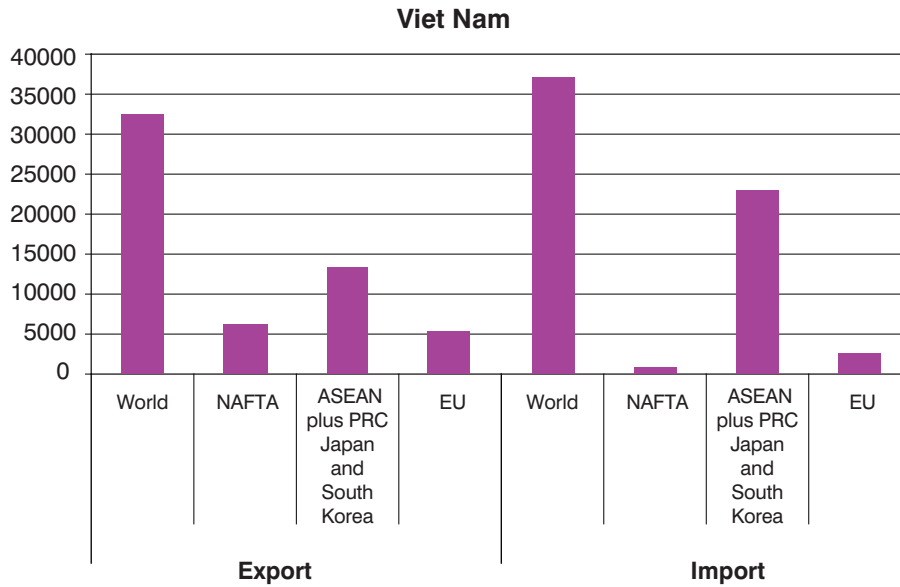


ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People's Republic of China.
Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

The trade pattern of Thailand, the most advanced economy in the subregion with total exports in 2006 of about \$110 billion, differs from that of the other GMS countries. Table 1 shows that Thailand's major export is machines and equipment, representing 44.67% of total exports, followed by food items (11.64%), chemical products and textiles (8.09%), and clothing (6.65%). Figure 5 shows the importance of Thailand's exports to other ASEAN member countries; they represent 44% of total Thai exports, while exports to the United States and the EU each accounted for about 20%.



Figure 6: Major Export Destinations and Major Sources of Imports for Viet Nam (\$US millions)



ASEAN = Association of Southeast Asian Nations, EU = European Union, NAFTA = North America Free Trade Area Agreement, PRC = People's Republic of China.

Source: United Nations Conference on Trade and Development Handbook of Statistics 2007.

Viet Nam's three most important export product categories are fuel, textiles and clothing, and food items. As shown in Table 1, fuel exports accounted for 21.43% of Viet Nam's total exports in 2006. Textiles and clothing ranked second with 18.66%. As in the Lao PDR, the textiles industry in Viet Nam depends heavily on imported yarn and fiber, and exports low-value-added products, mainly to the United States and the EU. Food item exports are as important as textiles and clothing, constituting 16.81% of Viet Nam's exports in 2006. Viet Nam's export profile is somewhat similar to those of the PRC and Thailand. Other ASEAN members constitute Viet Nam's largest export and import markets. The United States and the EU are Viet Nam's next most important export destinations. Figure 6 illustrates that Viet Nam's import sources are not as diversified as its export destinations. More than 70% of its imports come from other ASEAN member countries; the NAFTA countries and the EU are far less important.



Exercise 6: Assessing the Degree of Product and Export Diversification

1. Why do some policy makers worry that their country's exports are concentrated in too few products? Under what circumstances are those fears legitimate?
2. Describe the empirical steps you would take to assess the degree of product diversification of your country's exports. What data sources would you use? Would it make sense to evaluate the degree of diversification at a particular point in time or over many years? What conclusions might you draw from such an analysis?
3. To what extent, if at all, have your country's export markets become more diversified over time? Would having a diversified set of trading partners be advantageous during a substantial global economic downturn, such as the one experienced in 2008 and 2009?

Tariff Barriers Imposed by the Major Export Destinations of the Greater Mekong Subregion's Products

Despite attempts to facilitate export market access by developed countries for developing countries' products, gaining such access to major trading partners' markets is still limited for GMS countries. This is because their important exports are often sensitive products to their major trading partners, which therefore have typically imposed high tariffs on these products. Moreover, these products are often excluded from or have limited Generalized System of Preferences (GSP) benefits. Table 2 illustrates tariff rates charged by five important GWS trading partners (the United States, the European Union, Japan, the PRC, and Thailand²³) on six GMS export products: animal products, fruit and vegetables, fish and fish products, textiles, clothing, and leather and footwear. Clothing is very sensitive for all five trading partners, which impose tariffs on it ranging from 9.2% for Japan to 24.5% for Thailand. Leather and footwear products are highly protected in Japan (with a 15% tariff), the PRC (13%), and Thailand (12.7%). Interestingly, tariff

²³ Though the formulation sounds paradoxical, the PRC and Thailand are GMS countries that are important markets for other GMS countries. The PRC is an important trading partner for Thailand and Viet Nam, while Thailand is an important trading partner for Cambodia, the Lao PDR, and Myanmar.



escalation is found in textiles and clothing products.²⁴ For example, in the United States, the tariff rate on textiles is 7.9% but the tariff rate on clothing is 11.5%. In the EU, the tariff on textiles is 6.6% and on clothing, 11.5%.

Table 2: Tariffs Imposed on Important Product Groups by Major Trading Partners of Greater Mekong Subregion Countries (%)

Product	United States	European Union	Japan	PRC	Thailand
Animal products	2.5	25.4	15.5	14.8	28.1
Fruit and vegetables	5	11.8	12.9	14.9	27.6
Fish and fish products	1.1	10.3	5.7	11	14.5
Textiles	7.9	6.6	5.5	9.7	8.1
Clothing	11.5	11.5	9.2	16.1	24.5
Leather and footwear	4.3	4.2	15	13	12.7

Source: World Tariff Profiles 2006.

Referring to Table 2, it is clear that the tariffs imposed by the United States on animal products, fruit and vegetables, and fish products are low compared with those imposed by the EU, Japan, the PRC, and Thailand. The United States tariff rate on animal products is 2.5% and only 1.1% on fish and fish products is only 1.1%. By contrast, for the EU local animal products are sensitive and highly protected: the EU tariff rate on such products is 25.4%, which is far higher than the rate on fruit and vegetables or fish and fish products. Likewise, animal products are highly protected in Japan with an average tariff rate is 15.5%; tariff rates on fruit and vegetables are 12.9%, and on fish and fish products, 5.7%. Tariffs levied by the PRC are 14.8% for animal products, 14.9% for fruit and vegetables, and 11% for fish and fish products. Thailand is also very protective of its local animal products (28.1% tariff rate), fruit and vegetables (27.6%), and fish products (14.5%), significantly greater than other GMS countries' export destinations.

²⁴ Tariff escalation occurs when there is a positive correlation between the tariff imposed and the degree to which the product has been processed. That is, the tariff on raw materials is low, but that on finished products is much higher. The purpose is to protect domestically processed goods from imported processed goods.



Nontariff Barriers (Past and Present) Faced by the Greater Mekong Subregion Countries

Besides tariff barriers that prevent GMS countries from reaping the full benefits of trade liberalization, these countries have to confront nontariff barriers that can reduce the competitiveness of their exports in the global market, particularly rules of origin, the Technical Barriers to Trade Agreement (TBT Agreement), and the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Measures Agreement).

Rules of Origin

Rules of origin are the criteria used to determine where an export product was made.²⁵ They are an essential part of trade rules and regulations, because they determine whether an imported product should be given preferential tariff treatment or whether the MFN tariff should be paid. The purpose of such rules is to prevent a country that is not eligible for preferential tariff treatment from nevertheless taking advantage of preferential tariffs by exporting its products to a country that is eligible for such treatment and then transshipping them to the final destination. Strict rules of origin could be a problem for GMS countries whose manufactured products contain large percentages of imported raw materials. For instance, less developed countries such as Cambodia and the Lao PDR are granted duty-free and quota-free market access to some developed countries under the GSP. However, the benefit to their textile and clothing industries is small because these industries rely heavily on imported fiber, yarn, and fabrics, creating difficulties in meeting the local content criteria contained in the strict rules of origin imposed by some importing countries. Thailand's jewelry and accessories industries have been facing the same problem because silver and gold, mostly imported from India, are important raw materials for these products. Rising silver and gold prices created increased ratios of imported raw materials to total product value, correspondingly decreasing the value contributed by local content. The result was uncertainty whether exports of jewelry and accessories from Thailand still qualified for preferential tariff treatment under the rules of origin of some importing countries.

Technical Barriers to Trade Agreement and Sanitary and Phytosanitary Measures Agreement

The TBT Agreement relates to technical regulations and standards covering all products, including specifications such as size, shape, and weight as well as

²⁵ For a more general discussion of rules of origin, see II.2 of this module.



packaging requirements including labeling and safe handling. The WTO provides that each member country has a right to its own standards. At the same time, it encourages WTO members to adopt standards developed by international organizations. The primary objective of the TBT Agreement is to protect consumers of importing countries, so as to maximize social welfare. Nevertheless, there is evidence that the TBT Agreement can be an unnecessary impediment to exports from developing countries, including GMS countries.

SPS measures are standards for protecting food safety and animal and plant health. They include all measures to ensure the safety of food for human consumption and to prevent the spread of animal and plant pests and diseases. The SPS Measures Agreement covers the food and agricultural sectors and deals, among other things, with matters relating to levels of microbial, toxic, and physical contamination. While SPS measures serve legitimate purposes, this area is subject to excessive formalities, costs, and time expenditures, and the SPS Measures Agreement provides too much scope for importing countries to impose their own national requirements. All these factors impede exports from GMS countries. Furthermore, importing countries' SPS requirements can sometimes be based on improbable risks. The lack of a uniform scientific assessment of risk thus constitutes another major obstacle to international harmonization.

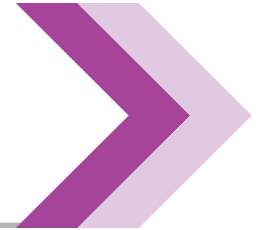
Generally, the GMS countries are standards takers, not standards setters. Therefore, the TBT Agreement and the SPS Measures Agreement are two-edged swords for them. Such measures simultaneously create both difficulties and opportunities for market access in industrialized countries. To ensure compliance with developed countries' TBT and SPS measures, the GMS countries must make substantial investments in new machines, factories, laboratories, and other infrastructure. In addition, exporting countries need time commitments and technical know-how at every step of the production process. For example, some standards require record keeping at the field level; producers and exporters of farm products in GMS countries have limited capacity to do this. Hence, large multinational companies may be able to meet these standards, but labor-intensive small and medium enterprises in the GMS countries are much less likely to do so.



Exercise 7: Trade Barriers Faced by Your Country's Exporters

1. What steps does your government take to identify the tariff and nontariff barriers faced by your country's exporters? Do you have any ideas that could improve the quantity and accuracy of information that your government has on these matters?
2. Could information on the trade barriers faced by your country's exporters influence how those firms upgrade their products and production processes?
3. To what extent could your country's RTA negotiating priorities be informed by a detailed analysis of the trade barriers faced by your country's exporters and the likely effects of those barriers?

Market Access Problems Related to Sanitary and Phytosanitary Measures: A Case Study of Chicken Exports from Thailand to Australia



Somchin Suntavaruk

The Issue

At the conclusion of the Uruguay Round of multilateral trade negotiations, the WTO membership agreed to eliminate traditional nontariff barriers, such as quantitative restrictions and voluntary export restraints, that were imposed upon the importation of goods, including agricultural products. However, developing countries in particular are concerned that compliance with these rules does not necessarily improve market access for their agricultural products because technical aspects of sanitary and phytosanitary measures can be used inappropriately to restrict imports. This concern is legitimate for at least three reasons:

- (i) The Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures provides each member country with the right to determine its own appropriate level of protection of human, animal, or plant life or health.
- (ii) A sanitary or phytosanitary measure must be based on scientific principles and scientific justification. Developing countries therefore must present scientific evidence to prove that the measures implemented by industrialized countries are more trade-restrictive than required to achieve the appropriate level of sanitary or phytosanitary protection. This evidence will be very costly to acquire, if it is available at all.
- (iii) Consumers in industrialized countries are inclined to require higher standards of protection and they have more organized movements to support national policy initiatives for higher standards.



This portion of the module presents a case of a very stringent SPS measure that provides an excellent example of how negative effect on trade can have a scientific justification.

International Trade in Poultry

Poultry is an important food item traded in the world market. According to the United Nations Food and Agriculture Organization trade statistics, the 20 largest importing countries imported 3.1 million tons of chicken in 1989 with a total value of \$4.489 billion. By 2004 these numbers had reached 4.3 million tons and \$5.963 billion. Table 3 provides statistics for the seven countries with the largest volume of imports.

Table 3: Imports of Chicken, Selected Countries

Importing Country	1998		2004	
	Quantity tons	Value \$ thousands	Quantity tons	Value \$ thousands
Japan	497,247	905,710	353,791	696,646
United Kingdom	250,759	729,903	342,275	1,186,603
Germany	256,060	608,361	226,439	555,382
Russian Federation	617,285	414,798	999,375	601,804
Saudi Arabia	272,450	348,763	427,195	456,457
France	104,057	207,048	158,375	344,367
Netherlands	106,883	189,285	223,307	348,529
Total (20 countries)	3,139,862	4,489,135	4,301,428	5,963,631

\$ = US dollars.

Note: Chicken includes cooked and uncooked meat.

Source: United Nations Food and Agriculture Organization Statistical Division, Rome.

Table 3 also shows that six of the top seven importing countries are industrialized. All have adopted high sanitary standards and implemented strict quarantine conditions for all food imports—which have not hindered all international trade in poultry.

Thailand is one of the few developing countries that can export poultry to these high-standard importing countries. In 1998, exports of chilled or frozen poultry

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cuts from Thailand to the world markets totaled \$405 million; the largest export markets were Japan and some members of the European Union (Table 4). However, after the outbreak of avian influenza in certain parts of Thailand and other Asian countries in 1998, importing countries switched from uncooked to cooked meat, with the total value of prepared poultry exports from Thailand reaching \$753 million in 2006 (Table 5). Again, the largest importers were Japan and some member states of the EU.

Table 4: Thailand: Export Value of Chilled or Frozen Poultry Cuts (\$ millions)

Importing Country	1998	2004	2005	2006
Japan	247.89	19.41	5.43	7.44
Germany	60.77	9.37	0.07	0.24
Netherlands	37.30	4.55	0.24	0.93
United Kingdom	18.73	2.49	6.84	2.15
Singapore	13.31	1.06	0.00	0.16
Others	27.10	7.55	0.58	4.86
Total	405.10	44.42	13.16	15.78

Source: Thai Customs Services and Ministry of Commerce.

Table 5: Thailand: Export Value of Prepared Poultry (\$ millions)

Importing Country	1999	2004	2005	2006
Japan	50.02	254.57	330.77	332.84
United Kingdom	40.87	135.75	198.13	248.33
Netherlands	37.50	51.55	68.51	72.29
Germany	18.10	24.73	26.12	32.11
Hong Kong	2.44	9.29	9.61	9.32
Others	7.8	41.1	50.2	59.1
Total	156.41	516.58	682.89	753.93

Source: Thai Customs Services and Ministry of Commerce.

Australian Sanitary and Phytosanitary Measures on Chicken

Australia is a continental island. The Australian government consistently maintains a strict quarantine system with the goal of ensuring that its territory is completely free from foreign-borne diseases. Chicken is one of the several food items covered



by this quarantine system: “Australia has maintained strict quarantine barriers against the importation of chicken and chicken products, permitting only canned products to enter.”²⁶

Australia felt obliged to assess its system objectively after receiving many requests, starting in the mid-1980s, from the governments of Denmark, Thailand, and the United States to allow imports of both frozen and cooked poultry products. The Australian Quarantine and Inspection Service (AQIS), which is responsible for assessing applications to import these products, started a review process in 1990 and issued a series of risk assessment discussion and position papers in 1990, 1991, and 1994. In response to comments made to the 1991 risk assessment report, AQIS decided to defer consideration of the applications to import uncooked chicken and to finalize the assessment of cooked chicken first.

The risk assessment of cooked chicken identified nine diseases that could be of concern. However, it was later concluded that the diseases with quarantine significance were Newcastle disease and infectious bursal disease (IBD). As reflected in the Committee Report, these two diseases pose a threat both to Australian poultry producers and to the Australian native bird population. It is claimed that the native birds in Australia are “immunologically naïve,” which means that they have no history of exposure and consequently no natural immunity to these particular diseases. Because of this, it is believed that they could be highly susceptible.

There is evidence that relatively mild strains of both diseases were found in all Australian states, but AQIS insisted that there were other strains of these diseases that could be more dangerous. These highly virulent strains, which were found in other countries, have not been observed in Australia. AQIS examined heat treatment as a method for inactivating the viruses of concern, reviewing a range of existing studies on the matter and finally endorsing a 1988 study of IBD conducted by Dr. Dennis Alexander, a scientist in the United Kingdom. The study was commissioned originally by General Foods Poultry of New Zealand.

AQIS employed Alexander’s study to determine the time and temperature parameters that it thought would inactivate the virus in cooked chicken. On 7 June 1996, AQIS published a draft protocol that specified the core temperatures and the corresponding required cooking time for chicken to be imported into Australia (Table 6).

²⁶ Australia. Parliament. Senate. Rural and Regional Affairs and Transport Legislation Committee. 1996. *Report on the Importation of Cooked Chicken Meat into Australia*. Canberra. <http://nla.gov.au/nla.cat-vn1409143> (The Committee Report).



Table 6: 1996 AQIS Draft Protocol for Chicken Imports

Temperature (C°)	Heating Time (minutes)
70	95
72	65
74	44
76	30
78	21
80	15

AQIS = Australian Quarantine and Inspection Service.
Source:

In Alexander's study, chicken was heated to 70C° for 90 minutes, resulting in a probability of 0.001 that any virus remained infectious. In the Committee Report, AQIS noted that the proposed cooking protocol was far more stringent than that required by any of the research studies examined. Another study conducted in the same year reported that the IBD virus was killed in chicken nuggets after 1–5 minutes at 80C°. It was also pointed out that Alexander used considerably higher concentrations of virus than would be found in infected chickens or in chickens contaminated after processing.

Despite all these assurances from AQIS, representatives of Australian poultry industries argued that its risk assessment was based on inadequate scientific evidence and that the draft protocol was not stringent enough. Many industry experts believed that time and temperature cooking protocols developed under laboratory conditions could not be replicated in commercial operations. They suggested that heating alone would not be enough to decontaminate infected chicken.

Authorities from Denmark, Thailand, and the United States also voiced their concern that the draft protocol was too stringent and infeasible to apply. Amid the protests from both sides, AQIS commissioned the Central Veterinary Laboratory to conduct two rounds of tests, which were submitted to AQIS in mid-1998. Using different strains of virus, the test results indicated that the IBD virus resisted inactivation from heat at temperatures lower than 74C°.



On 17 August 1998, AQIS issued new quarantine requirements for the importation of cooked chicken based on these test results:

cooked chicken meat/meat product [must be] de-boned and derived from clinically healthy birds which originated in the country of export and from a flock in which Newcastle disease, avian influenza or fowl cholera was not reported. The birds passed ante-mortem and post-mortem inspection under official veterinary supervision.

AQIS also imposed new heating requirements (Table 7):

Table 7: 1998 Amended AQIS Requirements for Chicken Imports

Temperature (C°)	Heating Time (minutes)
74	165
75	158
76	152
77	145
78	138
79	132
80	125

AQIS = Australian Quarantine and Inspection Service.

Source:

Biosecurity Australia continues to conduct periodic import risk analyses to determine what measures are required to manage the risk posed by avian viruses to Australia's imports. The last draft Generic Import Risk Analysis Report for Chicken Meat was circulated to members of the WTO's SPS Committee on 7 July 2006.²⁷ According to the draft report, the unrestricted risk posed by the following disease agents was above Australia's ALOP (appropriate level of protection): highly pathogenic notifiable avian influenza (HPNAI) virus, low pathogenicity notifiable avian influenza (LPNAI) virus, Newcastle disease virus, very virulent infectious bursal disease virus, virulent variant infectious bursal disease virus, *Salmonella pullorum* and *Salmonella gallinarum*, *Salmonella enteritidis*, and multidrug-resistant *Salmonella typhimurium*. AQIS concluded that the 1998 cooking protocol

²⁷ Biosecurity Australia. 2006. *Draft Generic Import Risk Analysis Report for Chicken Meat*. Canberra.



in Table 7 would be enforced until further evidence suggested it was no longer necessary.

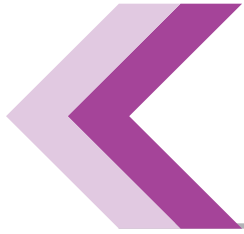
Many of Australia's trading partners questioned the conclusions of the draft Generic Import Risk Analysis Report. The EU maintained that Australia could not claim it did not have certain strains of the IBD virus, citing evidence that those strains had been present in Australia since at least 1968. Since scientific experts believe that genetically diverse IBD virus strains are distributed all over the world, Australia's claim that it has only moderately pathogenic strains is questionable. In addition, the EU objected that the report relied almost exclusively on worst-case scenarios, which meant that it was likely to overestimate the risk from importation of fresh chicken as well as the treatment necessary to inactivate any virus. Similarly, the US Animal and Plant Health Inspection Service was concerned that the disease agents were not clearly identified, that the Australian import restrictions were not supported by sufficient scientific evidence, and that inherent problems with the methodology used in the risk assessment rendered its conclusions questionable. The PRC commented that the heating requirement was too strict and might become a technical barrier for its chicken exports, citing research by Chinese scientists that showed that the IBD virus would be inactivated by heating at 70C° for 30 minutes.

Concluding Remarks

The 1998 cooking protocol is still in force. After 18 years of international efforts to gain market access for chicken in Australia, technically based SPS measures remain the main hurdle to imports.

Exercise 8: Sanitary and Phytosanitary Measures

1. Having read this case study, what policy options would you present to the Thai minister of commerce?
2. Obtain a copy of the WTO Agreement on the Application of Sanitary and Phytosanitary Measures. Given the agreement's provisions and the information presented in this case study, do you see any possible basis for a dispute settlement case against the importing country? If so, on what grounds?
3. How vulnerable to the SPS measures of your trading partners are the food and agricultural products that your country may export? What assessments of the threat has your government made of these matters and in what ways could those assessments be improved?



Reference

Arunpairojkul, K. 1999. *Australia's Quarantine Standards for Cooked Chicken Meat from Thailand*. Monterey Institute of International Studies.