

CAPACITY BUILDING ON “TRADE POLICY ANALYSIS”

Session 4: Multilateral and Preferential Liberalisation

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Structure

- **Multilateralism vrs. regionalism**
- **Effects of overlapping FTAs**
- **Rules of origin and the cost of compliance**
- **Effects to business sector**
- **The loss of tariff revenue and adjustment costs**

Multilateralism vrs. Regionalism

LITERATURE SURVEY

- **Regionalism vrs. Multilateralism:**

- Bagwell, Kyle, and Robert Staiger; 1996. "Regionalism and Multilateral Tariff Cooperation." Northwestern University and University of Wisconsin-Madison. Processed.
- Baldwin, R., 2006, "Managing the Noodle Bowl," CEPR Discussion Paper No. 5561, London.
- Bhagwati, Jagdish; 1991. The World Trading System at Risk. Princeton, N.J.: Princeton University; London: Harvester Wheatsheaf.
- Ethier, Wilfred; 1996b. "Regionalism in a Multilateral World." University of Pennsylvania, Philadelphia.

LITERATURE SURVEY

✖ Domino Theory

- ✖ Baldwin (1995) advanced a domino theory of regionalism that explains the spread of RTAs. He examined the rapid increase of membership of RTA and the slow progress of trade liberalization under General Agreement for Trade and Tariffs. He observed that the cumbersome GATT negotiations are not at fault , rather the creation of US – Mexico free trade and the Single Market in the EC started a domino effect that led to new waves of integration.
- ✖ Baldwin and Jaimovich (2010) presented a new model of the domino effect to generate an empirical index of how “contagious” FTAs are with respect to third nations. They tested their contagion hypothesis together with alternative specifications of interdependence and other political, economical and geographical determinants of FTA formation and observed that contagion is present in their data and is robust to various econometric specifications and samples.

LITERATURE SURVEY

Welfare effects of FTAs:

✗ Viner (1951) : Customs Union Issue – welfare effects

- ✗ Lipsey (1957) and Summers (1991) argued that if the member countries are geographically proximate and have very high trade dependence among each other, they were “Natural Trading Partners” and the RTA would be largely trade creating.
- ✗ Krugman (1991) pointed out that the beneficial effect of a regional trade agreement will depend on whether there is enough ‘inherent regionalism’ in the transport costs between the member countries of the RTA.
- ✗ Summers (1991) opined that regional trade agreements are likely to be more welfare enhancing because according to them, trade diversion is only likely to have a benign impact on the member countries.
- ✗ Krugman (1991) pointed out that the beneficial effect of a regional trade agreement will depend on whether there is enough ‘inherent regionalism’ in the transport costs between the member countries of the RTA.
- ✗ Bhagwati (1995), Panagariya (1996) and Bhagwati and Panagariya (1996) contested these views. According to them, trade diversion is more likely to dominate trade creation in most situations.
- ✗ Estevadeordal et.al (2005) have examined empirically the effects of regionalism on external trade liberalization using industry-level data on applied MFN tariffs and bilateral preferences for ten Latin American countries from 1989-2001.

LITERATURE SURVEY

Quantifying NTBs in FTAs

- ✗ Bellanawithana et al (2009) in their study have estimated the impact of NTMs on agricultural exports from both developed and developing countries while focusing on 40 countries.
- ✗ Katti (1995, 2000) has suggested that the trade barriers, tariffs as well as non-tariffs between SAARC countries should be removed rapidly. SAPTA could be used to identify items that should be freely traded between the countries.
- ✗ Katti (2000) has examined the costs associated with low level of intra-regional trade in SAARC. She has observed that non-cooperation in trade among the SAARC countries results in loss of revenue due to the availability of the same commodities from distant trading partners at higher prices and recommended that if SAARC members buy these commodities from within the region they will gain significantly.
- ✗ Chaisse, Chakraborty, and Nag (2008) examined India's regional economic integration approach to identify the major determinants behind the shift in the country's interest and the policy implications of this change.

LITERATURE SURVEY

Rules of Origin

- ✘ Arguments that restrictive ROO could undermine the utility of FTA, due to cumbersome conditions of ROO, were put forth by Grossman (1981). It was argued that the exporters may choose to export the goods under MFN tariff rather than seeking preferential tariff treatment.
- ✘ The implications of alternative ROOs in the long and short run have been dealt with by Krishna and Krueger (1995). According to them if a domestic input is a perfect substitute for the imported input, and there is a foreign monopolist, making a binding cost-based definition of origin, more restrictive reduces output.
- ✘ It has also been argued that ROO are themselves hidden protection (Ju *et al.*, 1998) as they create what looks like tariffs on imported intermediate inputs and affect the price of domestically made inputs.
- ✘ Panchamukhi and Das (1999) developed model to look at the trade deflection.
- ✘ ROO raise production costs and create administrative costs has been found by Anson *et al.* (2003). They argue that in the case of the recent wave of North–South PTAs, the presence of ROO virtually limits the market access that these PTAs confer to the Southern partners.

Effects of PTAs

- Four main effects
 - **Trade creation:** Import from partner what was previously produced at home
 - **Trade diversion:** Import from partner what was previously imported from 3rd country
 - **Preference erosion:** Loss of a preference when a previous partner forms FTA with a 3rd country
 - **Trade reversion:** Import from new partner what had been diverted to a partner in prior FTA (Deardorff, 2014)

Discussion Point: What is the difference between WTO negotiations and RTA negotiations



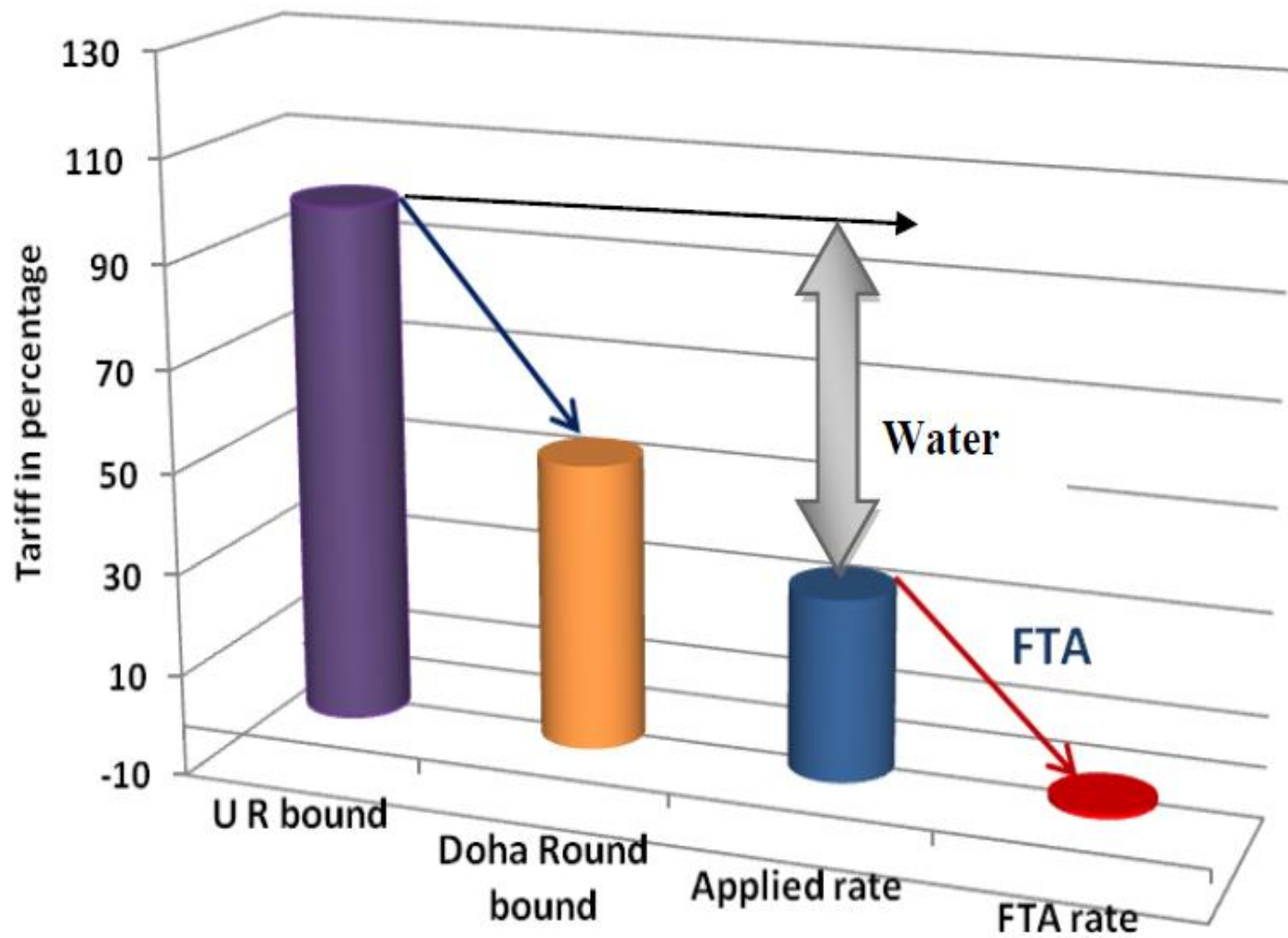
Comparison

WTO

- **Tariff – bound**
- **Services**
- **Trade Defence Measures**
- **Subsidies**
- **Agriculture**
- **Disputes**
- **S&D**
- **Technical assistance**
- **AfT**
- **Trade Facilitation**
- **Government Procurement**
- **Investments**
- **Competition Policy**

RTA

- **Tariff – applied**
- **Services**
- **Trade Defence Measures –**
 - **Only Preferential SG**
- **Subsidies - no**
- **Agriculture – DS and EC no**
- **Disputes**
- **Investments**
- **Trade Facilitation**
- **S&D**
- **Technical Assistance**
- **MRAs**
- **Environment**
- **Labour**
- **Singapore Issues**

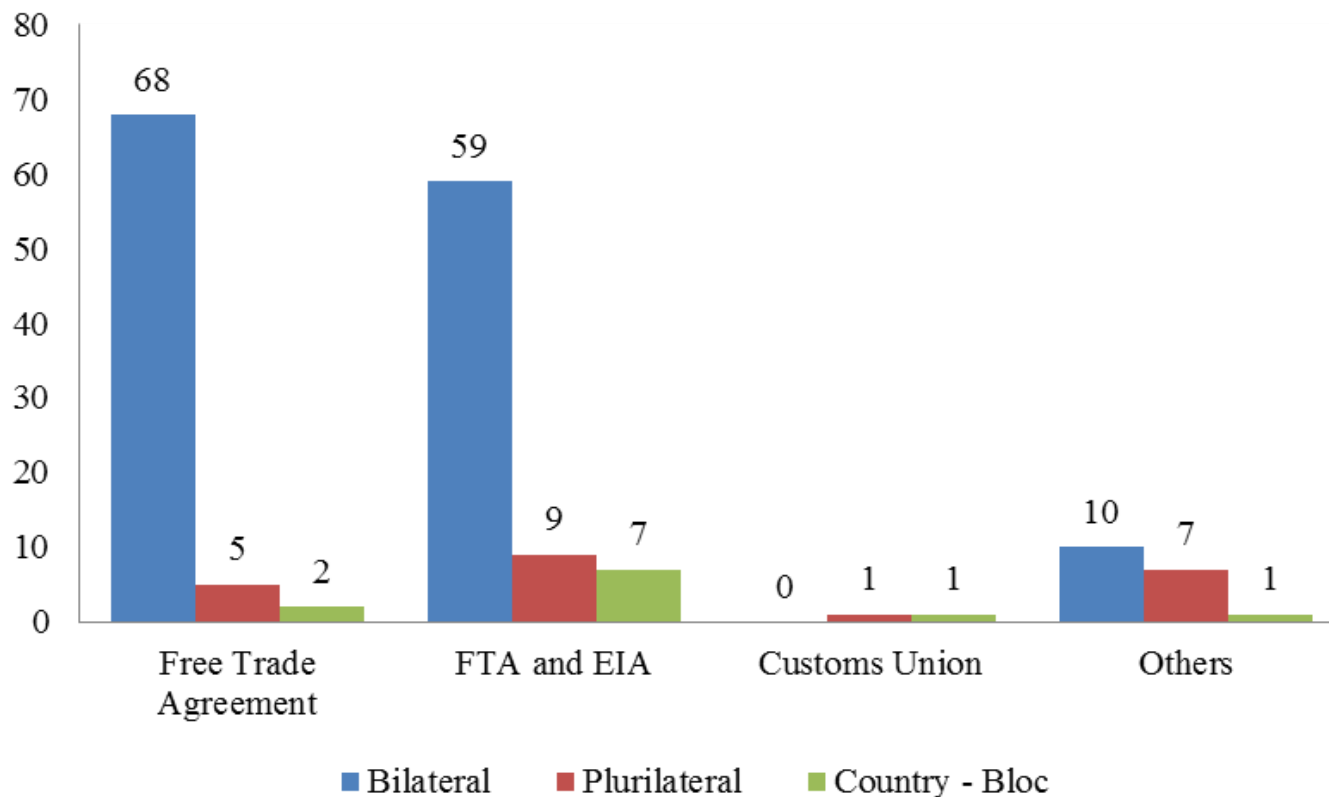


Asia-Pacific experiences

Asia-Pacific RTAs

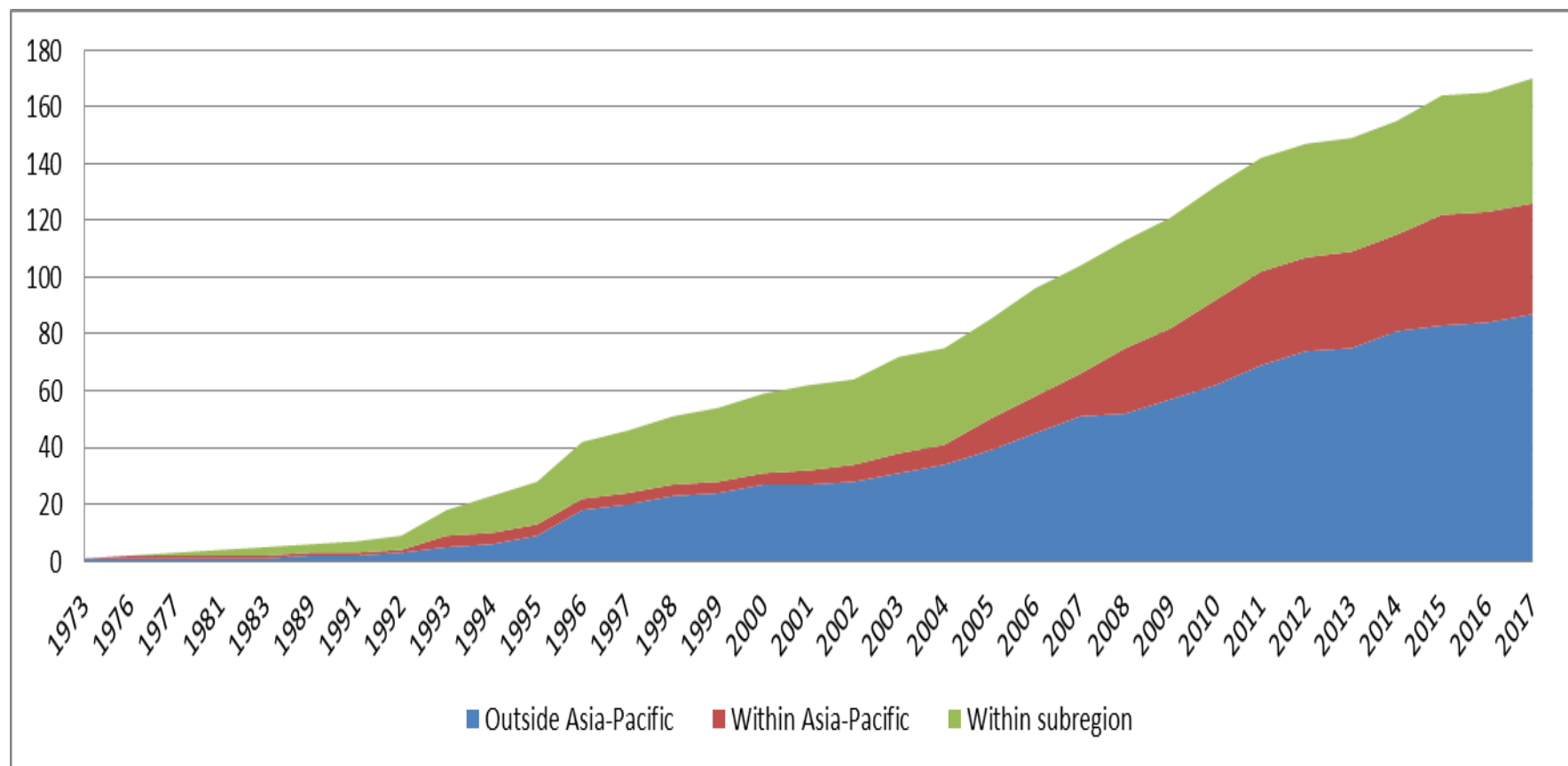
- As of July 2017, there were 257 RTAs in Asia-Pacific region which are either in force, signed or being negotiated.
- Globally 274 “physical” RTAs in force, and 170 (66%) are from AP
- 15 - signed but not implemented
- 72 - under different stages of negotiations.
- 88.2% - cover FTAs, and FTAs and EIAs (having equal share now).
- 10.6% of the PTAs in force are PSAs
- Only 1.2% of agreements are classified as customs unions.

PTAs in force, by type and scope (as of 31 July 2017)



Source: ESCAP calculation based on APTIAD data

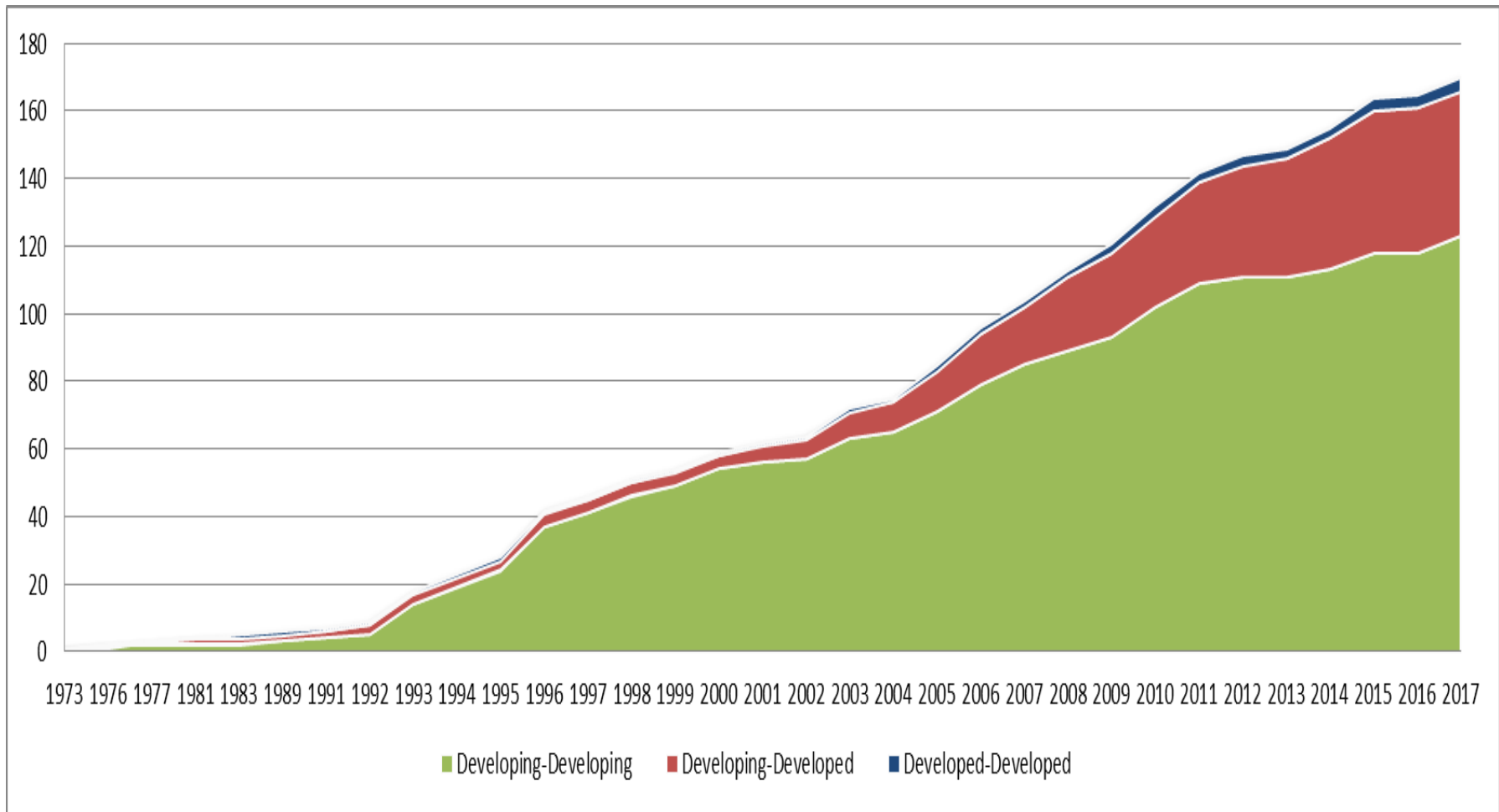
Cumulative number of PTAs (notified and non-notified to WTO) put into force by Asia-Pacific economies, by geographical region, 1971-July 2017)



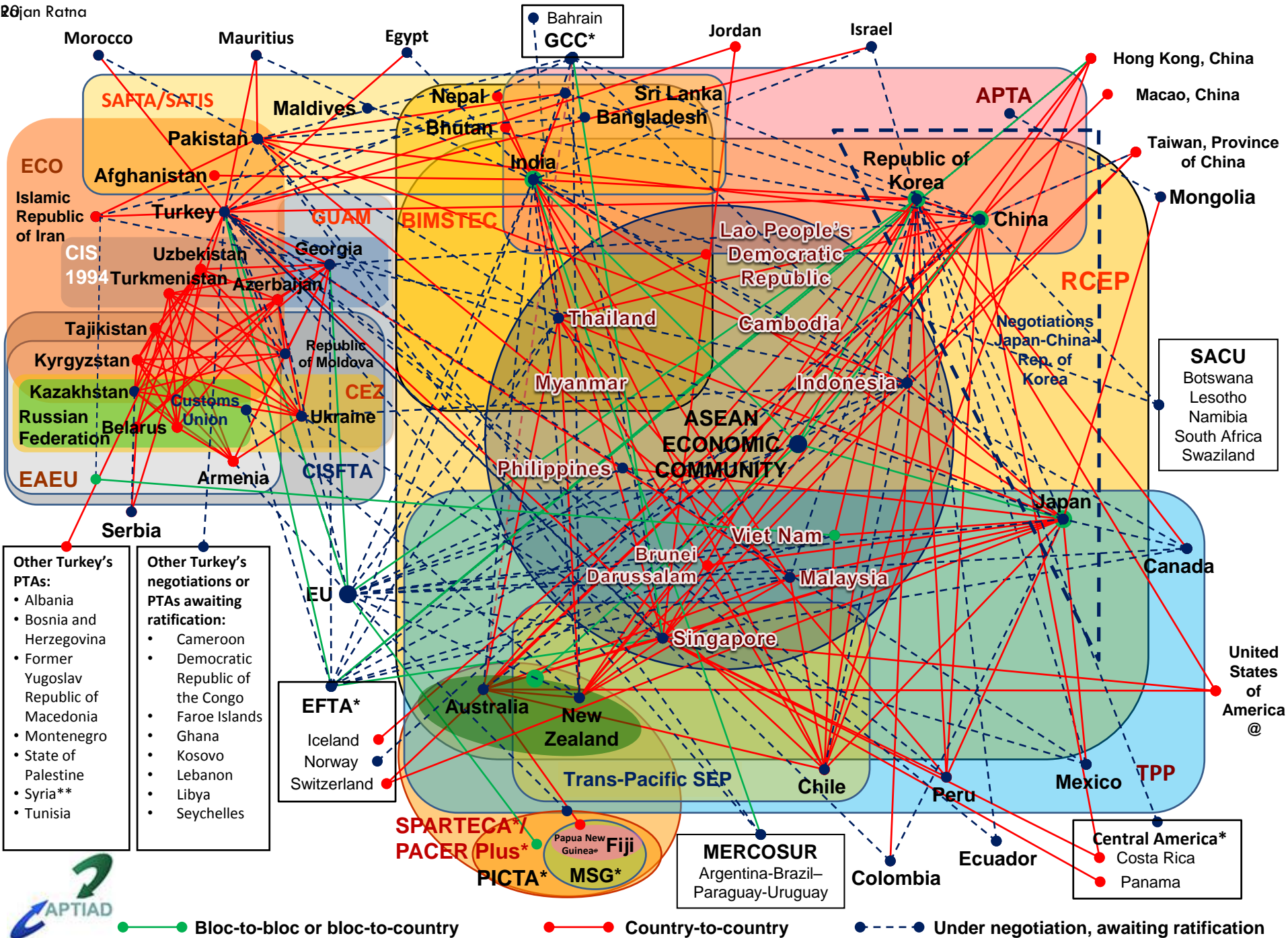
•Asia-Pacific members of ESCAP are grouped into five sub-regions: East and North-East Asia (ENEA); North and Central Asia (NCA); South-East Asia (SEA); South and South-West Asia (SSWA); and the Pacific.

•source: ESCAP calculation based on APTIAD data

Cumulative number of PTAs (notified and non-notified to WTO) put into force by Asia-Pacific economies, by level of development of parties, 1971-July 2017



Source: ESCAP calculation based on APTIAD data



Burden of the noodle bowls

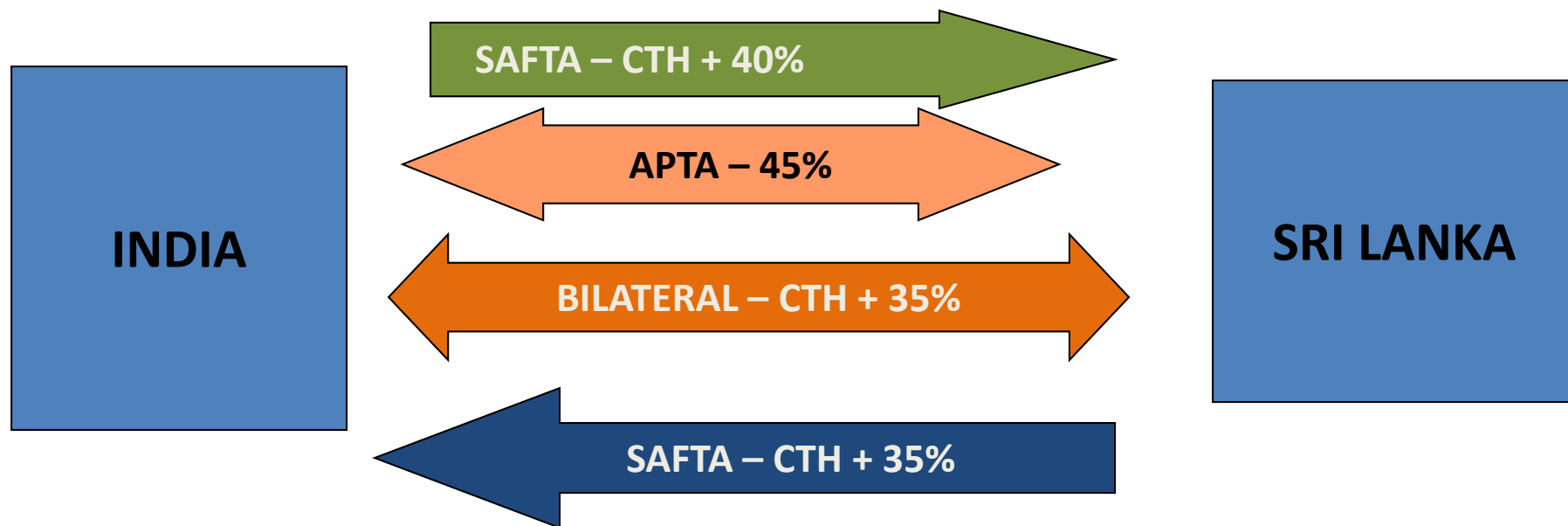
- **Overlapping and uncoordinated rules**
- **The complex rules and variable tariffs increase transaction costs**
- **Deter the use of FTA preference , particularly by small- and medium-sized enterprises (SMEs)**
- **One way to solve the problem is having an over-arching set of free-trade principles.**

Rules of origin and the cost of compliance

Rules of Origin

- Rules of origin are criteria used to determine the “nationality” of a product i.e. where the product was ‘made’.
- A product’s raw materials or components might come from a number of countries, but customs officials must determine the product’s origin to decide how to treat it, including what tariff to charge, as the product enters their jurisdiction.
- Issue of origin is also important in determining the anti-dumping or safeguard duties, regulate quotas and capturing trade statistics.
- Since the preferential treatment provided for in a FTA is normally granted only to products originating from members to that FTA, rules of origin are therefore an important part of any FTA.

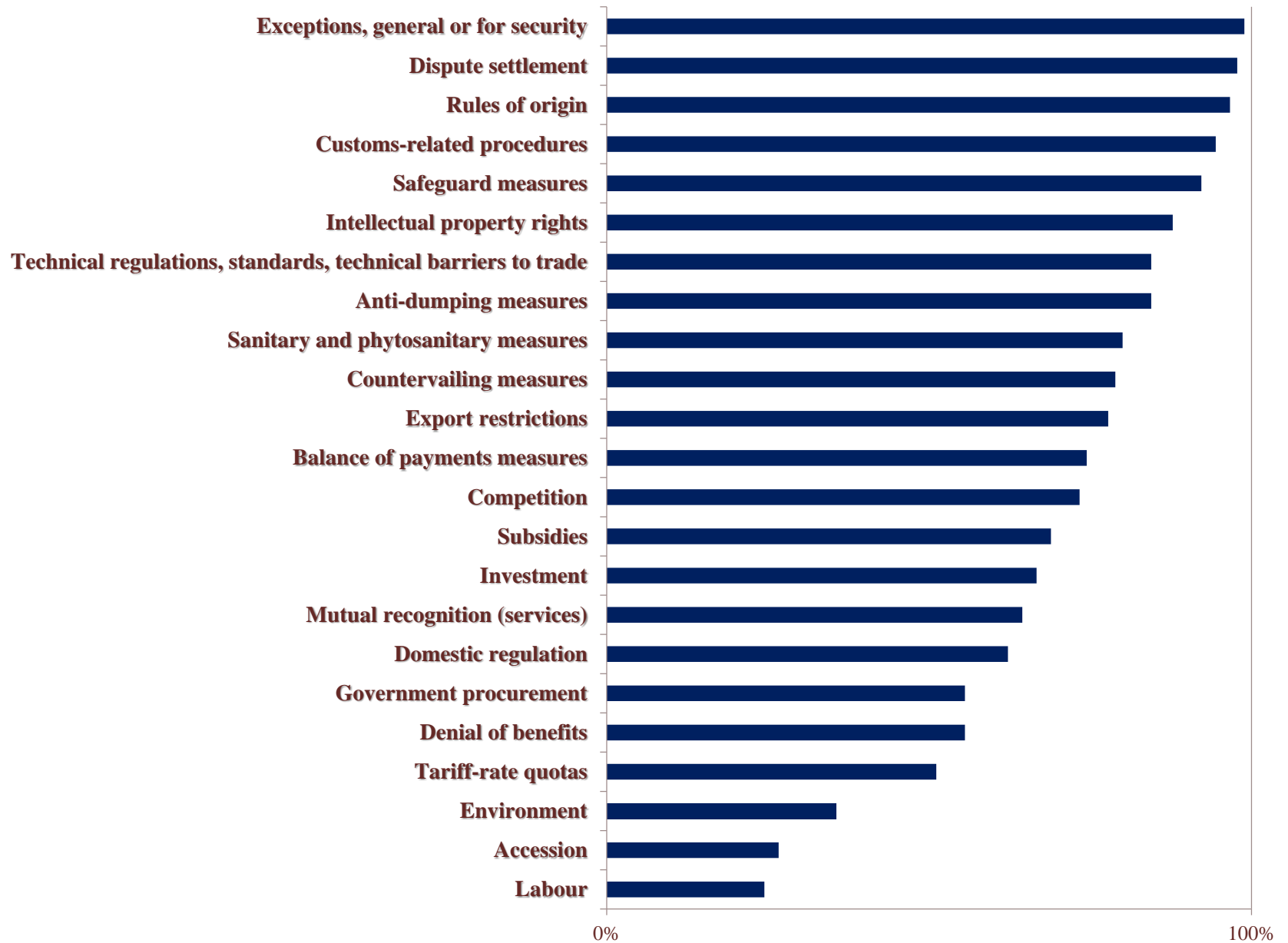
Case study – overlapping RoO



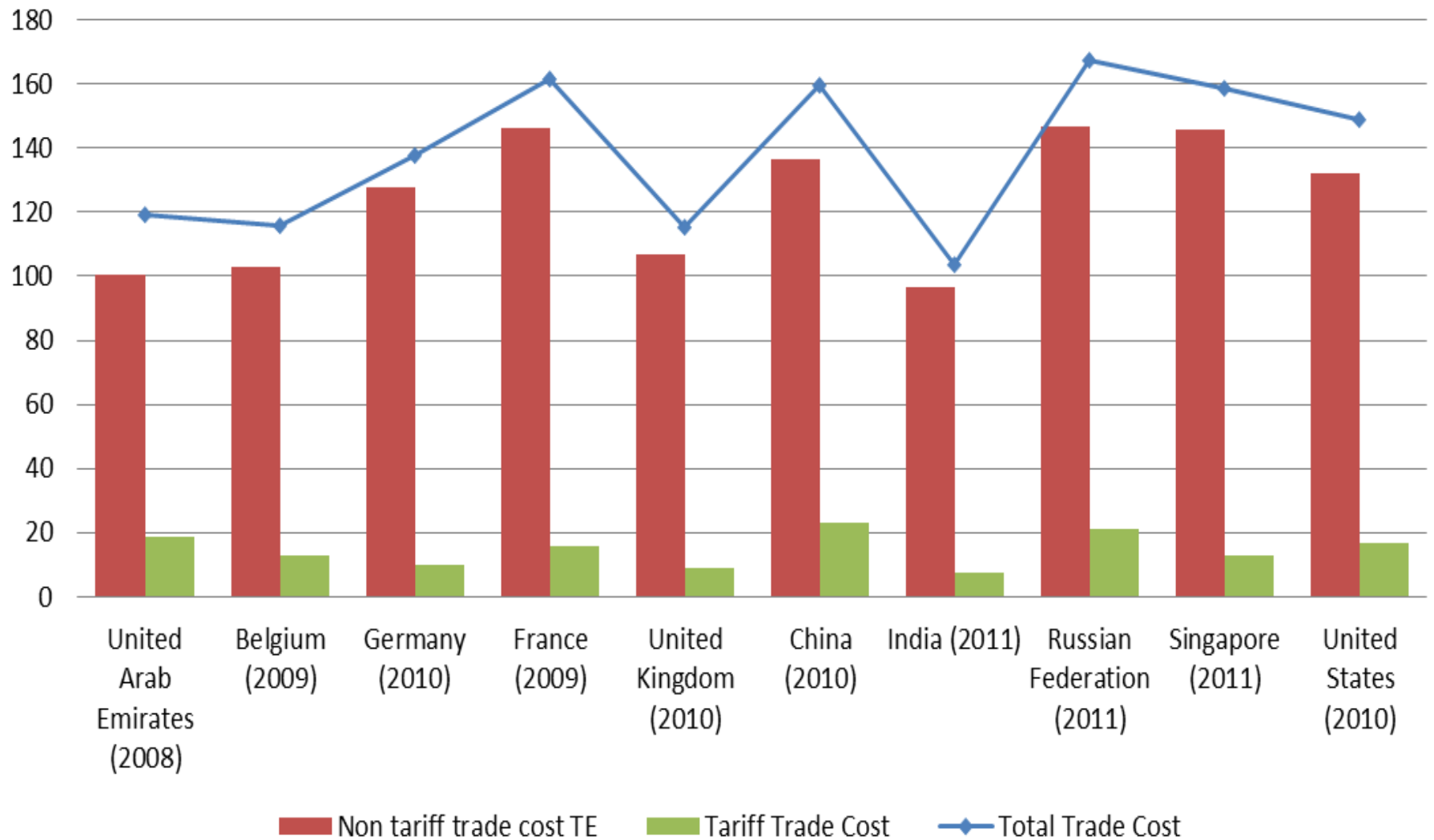
- Sri Lankan exporter enjoys benefits of harmonization for exports to India under the bilateral agreement as well as SAFTA as the RoO is same. Have disadvantage for exporting under APTA.
- India exporter has to meet different RoO to export to Sri Lanka under all the agreements, i.e. APTA, SAFTA and bilateral.
- Due to different thresholds in value added, its sourcing opportunities and strategic investment decisions could be affected.

Present rtas: Issues covered

Goods	Services	Non-Tariff Barriers	Investment
Competition	Labour Mobility	Environment	Labour standards
Government Procurement	E-commerce	Intellectual Property Rights	Dispute Settlement
Customs cooperation/ Trade Facilitation	MRAs	Technical Assistance	Areas of cooperation

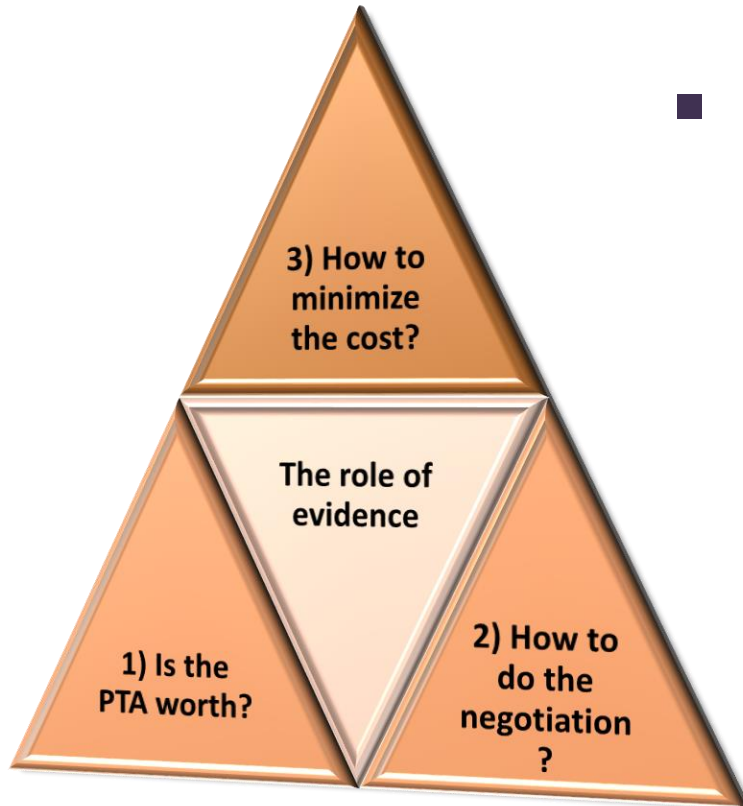


Sri Lanka Bilateral Trade Cost



How to minimize the cost?

- Revenue cost
- Adjustment cost



Mitigating revenue costs

- **Revenue loss an unavoidable effect of cutting tariffs**
 - An economic model should help estimate the scale
- **Falling average MFN duties have already reduced the impact**
 - What is the tariff share of Government's revenues?
- **Mitigation may not be necessary but...**
 - Progressive implementation will discount revenue losses
- **Alternative revenue sources should be considered in the context of the overall PTA strategy**
 - Moving from a production to consumption tax base
 - Restructuring and re-balancing existing excise, stamp-duties
- **Comprehensive agreements: cross cutting benefits (eg Singapore – MFN zero duty)**

Minimizing trade adjustment costs

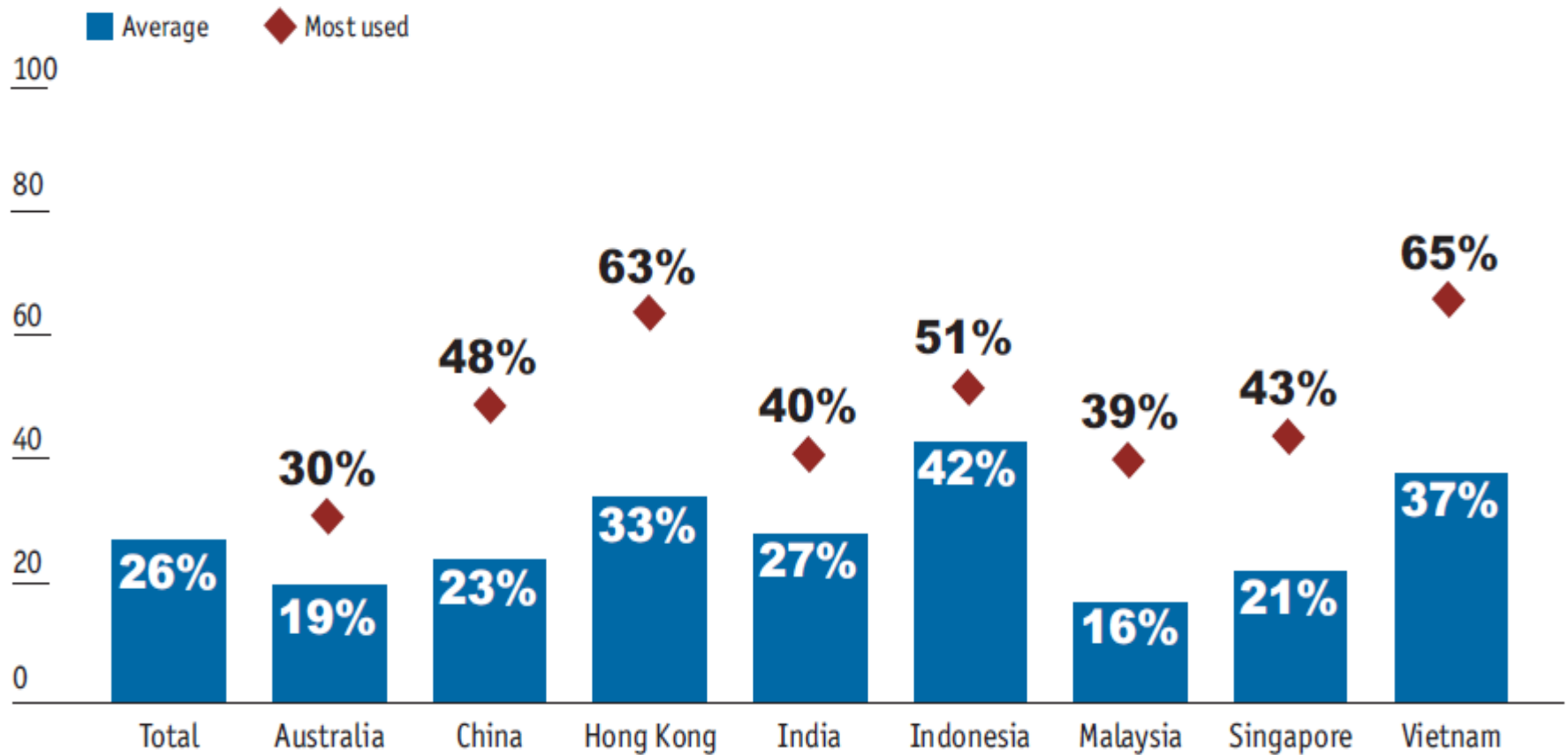
- **Economic specialization is not a “free lunch”**
 - Employment and investment returns industries whose assistance is cut as part of the PTA (a tariff, a services barrier) may fall
 - Freeing these resources for other more valuable uses
- **To help firms, households minimize the impact**
 - Involve stakeholders early in a transparent process with clearly defined goals and scope (sector coverage)
 - Investors, workers who anticipate changes will adapt more quickly and at least cost
 - Provide for and publish progressive liberalization schedules
 - Use temporary safeguards
 - In combination with adjustment, retraining assistance

Post Implementation Monitoring

- Implementation stage – awareness?
- Do you assess losses and benefits after implementation or get busy in next negotiation?
- Capturing of preferential trade data?
- Utilization of FTAs?
- Learn lesson from one FTA to another.... Building block or negotiate on your own ‘gut feeling’?

Usage of FTAs signed by named country

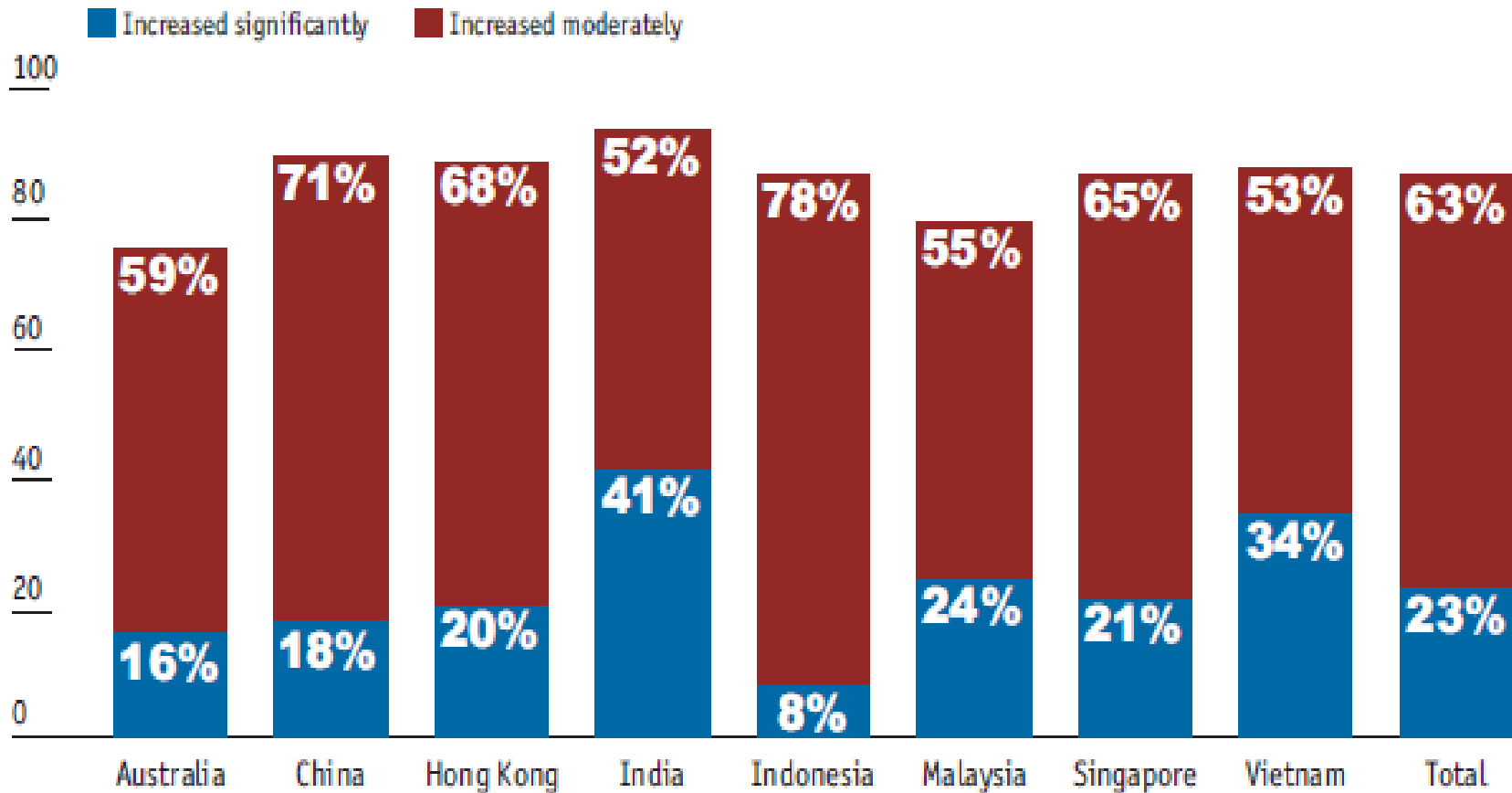
(% respondents)



Source: EIU Report “FTAS: fantastic, fine or futile?”

Firms reporting increase in exports as a result of FTAs used

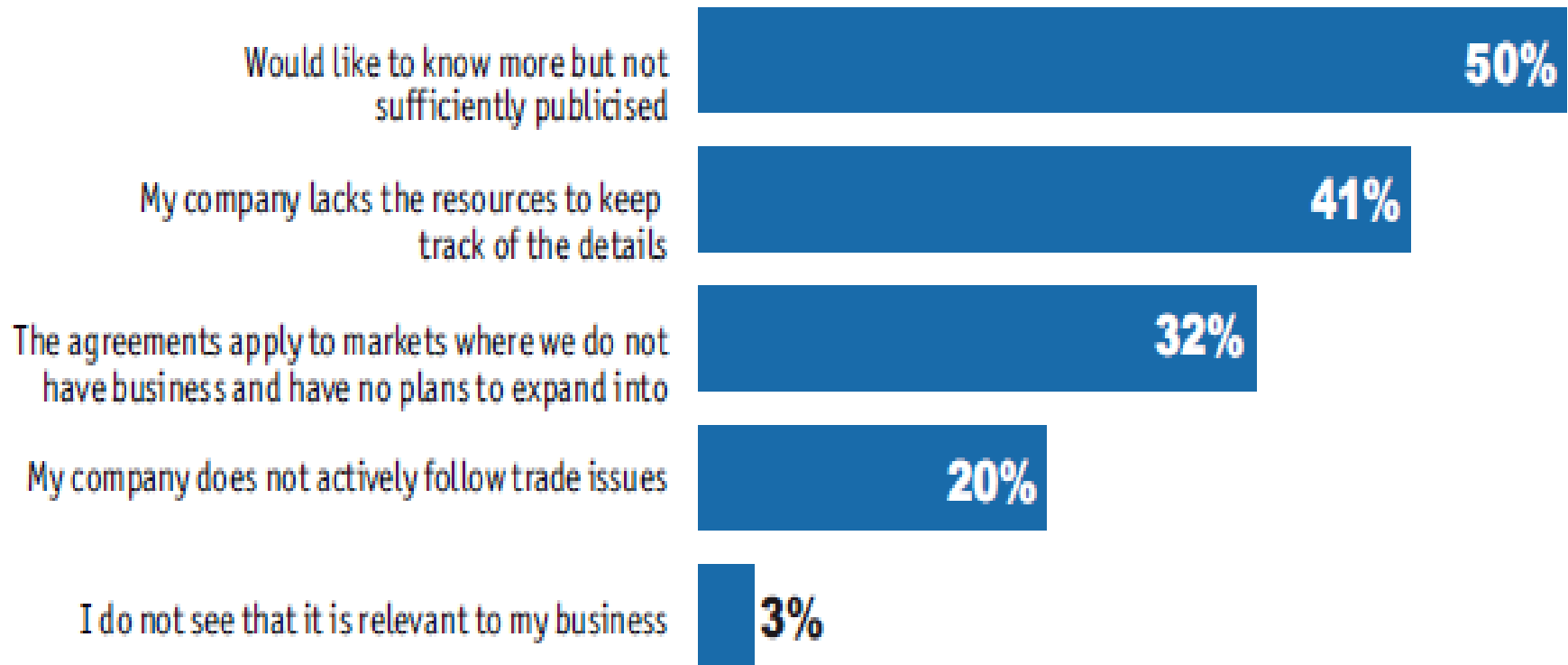
(% respondents)



Source: EIU Report "FTAS: fantastic, fine or futile?"

Reasons for limited understanding of FTAs

(% respondents)



NB: Totals do not add to 100 since respondents could select more than one answer

Source: EIU Report “FTAs: fantastic, fine or futile?”

THANK YOU