Regionalism vs. Multilateralism?

26

Dominique van der Mensbrugghe, Richard Newfarmer and Martha Denisse Pierola

Though few would argue that regionalism is an alternative to multilateralism, the rapid proliferation of regional trade arrangements (RTAs)[1] contrasts vividly with the slow pace of multilateral liberalization. It is worthwhile, therefore, to assess the projected benefits of both approaches to get a sense of what would happen if the Doha Round should whither on the vine. And, as developing countries pursue RTAs, it is worth exploring what types of arrangements—and under what circumstances—produce the greatest benefits.[2]

The major conclusion of the simulations reported here is that developing countries would be worse off under a complex system of overlapping bilateral and regional agreements: they would suffer losses averaging 0.4 percent in real income (and 1 percent for low-income countries alone). When the simulations are applied to selected North–South and South–South agreements, the gains obtained are significantly lower than those that could be obtained from a multilateral arrangement. All in all, multilateralism produces the most development friendly outcomes.

The prospect of obtaining first-mover advantages by signing bilateral trade agreements with major trading partners before others can do so has been one of the main reasons for preferring regionalism over multilateralism. But the days of first-mover advantages are probably over. The proliferation of RTAs around the world has already eliminated the possibility of obtaining the quick gains countries sought from regional deals. In addition, the profusion of RTAs is leading to the formation of trading blocs, a scenario in which weak economies can easily be marginalized.

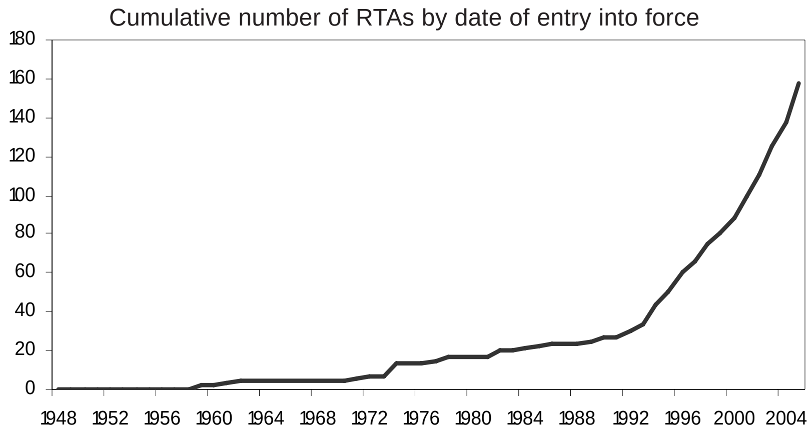
The landscape of national policy strategies: current trends

Since the early 1990s there has been a significant acceleration in the number of RTAs signed around the world. As of January 2005, 312 RTAs had been notified to the GATT/WTO, 170 of which are currently in force (Crawford and Fiorentino 2005). The increase in the number of RTAs was pronounced after 1993 (figure 1).

Crawford and Fiorentino (2005) identified the following trends in the formation of RTAs:

- The formation of RTAs is a phenomenon observed across countries. In fact, regionalism is, for an increasing number of countries, the main element of their trade policy.

Figure 1. The number of RTAs has strongly increased



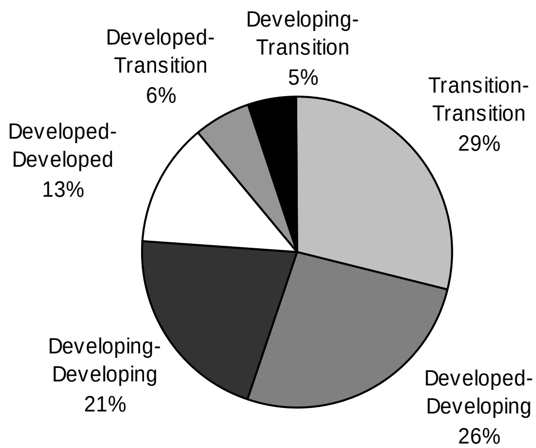
Note: We use the term RTA to refer to agreements signed either by pairs of trading partners or by a group of countries.
Source: World Trade Organization (WTO) (http://www.wto.org/english/tratop_e//region_e/eif_e.xls).

- Today's RTAs are broader in coverage than in the past. In that sense, they are becoming more complex. They contain provisions applicable to subjects that go beyond those negotiated at the level of the WTO—among them investment, competition, environment, and labor, among other topics.
- Reciprocal preferential North–South agreements are increasing in number. There is also a significant emergence of South–South partnerships.
- RTAs are expanding and consolidating across regions and within continents. Most countries today belong to at least one RTA. Indeed, a "spaghetti bowl" of multiple and overlapping RTAs around the globe has emerged.[3]

As far as typology of RTAs is concerned, Free Trade Agreements (FTAs) are the most common type (84 percent at all RTAs in force vs. 8 percent for Custom Unions and 8 percent for Partial Scope Agreements). As for the configuration of RTAs, bilateral agreements account for more than 75 percent of all RTAs notified and in force, and for almost 90 percent of those under negotiation.

Most RTAs are between transition economies (29 percent), followed by North–South agreements (26 percent) and South–South agreements (21 percent) (figure 2). Among the North–South agreements, those involving the states of the European Union and those of the European Free Trade Association (EFTA) together account

Figure 2. RTAs: Everybody is doing it



Note: Notified RTAs in goods by type of partner (as of February 2005).
Source: Crawford and Fiorentino (2005).

for more than half. The number of South–South agreements has increased significantly in recent years. Trade within RTAs covered a third of world trade in 2002; however, if MFN rates of zero are excluded, the RTA share declines to 20 percent (World Bank 2005).

Why have countries favored bilateral or regional trade strategies over multilateralism? There are three major reasons. First, countries may hope to maximize their benefits through so-called first-mover advantages. That is, they focus on the gains they could obtain from signing an agreement with a large trading partner before competing countries do so. Or they may seek to preempt other countries, by denying them first-mover advantages. The validity of this argument will be analyzed in the next section. Second, countries may seek to guarantee permanent access to particular markets. Signing an agreement bilaterally or regionally may be the quickest and easiest way of achieving that goal. Third, a bilateral agreement may be used as leverage to facilitate domestic reforms, particularly in areas that are not dealt with multilaterally, such as investment, competition, and environmental and labor standards.

Is regionalism better than multilateralism? Results from simulations

In this section we evaluate the gains and losses that a country might expect to realize by pursuing a bilateral or regional trade strategy instead of multilateralism. The methodology used in our simulations is based on the database of the Global

Trade Analysis Project (GTAP), headquartered at Purdue University. The GTAP database is widely used to assess the global, regional, and country implications of alternative trade liberalization scenarios. The database used to obtain the results has 2001 as its base year and takes preferential trade access into account.

To assess the relative impacts of various RTAs, we performed a benchmark simulation on a global reform scenario in which all merchandise trade distortions, domestic distortions in agriculture,[4] and import quotas in the textile and clothing sectors are removed. Services reform is left out for lack of sufficient data. Under this scenario, the ultimate outcome of successful multilateralism, global gains in 2015 amount to $263 billion, or an increase of 0.8 percent in baseline income.[5]

In addition to the benchmark, three scenarios were simulated:

- All developing countries sign a bilateral agreement with Quad-plus countries: Canada, European Union, Japan, and the United States, plus Australia and New Zealand.
- Developing countries minus large countries—Brazil, China, and India—sign a bilateral agreement with Quad-plus countries.
- Individual developing countries or regions sign an a bilateral agreement with the Quad-plus countries, while other developing countries do not.[6]

The results from the first simulation show that, as a group, developing countries are substantially worse off than with a multilateral agreement.[7] Instead of gaining $109 billion from global reform, they lose $22 billion relative to a baseline scenario, with no change in protection (Table 1).[8] Looking at countries separately, the results are similar. Only a handful of developing countries—for example, Brazil and China—would gain more from a system of bilateral agreements. High-income countries, too, would generally lose from this set of bilateral agreements compared with global reform, yet the impact is not uniform.[9] Both, the United States and the European Union (the most aggressive advocates of bilateral deals) would appear to benefit more from pursuing bilateral agreements with all developing countries than from global reform ($7 and $27 billion respectively). Although they would have to open up their agricultural markets to some extent (assuming exemptions were disallowed), they would not have to dismantle domestic support programs. In agriculture, the Quad-plus agricultural exporters—Australia, Canada, and New Zealand—would prefer multilateralism, because the gains from access to European, Japanese, and American markets and from the dismantling of distortionary agricultural support programs would be highly beneficial for their farmers.

In the second simulation, many developing regions still lose in absolute terms compared with the baseline scenario. They also lose relative to the benchmark global reform scenario, although in some cases (Indonesia, rest of Latin America and Caribbean, and rest of world), the gains from bilateral agreements approach those in the global reform scenario. The gains for the high-income countries are

Table 1. Comparison of bilateral scenarios to global trade reform

Change in real income in 2015 compared to baseline

	Global merchandise trade reform	All developing sign bilateral with Quad-plus	All developing (minus large countries) sign bilateral with Quad-plus
	(1)	(2)	(3)
		US$ billions	
High-income countries	154.4	133.6	46.9
Low-income countries	16.6	–19.0	–1.9
Middle-income countries	92.2	–2.6	–4.7
All developing countries	108.8	–21.5	–6.6
World total	263.2	112.0	40.3
		Percent	
High-income countries	0.6	0.5	0.2
Low-income countries	0.9	–1.0	–0.1
Middle-income countries	1.2	0.0	–0.1
All developing countries	1.2	–0.2	–0.1
World total	0.8	0.3	0.1

Source: World Bank simulations.

significantly lower when the large developing countries are excluded—not surprising given their weight in global trade with the Quad countries. Finally, the impact on the excluded countries is mixed: Brazil and China, which would gain according to the results obtained from the first simulation, lose when excluded. The other excluded regions—India, Mexico, Russian Federation, rest of East Asia, and rest of South Asia—would see a dampening of their losses.

With the results from the third simulation, in which each developing country or region signs an agreement with the Quad-plus countries while no other country or region does so, we address the question of first-mover advantages, one of the chief reasons for preferring a bilateral or regional strategy over a multilateral one. The results from the simulation support the notion of first-mover gains: about half of the developing regions would be better off with a bilateral agreement than with a global agreement (Appendix 1).[10] In some cases, however, this conclusion does not hold: the rest of the Sub-Saharan Africa region could suffer losses from a bilateral agreement with the Quad because this region already has relatively free access to the Quad markets. Permitting greater imports from the Quad would worsen their terms of trade and negate gains from the bilateral agreement. The Russian Federation and the Middle East are dependent on energy exports, which face low tariffs in industrial countries (even if energy is heavily taxed), so these regions have little to gain from additional market access.

The chief reservation about the third simulation, of course, is that it is starkly counterfactual. The idea that a single developing country or region would be able to sign an exclusive agreement with the Quad countries without competition from other developing countries is unrealistic. The increase in the number of agreements over the last decade means that a sizable portion of any first-mover advantage already has been eroded.

Conclusions

Developing countries could gain an (unweighted) average of 1.7 percent in real income from a global agreement. However, if all developing countries signed bilateral agreements with the Quad, creating a complex system of bilateral and regional agreements, developing countries would suffer losses averaging 0.4 percent (1 percent for the low-income countries). Virtually all developing countries would be worse off than at present,

While some individual developing countries might have gained from entering exclusive agreements with Quad countries, the proliferation of RTAs probably has already eliminated that first-mover advantage.

In general terms, multilateralism is the most development friendly outcome.

This conclusion is highlighted if we extend the simulation to several hypothetical North–South and South–South regional trading blocks (figures 3 and 4).[11] Several of these (a broad free trade region in East Asia, for example) offer significant gains, but not as great as the gains from global merchandise trade reform. The difference can be much more pronounced in the case of South–South agreements, where the multilateral alternative clearly dominates the regional one. Forming North–South regional blocks individually always produces higher gains than forming them simultaneously.

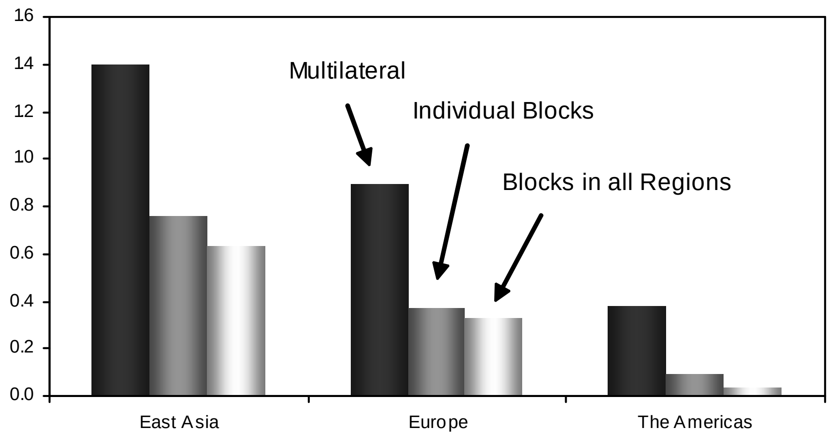
The potential benefits of RTAs are now well understood. They can be easier to negotiate because they involve fewer partners; they can help consolidate a domestic reform agenda; they usually extend beyond the reduction of tariffs to include other cross-border issues; and they can confer political benefits, such as strengthening regional relations.

Also well understood are the characteristics of the most successful and sustainable RTAs:

- Low external MFN tariffs
- Few sectoral and product exemptions
- Nonrestrictive rules-of-origin tests that build toward a framework common to many agreements
- Measures to facilitate trade
- Large ex post markets
- Measures to promote new cross-border competition, particularly in services

Figure 3. Global reform dominates North–South

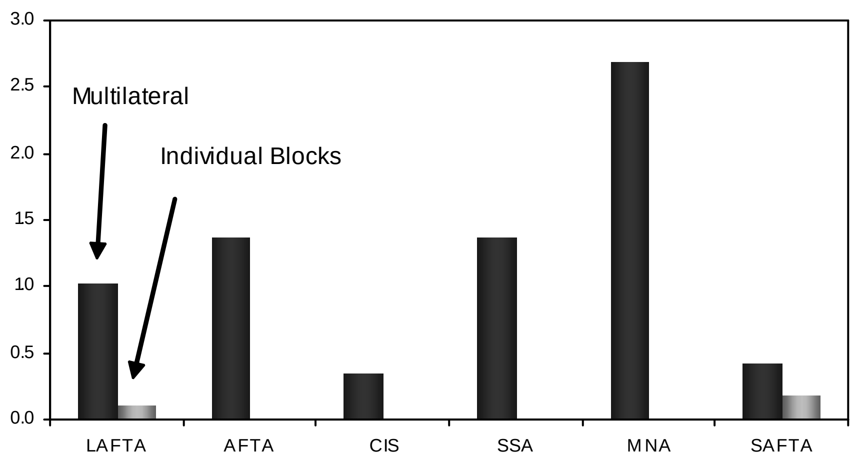
Change in real income in 2015 relative to the baseline in percent



Note: *Multilatera* refers to the global merchandise trade reform scenario, *Individual Blocks* is when the North/South regional blocks are formed individually and *Block in all Regions*is when the North/South regional blocks are implemented simultaneously.
Source: World Bank simulations

Figure 4. …and South–South agreements

Change in real income in 2015 relative to the baseline in percent



Note: *Multilateral* refers to the global merchandise trade reform scenario, and *Individual Blocks* is when the South/South regional blocks are formed in isolation.
Source: World Bank simulations.

- Rules governing investment and intellectual property that are appropriate to the development context.

The simulations reported here confirm the contention that to create trade and exert the fewest possible exclusionary effects, regional agreements must have low MFN tariffs and mild border barriers, so their impact gets closer to that of a global reform scenario. The best way to ensure that regional agreements have these characteristics is to accelerate progress on the Doha Round and to fill in the blanks of the July 2004 Framework Agreement with multilateral reductions in protection, especially for products produced by the world's poor.

Notes

1. We use the term RTA to refer to agreements signed eiether by pairs of trading partners or by a group of countries.
2. Note based on chapter 6 in Global Economic Prospects 2005.
3. Of all the WTO member countries, only Mongolia is not engaged in an RTA. Eleven nonmembers of WTO are not party to an RTA.
4. The distortions included are input and output subsidies, direct payments, and export subsidies.
5. The results described herein were produced using the GTAP V6.01 database. Using the most recent version of the database, the gains from global merchandise trade reform amount to $287 billion, but these minor differences in outcomes have little bearing on the overall findings.
6. Under the bilateral agreements, domestic distortions are not removed because they are not specific to any individual trading partner.
7. All scenarios overstate bilateral and multilateral effects because they assume that no sectors are exempt and that rules of origin are not restrictive.
8. A detailed table of effects is provided as Appendix 1.
9. Note that some of the high-income Asian countries—for example Republic of Korea and Singapore—are excluded from the bilateral agreements and therefore tend to lose, in part, because of trade diversion.
10. According to this scenario, the winners (relative to global liberalization) are: China, Indonesia, Mexico, Southern African Customs Union, rest of South Asia, and EU accession countries. Among the losers: Brazil, India, Russian Federation, Vietnam, rest of East Asia, rest of Europe and Central Asia, Middle East and North Africa, rest of Sub-Saharan Africa, and rest of Latin America and the Caribbean.
11. The three North–South agreements include a broad East Asia region that encompasses both the high-income and developing countries, the FTAA in the Western Hemisphere, and a broad free trade area centered on the European Union, including the new accession countries and extending to the Middle East and North Africa and Sub-Saharan Africa. The South–South agreements include a Latin American–wide RTA (LAFTA), a developing East Asian RTA (AFTA), a Europe and Central Asia RTA that excludes the EU accession countries (CIS), a Sub-Saharan African RTA (SSA), the Middle East and North Africa (MNA), and a South Asian RTA (SAFTA).

Further reading

Crawford, Jo-Ann, and Roberto V. Fiorentino. 2005. "The Changing Landscape of Regional Trade Agreements." WTO Discussion Paper 8. World Trade Organization, Geneva.

World Bank. 2005. *Global Economic Prospects: Trade Regionalism, and Development* 2005. Washington, DC: World Bank.

Appendix 1. Comparison of bilateral agreements with global trade reform

Change in real income in 2015 compared to baseline

	Billions of dollars				Percent			
	Global merchandise trade reform	**Bilateral agreements between Quad-plus and all developing countries**	**Bilateral agreements between Quad-plus and developing countries excluding large countries**	**Bilateral agreements between Quad-plus and each developing country**	**Global merchandise trade reform**	**Bilateral agreements between Quad-plus and all developing countries**	**Bilateral agreements between Quad-plus and developing countries excluding large countries**	**Bilateral agreements between Quad-plus and each developing country**
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Australia, Canada, and New Zealand	8.4	6.0	0.5		0.7	0.5	0.0	
United States	24.9	32.3	10.7		0.2	0.3	0.1	
European Union with EFTA	55.0	82.4	33.6		0.7	1.1	0.4	
Japan	29.7	25.0	4.8		0.9	0.8	0.1	
Korea and Taiwan (China)	26.4	–9.8	–2.3		2.6	–1.0	–0.2	
Hong Kong (China) and Singapore	9.8	–2.4	–0.3		2.8	–0.7	–0.1	
Brazil	8.0	1.5	–1.7	7.3	1.4	0.3	–0.3	1.3
China	14.1	9.7	–7.2	21.8	0.6	0.4	–0.3	1.0
India	4.3	–10.0	–3.1	2.1	0.5	–1.2	–0.4	0.2
Indonesia	3.6	–2.3	3.0	5.1	1.4	–0.9	1.2	2.1
Mexico	0.3	–1.5	–1.3	2.6	0.0	–0.2	–0.2	0.3
Russian Federation	2.9	–1.7	–1.3	0.8	0.8	–0.5	–0.3	0.2
South African Customs Union	2.5	–0.3	0.8	3.7	1.8	–0.2	0.5	2.6
Vietnam	2.4	–0.2	0.6	0.9	5.0	–0.5	1.3	1.9
Rest of East Asia	19.6	–5.0	–2.8	7.4	4.7	–1.2	–0.7	1.8
Rest of South Asia	0.4	–3.2	–1.1	1.2	0.2	–1.3	–0.4	0.5
EU accession countries	0.8	–2.0	–0.5	0.9	0.2	–0.4	–0.1	0.2
Rest of Europe and Central Asia	2.3	–3.3	–1.3	0.4	0.5	–0.7	–0.3	0.1
Middle East	6.1	–2.7	–0.1	1.3	0.9	–0.4	0.0	0.2
North Africa	19.1	1.9	4.3	5.7	6.7	0.6	1.5	2.0
Rest of Sub-Saharan Africa	2.9	–3.0	–2.5	–0.2	1.1	–1.2	–1.0	–0.1
Rest of Latin America and Caribbean	16.3	0.9	6.4	9.6	1.6	0.1	0.6	0.9
Rest of world	3.0	–0.3	1.2	4.0	1.3	–0.1	0.6	1.8
High-income countries	154.4	133.6	46.9		0.6	0.5	0.2	
Low-income countries	16.6	–19.0	–1.9		0.9	–1.0	–0.1	
Middle-income countries	92.2	–2.6	–4.7		1.2	0.0	–0.1	
All developing countries	108.8	–21.5	–6.6		1.2	–0.2	–0.1	
World total	263.2	112.0	40.3		0.8	0.3	0.1	

Source: World Bank Simulations