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Impacts of Regional Trade Agreements on International Trade

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ABSTRACT

The article talks various aspects to Regional Trade agreements, dealing with its advent, reasons for the increase in RTAs, its impacts on global multilateral trading system and its advantages and Disadvantages. In present times Regional Trade agreements contributes to a major portion of Global trading working parallel with the Multilateral trading system of WTO. Every country wants to increase its economic growth and for that purpose Regional Trade agreements with the neighbour countries or the trading partners are not a bad option reducing trade barriers, Tariffs and other duties which are levied on the import & export generally. Some countries have even set a benchmark by adopting such policies in RTAs setting precedents for the multilateral trading system for future rule making. RTAs has gained so much scope that goes beyond current multilateral trading system including area like – Infrastructure, Investment, Intellectual property, Competition measures etc. The Article will discuss all the major impacts of Regional Trade agreements.

Keywords: *Regional Trading System, Multilateral Trading System, Non-Discrimination, Trade Barriers, Developed & Developing Countries.*

I. INTRODUCTION

Regional Trade agreements are the trade facilitating agreements or treaties between 2 or more countries may not be necessarily of the same region. It can also be understood as a reciprocal trade arrangement between two or more countries for the flourishing of trade & Services. These group of members follow their own rules and regulations for the facilitation of trade avoiding trade restrictive measures, while dealing with the other non-member countries there are separate set of rules which are followed being followed by the countries. Regional trade agreements between the countries majorly aims to avoid the trade restrictive measures such as Quotas, Tariffs and various other duties. The major principle of WTO which is to be followed by all the members countries is the “*Principle of Non-discrimination*” with the trading partners but RTAs are an exception to the principle of Non-discrimination subject to

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certain rules given by WTO. Generally, regional trade agreements can cover every aspect including Trade in goods, trade in services and global arrangements for developing countries complying with the trade facilitative policy of WTO without creating any barriers to trade for the other member countries.

Regional Trade agreements can be considered to be one of the major developments in international trade aspect. Looking at facts and figures the count of RTAs have drastically increased from 50 in 1990 to 306 as of now till September 2020. World Trade Organisation (WTO) initially fostered the regional trade agreements believing it to contribute to the multilateral trade regime. However, with time looking at the proliferation of Regional trade agreements it is visible that it hampers and threatens to some extent the multilateral trading system as preference given under RTAs though approved by the principles of GATT but are inconsistent with the multilateral trading system, Principle of Most favoured nation & gives rise to discriminatory trade practices. The gradual increase in the number of RTAs in the recent decades have become a major part of global trade and multilateral trading system.

Looking at some major figures of the Regional trade agreements by countries currently part of:

The list is topped by Europe with 43, followed by European free Trade Agreement States i.e., (EFTA States) with 31, Chile with 29, Singapore with 25, Mexico & Turkey with 22, Peru with 19, Korea with 18, Japan with 17 followed by India with 16, Panama with 16 and China with 15 regional trade agreements.² Reason for such drastic increase in in the regional trade can be dissatisfaction with the multilateral trading system. On comparing regional trade with the multilateral trade system, it is quite visible that the members would find the regional trade a better alternative because in multilateral trade the number of participants creates a rigidity in the system and reduces the cost of non-cooperation. As a greater number of participants will create a better competition providing a better market access to the countries. Hence, it lowers down the chances of negotiations between the countries, while on the other side regional trade gives better opportunities for trade negotiations, better accessibility with removal of trade barriers among to the members.

Agreeing to the fact that Regional Trade agreements are an exception to the principle of Non-discrimination propounded by WTO but the functioning of these RTAs by countries using preferential tariffs and easier market access conditions than what is applicable to other WTO Member countries results in the non-member countries of the RTAs losing the markets.

² Facts&Figures, Regional Trade Agreements, January-June 2020, https://www.wto.org/english/tratop_e/region_e/rtafactfig_e.pdf

Trading within the regional trade block does not come under the purview of WTO as a major amount of global trade is being diverted in this way. World Trade Organisation in its Annual report, 2003 has also brought this fact to light that – “RTAs can complement the multilateral trading system, help to build and strengthen it. But by their very nature RTAs are discriminatory; they are a departure from the MFN principle, a cornerstone of the multilateral trading system. Their effects on global trade liberalization and economic growth are not clear given that the regional economic impact of RTAs is ex ante inherently ambiguous”.³

II. IMPACTS OF RTAS ON TRADE CREATION AND TRADE DIVERSION:

According to the traditional theory of the gains from trade, the removal of trade barriers by the countries will provide the consumers better options and market and will allow him to purchase goods which is the cheapest among all and favourable to its consumption, enhancing efficiency and welfare. Relying on this logic it was believed that the Regional trade agreements will provide gains as the other member country has removed all kind of trade barriers among themselves.

This traditional view was challenged by Viner in 1950 in his book “*Custom Union Issue*”⁴ by the introducing the concepts like “Trade Conversion & Trade Diversion.” According to this concept Regional Trade agreements lead to Trade conversion when a member country shifts from inefficient domestic producer and starts importing from the other member of the RTA. Which is quite beneficial for a member as it provides the same goods at a cheaper rate and in efficient manner. On the other hand, Concept of Trade diversion arises when a member of RTA switches from purchasing the goods at more cheaper prices from the outside world and starts importing the same goods at higher prices from the partner country of the RTA. Trade diversion not only degrades the trade of the partner country but impacts the rest of the world.

Concepts of trade diversion & trade creation has opposite effects but the result depends upon the net effect from both of these concepts. The Net effect will definitely depend upon the domination by each effect. Various studies have tried to address the net welfare effect by introducing various other methods but the net welfare effects of the RTAs still remain ambiguous. The ambiguity in relation with the relative dominance of trade conversion & diversion has given rise to a debate. Various economists like Summers (1991)⁵ & Lipsey

³ https://www.wto.org/english/res_e/booksp_e/anrep_e/anrep03_e.pdf Pg-27

⁴ Viner, Jacob (1950): *The Customs Union Issue*, Carnegie Endowment for International Peace, New York

⁵ Summers, L., (1991) “Regionalism and the World Trading System”. -Policy Implications of Trade and Currency Zones

(1957)⁶ are of the opinion that – Trade diversion is likely to have a very minimal impact on the Member country and if the member countries are geographically proximate and have very high trade dependence among each other (Natural Trading Partners), then the risk of trade diversion is minimal.

On the contrary, Justice Bhagwati (1995)⁷ & A. Panagariya (1996)⁸ are of the view that – Trade creation is likely to be dominated by trade diversion in most of the situations. Also, in multilateral trading system when a country imports and exports to a member country and also to the rest of the world trade diversion is inevitable. Moreover, if the members of the union is a bit less this effect is likely to be more dominant as a very small amount of trade will take place in a small cluster.

III. TRADE AGREEMENTS GIVING BIRTH TO REGIONAL TRADE

Several economists like Justice Bhagwati⁹, A. Panagariya¹⁰ are of the opinion that the Shift of Developed nations like United States & European nations from multilateral trading system to regional trade has given rise to the flourishing of regional trade agreements even more. In the last couple of decades, it has been seen that the involvement of developed economies like European Union and United States with the other developed economies in Free Trade agreements by bilateral or regional trade has fostered the growth of regional trade agreements or free trade agreements by the developing economies with the developed countries by the visible threat of exclusion from this market. It is implied that the encouragement for being a party to a regional trade or a free trade agreement will be quite enormous when the developing country is competing with another country to be a trade partner of a developed economy. When this non-member countries are excluded from being a partner of a free trade agreement with the developed economy, these excluded members form their own Regional agreement. It is implied that no country would like to be excluded from regional trade groupings. Hence, it is visible that the numbers of trade agreements formed gives rise to formation of some other regional trade agreements among the potential members who were excluded from being a party to the former agreement.

Advantages & Disadvantages of regional Trade agreements:

Firstly, looking at the advantages of the Regional trade agreements, the major advantage

⁶ Lipsey, R. G (1957): “The Theory of Customs Union: Trade Diversion and Welfare”

⁷ Bhagwati, J. (1995): “U.S. Trade Policy: The Infatuation with Free Trade Areas”.

⁸ Panagariya, A. (1996): “The Free Trade Area of the Americas: Good for Latin America?” *World Economy*

⁹ Bhagwati, J. (1993): “Regionalism and Multilateralism: An Overview,” in Melo and Panagariya eds. *New Dimensions in Regional Integration*, Cambridge University Press, Cambridge

¹⁰ Panagariya, A. (1996): “The Free Trade Area of the Americas: Good for Latin America?”

includes the removal of trade barriers by the members for the members. This Directly helps in fostering the trade and subsequent growth and also provides a better market access to the members. Moreover, RTAs are much smaller as compared to the other Mega-regional trade agreements like Trans-Pacific Partnership (TPP), the Transatlantic Trade and Investment Partnership (TTIP) between the USA and the European Union (EU), both promoted by the USA, and the Regional Comprehensive Economic Partnership (RCEP) between Australia, China, India, Japan, Korea, New Zealand and ten countries of the Association of Southeast Asian Nations (ASEAN).¹¹ Being a smaller agreement with less number of parties, it becomes easier to make it successful & quicker. Another advantage of RTAs includes international relations and harmony between the countries. It becomes more feasible to maintain relations on global level when it is bound by a mutually agreed pact as the members won't opt for breaking the pact and enter into a conflict which is more or less likely to impact their trade relations with the other countries. For example, the establishment of European Union was done to promote Trade between the European countries and provide economic security to the Nations and it is very successfully accomplished also.

Some disadvantages of the RTAs include Trade diversion as we have discussed above in the article. Another drawback can be seen when a Developed or a Wealthy Economy enter into an agreement with a developing or comparable poor economy, the former impliedly gets more bargaining power as compared to the latter one which leads it to a comparable disadvantage. This thing happens with the developing nations as there lies a risk with them to get completely excluded from the agreement. Regional trade agreements have also been cited as a limiting factor for economic globalization, as they tend to localize areas of trade, effectively barring states outside of the agreement from entering thanks to higher tariffs and restrictions.

IV. CONCLUSION

Regional Trade agreements being an exception to the non-discrimination principle of the WTO are valid agreements between the countries as it is a good option for the members to have exports and imports with removal of trade barriers as it works for all the members. But, in long term this regional agreement impacts multilateral trading system as we have seen by the means of trade diversion. The regionalism in trade has so much developed & enhanced with time that it can be deemed that in the coming years if this thing persists, it can have a detrimental effect on Multilateral trading system of WTO & WTO may lose its influence and

¹¹ Narayanan, B.G., Khorana, S. Mega-regional trade Agreements: Costly distractions for developing countries? *Economic Structures* **6**, 29 (2017).

relevance over the global trading system. The major boom RTAs got in 1990s were because of the dissatisfaction with the multilateral trading system. Also, as we've discussed in the article by following the developed countries and being a trade partner with them which gave rise to the bandwagon effect in turn creating more RTAs among the excluded members. Moreover, Trade liberalization by regional trade agreements are not the best solution of it. But agreeing to the fact that it promotes trade of smaller countries by having their participation in the RTAs. But at times this RTAs can also be seen as a means of exploitation by the developed economies of the poor countries by having a dominating position in the agreement. Also, if the global trade is divided in some Mega-Trade agreements then it will leave no scope for the weaker countries and they will get marginalized.
