



APTIAD BRIEFING NOTE

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How much trade is covered by the RTAs and why does it matter?

With the multilateral trade negotiations under the World Trade Organization (WTO) not moving forward, preferential trade agreements (PTAs) will be given even more weight. Therefore, if the issue of gains vs. costs in PTAs was ever important, it is now. In that context, this note looks at the linkage between the number of agreements and volume of trade covered by members of these agreements as one input in analysis of effectiveness of PTA.¹

Economies of Asia and the Pacific have contributed about 50 per cent of all trade agreements that have been put into force since 1995.² This resulted in more than 125 trade agreements being formally implemented in May 2011 by 49 economies of the region. This proliferation of trade agreements became known as a “noodle bowl” phenomenon,³ bringing with it questions on the net benefits of each additional agreement signed. APTIAD⁴ provides information on the number of agreements signed and in force per individual economy of the region. The number of PTAs signed per economy ranges from zero⁵ to 18,⁶ resulting in an average of 4.78. Globally, 1.94⁷ agreements are in force per WTO member, so the Asia-Pacific region is ahead of the world average.

The implementation of PTAs requires resources. As many developing countries have limited resources for governing trade matters (including trade negotiations and implementation of commitments), multiplicity of PTAs creates challenges for many of them. This situation is complicated by the fact that many of these countries are also members of WTO. As such, they need to trade off between utilizing their resources for PTA negotiations or WTO negotiations. In an ideal world this division of resources would be driven by the potential benefit that a country could derive from either form of trade liberalization. As a basis for balancing trade policy resources, countries need to know the impact that PTAs have had on trade and what the trade flow would be if there were no PTAs. However, the precise gains for many economies from trade liberalization, either multilateral or that driving PTAs, have still not been clearly identified.

Trade theory states that a free trade agreement might improve national welfare, as it forces the replacement of inefficient domestic production by a partner’s (a foreign country’s) production. This positive impact needs to be corrected by the effect of trade diversion that occurs because a free trade agreement allows import from a less efficient (higher cost) partner country to displace a more efficient (lower cost) one from a non-partner country. In practice it

¹ The data on trade agreements used in the analysis is from APTIAD and WTO RTA-IS, accessed in May 2011.

² ESCAP (2011, forthcoming). *Asia-Pacific Trade and Investment Report 2011 – Post-crisis Trade and Investment Opportunities for Asia and the Pacific*, chapter 8. Bangkok.

³ This term is frequently used in the Asia-Pacific context to describe the “spaghetti bowl” phenomenon of the tangle of relationships created by multiple overlapping preferential trading arrangements that often have different tariff schedules, sectoral and/or product coverage, implementation time frames, rules of origin, customs procedures etc. “Spaghetti bowl” was introduced by Jagdish Bhagwati in the early 1990s.

⁴ Asia-Pacific Trade and Investment Agreements Database (APTIAD), available at: www.unescap.org/tid/aptiad/Agreements_by_country.aspx.

⁵ Mongolia, Palau, Northern Mariana Islands, New Caledonia, Guam, French Polynesia, American Samoa, Timor-Leste and Democratic People’s Republic of Korea

⁶ Singapore.

⁷ A total of 297 PTAs in force among 153 WTO members.

is barely possible to quantify these effects, as trade flows are affected by many factors at the same time; it is very difficult to identify the change in welfare or even the volume of trade attributable to the existence of a free trade agreement. However, what could be assessed simply is the share of trade of a country's total trade done with countries with which a country has trade agreements. Tables 1 and 2 show the average shares over 2007-2009 for export and import for those economies in the region for which there is available trade data.⁸

Developing economies of Asia and the Pacific on average directed 38.4 per cent of their exports towards partner economies, while they received 46.5 per cent of their imports from the same economies. Developed economies - in the Asia-Pacific region only Australia, New Zealand and Japan - traded 27 per cent of their exports and 33.9 per cent of imports with partner economies. Thus, on average for the whole region, the share of export done under the PTA was 37.7 per cent while share of import was 45.7 per cent. At the country level, these numbers vary significantly for each economy, as shown in tables 1 and 2.

Table 1. Economies with large trade share through their PTAs (average, 2007-2009)
(Unit: Per cent)

Economy	PTAs signed	Export to PTA partners	Import from PTA partners
Singapore	20	67.29	66.11
Turkey	19	66.08	50.02
Malaysia	12	54.62	59.58
Thailand	10	49.66	53.46
Lao People's Democratic Republic	9	82.41	93.92
Kyrgyzstan	9	55.71	59.99

Source: Calculated based on Comtrade data downloaded from WITS in May 2011.

Table 2. Economies with small trade share through their PTAs (average, 2007-2009)
(Unit: Per cent)

Economy	PTAs signed	Export to PTA partners	Import from PTA partners
Japan	13	15.34	16.59
China	11	31.01	25.64
Pakistan	9	20.26	23.24
Australia	8	21.44	37.15
Russian Federation	7	15.00	13.81
Sri Lanka	4	8.22	33.19

Source: Calculated based on Comtrade data downloaded from WITS in May 2011.

From tables 1 and 2, it can be concluded that the number of PTAs signed by an economy has no direct bearing on the amount of trade being done by that economy with partners in those preferential deals. In other words, there is no correlation between the number of PTAs to which a country is a signatory and the share of its trade that is attributed to those agreements. For example, the Lao People's Democratic Republic's nine agreements now in force capture a much larger share of its trade than Singapore's 20 trade agreements. A second example is Japan, which is a member of almost the same number of PTAs as Malaysia but which has a significantly lower share of its trade attributable to its PTA partner countries.

Table 3 and 4 summarize the information on changes of exports and imports on average between 2007 and 2009. In the case of two-thirds of the observed economies, exports and imports with their partner economies do not increase more rapidly (or decrease more slowly) than exports and imports with non-PTA partners. This means that there is no obvious evidence that trade is driven by having more of PTAs. Trade with PTA partners does not necessarily grow any faster than trade with non-PTA partners.

⁸ The accuracy of the reported data varies between countries. Not every country reports trade in every year. In those cases, mirroring reported data of partner countries allows missing information to be estimated.

The growth of trade in general was strongly influenced by the global economic crisis in 2008 and the recovery in 2009; the rates of change in trade shown in tables 3 and 4 include the impact of those global changes. Expanding the period to years before 2007 was not an option as many of the trade agreements signed by these economies were not in (full) operation at that time. Thus, it is very important to be cautious about reading too much into these differential growths of trade with PTA partners and non-partners; as such, it is not possible to conclude that PTAs did not contribute to growth of trade. There are many factors at work that could influence trade flows.

Table 3. Economies registering higher trade growth with non-PTA partners compared with PTA partners, 2007-2009

(Unit: Per cent)		
Economy	Average annual rate of change of trade with partners in PTAs	Average annual rate of change of trade with non-partners
China	0.19	2.70
Hong Kong, China	-2.74	-1.89
Malaysia	-6.39	-3.63
Singapore	-3.76	0.67
Thailand	-0.04	0.08
Viet Nam	8.11	10.08
Sri Lanka	-12.84	-2.20
Turkey	-6.44	1.08
Armenia	-7.29	14.00
Azerbaijan	-4.49	293.67
Kazakhstan	-4.68	3.23
Kyrgyzstan	4.40	39.54
Australia	0.61	7.52
Fiji	-8.89	-1.30

Source: Calculated based on USD values of trade recorded in Comtrade and downloaded from WITS in June 2011.

Table 4. Economies registering higher trade growth with PTA partners compared with non-PTA partners, 2007-2009

(Unit: Per cent)		
Economy	Average annual rate of change of trade with partners in PTAs	Average annual rate of change of trade with non-partners
Japan	-2.19	-6.18
Republic of Korea	1.84	-2.51
Indonesia	12.14	8.24
Philippines	-8.99	-13.05
India	15.27	11.05
Pakistan	9.08	-0.78
New Zealand	-2.87	-6.72

Source: Calculated based on USD values of trade recorded in Comtrade and downloaded from WITS in June 2011.

It must first be recognized that a number of agreements signed by the observed economies in recent years were with the partners with whom some other agreements already existed (thus adding to the “noodle bowl” phenomenon) without necessarily improving conditions for trade.⁹

Second, trade agreements might not address the most restrictive trade barriers. In such a case, a PTA might not lead to significant improvements for traders. On the contrary, many argue that adding more agreements would just make the trading environment more complex, while transaction costs would rise as the time involved in identifying the best “channel of trade” would increase with each additional set of rules of origin accompanying each PTA. A

⁹ For example, agreements between (a) ASEAN, and individual ASEAN member States, and China, India, Japan and Republic of Korea; (b) India and Sri Lanka; and (c) Singapore and New Zealand etc.

relatively high cost of compliance with some of these rules of origin make it more costly for traders to use the negotiated preferences than the ordinary most-favoured-nation rules, given that in many cases the margin of tariff preference is not very large.

Another reason is related to the ability of traders to use the preferences under PTAs. In many cases, producers and traders do not have sufficient information and knowledge about trade opportunities being opened through the PTAs; some are unaware of the existence of such trade concessions and do not know how to use them. Thus, governments ought to pay more attention to preparing companies for utilizing the trade concessions that have been negotiated for them. In other words, utilization of trade preferences will not happen if the business sector is not well informed and enabled to use them.

Further reasons why trade volumes do not necessarily grow with more PTAs might lie beyond aspects of trade liberalization. Industries might not unlock their potential just by removing trade barriers through PTAs, as many barriers to more efficient production and trade lie “behind-the-border” and are domestic in nature. ARTNeT (www.artnetontrade.org) provides the most recent and regionally-focused empirical evidence of the significance of these types of barriers.

Trade negotiators should be aware of their countries’ productive capacity and potential for increasing production and trade. An economy’s resources, industrial specialization as well as the supply of and demand for specific traded products should determine the areas of trade policy-making. It is difficult to expect much impact from a trade deal with partners with whom there are no complementarities on the export/import side and no real potential for new trade based on current production and consumption patterns of the economies involved.

Having said this, also the state of an industry – market structure, competition and technological level – as well as the structure and type of labour and capital markets should be taken into careful consideration. Would trade liberalization lead to an increase in competition and a new dynamics on the producers and suppliers side, with ultimate positive effects for consumers? Or would it cement the position of a few strong (perhaps foreign) players in a market for a certain good, and allow them to eliminate competitors that formerly enjoyed a tariff or other protection?

There are instances where trade agreements are signed just for the purpose of “normalizing” trade relations and which carry the title of “trade agreement” without any actual trade liberalization intent or impact.¹⁰ There are also trade agreements that are signed for the purpose of wider economic (and perhaps security) cooperation, and an impact on increased trade is not expected (immediately or even in the future). These should not be counted as trade agreements (in fact, more care should be taken when naming these agreements) as they may make the “noodle bowl” look more complex than necessary.

In summary, this note sheds some light on the effectiveness of trade agreements by quantifying how much of the export and import flows are captured by partners in PTAs. PTAs signed and under implementation by economies in the Asia and Pacific region are not always associated with increasing or faster growing trade among the PTA partners. A note of caution is thus raised in terms of the value added by signing more agreements (frequently also) by the same partners. However, to fully assess the quality of PTAs, it is necessary, *inter alia*, to quantify the utilization of negotiated preferences. Such utilization refers to the amount of exporting and importing actually registered as being done under reduced or zero trade barriers valid for a particular agreement.

Little and non-systematic empirical evidence points to relatively low rates of utilization. In principle, utilization of preferences is inversely proportionate to the complexity of the rules of origin, given the margin of preference – the more complex the rules of origin, the more expensive is compliance, resulting in less willingness to use the preferences. In many cases

¹⁰ These agreements were previously more frequent when many countries were not members of WTO, and MFN status had to be granted and renewed almost annually. In fact, even recently, agreements like that have been established (e.g., the bilateral trade agreements between India and Bangladesh, and Viet Nam and the United States).

the traders just use so-called most-favoured-nation rules of origin and do not utilize preferences. This practice prevents agreements from effectively increasing trade. This is a serious problem, but it is difficult to study in detail as data are not readily available. Without knowing how much trade does actually occur under preferential terms, it is difficult to say much more on the benefits of PTAs with regard to generating trade. Of course, the vast arrays of side benefits that might be gained, directly or indirectly, via these PTAs (technical assistance, financial aid, regional stability, technology transfer etc) also need to be taken into account when making a judgment on PTAs.

About APTIAD –

YOUR GATEWAY TO INFORMATION ON PREFERENTIAL TRADE AGREEMENTS IN ASIA AND THE PACIFIC

In order to provide a useful tool for observers and stakeholders (government, researchers and policy analysts) to monitor and analyze the development of trade agreements in this new environment, Trade Policy Section of Trade and Investment Division (TID) of ESCAP launched an online database, known as **Asia-Pacific Trade and Investment Agreements Database** or **APTIAD** and available at <http://www.unescap.org/tid/aptiad>. It comprises three platforms: Trade Agreements Database (TAD); Interactive Trade Indicators (ITI) and Glossary.

Trade Agreements Database platform provides detailed descriptive and updated information on the provisions of regional trade agreements (RTAs) / bilateral trade agreements (BTAs) involving one or more members from the ESCAP region that are either signed, in force or under negotiations. By June 2011 there were 177 such agreements, including those agreements that have not been notified to the WTO but for which there is official information readily available, and also those agreements under negotiation for which there has been at least a first formal negotiation round.

The online database allows searches in two ways. One relates to the **agreements** themselves where users could search by titles, members, key terms, types and scopes of agreements and their status. Another one is the possibility to search **publications** relevant to regional integration and trade agreements. For easier use of the database, users can download a **Glossary** of related terms. There are also links to national **trade statistics** of each country. The database is continuously updated and expanded to include statistics on trade flows between countries that are members of individual agreements. Furthermore indicators to monitor performance of trade agreements are developed and calculated for individual economies and trade agreements in the region. Some of the indicators are: export propensity, trade dependence, trade shares, export-import coverage, normalized trade balance, and trade shares.

Furthermore an **Interactive Trade Indicators** platform allows for a calculation of a number of other indicators including export growth rates, trade complementarity, revealed comparative advantage, or intra-industry trade. These indicators allow for quick and easy monitoring of developments in trade patterns and trade flows at single economy and trade agreements levels.



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