Theory of Economic Integration

Preferential Trade Agreements and the Multilateral Trade System

Katarzyna Śledziewska
Outline

• Definitions
• The stages of economic integration
• WTO rules
Definitions

- **Multilateralism:**
  - multiple countries working in concert on a given issue under certain international relation agreements

- **Regionalism:**
  - any trade agreement that involves two or more countries but fewer than all members. (WTO)

- **Economic Integration:**
  - a process by which the firms and economies of separate states merge in larger entities
  - discriminatory removal of all barriers of economic cooperation
Variety of Trade Governance

- **Unilateral**: Trade Policy of some Asian countries
- **Bilateral**: US-Canada Auto pact\(^1\) or US-Japan VER’s \(^2\)
- **Minilateral**: EU, MERCOSOR, NAFTA\(^1\) or PTA\(^2\): Protocol Trade Agreement
- **Multilateral**: GATT, GATS → WTO

\(^1\) geographically concentrated
\(^2\) geographically dispersed
Outline

• Definitions
• The stages of economic integration
• WTO rules
A hierarchy of regional economic arrangements

- Free trade area
- Customs union
- Common market
- Economic union
Preferential tariff agreement

- the tariffs among the signatory countries are lower in relation to tariffs charged on the trade with third countries

Partial customs union

- The participating countries retain their initial tariffs on trade with third countries
Preferential tariff agreement

Country A tariff = 10%

Country B tariff = 30%

Country C tariff = 20%

ROW

ROW

ROW

ROW

PTA

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A free trade area

• Countries
  – remove:
    • tariffs
    • non-tariffs barriers
    • quantitative restrictions
      – on mutual trade
  – retain own tariffs and other regulations of trade with third countries
    • free to choose how they treat goods and services imported from non-regional-partner states (own policies vis-a-vis the outside world)

• membership - does not prevent a country from establishing or joining other free trade areas

• impose relatively few constraints on national decision-making autonomy
A free trade area

Country A
- tariff = 5%

Country B
- tariff = 30%
- FTA

Country C
- tariff = 20%

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A free trade area

- the easiest of the regional arrangements to negotiate
- more than 90 per cent of regional partnership take this form
  - NAFTA,
  - the Japan-Singapore Economic Partnership Agreement
- The bases of the agreement – **roles of origine (ROOs)**
ROOs - used to determine the country of origin

• **Product**
  – wholly obtained or produced completely within one country
    • the product shall be deemed having origin in that country.
  – produced in more than one country
    • the product shall be determined to have origin in the country where the **last substantial transformation** took place
      – 3 general rules are applied:
        » Change of tariff classification (on any level, though 4-digit level is the most common)
        » Value added-rule
        » Special processing rule, the minimum transformation is described
  – has exactly one country of origin
    • usually it is the rules of the country into which a product is being imported that apply.

• **Rules may differ from country to country**
  – the same product may have different origins depending on which country's scheme is applied
Why do we need ROOs?
trade deflection

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Why do we need ROOs?

- To establish whether a given product exemption from customs duties
- To prevent trade deflection
- To determine the geographical source of imports
- To identify the criteria confer originate status on the export good.
Why do we need ROOs? 
preventing trade deflection

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When are ROOs likely to matter more?

ROOs influence the sourcing on intermediate goods and final goods trade;

- The higher the intermediate share in production;
- The higher the export share in the final good production;
- The lower the import tariffs among non-cumulating countries;
- The higher the share of exports of the final good destined for a FTA;
- The greater the possibilities of sourcing substitute intermediates from within FTA.

Lack of compatibility among the ROOs across different FTAs make organization of production and international supply chains complicated for firms.
FTAs in Asia
A customs union

• Countries
  – Remove tariffs and quantitative restrictions within the region
  – introduce a common external tariff on trade with third countries
• costs governments autonomy in their foreign economic policies
  – joint institutions required to negotiate and administer the common external trade policies
• more difficult to negotiate
• small number of customs unions
  – Adean Community,
  – CARICOM,
  – MERCOSUR,
  – the Southern African Customs Union
• many have experience difficulties in negotiating
  – EU – individual states maintained different tariffs on some products for more than 30 years after its formation
A customs union

Country A tariff = 15%

Country B tariff = 15%

Country C t = 20%

no tariffs + CET

CU

ROW

ROW

ROW

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Integration in Europe
A common market

- allows for free movement of labour and capital within the region partnership
- requires governments to collaborate in additional policy areas to ensure comparable treatment in all countries
- loss of policy making autonomy
- examples:
  - Adean Community,
  - CARICOM,
  - the COMESA
    - have committed themselves to work for the establishment of a common market
    - too early to judge whether their inspirations will be realised
An economic union

- A common market plus the harmonization of monetary, fiscal and social policies
- Total assumes union with a single economic policy and a supranational government
- European Union
The stages of economic integration, schematic presentation

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The stages of economic integration

- The process of integration does not necessarily have to be gradual from one type to another
- The establishment of any of types depends on the agreement among participating countries
The stages of economic integration

- Preferential tariff agreement, partial customs union
- Free trade area
- Customs union
- Common market
- Economic union

WTO Regional Trade Agreements (RTAs)

- Partial Scope Agreement (PS)
- Free Trade Agreement (FTA)
- Customs Union (CU)
- Economic Integration Agreement (EIA)
Some Figures on Regional Trade Agreements notified to the GATT/WTO and in force

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Outline

• Definitions
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• WTO rules
WTO rules

• The basic principles of the GATT:
  – Non-discrimination
  – Reciprocity
  – Transparency
  – Enforcement
  – The impartial settlement of disputes
Most favoured nation MFN treatment

• *Any advantage, favour, privilege* or immunity granted by any contradicting party to any product originating in or destined for any other country shall be *accorded immediately and unconditionally* to the like product originating in or destined for the *territories of all other contracting parties*

• **Consequences:**
  – if a country opens up its market to another country, it must also open it to all other GATT member countries
WTO rules

The GATT recognised the importance and value of economic integration between countries

Regionalism - the most significant exception to WTO’s principal of non-discrimination

Three sets of rules in the WTO permit the creation of RTAs:
1. Article XXIV of the GATT
2. The Enabling Clause
3. Article V of the General Agreement on Trade in Services (GATS)
Some Figures on Regional Trade Agreements notified to the GATT/WTO and in force

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Physical RTAs in force, sorted by coverage:

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Map of RTAs by country, participation in Regional Trade Agreements for **goods**

*Source: WTO Secretariat.*
Map of RTAs by country, participation in Regional Trade Agreements for services

Source: WTO Secretariat.