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Do preferential trade agreements contribute to the development of trade? Taking into account the institutional heterogeneity

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ABSTRACT

Following the surge of preferential trade agreements (PTAs) from the 1990's, especially bilateral ones, recent research has begun to reconsider their effects on the development of international trade. These agreements are so different in terms of scope, sectorial coverage, institutional framework...that they can be no more considered as belonging to a homogeneous category. Especially, the inclusion of new areas of negotiation raises questions as to their positive or negative contribution to trade liberalization. In this paper, four trade-related policy domains, more and more frequently negotiated in PTAs, are identified (capital mobility, competition policy, labor mobility and environment). After a general discussion of their supposed effects on international trade, an empirical investigation identifies their effects separately. The gravity model with panel data on the 1960–2010 period is used. To account for zero trade flows, Poisson Pseudo-Maximum Likelihood approach has been applied. Results show that negotiating labor mobility and environmental provisions significantly increases trade, whereas the effects of clauses on capital mobility and competition policy are not systematically significant. Statistical analysis shows that negotiation on labor mobility and environmental issues have an impact independent from the agreement as a whole, confirming the relevance of the heterogeneity hypothesis.

1. Introduction

The world is experiencing an unprecedented growth of preferential trade agreements (PTAs).[1] Currently, more than 300 PTAs are enforced all over the world. The first arrangements were exclusively regional and allowed by the exemption, with restrictions, of article 24 of GATT, but later on PTAs, involving countries or groups of countries from different regions tended to multiply. They could be bilateral or plurilateral.[2] Whether notified or not to the WTO, these recent arrangements introduce a completely new logic of trade negotiations and enlarge the scope of negotiations to areas which did not fall under the WTO mandate. They have become preferred policy instruments and serve as a forum for negotiating various policy issues. The scope, coverage and institutionalization of these agreements nevertheless differ from each other, and in fact display widespread heterogeneity, raising methodological issues

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[1] PTAs are understood as encompassing all five categories of discriminatory arrangements classified by the WTO (partial scope agreements, free trade agreements, custom unions, common markets and economic unions). See also Balassa (1961).

[2] Plurilateral agreements involve more than two countries (or regional blocs) and are transregional.

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to analyzing the impacts of these arrangements on the overall trading system. Heterogeneity has been widely discussed to distinguish agreements whether deep or shallow (Vicard, 2009; Orefice and Rocha, 2014; Kohl et al., 2013).

Indeed, PTAs can be ranked from *"shallow"* to *"deep"*. Shallow integration involves reducing or eliminating tariff barriers to trade in commodities whereas deep integration is characterized by harmonization of national policies and is oriented towards so-called "*behind the border measures"* (Kahler, 1995; Anderson and van Wincoop, 2004).

As the WTO notes:

"The coverage and depth of preferential treatment varies from one regional trade agreement (RTA) to another. Modern RTAs, and not exclusively those linking the most developed economies, tend to go far beyond tariff-cutting exercises. They provide for increasingly complex regulations governing intra-trade (e.g. with respect to standards, safeguard provisions, customs administration, etc.) and they often also provide for a preferential regulatory framework for mutual services trade. The most sophisticated RTAs go beyond traditional trade policy mechanisms, to include regional rules on investment, competition, environment and labour"

(World Trade Organization Website).[3]

This paper adds to existing literature by focusing on this new trend. The fundamental question remains whether preferential agreements contribute to the development of trade, or have a negative impact as supposed originally by Bhagwati (1993). The dominant position that PTAs contribute positively to the development of bilateral trade (Baier and Bergstrand, 2007) was based on conventional types of trade arrangements running in parallel with progress at multilateral level. In this respect, it is to be noted that the new trend of negotiations on behind the border measures requires to reinvestigate this issue.

Agreements are complex, as already pointed out, their content may vary substantially from one agreement to the other (Dür et al. 2014). Consequently, empirical analysis cannot anymore assess them as homogenous observation material. The added value of this paper is to attempt to go deeper in the details of these agreements and in particular, to distinguish various areas they are encompassing to assess the contribution of each of them to the development of trade.

Previous literature has already engaged this investigation by introducing a distinction among clauses discussed in PTAs, namely WTO^{+} and WTO^{X}. This distinction was introduced by an article published by Horn et al. (2010), referring to areas of negotiation falling under the WTO mandate (e.g. tariff barriers, customs administration, technical barriers to trade, import and export restrictions etc…) then called WTO^{+}, or outside of the WTO mandate (e.g. competition policy, labor mobility, environmental standards etc…) then called WTO^{X}. Building on this distinction, Kohl et al. (2013) and Orefice and Rocha (2014) identify, in important papers, the separate impact on trade of the inclusion of WTO^{+} and WTO^{X} on trade flows. However, a limitation of their analysis was to consider WTO^{X} clauses as a quantum assessed by the number of areas they cover. By doing this, the specific contribution of each area of WTO^{X} could not be identified. This paper proposes to enter into the detail of clauses falling in WTO^{X} category, by introducing a theoretical discussion followed by empirical investigations on four WTO^{X} sub-areas, namely *capital mobility, competition policy, labor mobility and environmental standards.*

Going deeper is justified by the fact that Kohl et al. (2013) exhibit results that are contradicted by Orefice and Rocha (2014). According to Kohl et al. (2013), the presence of WTO^{X} clauses in PTAs have a negative impact on trade which is the opposite of Orefice and Rocha's (2014) findings. In this respect, these investigations are inconclusive. Distinguishing between four areas of WTO^{X} clauses, to identify separately their negative or positive contribution to trade is the strategy proposed to try to settle these divergences.

This study applies a gravity model with panel data. It adopts the Poisson-Pseudo Maximum Likelihood (PPML) method which allows for dealing with zero trade flows (Westerlund and Wilhelmsson, 2011; Head and Mayer, 2014). Further, it controls for multilateral resistance terms by introducing exporter-year and importer-year fixed effects (see Anderson and van Wincoop, 2003).

The econometric approach should be able to identify the effect of each separate clause, positive or negative, on bilateral trade flows. In order to implement that, four separate dummy variables are introduced in different estimations to subdivide the content of WTO^{X} clauses. To justify this more elaborated procedure, it has also to be shown that the results obtained are significantly different from those obtained with less detailed analyses.

The paper proceeds as follows: Section 2 presents a brief discussion of literature on trade creating/diverting mechanisms of WTO^{X} provisions. Econometric methodology and results are presented in Section 3. Robustness of the results is analyzed in Section 4, whereas Section 5 concludes.

2. Content of WTO^{X} clauses and discussion

Although, areas included under the heading of WTO^{X} are very numerous and diverse, it is proposed to classify them into four main categories. Their impact on trade will be discussed below.

2.1. Financial capital mobility

Financial capital mobility (to be distinguished from foreign direct investment) encompasses the ability of private funds (such as interbank lending, transactions in bonds and equities…) to move across national boundaries. It has become an important issue only

[3] https://www.wto.org/english/tratop_e/region_e/scope_rta_e.htm