

**Bridging
Regional Trade Agreements
in the Americas**

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SUMMARY

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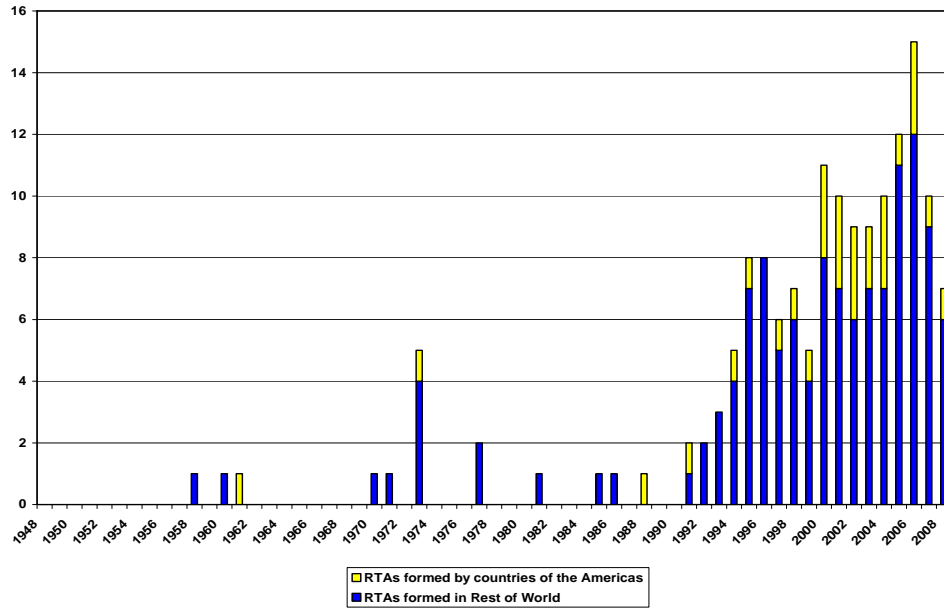
Regional Trade Agreements: State of Play in the Americas

Since the 1990s, countries of the Americas have pursued a multitiered trade liberalization strategy composed of unilateral opening, regional trade agreements (RTAs), and multilateral trade liberalization¹. The various tiers of integration are widely seen as complementary and beneficial for fostering the region's global economic competitiveness.

Today, particularly in light of the complex trade agenda at the multilateral level, the countries of the Americas have opted to place an increasingly strong emphasis on the formation of RTAs. Indeed, they have been the key drivers of the global spree of RTAs, having collectively reported to the World Trade Organization (WTO) some three dozen comprehensive intra- and extraregional RTAs (Figure 1) and set out to negotiate several additional ones.

¹ RTAs here include free trade agreements, customs unions, and common markets.

Figure 1. New RTAs Reported to the WTO in the Americas and around the World, 1948-2008



Source: Integration and Trade Sector, IDB calculations based on WTO data.

RTAs have transformed the global and regional economic landscapes: they regulate some one-half of world trade, nearly all trade in the Americas, and the bulk of trade in some of the most prolific integrator countries such as Chile and Mexico, each of which has entered into RTAs with all of its main trading partners.

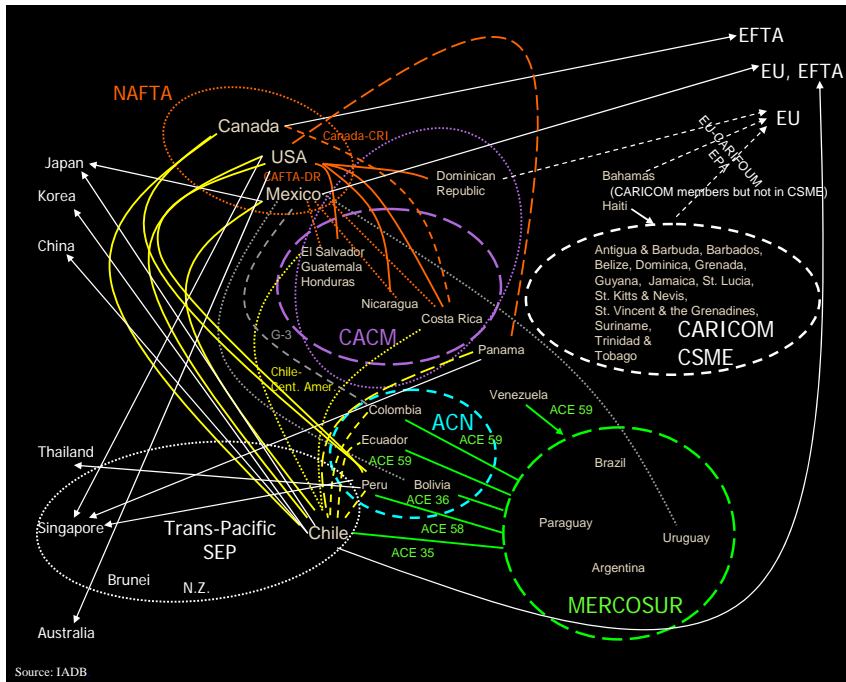
The hard-won agreements have created benefits in terms of expanded market access, greater trade and investment flows, increased firm productivity, and arguably also macroeconomic stability (IDB, 2002). However, at the same time, the proliferation of RTAs has created a veritable “spaghetti bowl” of multiple and often overlapping agreements (Figure 2). The various disciplines included in

each RTA—such as tariff liberalization schedules, rules of origin (RoO), standards, safeguards, and investment rules—entangle the bowl further (Estevadeordal et al. 2009) Baldwin and Low (2009).

The seemingly incessant proliferation of overlapping, complex RTAs entails a number of risks:

- It can “balkanize” the regional and global trading systems. If the various agreements carry widely distinct features, they can impose undue transaction costs on traders, investors, and governments operating in several RTA partner markets simultaneously.

Figure 2. RTA Architecture in the Americas, 2009



Source: Integration and Trade Sector, IDB.

- The spread of RTAs risks the rise of hub-and-spoke systems centered on a few hub countries in which the potential cost savings from cumulation of production *among* the spokes remain untapped.
- The proliferation of RTAs means that although any given country will likely be an insider to a growing number of RTAs, it will also be an outsider to an even larger set of RTAs. Even the most prolific integrator countries can thus end up facing some degree of discrimination and/or preference erosion in a growing number of RTA markets.

The concerns about the RTA spaghetti bowl will likely only intensify should RTAs continue proliferating at the predicted pace. Though also relevant for countries in regions with spreading RTA systems, such as Asia, these concerns are particularly acute for the countries of the Americas given their extensive network of RTAs with one another and their ongoing RTA negotiations with various Asian countries and the European Union (EU). Indeed, many countries in the Americas are today enmeshed in a number of “RTA systems” – including subregional, hemispheric, trans-Pacific, and trans-Atlantic ones.

The key question for the countries of the region is the extent to which the various RTAs are exerting centrifugal pressures that create gaps between their respective members’ trade policies and trade flows.

To the extent that the centrifugal forces are present and matter for doing business, the policy question is how to induce some rapprochement among the various RTAs.

The countries of the Americas are at a crossroads: they can choose to continue trading amid the RTA tangle, or they can pursue proactive policies that could overcome the potential spaghetti bowl problems and expand regional market access and production possibilities. One major policy alternative, and perhaps the most feasible one in the short run, would be to build bridges among the existing RTAs—strive to achieve some form of convergence or gradual harmonization of the various RTAs in the Americas, and subsequently to implement cumulation of production among them.

The starting point and initial focus of such an effort could be market access provisions and rules of origin, in particular. While differing in process from that geared towards reaching a megaregional agreement like the Free Trade Area of the Americas (FTAA) that languished in 2003, bridging RTAs would have economic effects similar to those of a single integration agreement. It would also help circumvent the rise of hub-and-spoke systems and create a level playing field, eliminating the discrimination stemming from any one RTA. And provided it were based on open regionalism and firmly nested in the WTO system, such a regional scheme would also create trade with nonmembers and could even help propel multilateral talks forward.

As such, convergence would in essence “flatten” the regional RTAs and tame the RTA rule tangle. In a gastronomic analogy, it would mean converting the regional RTA spaghetti bowl into a lasagna plate. Convergence would facilitate trade and production across the region and, as such, harness hemispheric scale economies and opportunities for cost savings. It could also undermine protectionist interests and prospects for trade diversion and serve as a basis for further region-wide and global negotiations. In short, bridging RTAs could make the whole of the RTA spaghetti greater than the sum of the parts.

Convergence in the Americas: What Prospects?

The report examines the prospects for convergence in the area of market access in the Americas, particular:

1. Takes stock of the extent of the spread, liberalization, and comprehensiveness of RTAs formed by countries of the Americas in the past several years in a comparative perspective;
2. Diagnoses in detail the extent of compatibilities and divergences in market access disciplines among some three dozen RTAs signed among various countries of the Americas; and

3. Develops practical policy options for the regional economies to deal with the potential challenges posed by the web of RTAs in the Americas so as to facilitate region-wide trade and production.

The assessment of the state of RTA liberalization in the Americas yields three main results:

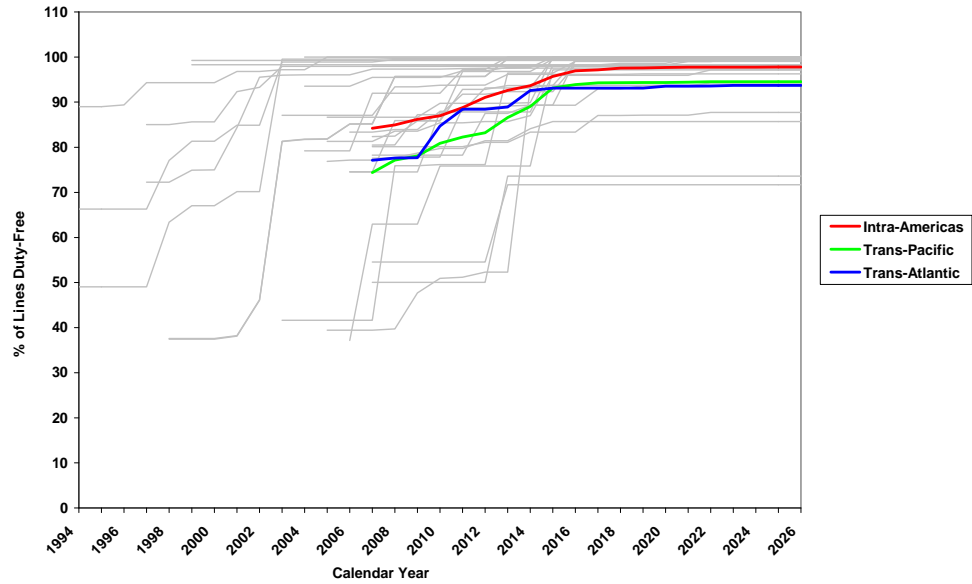
- While trade and foreign direct investment have surged in importance in regional economies in the past two decades, so has the relevance of RTAs in regulating the regional economies' trade and investment flows. For many economies in the Americas, trade with their RTA partners makes up the bulk of their total foreign trade.
- RTAs formed by the countries of the Americas—and those formed by the North American Free Trade Agreement (NAFTA) members, in particular—are mature and deeply and rapidly liberalizing. However, there are number of outlier RTA parties and product categories (particularly in sensitive sectors) that trail the overall trend of liberalization. Moreover, the region's liberalization is limited by the use of potentially restrictive instruments such as restrictive rules of origin and exclusions. Overall, however, RTAs in the Americas free more than 90 percent of product categories within their first 10 years; agreements currently in force will have freed more than 95

percent of product categories by 2015 (Figure 3).

- The advance of RTAs has been paralleled by extensive liberalization of external tariffs in the region, which has reduced the discriminatory potential of the RTAs. While opening on the external front has been more modest in recent years, the region's economies fare quite well when compared to those of other world regions. Against this backdrop, a number of recent rigorous empirical studies have found the region's RTAs to be trade-creating and conducive to global trade liberalization.

However, this study also finds that preferential margins—the gap between external and preferential tariffs—are still notable in the region, which increases the lure of trading under the RTA rules. At the regional level, the drive to form RTAs has produced a complex web of agreements that has generated additional transaction costs to producers across the Americas, so that connecting RTAs would have important economic benefits in terms of reduced trade diversion and increased scale economies.

Figure 3. Evolution of Duty-Free Treatment by RTA Members of the Americas in 1994–2026 (Individual RTA’s and regional averages)



Source: Integration and Trade Sector, IDB calculations.

The feasibility of such convergence in the area of market access regimes among RTAs in the Americas is rather substantial:

- Tariff elimination—the first precondition for effective convergence—is highly advanced in the Americas. The various countries examined here have already liberalized at least some four-fifths of their tariff lines with one another. A case study into 74 hypothetical “cumulation” triangles—relationships in which each of the three partners is linked to each of the other

two through a bilateral RTA, yet there is no cumulation among the three RTAs—in the Americas is illustrative. Most of these triangles will have freed bilateral trade flows in more than 80 percent of products by 2016. As far as tariffs are concerned, the region holds solid potential for meaningful convergence.

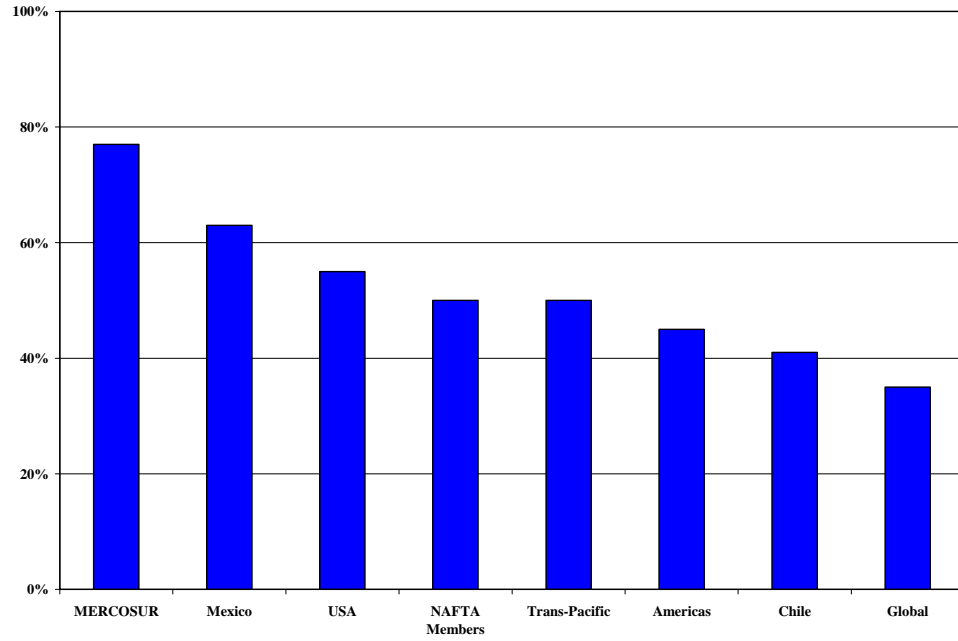
- In the area of rules of origin, the picture is more mixed. The extent of compatibilities in origin regimes—a factor that can augur well for the negotiation of the second precondition for broad cumulation: a common origin regime—varies across subsets of RTAs as well as across economic sectors in the Americas. RTA families built around the Southern Common Market (MERCOSUR), the United States, and Mexico are particularly coherent internally (Figure 4). Similarly, although RTAs differ quite notably in their definition of market access rules for agricultural products, textiles, and machinery, there are also a number of sectors, such as arms, wood products, and precision instruments, in which there are only marginal differences across the hemispheric agreements (Figures 5a and 5b).

A cursory look at selected trade-related disciplines—investment, services, customs procedures, and competition policy rules—echoes these patterns. Americas-wide, some three-quarters of all agreements cover the main provisions within these four disciplines. However, there is clear clustering of RTAs into families grouped around NAFTA members and Chile, which have formed highly

comprehensive and also very similar agreements, and MERCOSUR and intra-South American agreements, which are quite thin on these rules.

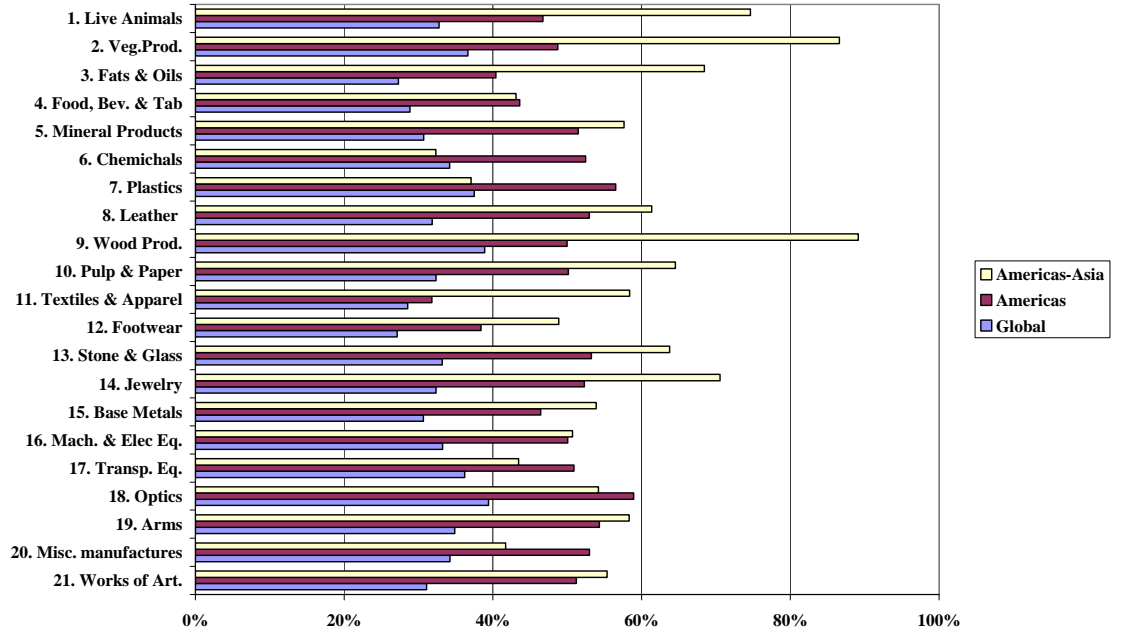
Overall, the countries of the Americas are quite well-positioned to pursue convergence. There are already a number of initiatives at different stages of discussion about some forms of convergence, such as the 11-country Pacific Basin Forum formed in January 2007 or the Latin American Free Trade Area (Espacio de Libre Comercio) initiative. Five countries of the region (United States, Canada, Mexico, Chile and Peru) are also involved in convergence discussions in the 21-member Asia-Pacific Economic Cooperation (APEC) forum.

Figure 4. Index of Similarity in Product-Specific RoO within Selected RTA Families



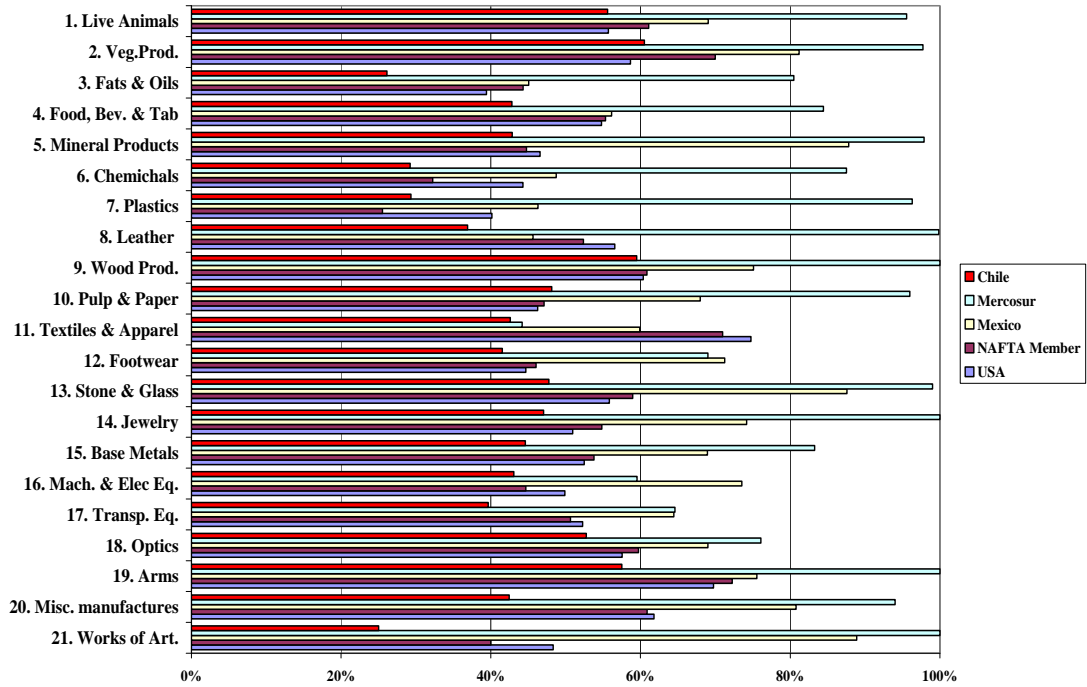
Source: Integration and Trade Sector, IDB calculations.

**Figure 5a. Index of Similarity in Product-Specific RoO within Asia-
Americas, Americas, and Global RTA Families (HS System)**



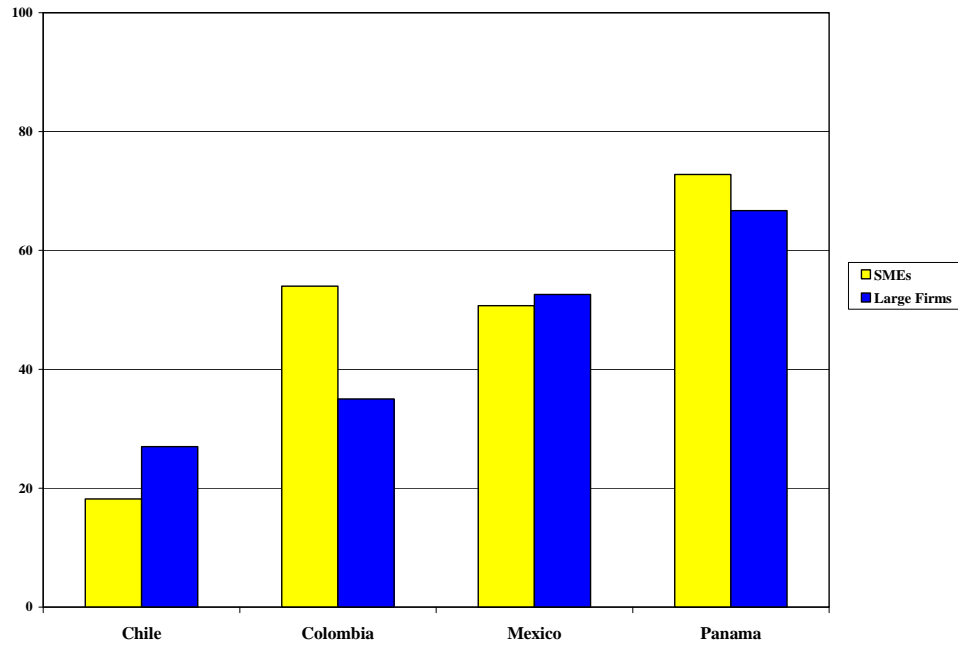
Source: Integration and Trade Sector, IDB calculations.

Figure 5b. Index of Similarity in Product-Specific RoO within Selected RTA Families in the Americas (HS System)



Source: Integration and Trade Sector, IDB calculations based on the INT/IDB Rules of Origin Database.

Figure 6. Percentage of Firms Stating that Cost Savings from Cumulation across Their Country's RTAs Would Be "High" or "Very High"



Source: Integration and Trade Sector, IDB survey data.

The benefits of convergence would be significant. A recent IDB survey in four countries in Latin America reveals that companies in the region tend to expect important gains from convergence and cumulation across their respective countries' RTAs (Figure 6). The overall trade effects can also be large. In Europe, RTA harmonization in the 1990s is estimated to have increased trade between the Eastern European spokes by up to 22 percent (Gasiorek, Augier, and Lai-Tong, 2007). Harris and Suominen (2008) examine the effects of cumulation

over a longer time period (1960–2005) in more than 100 RTAs, finding that when two small RTA partners are able to cumulate production with a large partner, they will both see a net increase in their bilateral trade, as well as a reduction in trade diversion in the bilateral relationship.

Toward Convergence

Although a complex process, convergence of RTAs in any one grouping or hemisphere-wide could be initiated through smaller, more technical endeavors aimed at facilitating trade within existing RTAs and reducing trade costs and uncertainty for exporters. In the area of market access, there are perhaps four short-term measures that could be considered:

- **Harmonized digital “Americas Origin Certificate.”** The first step could be the establishment of a standardized set of information to be included in origin certificates. The information should be digital so as to facilitate the certification process. Developing common guidelines and procedures for the electronic transmission and reception of origin certificates, and perhaps a common “Americas Origin Certificate,” would help reduce the number of different procedures that traders would have to master and build mechanisms and institutions for customs cooperation, an area of various positive externalities.

- **Standardized origin verification procedures.** Accompanying a standardized certificate could be a set of common parameters for verification procedures, such as the time period for which records and documents must be retained and within which separate phases of a verification process must be completed. Reliable regional verification systems are crucial for ensuring the viability of convergence—to avert trade deflection in a region consisting of multiple economies of distinct verification capacities. The potential gains from increased transparency, as well as the intergovernmental cooperation that would be involved in such an exercise, would boost trade and even potentially create institutions that might facilitate further agreements.
- **Sectoral most-favored-nation tariff harmonization.** Because RoO are necessary only when there are differences among RTA members in tariffs on goods from third parties, they could be eliminated in cases in which RTA members can easily harmonize their tariffs. Such “mini-customs unions” carrying a commonly agreed-on most-favored-nation (MFN) tariff could be feasible in sectors in which all RTA members’ tariffs are already quite low. This effort could be modeled after the Information Technology Agreement reached at the WTO in 1996 and the handful of mini-customs unions instituted in NAFTA. It would help reduce the administrative burdens imposed by rules of origin and enable improved circulation of goods in the common convergence area. The feasibility of such

mini-customs unions is quite high: there are several product groups in the Americas that display relatively small differences in MFN tariffs across rather large groups of countries, including inorganic chemicals and fertilizers, raw leather, photographic goods, and paper products.

- **Selective MFN tariff liberalization.** The regional economies could also eliminate tariffs on an MFN basis (both in RTAs and vis-à-vis third parties) in product categories that countries in the region have already liberalized to major exporters in or outside the region. In these situations, the marginal pain of liberalization is small or nonexistent. For example, in the U.S.-Central America-Dominican Republic Free Trade Agreement (DR-CAFTA), Central American countries freed photographic or cinematographic goods and fruit and nuts to imports from the United States, the key source of their imports in the two sectors. Yet they also maintain positive applied MFN rates in these sectors, although the tariff no longer provides meaningful protection given that the imports from their principal supplier enter duty free. Another example is wood pulp for Chile in the Chile-U.S. Free Trade Agreement.
- **Sectoral RoO convergence.** Convergence could likely be accomplished more easily in sectors where the rules are similar across the hemispheric agreements. There are indeed some major sectors, such as vehicles and footwear, where RoO in the regional agreements are rather alike across agreements. Similarities tend to encompass a larger number of sectors in

certain subgroups of RTAs, such as in the “family” of agreements formed by the original NAFTA members. Such sectoral convergence could serve as a testing and training ground for pursuing convergence in the sectors where there is greater heterogeneity in rules across the hemisphere, such as textiles.

There are two important issues to keep in mind in any convergence process. First, although it is the role of governments to form and redefine international agreements, considerations of convergence should incorporate private sector actors. Companies are the end users of RTAs and thus hold the best information about the operation of RTAs and the problems posed by the RTA spaghetti bowl in regard to doing cross-border business.

The second important issue is ensuring that the convergence process neither jeopardizes the existing degree of liberalization in the region nor undermines global liberalization. At the regional level, in the case of RoO, a common regime would preferably not be more stringent than any of the RoO regimes in the hemisphere, but rather be based on a simple and flexible model. The goal of convergence processes in the region should also be to promote more liberal trade with the rest of the world so as to ensure open regionalism and compliance with WTO agreements and with the General Agreement on Tariffs and Trade (GATT).

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