

# On the Relationship between Preferential Trade Agreements and the Multilateral Trading System

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# Proliferation of PTAs

- Consensus: Multilateralism superior to Regionalism but may not be feasible
- Regionalism chosen as the next best alternative to reach global free trade
- PTAs do not always necessarily benefit their members
- Adverse effect on excluded countries

# Regionalism versus Multilateralism: The debate

- Does the current proliferation of PTAs encourage evolution toward globally free trade?
- Two approaches:
  - Endogenous Bloc Expansion: Do PTAs have a tendency to expand or to merge until reaching global free trade?
  - Endogenous Trade Policy: How do the establishment of a PTA affect the incentives of member and non-member countries to undertake MFN liberalization?

# Endogenous Expansion

- Incentives of non-members
  - Trade-off between (i) increased competition, and (ii) preferential access.
  - If the PTA had an open membership policy—PTA expansion continues until global free trade (Competitive Liberalization)
- Incentives of PTA members
  - Trade-off between (i) market enlargement, and (ii) preference dilution.
  - If PTA membership is selective—PTA expansion fails to lead to global free trade (at some point member countries reject) new members

# Endogenous Expansion: Incentives for PTA mergers

- Excluded/rejected countries have an incentive to create their own PTAs
- Would PTAs merge to yield progressively larger blocs leading to one single bloc?
- Global free trade can be achieved through merger if PTAs lower their MFN tariffs (not necessarily to zero) at the same time they abolish their internal tariffs.

# Endogenous Protection: Incentives for MFN liberalization

- Incentives of non-members
  - An increase in the degree of preference in the PTA increases the excluded country's support for large multilateral liberalization (Competitive Liberalization)
- Incentives of PTA members
  - An increase in the degree of preference in the PTA reduces a PTA member's willingness to undertake large multilateral trade liberalization
- Given sufficient trade diversion, multilateral liberalization that was feasible before the PTA can cease to be so afterwards

# Conclusion

- Vicious circle?
  - Difficulties in Multilateral liberalization prompted propagation of PTAs
  - Propagation of PTAs make Multilateral liberalization more difficult
- Adjustments to make Regionalism consistent with Multilateralism
  - PTAs should have “open membership” policy
  - PTAs should be accompanied by decrease in MFN rates

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