

News clips:

-Russia and China have affirmed their determination to support each other's core interests in a further sign of strengthening an alliance that is looked upon as-

-During his meeting with Brazil's president at the Kremlin, Putin pledged to develop economic ties between the two countries.

-Africa's relationship with China was in the spotlight this week as Senegal hosted the 2021 Forum on China-Africa cooperation.

Bruce Edwards:

As the events of the past three years chip away at globalization, some economists argue that a fragmented world will strengthen regional alliances, especially when it comes to trade.

Michele Ruta:

I disagree with this point. I think this age of conflict will change the nature of regionalism, but it will not necessarily make it stronger. And as a matter of fact, I think it will make it weaker. Going forward, we could see more discriminatory regionalism which is, instead of reducing trade barriers between members, increasing trade barriers with non-members.

Bruce Edwards:

In today's program, how growing global tensions are making regional trade, less about integration and more about discrimination.

Michele Ruta:

Regional trade agreements in the past few years increasingly have provisions such as export restrictions vis-a-vis non-members. So just to give you an example, a country may impose export bans on food. This happened, by the way, just one year ago, as food prices were climbing up, but then it excludes the members of its RTA.

Bruce Edwards:

So they can trade among the members of the trade agreement, but they won't allow trade for non-members.

Michele Ruta:

Exactly. They will allow the export of wheat, for instance, to the other members, but not to the non-members. Another example is the use of local content requirements in subsidy schemes. What more recent regional trade agreements are doing is that they say, well, it's not just the product needs to be produced in the country, it can be produced in any of the countries that are members of the regional trade agreements. So again, these are all examples of elements in agreements that are very discriminatory.

So my name is Michele Ruta. I'm currently the deputy division chief in SPR. I lead the trade team in the department. Essentially I'm a trade economist primarily, and I became interested in trade over time. There's a little bit of chance as always in life, but essentially my interest in trade is because trade is about integration, and I've always been deeply interested about integration.

Bruce Edwards:

Michele Ruta's article titled *The Rise of Discriminatory Regionalism* is published in the June edition of *Finance & Development* magazine.

So in this globalized world where countries can essentially trade with whoever they want to trade with, why would a region want to have its own trade agreement?

Michele Ruta:

Essentially, the reason why there are trade agreements is that markets need rules and these trade agreements provide rules. So just to understand what I mean. Countries, especially large countries, can take some policy actions. Tariffs would be the textbook example, and these actions can be good for themselves and have a negative effect on others.

Now, if everyone thinks that way, you end up in a situation where there are lots of tariffs and everyone is worse off. So a basic reason why you want a trade agreement is to ensure that countries don't impose too much tariffs and reduce the tariffs that they might have.

Now, why sometimes these agreements are done at the regional level instead of at the multilateral level, at the WTO, there can be different reasons. Some are good and some are less good. So one obvious reason is that the World Trade Organization has over 160 members. So it's very difficult to find an agreement in such a large context.

Another reason, which I would say is a very good reason to have regional trade agreements, is that sometimes a group of countries may want to go beyond and deepen their integration. And so that's why they want to use regional trade agreements. Another reason which is less good is that these countries may try to discriminate against non-members, and so they may go the regional route for that reason.

Bruce Edwards:

So I'm just thinking about how market forces might fit into all of this in terms of discrimination. I mean, if two countries find it beneficial to trade with each other economically, wouldn't that sort of take care of any potential discrimination within a regional trade agreement?

Michele Ruta:

That's a good point. I mean, generally, discrimination is not something that is truly beneficial even for the countries that enact such discrimination. But governments may have other reasons to act that way. The reasons can be related to national security, may be related to industrial policy, or other reasons why they decide to go that route. But as a matter of fact, in fact, that is one of the big points that I'm trying to make in the *Finance and Development*, is that regionally may be used for discriminatory purposes.

Bruce Edwards:

So market forces isn't necessarily the thing that everybody's aiming for when they're looking at trade agreements.

Michele Ruta:

Exactly.

Bruce Edwards:

So you also mentioned in your article, in your research, you talk about how the nature of these trade agreements have changed over the years, in that they include a lot more policies than they used to. How has that changed the dynamics of trade in these regions?

Michele Ruta:

Yeah, so actually regional trade agreements in the past 30 years have been very interesting, and I spent quite a bit of time trying to collect the data and look at the evidence on RTAs. So the first fact that I would say many people know is that the numbers of these agreements has exploded. So if we go back to 1990, there were less than 50 regional trade agreements. Right now, there are more than 350.

Bruce Edwards:

Wow.

Michele Ruta:

So a big, big increase.

Bruce Edwards:

And these are complicated to establish. I mean, it takes a long time to establish regional trade agreements.

Michele Ruta:

It takes a long time. It takes resources of governments to negotiate these agreements, especially because of the second aspect that has changed in RTAs is that they have become much more complex documents. Their content has changed.

So while 30 years ago or even longer, there were just a few policy areas that were covered by these agreements, and as a result, RTAs were just a few pages documents. Now they've become much, much more complex, covering many different areas.

Just to give you a schematic sense of what they cover, there are essentially three types of policy areas that they include. The first is the policy areas that try to integrate markets. This would be reductions of tariffs or reduction of services-related costs. The second is the policy areas that try to limit the ability of governments to take back market integration. So one example would be that once you open up trade-reducing tariffs, some governments may be tempted to use more subsidies, or trying to reduce competition in order always to favor domestic producers.

Bruce Edwards:

So essentially protectionist policies.

Michele Ruta:

Yes. And so there are these other set of rules that basically try to tell governments you shouldn't do this set of things.

And then the third is a concern is that market integration may come with other negative effects. Could be on labor, could be on environmental outcomes. And so these trade agreements also tend to have rules that cover this space.

One point that is very, very important, in the past 30 years if we look at the content of trade agreements, they've mostly been about deepening integration between members. So in some sense, this is a good kind of integration.

Bruce Edwards:

So how would you explain this boom of regional trade agreements over the years? Why do you think so many have been drawn up in the past 10 or 15 years?

Michele Ruta:

There are various reasons. I mean, one thing is that if we go back to what happened in the '80s with the fall of the Soviet Union, there were many more countries that were created in that period, and these countries wanted to sort of create markets. And so there was one obvious reason why this happened. But second, I think genuinely over those years, governments were trying to seek to reduce trade cost, to increase efficiency, and regional trade agreements were a tool that they have used towards those goals.

Bruce Edwards:

So you mentioned just earlier about how various provisions are included in these trade agreements, including things like environmental provisions, which only a few years ago would've been very controversial in terms of trade. How has that turned out? I mean, has this proved to benefit the environmental policies of these countries, do you think?

Michele Ruta:

So first of all, let me take a step back. So the main reason for these deeper agreements has been to promote trade. So our first question will be were they successful? And there is actually a ton of research out there that focuses precisely on this question. And the short answer is yes. These deeper trade agreements were indeed very successful. One paper finds that the deeper agreements boosts trade between members by 40%. Now, because these agreements were richer, as I was saying in terms of this policy areas, they did not only improve trade, but also other areas of integration.

So we have seen an increase in FDI, foreign direct investment, technology flows, all associated to the inclusion in these trade agreements of provisions that were precisely aiming to regulate FDI or technology, et cetera. So very successful in deepening integration between members.

One point that is underappreciated in my view is that they were also successful in promoting trade with non-members. And this is a point that requires a little bit of explanation. The reason is that many of these provisions in trade agreements were non-discriminatory in nature. And because they were non-discriminatory, they reduced trade costs between members and between members and non-members.

Let me give you an example just to pin down the point. Many of these agreements, as we said, had rules on competition. Typical rule on competition would be that member countries should have a competition authority, or if they don't have it, they should establish a new one. Now, once you go that route, it means that you improve the competitive environment in the country. And this effects in a positive way the members of the trade agreements, but any firm that operates in that market, regardless where it comes from, will have a benefit. So that's why these agreements were sort of public good. They provided a benefit to members and non-members.

So the last point that I want to make goes precisely to your point, what is the impact on other non-trade outcomes such as environment or labor? And here the picture is mixed. So in the case of the environment, there is one paper that looked at the impact of provisions that protect against deforestation or biodiversity laws on these outcomes. And what it finds is that these agreements were quite successful. So this research, just to give a number, shows that in a period of 10 years between 2003 and 2014, this type of provisions reduced deforestation of an area of 7,500 square kilometers.

Bruce Edwards:

Wow.

Michele Ruta:

This is essentially the entire forest area of a mid-size European countries.

Bruce Edwards:

That's very significant.

Michele Ruta:

It's very significant. So when governments try to include these provisions in trade agreements, I think it makes a lot of sense to protect against deforestation.

Bruce Edwards:

But what would an environmental provision look like? What does it consist of?

Michele Ruta:

So the main goal there was to avoid a specific channel, which is the reason why I think it was so successful. So what happens when a country, an advanced economy and a developing economy, sign a trade agreement is that they tend to specialize. And very often the developing economy specializes in agriculture where it has its comparative advantage. What this implies though is that they will tend to increase the arable land, the land that they can cultivate, and this is often done at the expense of forest areas.

Bruce Edwards:

That's right.

Michele Ruta:

So what the trade agreement in this case tried to do is just to impose some constraints, so protecting forest areas. And this creates incentives to intensify agriculture rather than extensify agriculture. So that's why it was successful.

Bruce Edwards:

Interesting. So the example that you just described there, where was that?

Michele Ruta:

So what we were looking in the paper was all the trade agreements globally that had provisions on deforestation.

Bruce Edwards:

I see. So wasn't one region specifically?

Michele Ruta:

It wasn't one region in particular. The countries that more frequently have these kind of provisions are the United States and the EU, and they sign agreements with different countries in Latin America, in Northern Africa, in Africa, and in East Asia.

So it's interesting that also when you look at the data, the stronger effects were in subtropical areas, which is precisely where you would want to see these effects, because that's where the remaining forest in the world are. So these provisions were very useful.

There are also examples of cases where the impact was less good. And one example that I have in my research is bans on child labor. Now, nobody likes child labor, obviously, and so it makes sense that governments try to use trade agreements to avoid child labor.

The problem with that is that we also need to think about the incentives in developing countries. So what has happened in practice is that these plans reduce schooling attainments for children, and very often because they reduce the income for low, lower-income families, it ends up having a perverse effect where children end up working more instead of working less. So that suggests that the way forward is not a straight ban on labor, but try to find incentives for poor families to avoid child labor.

Bruce Edwards:

So I think I need to unpack that a little bit... Like how would a ban on child labor affect educational outcomes for children?

Michele Ruta:

So in practice, the way it works is that in many developing countries, you have poorer income families that have kids that work and go to school. So once there is a child labor ban, they may end up not going to school because they don't have their resources. Second, is that there is a strong income effect. Very poor families rely on income from children. And because of that reason, they may send kids to work in the black market essentially, in the informal economy. And this, again, has a negative effect because the lower wages imply more hours of work and imply less schooling.

So the problem is there. It's just that advanced economies, when they think about these provisions, in addition to listening, as they obviously do, to their domestic constituencies, they should also engage with developing countries to try to understand exactly how a child labor ban would affect incentives in the developing world.

Bruce Edwards:

So where does the WTO fit into all of this? I mean, the World Trade Organization is really the body that keeps countries in line in terms of global trade. Do they have any authority over these regional trade agreements?

Michele Ruta:

So the WTO itself has surprisingly little authority on regional trade agreements. So there is first of all, a notification requirement and that most countries do it, they notify when they have a new regional trade agreement, and there are some basic rules that should be respected.

The most obvious one is that when countries sign regional trade agreements, they should not increase their tariffs vis-a-vis non-members. But that's essentially it. And this has led some people to think that the WTO and the regional trade agreements are really substitute, and the weakening of the WTO will just lead to more and stronger regional trade agreements.

Now, if we look at the last 30 years, go back to the 1990s when the WTO was created, that's also the moment where this wave of regional trade agreement started. So over this period, the WTO was fairly strong. It's dispute settlement mechanism was perfectly functioning and strong, and still we had many RTAs and many RTAs that became deeper. And so you should ask why. And the reason is that there are important complementarities between these two systems. The first is that many regional trade agreements really saw in WTO law and it's dispute settlement, their foundation. So in some sense, this was the rock upon which the RTAs were built.

Bruce Edwards:

So when there is a dispute, a regional dispute or a dispute within the regional trade agreement, does the WTO step in? I mean, do they resolve the dispute among themselves? Is there some kind of a body within the regional trade agreement that helps resolve these disputes or does the WTO still have a role?

Michele Ruta:

So first of all, what happens is that in regional trade agreements, they would typically start from WTO law, and so they just restate their WTO commitments, and then they will go a little bit beyond. So what typically happens is that these regional trade agreements have a dispute resolution mechanism, but very often they will go first to the WTO dispute settlement mechanism because it was a system that until quite recently, when essentially the US stopped appointing members to the upper body and so it stopped working, the WTO settlement system was the crown jewel of the WTO. It was working very, very well. So that's one important reason why the two systems complimented each other.

The second reason is what I was referring to earlier, is the fact that very often in these trade agreements, there will be provisions that were really non-discriminatory. They will not discriminate between members and non-members. So in that sense, they were already somehow multilateral.

Bruce Edwards:

So are these regional trade agreements, in your opinion, exacerbating the issues we're seeing in terms of fragmentation, increasing fragmentation in the world?

Michele Ruta:

Yeah, that's precisely the risk. So in relation to your point, first of all, if we had a strong and functioning dispute settlement system at the WTO, these things would be disputed and eventually you would imagine that a resolution to the dispute is found. So I would be less concerned in that world. But because that's not currently the world we are living in, then these type of provisions can proliferate. And because they

proliferate, they may increase the risk of fragmentation of the global economy. So that's essentially the concern.

Just to give you an example, if you think of the trade agreement that sort of started the deep trade agreements wave over 30 years ago it was NAFTA. The North American Free Trade Agreement was a new type of trade agreement with all those deep elements that-

Bruce Edwards:

Also very controversial.

Michele Ruta:

It was very controversial because obviously integration is always controversial, because you have those that lose and those that win. But in my mind, there was no doubt that that was an agreement about deepening integration between Canada, Mexico, and the United States. Now, if we fast-forward to the last agreements that the United States have signed, that's the Japan US Critical Mineral Agreement, very different kind of agreement.

Bruce Edwards:

And less controversial, would you say?

Michele Ruta:

Not from my point of view. That's a more controversial agreement because it's an agreement that is less about deepening integration between, in this case, the US and Japan, but it's an agreement that has stronger discriminatory elements. Now that, and I want to be clear about this point, doesn't mean that all the regional trade agreements from now on are bad.

There are very important regional integration processes that are about reduced entry costs, deepening integration with members, and those are very good and need to be supported. My favorite example there that is currently ongoing is the African Continental Free Trade Area.

Bruce Edwards:

Right.

Michele Ruta:

My point is that there are these new elements in regional trade agreements, that including important members like the United States, the European Union, China are signing or thinking to sign, that have these discriminatory elements and can increase the risk of fragmentation. Now, what's the solution of that? The solution is to try to promote multilateralism, reinvigorate multilateralism to bring countries together and trying to discuss better ways of doing things, either the guard rails or the set of rules that can limit discrimination.

Bruce Edwards:

Michele Ruta is a Deputy Division Chief in the Strategy, Policy and Review Department at the IMF. Thank you so much.



Michele Ruta:

Thank you so much for having me.

Bruce Edwards:

You can read Michele Ruta's article on the Rise of Discriminatory Regionalism in the June issue of Finance & Development magazine. Check it out at imf.org/fandd,

And look for more IMF podcasts wherever you get your podcasts. You can also follow us on Twitter [@IMF_podcast](https://twitter.com/IMF_podcast).

I'm Bruce Edwards. Thanks for listening.