ERS Report Summary

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Reciprocal Trade Agreements

Impacts on U.S. and Foreign Suppliers in Commodity and Manufactured Food Markets

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What Is the Issue?

Reciprocal trade agreements (RTAs) between two or more countries offer an alternative approach to lower trade barriers than that provided through multilateral negotiations of the World Trade Organization (WTO). But because RTAs grant preferential cross-border treatment to member countries, they may distort markets and divert trade from nonmember exporters. This study focuses on two agricultural subsectors—commodity foods and manufactured foods—and quantifies the extent to which RTAs have expanded trade between member countries and altered trade between member and nonmember countries.

Most applied research on RTAs has examined the effects on intra-bloc trade, or trade between partners belonging to the same trading bloc. This study examines the impacts of 11 RTAs on both intra-bloc trade and extra-bloc trade, or trade between member and nonmember countries. The study also differentiates between the effects on the United States as a nonmember exporter and the effects on other nonmember competitors.

What Did the Study Find?

Given that international policy dynamics make negotiating a multilateral trade agreement difficult, countries have used RTAs as a practical and feasible route to gain greater access to foreign markets. These agreements have affected the pattern and volume of bilateral trade.

- RTA membership increased trade in most commodity and manufactured food markets during the 1975-2005 period. However, in some cases, the increase in intra-bloc trade came at the expense of a shift in imports away from nonmember food exporters.
- Not surprisingly, the rise in exports to partner markets was particularly pronounced when the exporter and the importer were members of the same RTA. For example, the formation of the European Union (EU) induced an expansion of intra-EU trade in manufactured foods and commodity foods of 93 and 95 percent, respectively, between 1975 and 2005. This growth equates to an average annual increase in food trade between EU countries of 3 percent per year.

- The rise in intra-bloc trade within the North American Free Trade Agreement (NAFTA) and the Closer Economic Relations (CER) agreement was, in contrast to that within the EU, substantially greater for manufactured foods than for commodity foods. Between 1989 and 2005, trade between NAFTA members expanded 6 percent per year, on average, in manufactured foods and 3 percent per year in commodity foods. Over the same period, trade between CER members Australia and New Zealand increased 14 percent per year in manufactured foods and 3 percent per year in commodity foods.
- Empirical results also show that bloc-member exports often expanded to nonmember markets following the start of the agreement. This finding supports the view that RTA liberalization often spills over into other markets, increasing member exports to nonmember importers. Given that RTAs grant preferential treatment to members, the rise in extra-bloc trade was understandably less than the increase in intra-bloc trade (with the exception being extra-bloc trade involving members of the Association of Southeast Asian Nations Free Trade Agreement, or ASEAN).
- In some markets, nonmember exporters of food bore the cost of RTA formation. Members of ASEAN, the EU, the Common Market for Eastern and Southern Africa (COMESA), the Greater Arab Free Trade Area (GAFTA), and the South Asian Preferential Trade Arrangement (SAPTA) were found to have lowered food imports from extra-bloc exporters following implementation of the agreements. The adverse effects of four of these RTAs were more pronounced for the United States than for other nonmember exporters. COMESA diverted trade in commodity foods away from non-U.S. exporters, but it did not curtail imports of food from U.S. suppliers.

How Was the Study Conducted?

ERS adopted the gravity framework and estimated benchmark and generalized equations to quantify the effects of 11 specific RTAs on intra- and extra-bloc trade in commodity and manufactured food markets. Data used in the applied analysis include 31 years of bilateral trade flows and selected socioeconomic characteristics of 69 countries and all partner pairs covering the 1975-to-2005 timeframe. To isolate the dimensions of trade creation and trade diversion attributable to each of the RTAs, the benchmark models accounted for such factors underlying trade as bilateral exchange rates, relative factor endowments, transportation costs, and membership/nonmembership in the various RTAs. The generalized models incorporated country-pair effects. By fixing these effects, the generalized equations embody nonobservable factors affecting trade. Both theory and statistical criteria were used to differentiate and identify the preferred analytical approach.