

sciousness of business to look beyond a domestic market and in part by reducing the risks of undertaking the investments (which are of a sunk cost nature) needed to establish a foreign market presence—advertising, establishment of distribution and service support systems abroad, etc.²¹ The question then becomes whether RTAs generate net global welfare gains which in turn depend on whether or not the economic growth engendered by the efficiency gains that flow from that increased trade dominate any trade distortion and associated inefficiencies in the allocation of resources that arise from the preferential tariff structure and the dead-weight costs of administering the arrangement—for example, the costs of monitoring rules of origin to enforce the RTA.²²

The evidence suggests that, while trade diversion has probably occurred as a result of RTAs, trade creation on balance has dominated leading to welfare gains.²³ This is certainly the logical conclusion from the empirical results from gravity models that membership in an RTA boosts trade substantially.

²¹ See Caroline Freund, "Different Paths to Free Trade: The Gains from Regionalism," *The Quarterly Journal of Economics*, Vol. CXV, No. 4, November 2000.

²² The administrative costs for governments and the private sector in establishing the origin of products increases the greater are the incentives for importers and exporters to circumvent the rules by repackaging imported goods for onward export. In low-income countries, the incentives can easily lead to corruption, raising the administrative requirements of policing the system for all concerned. This is an unseen cost of trade that rises as RTAs proliferate. Avoidance of these costs is one of the major incentives for countries that trade heavily with each other to create a customs union.

²³ The strength of RTA trade creation is not entirely undisputed. Insofar as trade deals or monetary arrangements are prompted because countries trade intensively for other reasons, the empirical evidence could overstate the potential to expand trade: the flow of causation might well be from trade to these policy initiatives rather than vice versa, as we might suppose.