

Regional Trade Agreements and Integration

Comments by Bob Koopman, USITC

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My charge – as I understand it -

- is to help researchers shape their research priorities with respect to key policy questions being addressed – in this case...
- Regional Trade Agreements and Integration
- Where should researchers spend more time? And less time?

RTA's

- Bhagwati's spaghetti bowl
- “an unruly mess of criss-crossing strings that, in any case, is beyond my capabilities.”
- Guess what?
- Policy makers and trade negotiators appear to *LOVE* pasta. With the US appetite growing recently.

US interest in RTA's

- The obvious ones
 - US- Canada
 - NAFTA
 - US - Israel – perhaps not so obvious
- Old ones being “negotiated”
 - FTAA
 - APEC
- New ones being negotiated
 - Chile – well not so new...but perhaps almost done
 - Singapore
 - Jordan
 - Morocco
- Being thought about
 - Central America
 - South Korea
 - Taiwan
 - Australia
 - Xi, where i is an element of the list of countries in the world except EU and Japan?

- Did I mention UK joining NAFTA?
- Preferential agreements
 - ATPA
 - AGOA, etc.
- EU makes US interest look like childs play...
- So clearly interest in RTA's is unlikely to abate any time soon – so good idea to keep working on them.

The Challenge to researchers?

- We've got some good tools – and we are using them...
- In this conference alone – so far
 - Roland-Holst and van der Mensbrugghe
 - Ma and Wang
 - Itakura, Hertel, and Reimer
 - Cheong
 - Nakajima
 - Lee
 - Karingi, Siriwardana, and Ronge
 - Others...
- ITC studies

So lots of studies...

- Any of them find trade diversion important?
- Economics really the driving force, or cover for political goals? Integration and growth is a big empirical question. World Bank Report on Trade Blocs (2000)
- I'm going to lay out a specific challenge, rather than make a long list. Its relatively doable...
- Compared to Yesterday's services discussion....
- And it really does need to be done - but its messy and apparently not well rewarded by journals and tenure committees.
- But its important ...
- Parameters.
- Where'd you get yours?

An example using Armingtons

- There are many parameters to worry about...
- This is a story about welfare and terms of trade –
- Use GTAP and run some (65) bilateral FTA's for the US – off the shelf for illustrative purposes only
- In 22 of the 65 runs, partner country loses – and in a number of these examples TOT seem to drive the results.

The 10 biggest losers from forming an FTA with the United States

Effects of the FTA on the partner (Equivalent Variation, \$ million)

Partner	Allocative Efficiency	Terms of Trade	Capital Goods	Total
Rest of Middle East	-1535	-1604	8	-3126
Japan	-462	-1383	35	-1811
Switzerland	-859	-196	19	-1033
Rest of North Africa	-311	-496	-49	-854
Rest of EFTA	-547	-351	47	-850
Poland	-89	-173	-69	-331
Argentina	-139	-120	-36	-295
Chile	-70	-32	-14	-117
Morocco	-36	-65	-6	-108
Belgium	20	-94	-4	-78

The 10 most beneficial FTAs for the United States

Effects of the FTA on the United States (Equivalent Variation, \$ million)

Partner	Allocative Efficiency	Terms of Trade	Capital Goods	Total
Japan	-153	7465	458	7771
Rest of Middle East	99	4589	388	5075
Korea	80	3630	245	3956
China	353	3159	149	3661
Brazil	187	1800	162	2150
Rest of North Africa	57	1418	133	1608
Central America, Caribbean	382	1131	59	1572
United Kingdom	50	1289	69	1407
India	94	1036	60	1190
Germany	27	859	23	909

Armington story

- Key – demand equations, $\sigma(D, M)$
- Each country has complete monopoly in market for their exports
- This market power can be exercised by imposing a tariff (decrease export supply and get TOT gain)
- Holds for each country regardless of size - so even small economies can have non-zero optimal tariff

- Relative sigma's values across countries matter
 - Raising them all doesn't get rid of market power issue. Brown (1987)
- But many models use sigma's from standardized data base or "synthetic" values for all countries and it appears that most sensitivity analysis has varied all Armingtons, or conducted on single country model – nice example is Rutherford, Rutstrom, and Tarr (1997).
- Let's look at Chile's welfare response to various assumptions for Armington values...

US-Chile FTA – sigma changed “lock step” for all countries

Value of sigmas	Welfare Total	TOT	Allocative
Default - no change	-115	-32	-69
2x	-252	-59	-174
1/2	-40	-6	-22

- So question whether Armington's too low, or too high, when examined in "lock step" may not be that interesting – results appear materially the same in terms of relative contributions of allocative efficiency and terms of trade.
- But what happens if you think that Armington's might differ across countries, not just commodities?

		<u>USA - Chile FTA</u>			
Parameters		<u>TOTAL</u>	<u>Alloc. effic.</u>	<u>ToT</u>	<u>CGDS</u>
<i>1/2 Chile</i>	Chile	65	12	58	-5
	USA	3	12	-6	-3
<i>1/2 USA</i>	Chile	-73	-19	-40	-14
	USA	574	38	466	70
<i>2 Chile</i>	Chile	-471	376	-765	-82
	USA	4730	471	3667	592
<i>1 1/2 USA</i>	Chile	1650	288	1285	77
	USA	242	1078	-767	-69
<i>1 1/2 USA & Chile</i>	Chile	1317	465	835	17
	USA	603	1266	-652	-11

Total Equivalent Variation and components

Chile opens trade with USA

Parameters		<u>TOTAL</u>	<u>Alloc. effic.</u>	<u>ToT</u>	<u>CGDS</u>
<i>1/2 Chile</i>	Chile	4	1	11	-8
	USA	17	1	15	1
<i>1/2 USA</i>	Chile	-76	-20	-42	-14
	USA	574	38	466	70
<i>BASE</i>	Chile	-67	-18	-36	-13
	USA	297	30	230	37
<i>2 Chile</i>	Chile	-484	369	-771	-82
	USA	4733	460	3679	594
<i>1 1/2 USA</i>	Chile	-47	-15	-20	-12
	USA	98	25	63	10
<i>1 1/2 USA & Chile</i>	Chile	-290	-55	-199	-36
	USA	763	248	441	74

Conclusions

- Results appear sensitive to relative Armington values across countries.
- Any reason to assume same relative Armington's applied to every country?
- When asked about sensitivity of results to Armington specification – how do I choose “right” values?
- If going to use Armington specification systematic estimation important...