

PROJECT

The MERCOSUR and the Creation of the Free Trade Area of the Americas

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MERCOSUR NET, sponsored by the TINKER Foundation

Winners and Losers in a Free Trade Area between The United States and MERCOSUR

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Comments welcome!

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OBJECTIVES

- The development of a methodology for the construction of two lists of products, one expansive (opportunities) and one defensive (perils), for each country that participates in the creation of an FTA.
 - Mercantilist focus: exports are good and imports are bad. Trade negotiations are mercantilist.
 - The idea is to identify the private interest groups that are for or against the trade arrangement. Political economy of trade policy.
 - We argue that a government will try to include in the trade liberalization agreement those industries on the opportunities list and to exclude those on the perils list.
- The application of the developed methodology to a particular FTA: US-MERCOSUR.

ORGANIZATION

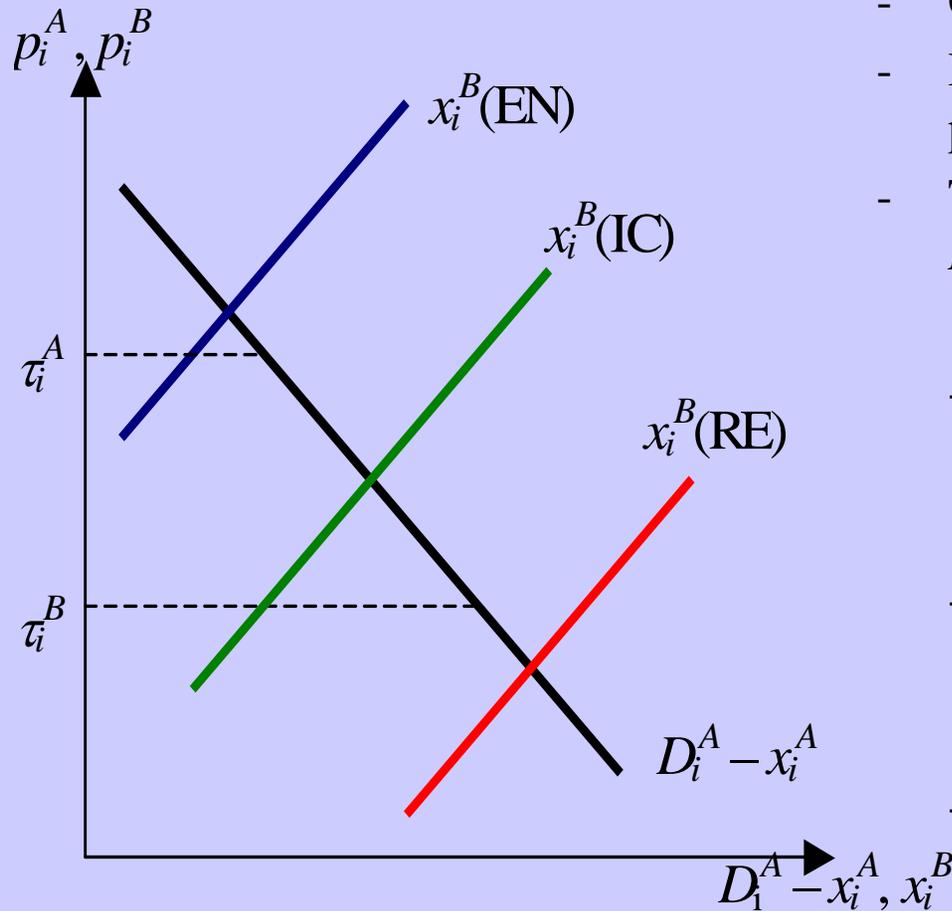
- I) Product typology for the Economic and Welfare Effects of an FTA (Grossman and Helpman, 1995)
- II) Methodology for the Construction of the Opportunities and Perils Lists
- III) US-MERCOSUR: Results and Conclusions

Grossman and Helpman Model (1995)

- Production framework: specific factor trade model; all goods are produced with labour and a sector-specific factor with constant returns to scale; and there are fixed endowments of all specific factors.
- Each consumer is endowed with labour, and possibly with some sector-specific factor. The consumer receives a lump sum transfer from the government, which corresponds to the uniform redistribution of tariff revenue.
- The owners of specific factors are all organized in lobby groups, and ownership is highly concentrated in the population. Contribution game with the government.
- Economic interests are given by the specific factor owners in a certain sector (the producers), who seek to maximize their own industry profit function, and those consumers who are only endowed with labour.
- The economy is small: the world prices are exogenous.

Typology of Cases: Regimes of Protection

Country B's Supply and Country A's Import Demand



- Countries A and B are negotiating an FTA.
- In a certain product, A is the less efficient producer.
- Three cases according to the size of country B's supply of product i :

- **ENHANCED PROTECTION**
(B small)

- **REDUCED PROTECTION**
(B big)

- **INTERMEDIATE CASE**

EN: Economic and Welfare Effects of an FTA

- Under an FTA, *A* has to continue importing from the ROW and its domestic price remains unchanged.
 - **Producers in *A*** are not affected.
 - Consumers in *A* are negatively affected: loss in tariff revenue.
 - Country *A*: welfare loss.
 - **Producers in *B*** are positively affected: they benefit from the higher protection in market *A* (Enhanced Protection). **Production expansion.**
 - Consumers in *B* could be positively affected: gain in tariff revenue.
 - Country *B*: welfare gain.
 - Zone as a whole: welfare loss.

RE: Economic and Welfare Effects of an FTA

- Under an FTA, A stops importing from the ROW and its domestic price falls to τ_i^B .
 - **Producers in A** are negatively affected: less protection under the FTA than in the initial equilibrium (reduced protection).
Production contraction.
 - Consumers in A are ambiguously affected: loss in tariff revenue and increment in consumers' surplus (positive when B is efficient).
 - Country A : ambiguous effect on welfare (positive when B is efficient).
 - **Producers in B** are not affected.
 - Consumers in B could be positively affected: gain in tariff revenue (B inefficient).
 - Country B : could be a welfare gain (B inefficient).
 - Zone as a whole: welfare gain.

METHODOLOGY

- The FTA implies a trade off between the gain in access to the new partner market and the loss in protection in the domestic market.

FIRST STEP: Industries with high Trade Complementarity (SITC 4 digits)

- Identify the industries where the greatest contractive or expansive adjustments are expected.
 - The industries in which the differences in the conditions of production in the two countries are greatest.
 - One country is an exporter and the other an importer.
 - High Trade Complementarity Set:

$$HTC^{BA} = \left\{ s \in S / XS_s^B > 1 \text{ and } MS_s^A > 1 \right\}$$

SECOND STEP: Sensitive Products (HS 6 digits)

- Identify the products for which the FTA means an improvement in access conditions to the other market.

- **Sensitive products** set when B is the exporter and A the importer:

$$SP^{BA} = \left\{ i \in s \in HTC^{BA} / X_i^B > 0 \text{ and } M_i^A > 0 \text{ and } t_i^{AB} > 0 \right\}$$

THIRD STEP: Opportunities and Perils

- Classify the sensitive products in trade opportunities and trade perils.

- **Opportunities** set for B in A :

$$OP^{BA} = \left\{ i \in SP^{BA} / x_i^{B^{FTA}} > x_i^B \right\}$$

- **Perils** for A generated from B :

$$PE^{AB} = \left\{ i \in SP^{BA} / x_i^{A^{FTA}} < x_i^A \right\}$$

FINAL LINK:

- **Enhanced protection** implies an **opportunity** but not a peril:

$$EN = \{i \in s / i \in OP^{AB} \text{ and } i \notin PE^{AB}\}$$

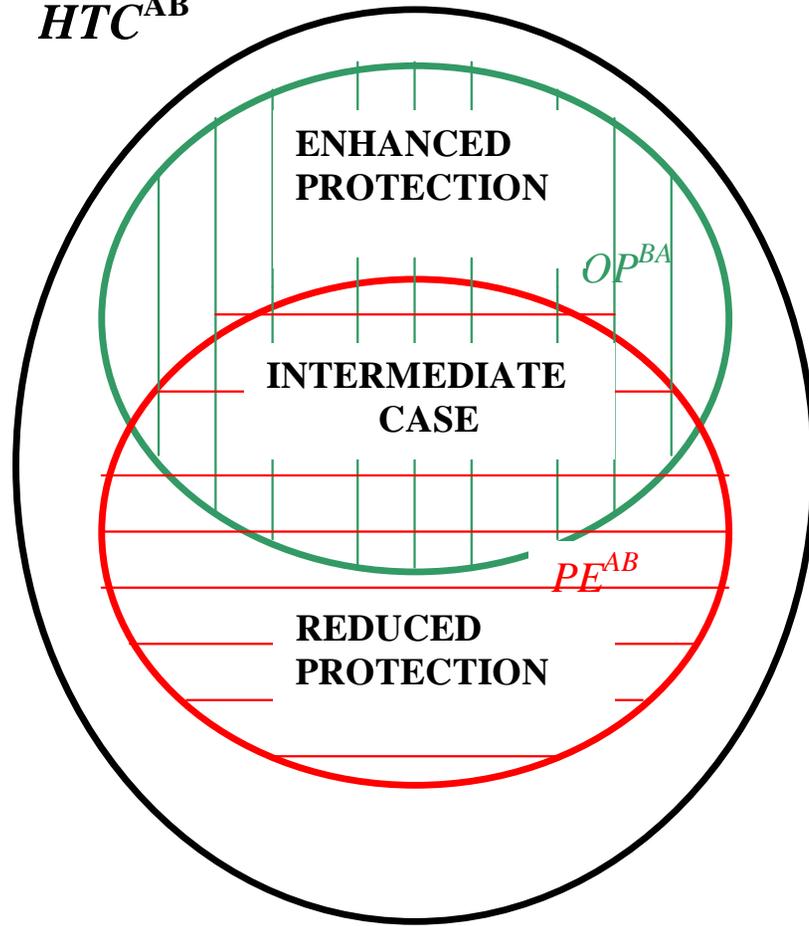
- **Reduced protection** implies a **peril** but not an opportunity:

$$RE = \{i \in s / i \notin OP^{BA} \text{ and } i \in PE^{AB}\}$$

- The **intermediate case** implies an **opportunity and a peril**:

$$IN = \{i \in s / i \in OP^{BA} \text{ and } i \in PE^{AB}\}$$

HTC^{AB}



$$SP^{BA} = OP^{BA} + PE^{AB}$$

Application to US-MERCOSUR FTA

- **Data sources:**

- Trade data (SITC 4 digits): World Trade Flows (2000)
- Trade data (HS 6 digits):
 - MERCOSUR countries: LAIA
 - US: USITC
- Trade policy data:
 - MERCOSUR CET: LAIA
 - US MFN tariffs (ad valorem equivalent of complete MFN rate) + GPS preferences: USITC
- Import elasticities: GTAP

SETS OF PRODUCTS

		Argentina	Brazil	Paraguay	Uruguay	USA
Total exports	Value (mill USD)	25187	52053	1034	2631	680474
	Industries (SITC4)	470	468	254	393	482
	Products (HS 6)	4142	4250	499	1873	5091
	Impoused Tariff	4.7	5.55	3.04	5.87	9.89
	Big division (SITC1)	0	7	2	0	7
	Big division share	0.38	0.24	0.56	0.46	0.52
Trade Complementarity	Export share	0.26	0.47	0.11	0.27	0.47
	Industries (# SITC4)	46	85	19	36	134
	Products (# HS 6)	323	799	34	181	1781
	Impoused Tariff	5.12	7.24	8.25	6.03	9.42
	Big division (SITC1)	0	7	0	0	7
	Big division share	0.38	0.27	0.68	0.76	0.62
Sensitive Products	Export share	0.07	0.15	0.07	0.17	0.38
	Industries (# SITC4)	23	35	4	17	129
	Products (# HS 6)	86	168	19	96	1686
	Impoused Tariff	15.53	21.55	13.11	9.13	11.66
	Big division (SITC1)	0	0	0	0	7
	Big division share	0.48	0.32	0.77	0.77	0.57

OPPORTUNITIES AND PERILS

		Argentina	Brazil	Paraguay	Uruguay	USA
Sensitive Products	Export share	0.07	0.15	0.07	0.17	0.38
	Industries (# SITC4)	23	35	4	17	129
	Products (# HS 6)	86	168	19	96	1686
	Impoused Tariff	15.53	21.55	13.11	9.13	11.66
	Big division (SITC1)	0	0	0	0	7
	Big division share	0.48	0.32	0.77	0.77	0.57
Reduced Protection	Export share	0.06	0.11	0.06	0.13	0.38
	Industries (# SITC4)	20	25	8	7	129
	Products (# HS 6)	47	61	12	16	1686
	Impoused Tariff	16.99	26.57	13.73	7.98	11.66
	Big division (SITC1)	0	0	0	0	7
	Big division share	0.53	0.44	0.87	1.00	0.61
Enhanced & Intermediate	Export share	0.01	0.04	0.01	0.04	
	Industries (# SITC4)	10	19		12	
	Products (# HS 6)	25	64	6	80	
	Impoused Tariff	22.61	8.53	8.72	13.04	
	Big division (SITC1)	7	8	8	8	
	Big division share	0.90	0.65	0.63	0.97	

Main Opportunities and Perils

		Argentina		Brazil		USA	
		HS	Export	HS	Export	HS	Export
Sensitives products							
First product		870421	373	200911	1133	852520	1568
Second product		020130	346	170111	1070	870899	1463
Third product		020230	201	640399	1002	870829	1039
Reduced protection							
First product		870421	373	200911	1133	852520	1568
Second product		020130	346	170111	1070	870899	1463
Third product		020230	201	240120	892	870829	1039
Enhanced&intermediate							
First product		870431	153	640399	1002		
Second product		870120	5	401120	228		
Third product		640610	5	401110	177		

FINAL REMARKS

- All sensitive products with the US as the exporter constitute a peril for MERCOSUR producers (belong to the reduced protection set).
 - These perils are concentrated in industries of machinery and transport equipment.
- A majority of the sensitive products with the MERCOSUR as the exporter constitute a peril for US producers.
 - These perils are concentrated in agriculture and there are some relevant manufactures too.
- MERCOSUR producers have some opportunities.
 - Brazil: footwear, rubber products, apparel.
 - Argentina: motor vehicles.
 - Agricultural products when the FTA creation implies an increment in world prices.
- The majority of sensitive products in the reduce protection sets suggests that consumers in both sides would enjoy a welfare gain under an FTA.