

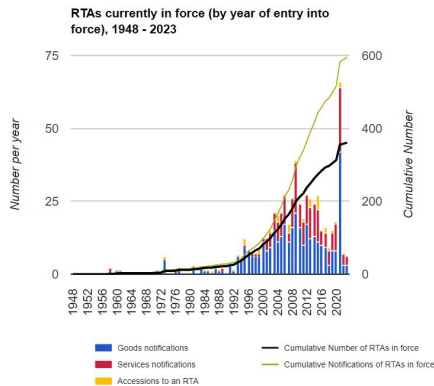
# Firms, Dynamics, and Stumbling Blocks in Trade

Jason Sanwalka Davis

Florida State University

October 27, 2023

# Are Preferential Trade Agreements “Stumbling Blocks”?



## Recent Notifications

RTA Name	Coverage	Date of notification	Date of entry into force
India - Australia	Goods & Services	Sep 7 2023	Dec 29 2022
United Kingdom - Australia	Goods & Services	Jun 22 2023	May 31 2023
United Kingdom - New Zealand	Goods & Services	Jun 22 2023	May 31 2023
Korea, Republic of - Cambodia	Goods	Jun 21 2023	Dec 1 2022
Indonesia - Korea, Republic of	Goods & Services	Jun 15 2023	Jan 1 2023

# Are Preferential Trade Agreements “Stumbling Blocks”?

## *Trans-Pacific Trade Partners Are Moving On, Without the U.S.*

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Trade ministers and delegates from the members of the Trans-Pacific Partnership at a meeting Thursday in Vietnam. Eleven countries committed themselves to resurrecting the pact without the United States. Pool photo by Na Son Nguyen

By [Alexandra Stevenson](#) and [Motoko Rich](#)

Nov. 11, 2017

# Are Preferential Trade Agreements “Stumbling Blocks”?

## The meaning of RCEP, the world’s biggest trade agreement

It is unambitious in scope but marks a win for China and a setback for India and America



Nov 15th 2020

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# Are Preferential Trade Agreements “Stumbling Blocks”?

## A new trade deal has FOMO as its secret sauce

The aim is to make President Donald Trump feel like he is missing out



Jul 6th 2019

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## Argentina, Brazil seek 12.5 billion euros of financial aid in EU-Mercosur talks

By **Belén Carreño** and **Anthony Boadle**

October 20, 2023 2:35 PM EDT · Updated 6 days ago



# YES, because they:

- ▶ Divert trade negotiations from multilateral institutions (WTO)
- ▶ Concentrated production alleviates collective action problems for protectionists

# NO, because they:

- ▶ Weaken the influence of import competing industries/firms
- ▶ Reduce the number of “building blocks” in multilateral negotiations

## This paper: MAYBE, because:

- ▶ Liberalization within a PTA bloc → concentration of production in large/productive firms who:
  - ▶ Benefit more from integration with world markets
  - ▶ Better able to lobby
- ▶ QUESTION: will these remaining firms oppose further liberalization?
- ▶ **ANSWER: Depends on competitiveness of PTA firms relative to world markets**



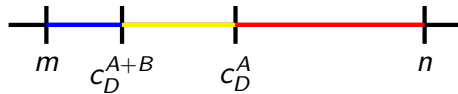
# Model: Economic foundations

- ▶ Builds off of Melitz and Ottaviano (2008). Features:
  - ▶ Monopolistic competition.
  - ▶ Consumer preferences for variety are quasilinear (in numeraire) and quadratic (in differentiated sector).
  - ▶ Firms differ in productivities.

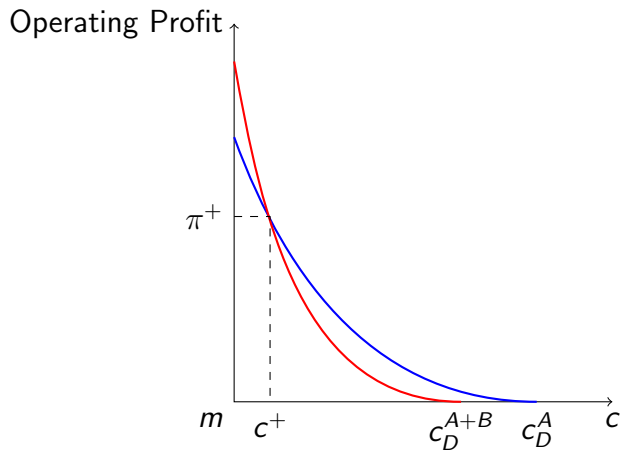
# Model Example: Countries and Technology

- ▶ Two identical countries,  $A$  and  $B$ , are potential parties to a PTA.
- ▶ Third “country”,  $W$ , stands in for the remainder of world markets. Same size as  $A + B$ , much more productive
- ▶ All other characteristics (love of variety, etc.) identical.
- ▶ Country A:  $c \sim U(m, n)$ ,  $L_A = L'$
- ▶ Country B:  $c \sim U(m, n)$ ,  $L_B = L'$
- ▶ Country W:  $c \sim U(0, m)$ ,  $L_W = 2L'$

# Firms after liberalization between A&B



# Profits after liberalization between A&B



# World Market Integration

- ▶ Model example assumes world markets are **much** more productive.
- ▶ As a consequence, the cutoff when  $A$  and  $B$  are integrated with  $W$  is **below** the cutoff for the most efficient firm from  $A$  or  $B$ .
- ▶ **Therefore:** All firms in  $A$  and  $B$  exit.

- ▶ A Grossman-Helpman type setup: money in exchange for policy
- ▶ Fixed cost to engaging in any lobbying  $F > \pi^+$
- ▶ Because every firm is eliminated upon integration with  $W$ , they are willing to pay any profits to avoid this
- ▶ **With these assumptions:** Concentration of production in larger, more productive firms after  $A$  and  $B$  integrate increases the surplus over fixed costs that can be used for lobbying against liberalization.
- ▶ **Consequence:** lower likelihood of liberalization with  $W$  than if  $A$  and  $B$  did not integrate first.

# NAFTA and the Auto Sector



# NAFTA and the Auto Sector

- ▶ Estimates that half of the gains came from reallocations from less productive to more productive firms. (Trefler 2004)
- ▶ Gordon Hanson suggests that without the trading bloc, “we would have lost the whole [auto] industry”.
- ▶ Auto tariffs continue to exist (2.5% on all cars, 25% on light trucks and vans), and higher protection has been threatened recently (Section 232 via Trump administration, demands for export restraint)
- ▶ Would such latent protectionist impulses still be present if the industry had essentially ceased to exist? Absence of the bloc may have led to full liberalization with world markets.



# Eurasian Economic Union and the Auto Sector



Photo by Andrey Lunin  
Andrey Lavrentiev.

*“The auto market only really developed after Kazakhstan entered the Customs Union (CU), because Kazakhstan - with a population of just 17 million - is a very small market. The Russian market, by contrast, is large. The CU increased customs duties to 30%, and car manufacturers were suddenly given incentives to develop. ”*



## THE ASTANA TIMES

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### Kazakhstan's New Vehicle Sales See 60% Growth in January-June

BY STAFF REPORT *in BUSINESS* on 25 JULY 2023

ASTANA – The Kazakh car industry witnessed a 60.2% increase in new car sales in the first half of the year, reported the Association of Kazakhstan Auto Business on July 17.

Customers purchased 83,235 new cars in January-June.

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# Eurasian Economic Union and the Auto Sector

KAZAKHSTAN, CENTRAL ASIA, ARMENIA



## Kazakhstan cracks down on Eurasian Union car imports

Used cars are far cheaper in other members of the Eurasian Economic Union. So some 170,000 Kazakhs imported cars from these partners duty-free. Now they're getting an unexpected bill.

Yelnur Alimova Feb 20, 2020

31 JUL 2019, 08:48

## Kazakhstan bans state procurement of foreign cars for two years

# Conclusions

- ▶ There exist conditions under which liberalization within a bloc leads to more effective resistance to future liberalization.
- ▶ Suggests implications for the stepwise path of liberalization; order might matter!
- ▶ Exploration of the conditions under which this can happen will yield further insight, e.g.:
  - ▶ Which political institutions yield higher fixed costs to lobbying?
  - ▶ What kinds of trade agreements are likely to privilege firms who are uncompetitive with respect to potential future agreements?
- ▶ Moreover: how will forward-looking actors' political calculus change with knowledge of effects on future influence?