Australia, EU and the potential for deep integration: what information is there in the trade statistics?

Trade and Investment issues for the 21st century: Building an Agenda for Australia/EU Cooperation
ANU 17 & 18 November 2009

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Outline
• The Sussex Framework for helping to analyse Trade policy choices
• Rules of thumb and diagnostic statistics
• Australia/ EU relations in the context of the Sussex Framework
• Looking for deep integration in the Australian/EU trade in goods data
• Concluding thoughts

Sussex Framework
• The genesis was the need for desk officers in a development ministry to get a quick fix on how trade agreements affected specific developing countries
• trained people + resources key binding constraint for any bureaucracy and for assessing policy.
• Existing methods (econometrics, CGE) are expensive
  – highly skill intensive
  – often depends on heroic assumptions about the data and behaviour: our system is fairly robust
• work at a highly aggregate level
• Intention to create an easy to use and understand framework on impact of specific agreements to help relax that constraint
• Trade policy analysis which is effective, cheaper, easier, and can work at a much more detailed and flexible level.

The objectives...
• To check-off and analyse the actual content of any proposed agreement in a systematic way that reveals
  – what is in and what is out
  – the extent of proposed liberalisation and any exceptions
  – potential for overall welfare impact
  – potential for impact on particularly politically sensitive groups
  – remaining regulatory barriers and the elements of deep integration proposed
• how it interacts with existing agreements including WTO
• To be replicable and capable of being used with readily available and cheap data
• Offers ability to work at highly disaggregated level
• To be useful for economically literate but non-specialist staff and therefore to build in-house capability

The approach taken...
• four key elements:
  – conceptual base
  – looking at details of agreements / changes in trade policy using an analytical check list of the likely elements and their implications
  – simple rules of thumb for assessing the likely impact of integration eg. with respect to balance of trade diversion and trade creation
  – A range of diagnostic indicators
• The SF has been applied in the context of a series of bilateral agreements:
  – EU-India, Egypt, Russia, Georgia, Armenia, SAARC, UK-Korea, EU-Pakistan...
  – Presented at / used with World Bank, European Commission UNCTAD, IMF, DFID, OECD, WTO....

Conceptual base
• Empirics and theory identify (potentially substantial) gains from trade
  – But, for example, in the context of regional integration issues of trade creation / trade diversion arise
• Distribution versus efficiency:
  – identifying where barriers / distortions are high
  – importance of sectoral issues
• Possible importance of deep integration:
  – Investment,
  – productivity,
  – technology transfer,
  – economic growth
Checklist:

<table>
<thead>
<tr>
<th>Category</th>
<th>Potential issues raised</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Nature of economic relationship between partner countries</td>
<td>size, asymmetry, tariff levels, cost differences.</td>
</tr>
<tr>
<td>1. FTA or Customs Union, or other</td>
<td>flexibility, rules of origin</td>
</tr>
<tr>
<td>1. Overlap with other agreements</td>
<td>complementarities + spaghetti bowl, preference erosion</td>
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<tr>
<td>1. Likely ease of negotiations</td>
<td>depth &amp; scope of agreement, sensitive sectors, exceptions</td>
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<tr>
<td>1. Barriers to trade</td>
<td>tariffs, NTBs: incidence, levels &amp; range</td>
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<tr>
<td>1. Elements of deep integration</td>
<td>Standards, trade defence, investment rules, competition policy, labour mobility...</td>
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<td>1. WTO compatibility</td>
<td>important if third country may be affected</td>
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<td>1. Role of donors</td>
<td>motivation of the agreements, presence + extents of assistance</td>
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Rules of Thumb

- The effects will be greater the higher are the initial barriers
- The higher the percentage of trade with potential partners the more likely the agreement will be welfare enhancing.
- The greater the number of partners the more likely it is the agreement will be welfare enhancing.
- Wide differences in comparative advantage likely to lead to a welfare improving agreement provided the initial barriers are not too high and these differences are not already fully exploited.
- The more similar is the product mix in the economies concerned and the higher the elasticities of supply the more likely there is to be welfare gain through trade creation from bilateral liberalisation
- The greater the possibilities for supply chain integration the greater the likely gains

Diagnostic indicators:

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Revealed Comparative Advantage at 2 Digit

Not much Intra Industry trade at top ten level at 4 digit level

Low RCA turn into high RCA the deeper you drill

Some more evidence among the high RCA commodities at 4 digit – Honest!
So what is there to say on goods

- Australia’s trade with the EU is dominated by products where by and large regulatory barriers are not yet a big issue (coal?)
- There are areas of manufacturing success with high revealed comparative advantage in pharma, electrical and mechanical industries
- There are a few signs of IIT at high level and growing but very spotty and supply chains not much in evidence
- These limited areas of success might deserve further investigation to see what regulatory barriers there are
- But also some investigation at home to see why they are these successes and what there is to learn