

A

STUDIES ASSESSING THE COSTS OF PROTECTION

A.1 Costs from trade protection arise in a number of ways, as outlined from paragraph 3.42 in the main text.¹ The costs of protection can be estimated by using models that take account of how barriers to trade affect production and consumption decisions of firms and households in both domestic and foreign markets. Depending on their complexity, models account for a combination of changes in prices, trade volumes, allocation of resources (capital and labour), production, consumption, terms of trade, government revenue and more. They provide estimates based on a particular scenario of reductions in tariffs and other forms of trade protection.

A.2 Such models estimate the total welfare change, expressed in monetary terms, resulting from the scenario they have used. It is often divided into effects on different countries, regions or economic sectors. The estimated gains represent the value of the increased consumption made possible by a reduction in protection, and combine the effect of changes to incomes and changes to consumer prices.

A.3 Of necessity, any model is a simplified representation of the real world, and the choice of modelling assumptions accounts for much of the variation in results obtained by different studies. Variation is also driven by uncertainty over the precise values of the parameters which determine the supply and demand of goods and services within each model.

A.4 Key choices will include the number of sectors and regions included ('dimensionality'), the elasticity of substitution between products,² and which variables are considered exogenous.³ Some degree of aggregation will also be necessary, and while this can help a model to focus better on specific countries, regions or production sectors, the model's applicability to other areas will be reduced. Estimates will also depend on whether reductions are taken to occur from bound or applied tariff levels.⁴

A.5 Assumptions about market structure are significant. In general, estimates of the costs of protection are greater in models that consider imperfect competition. This allows for product differentiation between firms as well as between countries and introduces market power effects. Estimates tend also to be higher in models that allow for increasing returns to scale, in which productivity rises as the scale of production increases. The potential gains from specialisation in the presence of larger markets are an important source of gains from openness in new trade theory. However, estimates of market power and scale economies required for such models introduce additional uncertainty as they expand the set of parameters which need to be specified.

¹ Some studies describe their results as costs of protection, others as potential benefits of liberalisation. We regard the two as equivalent: both measure differences in welfare between more protected and less protected markets. A potential benefit from liberalisation represents a current opportunity cost of protection.

² High elasticities tend to give rise to greater effects from liberalisation

³ *Exogenous variables* are those external to the model which are fed in as data inputs. Values of *endogenous variables* are calculated within the model and are its intermediate or final outputs.

⁴ Bound levels are upper limits agreed internationally, usually in the WTO. Applied levels are the tariffs actually imposed on traded goods, and can be far lower, especially in developing countries. Reductions in bound tariff levels can have little or no effect on applied tariffs for certain products and countries.

A.6 Models which consider dynamic effects, such as changes in investment, productivity and technological spillovers, tend to yield larger overall effects than models which do not. They are more accurate to the extent that they capture additional sources of protection costs which are ignored by simpler models. However, uncertainty about the magnitude of such effects contributes to the variation between different model results. In addition, dynamic effects are likely to build over time, and may have a limited effect in the short run.

A.7 Studies divide broadly into two types: Computable General Equilibrium (CGE) and Partial Computable Equilibrium (PCE).

A.8 CGE models take a broad approach, designed to estimate aggregate impact and take account of the interactions between different sectors. They generally divide the economies under consideration into production and consumption sectors and model changes to all sectors simultaneously. Most models in the literature are of this type, and Annex B summarises the results of a selection of recent CGE-model studies.

A.9 By contrast, PCE models⁵ generally consider the effects within a given sector, and generally do not attempt to model the effect of interactions between sectors. This can lead to an underestimation of the total effects, but the lower level of aggregation allows for more accurate modelling of specific industry demand and supply conditions as well as changes in trade barriers that have highly distortionary effects on certain industries. PCE models can therefore provide finer detail on the effects of trade liberalisation within particular industries, such as changes in prices, costs to consumers and the effect on jobs.

A.10 Results from all these models must be viewed as estimates only, and are inevitably dependent on the assumptions embedded in model. In particular, they take account neither of the political aspects that play a role in trade policy, nor intricacies specific to individual countries. Many general assumptions – efficient operation of markets, small effect of any rigidities constraining supply-side responses and of corruption or poor governance – may lead to overestimation, particularly in developing countries. Nevertheless, these models provide an indication of the potential benefits of trade reform and are important tools for understanding the implications of trade policy decisions.

⁵ Such as those used in the IIE studies referred to in Chapter 3

B

ESTIMATIONS OF GLOBAL WELFARE GAINS FROM TRADE LIBERALISATION

B.1 Models consider gains post implementation of Uruguay Round agreements. (Lippoldt and Kowalski, 2003, find gains of \$18bn still waiting to be realised from completion of UR)

Model	Base year ¹	Projection year	Scenario ²	Gains (US\$ billion p.a.) ³		Comments on distribution of gains
				Global	DC only ⁴	
Static, with perfect competition and constant returns to scale						
Lippoldt and Kowalski (OECD) 2003	1998		100%↔M tariffs	63.3	51.4	DCs gain more in absolute terms, as well as % of GDP
			100%↔M tariffs plus trade facilitation	139.5	73.0	
			50%↔A + M tariffs	41.1	28.2	DCs gain more in absolute terms, as well as % of GDP
			50%↔A + M tariffs plus trade facilitation	117.2	50.0	If include trade facilitation, DCs gain more as % of GDP, but not in absolute terms.
			100%↔A + M tariffs,	97.2	68.4	DCs gain more in absolute terms, as well as % of GDP
			100%↔A + M tariffs, plus trade facilitation	173.6	90.1	
			100% liberalisation in ICs; 50% liberalisation in DCs	63.2	62.0	DCs gain more in absolute terms, as well as % of GDP
			100% liberalisation in ICs; 50% liberalisation in DCs, plus trade facilitation	139.4	83.5	

¹ 1995 equates to GTAP 4; 1997 equates to GTAP 5; + indicates data for services also added (services are not included in GTAP); (+) indicates data set updated in some form but services not added.

² A = agriculture; M = manufacturing; S = services; ↔ indicates a reduction.

³ Welfare gains measured by Equivalent Variation

⁴ Throughout table DCs = developing countries; ICs = industrialised countries

Model	Base year	Projection year	Scenario	Gains (US\$ billion p.a.)		Comments on distribution of gains
				Global	DC only	
World Bank Global Economic Prospects 2002 (static version)	1997	2015	100% liberalisation in A by all	248	142	
			100% liberalisation in A + M by ICs only	124	75	
			100% liberalisation in A + M by DCs only	239	121	
			100% liberalisation in A + M by all	355	184	
World Bank Global Economic Prospects 2004 (static version)	1997	2015	A cut to 10% in ICs, 15% in DCs	193	101	
			M cut to 5% in ICs, 10% in DCs	98	58	
			A + M cut by ICs and DCs	291	59	
Anderson, Francois, Hertel, Hoekman, and Martin 2000	1995	2005	100% M liberalisation	254.3	108.1	
			100% A liberalisation	164		
Cernat, Laird and Turrini (UNCTAD) 2002	1997+		50%↔A applied tariffs	21.5		
			50%↔A applied tariffs in ICs only	9.6		
			100%↔A subsidies (tariffs unchanged)	-1.8		\$-2.2 loss for N Africa and Middle East; \$2.4 gain for W Europe. Net global loss.
			50%↔M applied tariffs	39.6		

Model	Base year	Projection year	Scenario	Gains (US\$ billion p.a.)		Comments on distribution of gains
				Global	DC Only	
Hertel and Martin 2001	1995+		33% \Leftrightarrow M applied tariffs	107.4		DCs gain more in relative terms
Shakur, Rae and Chatterjee 2002	1997	2005	36% \Leftrightarrow A + M tariffs; 36% \Leftrightarrow A subsidies in ICs	38		
			100% \Leftrightarrow A + M tariffs plus removal of subsidies by all	82.3		All gain except USA which suffers negative terms of trade effect
Van Meiji and Van Tongeren 2001	1997		100% \Leftrightarrow A tariffs and domestic A support	44.4		
			100% \Leftrightarrow M protection	78.3		
Diao, Somwaru and Roe 2001 (static version)	1997		100% \Leftrightarrow A tariffs and domestic support	31		
			100% \Leftrightarrow A + M tariffs	82	18 ⁵	Both OECD and non-OECD groups gain 0.2% of GDP.
Dessus, Fukasaku and Safadi (OECD) 1999 (static version)	1995 (+)	2010	100% \Leftrightarrow A+M tariffs by OECD; 50% \Leftrightarrow A+M tariffs by non-OECD	73	43	Non-OECD gain more as % of GDP and also in absolute terms.
			100% \Leftrightarrow A+M tariffs by OECD; non-OECD \Leftrightarrow A+M tariffs to 5% max.	81	37	Non-OECD gain more as % of GDP but not in absolute terms.

⁵ Breakdown of gains for Dessus et al model are to non-OECD countries

Model	Base year	Projection year	Scenario	Gains (US\$ billion p.a.)		Comments on distribution of gains
				Global	DC Only	
ABARE 2000	1997	2010	50%↔A support	53		
			50%↔A support plus 50%↔import protection in all other sectors	94		
Australian Department of Foreign Affairs and Trade 1999	1995		50%↔A barriers	90		
			50%↔M barriers	66		
			50%↔S barriers	250		
			50%↔barriers in all sectors	406		
			100%↔barriers in all sectors	750		
Static, with imperfect competition and increasing returns to scale						
Nagarajan 1999	1995		20%↔in all protection on M, A + S, plus trade facilitation	219		All gain. Over half accrue to DCs
			50%↔in all protection on M, A + S, plus trade facilitation	385		All gain. Over half accrue to DCs
Dee and Hanslow 2000	1995 (+)		100%↔A + M tariffs	133.5		
			100%↔S barriers	133.4		
Brown, Deardorff, Stern 2002	1995	2005	33%↔A tariffs + subsidies	-3		Most regions experience some loss (except EU/EFTA, S Asia, Thailand)
			33%↔M tariffs	163.4		
			33%↔S barriers	413.7		
			33%↔in A, M + S	574.0		Large + positive for all regions
			100%↔in A, M + S	186.0	370	

Model	Base year	Projection year	Scenario	Gains (US\$ billion p.a.)		Comments on distribution of gains
				Global	DC Only	
Dynamic Models						
Dessus, Fukasaku and Safadi (OECD) 1999 (dynamic version)	1995 (+)	2010	100%↔A + M tariffs	1212	455 ⁶	non-OECD gain more as a percentage of GDP.
			100%↔A+M tariffs by OECD; 50%↔A+M tariffs by non-OECD	912	292	non-OECD gain more as a percentage of GDP.
			100%↔A+M tariffs by OECD; non-OECD ↔A+M tariffs to 5% max.	1183	459	non-OECD gain more as a percentage of GDP.
Scollay and Gilbert 2001	1995		100%↔A tariffs	69.43		
World Bank Global Economic Prospects 2002 (dynamic version)	1997	2015	100% liberalisation in A by all	587	390	
			100% liberalisation in A + M by ICs only	273	124	
			100% liberalisation in A + M by DCs only	575	424	
			100% liberalisation in A + M by all	832	539	
World Bank Global Economic Prospects 2004 (dynamic version)	1997	2015	A cut to 10% in ICs, 15% in DCs	358	240	
			M cut to 5% in ICs, 10% in DCs	156	108	
			A + M cut by ICs and DCs	518	349	

⁶ Breakdown of gains for Dessus et al model are to non-OECD countries

Model	Base year	Projection year	Scenario	Gains (US\$ billion p.a.)		Comments on distribution of gains
				Global	DC Only	
Diao, Somwaru and Roe 2001 (dynamic version)	1997		100%↔A tariffs and domestic support	56		
			50%↔A protection	27		
François 2000	1995		50%↔A, M + S protection	384		

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