

# **Managing Integration: Capital Market Effects of Regional Trade Agreements**

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# Why Should we *Really* Foster Integration? Development!

- International Trade: Potentially Key Driver of Development
  - Competitors: institutions, geography, ...
- Universal Agreement: *trade never hurts*
  - Disagreement about financial integration
- Lots of Evidence
  - Academics (Frankel-Romer)
  - Policy-Makers (E Asia, China, ...)

# How to Stimulate Trade?

- Technological Innovation
  - Largely from private sector (not exclusively)
- Important Role of Public Sector
  - Liberalization, reducing trade barriers

# Multilateral Liberalization

- Widespread Agreement: multilateral approach best (Bhagwati, *Economist*)
  - Hence importance of WTO
    - Chinese accession 2001
    - Pending Russian accession? (began 1993)
- But is multilateral liberalization feasible?
  - Doha round dragging on
  - “Lack of enthusiasm” for WTO

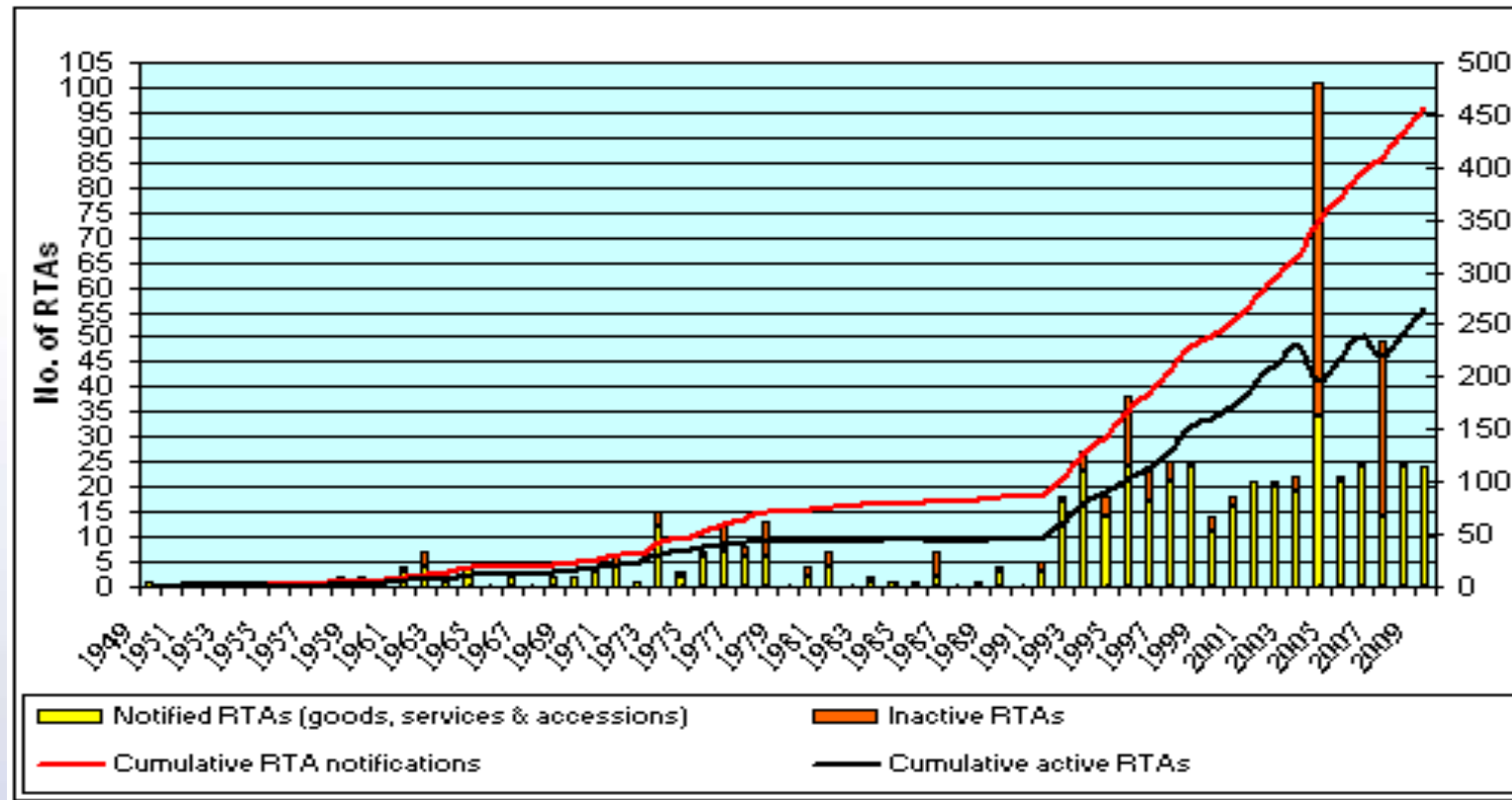
# Regional Trade Agreements: A Viable Alternative?

- RTAs may be “building blocks” for liberalization ... or “stumbling blocks”
- Effects of RTAs on income and welfare much disputed
  - Trade: beneficially “created” or harmfully “diverted”?
    - Diversion: governments loses more tariff revenue than consumers gain

# RTA Effects even on *Trade* is Disputed

- Estimates of effectiveness vary dramatically
- RTAs are not random but *endogenous*
  - RTAs deliberately chosen by those likely to trade anyway
- Difficult to analyze RTA effects without reliable international trade model

# But ... RTAs are Proliferating



# A Special Doubt: Do Poor Countries Benefit from RTAs?

- New Trade Pacts Betray the Poorest Partners *Wall Street Journal* July 10, 2004
  - “The United States and Morocco last month signed a new bilateral trade treaty ... But regrettably, in negotiating the trade agreements with Morocco, Chile and other countries ... economic policy was dictated more by special interests than by a concern for the well-being of our poorer trading partners.”



# The View of Stiglitz

- “Trade negotiators I met in other countries point out that you don’t negotiate with the United States; it’s ‘take it or leave it’” Stiglitz said.  
– *Korea Herald*, Nov. 16. 2007

# What Does the Data Say?

- Results from some recent research  
*“Who Benefits from Regional Trade Agreements? The View from the Stock Market”*
  - joint with Christoph Moser (ETH, Zurich)
  - freely available online

# Objective

- Who, if anyone, gains from integration achieved through Regional Trade Agreements?
  - Special focus on developing countries
  - Much data from Europe (continuing accession to EEC/EC/EU)

# Technique

- Rely on views from Capital Markets
  - Stock Markets assessment of RTA news
  - Markets look forward
  - Little reliance on econometric models
    - “Event-Study” methodology
  - Use data on many RTAs, countries, dates
    - Which features lead to biggest gains?

# Data Set

- Examine all possible observations of RTAs news with stock markets
  - 122 Regional Trade Agreements
  - 1988 through 2009
  - 82 countries with active stock markets
    - Developed and developing
  - 1001 observations of RTA “events”

# Examples

- EC-Croatia (May 24, 2000) “Start”
  - “European Commission recommended closer ties with Croatia as recognition for reforms underway there [...] proposal authorizing the start of negotiations for a Stabilization and Association Agreement between the EU and Croatia.”
- Chile-China (Nov 18, 2004) “Start”
  - “Chinese President Jintao and Chilean President Lagos said Thursday they have agreed to commence negotiations for a bilateral FTA.”

# RTAs: Stock Markets Care!

- “Mexican stocks closed higher Wednesday as news that Mexico and the European Union has reached a long-awaited agreement on a free trade pact buoyed market activity ... market’s key *IPC* index closed up 71.29 points or 1.2 percent”
  - AP, Nov 24, 1999

# Sign of Effect not Guaranteed

- “Singapore share prices fell 0.8 percent Wednesday as bank stocks fell on concerns about increased competition from US institutions when a bilateral trade pact takes effect, deals said.”
  - Agence France Press, Nov 20, 2002



# Data Details

- WTO collects data on RTAs (“RTA-IS”)
- Examine residual stock market change around RTA “news” days
- Dates identified via LexisNexis (!)
  1. “Start” of RTA negotiations
  2. RTA “Deal” reached

# Methodology

- National Stock Market indices
  - Denominated in both LC and \$
  - Taken from *GFD*, *MSCI/Barra*, *S&P*, ...
- Remove global stock market changes
  - MSCI World and EAFE indices for world
  - Adjust daily returns (1,13) months before RTA news to estimate “abnormal” returns

# “Cumulative Abnormal Returns”

- Use windows of different lengths around RTA news
  - Start one day before
  - End 1/3/5/10/15/20 days after
- Link CARs to conventional macroeconomic/financial determinants
  - Country size, income, openness, financial development, exports, ...

# Findings

1. Gains are *inversely* linked to income per capita
  - Poorer countries benefit more from RTAs
2. Gains are bigger for “natural” RTAs
  - Countries gain more if they liberalize with current trading partners
3. Gains are bigger for more closed countries (weaker)

# Key Table

**Table 1: Default - Stock Market Returns in Local Currency**

Event window	(t-1, t+1)	(t-1, t+5)	(t-1, t+10)	(t-1, t+15)	(t-1, t+20)
<i>Log Real GDP p/c</i>	-0.231* (0.09)	-0.357** (0.11)	-0.419** (0.15)	-0.573** (0.21)	-0.676** (0.24)
<i>Log Population</i>	-0.023 (0.04)	-0.026 (0.08)	0.011 (0.11)	-0.128 (0.13)	-0.097 (0.16)
<i>Log Trade/GDP</i>	-0.221 (0.13)	-0.244 (0.22)	-0.152 (0.31)	-0.601° (0.36)	-0.837 (0.52)
<i>Log National Stocks/GDP</i>	0.079 (0.05)	0.082 (0.09)	0.062 (0.12)	0.097 (0.14)	0.022 (0.19)
<i>Exports to RTA partners/GDP</i>	1.670** (0.52)	2.961** (0.79)	3.806** (1.24)	4.833** (1.57)	6.698** (1.73)
<i>RTA-partner's log real GDP</i>	-0.092** (0.03)	-0.100° (0.06)	-0.085 (0.07)	0.071 (0.10)	0.025 (0.11)

Note: Each column is estimated via OLS. Estimates based on 1001 observations, covering 82 developing and developed countries and 122 RTAs from 1988 to 2009. Event date defined as announcement of the start of negotiations of RTA or announcement of a successful conclusion of such an agreement. Coefficients with standard errors clustered at country-level in parentheses. Coefficients significantly different from zero at [0.10] 0.05 (0.01) marked with [one circle] one (two) asterisk(s). Regressand: National Stock Market return in local currency, adjusted for MSCI movement. Intercepts and Goods/Goods&Services dummy included but not reported.

# And the Winners Are ... the Poor!

- Sample includes emerging markets and developing countries:
  - Argentina, Bulgaria, Brazil, Chile, China, Cote d'Ivoire, Colombia, Costa Rica, Czech Republic, Egypt, Estonia, Croatia, Hungary, Indonesia, India, Jordan, Lebanon, Sri Lanka, Lithuania, Latvia, Malta, Malaysia, Morocco, Oman, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Russia, Saudi Arabia, Slovak Republic, Slovenia, Thailand, Tunisia, Turkey, Ukraine, Vietnam, South Africa.

# Results are Insensitive

- Adjust with different global stock indices (or not at all)
- Drop outliers
- Different currency denominations
- Other controls

# Summary

- Economists (and *Economist*) agree: trade liberalization is good
- Now we know: stock markets agree
  - Regional Trade Agreements deliver expected future benefits
    - Poor gain more
    - “Natural “RTAs” most beneficial



# Conclusion

- Poor closed economies near larger richer ones have most to gain from liberalization (CESEE? China?)
- RTAs an effective alternative in absence of multilateral vehicle (WTO)

# Occupy the NGOs!

(aka special interests)