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Heterogeneous Effects of Economic Integration Agreements*

Scott L. Baier[†], Jeffrey H. Bergstrand[‡], and Matthew W. Clance[§]

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Abstract

It is now widely accepted that economic integration agreements (EIAs) and other trade-policy liberalizations contribute to nations' economic growth and development and help alleviate poverty. However, the economic effects of such policies vary across countries' economic structures; for instance, developing countries face higher fixed trade costs (partly due to higher government border-crossing costs and weaker port infrastructures). We offer three potential contributions. First, we extend a standard Melitz general equilibrium trade model with firm heterogeneity to show how variable-cost and fixed-cost "trade elasticities" associated with trade liberalizations are heterogeneous and endogenous to *levels* of country-pairs' bilateral policy and non-policy, variable and fixed trade costs – even allowing for CES preferences and an untruncated Pareto distribution of productivities. Using associated comparative statics, we provide several explicit predictions of the heterogeneous (variable- *and* fixed-cost) bilateral extensive-margin, intensive-margin, and trade elasticities. Second, we provide empirical support for the theoretical hypotheses. Trade elasticities vary across particular settings. Third, we demonstrate the relevance of these theoretical and empirical results for *ex ante* trade-flow predictions of potential EIAs. For instance, we show that a 10 percent lower average per capita income of a country-pair is associated with a *60 percent* higher partial EIA effect. Moreover, we show empirically that 95-99 percent of the welfare (or probability) estimates of EIA liberalizations between 1,358 North-North, North-South, and South-South country-pairs can be explained by our heterogeneous EIA partial treatment effects.

Key words: International trade, economic integration agreements, gravity equation, welfare
JEL classification: F1, F13, F63, O10, O24

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