

Comment

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This is an interesting paper. It is subtle in terms of its scope and deals with an important topic. APEC will likely continue to be an important item on the world's trade policy agenda. Also, Endoh has nested the investigation of APEC theoretically in the context of—and alongside—further liberalization in the form of free trade agreements (FTAs) as well as in the form of further liberalization under the WTO. The three major questions of his paper are:

1. Is "open regionalism" defined in the context of APEC (i.e., unilateral liberalization) welfare enhancing?
2. Does open regionalism enhance or detract from the welfare changes associated with FTAs?
3. Does open regionalism enhance or detract from the welfare changes associated with continued multilateralism?

While Endoh cites earlier papers, he does not provide much motivation for his particular framework. Thus, I was left quite curious why he used it given numerous other approaches potentially available. Endoh's model is most closely related to Venables (1987) and Krishna (1998). On the producer and consumer side, it is virtually identical to Krishna's model, with firms treating markets as "segmented" and providing goods that are perfect substitutes. The other models cited all specify linear demand curves. Whereas Venables' model has free entry and exit allowing an endogenous number of firms, Endoh's model—with one firm producing the "imperfect competition" good in each country—is closest to Krishna's model, where there are an exogenous number of multiple producers in each country of "the good."

There are two notable differences from Krishna and Venables. First, the government's objective is potentially more realistic than in the Krishna or Venables models. In Krishna, the government only weighed producers' interests, i.e., producer rents. In essence, Krishna found that in the absence of trade diversion from an FTA with respect to ROW firms, an FTA is a zero-sum game. Firms gain from an FTA more the greater the trade diverted from the rest of the world. In Venables, only consumer welfare matters, since competition precludes producer surplus, and consumer welfare is a function of tariff revenue and consumer surplus.

In Endoh's model, in contrast, the government weighs both producer and consumer interests. Producer interests are represented the same as in Krishna. However, consumers potentially are affected here ambiguously by trade liberalization; consumers lose tariff revenue on the income side but gain in terms of lower prices for imported goods on the price side. The choice for the govern-

ment objective between only firms' special interests vs. one representing both consumer and producer interests has been debated in the literature. I am more comfortable with the broader approach used here instead of that in Krishna, especially in light of the recent evidence in Goldberg and Maggi in the *American Economic Review* in December 1999 where they estimate a relatively strong weight for consumer welfare relative to producer interests in the government's objective function.

The second notable difference is that Endoh is interested in determining whether APEC's "open regionalism" is a welfare-enhancing approach to trade policy, either independent of free trade agreements or in conjunction with FTAs. Krishna focused on the impact of regionalism on multilateralism and did a comparative static analysis to show the conditions under which the entering into—in a first-stage—a bilateral free trade agreement might lead—in a second-stage—to *less* multilateralism. Endoh uses the same framework differently.

I will summarize what I consider the major findings in this paper and offer some criticisms. The first major finding is introducing in the model's context APEC in isolation (i.e., unilateral liberalization here). In the context of this model, unilateral liberalization is unambiguously welfare decreasing, and this is confirmed using computer simulation. Producers at home lose competitiveness and profits, while for consumers the loss of tariff revenue always exceeds the surplus gained, so that consumers also are always worse off with open regionalism.

Endoh notes that general voter support for open regionalism is uncertain, depending upon tariff revenue losses versus consumer surplus gains. While his model has numerous countries, I did some comparative statics of a simple 2-country version of his model. The conclusions of this comparative statics analysis for the simple case confirmed his simulation results. For specific tariff values on the imperfect-competition good that are no higher than marginal production costs (normalized in his paper to unity), unilateral liberalization is unambiguously welfare decreasing. Only if the specific tariff rate (in terms of the good) is higher than marginal production costs could consumer surplus gains ever potentially exceed the tariff revenue losses.

This result about open regionalism begs a couple of questions. First, and most obviously, why have so many countries—especially surrounding the Pacific Rim—pursued open regionalism if, as this theory suggests, it is always welfare decreasing? Such a contrast raises doubts about the limitations of the model. In reality, of course, every model is inherently falsifiable, so what is it in this model that might preclude welfare benefits from open regionalism?

One item that comes immediately to mind is the absence of variety effects. Goods here are perfect substitutes, à la Brander or Brander and Krugman. Second generation models of trade policy have incorporated this element over earlier perfect competition models, and allowing for variety may permit the possibility of consumer surplus to offset tariff revenue losses in this model.

Also, there is cursory evidence from policy discussions of reasons why countries have pursued open regionalism in the past two decades. One popular argument has been to spur competitiveness of domestic firms and export-related domestic firms and to augment growth and development. Yet such a channel cannot be recognized in the present parsimonious model. Thus, the model might somehow be modified to address this potentially important shortcoming to generate net welfare gains from unilateral liberalization.

The second major set of findings concerns the introduction of FTAs into this model with and without open regionalism. The results seem quite consistent with earlier ones in a similar framework. Large countries tend to form bilateral FTAs with other large countries. The intuition is the same as in Krishna: with a bilateral FTA the home producer gains better access to the partner's market. The larger the partner's market, the greater the gains.

While these results are consistent with Krishna, new findings arise due to the different government-objective function here, since the government's weight on producer vs. consumer interests can vary. Endoh finds that as producer interest weighs more heavily, countries do form more FTAs. The intuition is consistent with Krishna: there are potentially more markets to benefit from liberalization.

With APEC, Endoh finds additionally that the APEC countries incur a reduction in their rates of total surplus change, while the non-APEC countries incur an increase in their rates of total surplus change in the context of FTAs. This largely reflects, in the model's framework, the negative consumer-welfare and tariff-loss effects from the unilaterally liberalized economics.

Thus, the limitation from the earlier scenario surfaces again. Endoh points out that no country has an incentive to liberalize imports voluntarily and unilaterally. I find this outcome the most limiting aspect of the paper that is entitled "Is APEC a Building Block or Stumbling Block towards Trade Liberalization?"

Given this limitation, rather than moving on as he did to explore WTO liberalization with and without an accompanying APEC agreement, I would have preferred if he would have searched more thoroughly toward determining the limitations of this albeit parsimonious model to determine the *sensitivity* of the model at hand to assumptions that apparently preclude any potential net welfare gain from open regionalism.

The third and final major set of findings concerns further WTO-based multilateral liberalization with and without open regionalism. The modeling of further WTO-motivated liberalization by introducing WTO-positive countries (with intentions to completely eliminate mutual tariffs) and WTO-negative countries (countries who do not intend to liberalize) is a very interesting exercise. However, it seems beyond the scope of this paper, in light of the limitations noted above. However, I liked the construct of this simulation exercise, and if the constraints of the model are feasibly addressed, this is worth pursuing.

The limitation of this particular experiment, however, is that WTO-positive countries only liberalize *among themselves*. This introduces a bias in the computer-simulated results. APEC in the context here does not discriminate multilaterally. However, the WTO liberalization discriminates against WTO-negative countries. If such discrimination was absent (i.e., MFN treatment truly held), it is unclear what the outcomes theoretically would be. Endoh notes this shortcoming, and clearly the experiment needs to be redesigned before having more relevant economic content.

Overall, the scope of Endoh's chapter is perhaps too broad. It is difficult just trying to understand the relationships between unilateral liberalization, free trade agreements, and free trade agreements in the presence of APEC's open regionalization. It would have been preferable to focus on the foregoing issues and to leave the issues of the WTO and the WTO along with APEC's regionalism to a separate paper. A second major limitation is that unilateral liberalization is always welfare decreasing. This also influenced the results on APEC-enhanced FTAs as well as APEC-enhanced WTO liberalization. The model might well be broadened to introduce the positive gains from variety, especially since it is closely related to Venables' 1987 article. It is further important to explore the limitations of the linear demand curve for precluding potentially ambiguous results. Third, and the most ambitious challenge, if APEC's open regionalism has been pursued to advance growth, then dynamic factor-accumulation becomes an important feature that may induce positive welfare gains from open regionalism.

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