Abstract: Trade and Welfare Cost of Double Standards

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The current challenge of trade liberalization is to tackle the non-tariff barriers to trade. Indeed, with already low import tariffs across trading partners, there is not much scope left for further reducing the variable trade costs.

Moreover, fixed costs have been proved to significantly deter firms from entering foreign markets. It is well known that this extensive margin of export participation explains much of the variation in international trade.

In this paper, I study the divergences between product standards and conformity assessment procedures across trading partners as an example of non-tariff barriers that can exacerbate the fixed costs to export.

Given the difficulties surrounding the ongoing negotiations of the Transatlantic Trade and Investment Partnership, it is particularly important to understand the implications of a reduction of this kind of non-tariff barriers.

I estimate the sensitivity of trade and welfare to a reduction of fixed costs achieved through mutual recognition of American and European regulatory standards. I use a standard general equilibrium model a la Melitz with firm entry and heterogeneous productivity, augmented with an endogenous choice of fixed costs. Firms can decide the level of fixed costs to incur in order to comply with the standards most valued by consumers. The endogenous choice of fixed costs is enabled by incorporating the consumers' perceived quality of differentiated goods that I model as a function of these fixed costs paid by firms.

I simulate a mutual recognition of standards and regulatory procedures between the United States the European Union. The mutual recognition embedded in this endogenous standards model generates smaller gains due to export participation than those predicted by exogenous reduction of fixed costs as it is often done in the literature.

I also compare counterfactuals obtained from preferential versus multilateral recognition of standards. In line with previous studies, I find small gains under preferential liberalization, with the E.U. gaining 2.10 percent and the U.S. 1.57 percent of GDP per capita. However, welfare is significantly enhanced when countries integrate their standards at the multilateral level, with U.S gains increasing to 7.37 percent and E.U. gains to 3.11 percent. The model shows marginal gains the third countries under a preferential agreement, but more significant ones under the multilateral scenario.