

## Discussion:

# Trade Adjustment Dynamics and the Welfare Gains from Trade

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## Overview

Good trade paper for macro conference

- ▶ Trade literature focuses on steady states
- ▶ Macroeconomists know transitions are important, especially for welfare

Compelling quantitative findings

- ▶ Including transitions makes welfare gain from tariff reduction 15 times larger. . .
- ▶ . . . even though initial trade elasticity is half that of long-term elasticity

## Mechanism

Tariff reduction  $\Rightarrow$  fewer varieties in new steady state

Drop in entry larger in short-term than long-term as stock of varieties allowed to run down

Large short-term drop in investment in new varieties temporarily frees up lots of resources for consumption

Outweighs increased investment in capital stock and export capacity

## Supporting evidence

Does number of varieties drop after tariff reduction in the data?

Evidence from Canadian trade reforms: YES

- ▶ Canada-U.S. FTA (1988): Head and Ries (1999), Gu et al. (2003), Lileeva (2008)
- ▶ NAFTA (1994): Baldwin and Yan (2010)

## Number of Canadian mfg. firms before and after 1988 FTA (Head and Ries, 1999)

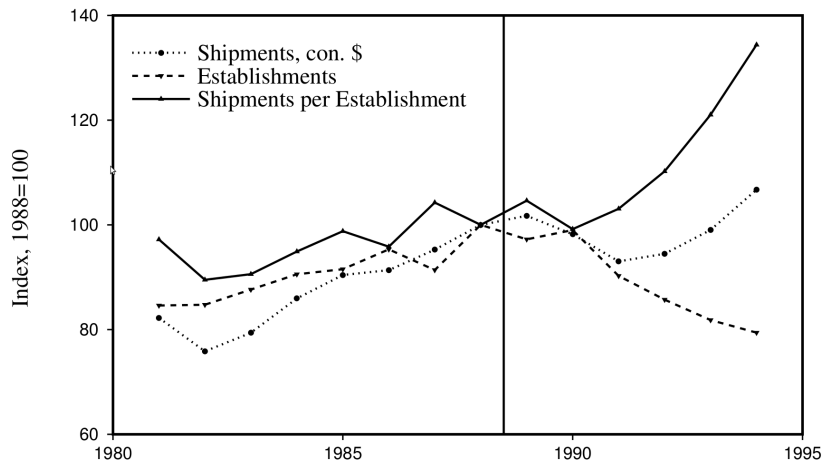


Fig. 1. Scale of Canadian manufacturing, 1981–1994.

## Limits of symmetric country model

ACR (heh!) focus on symmetric country model

Cannot speak to impact of transition dynamics following tariff reduction on

- ▶ Trade balance
- ▶ Real exchange rate
- ▶ Importance of open financial markets for welfare gains

Lots of potentially interesting macro questions require asymmetric version of model

## Some very preliminary results from asymmetric model

Consider two countries that are identical except for size

Big country (USA) has larger labor endowment than small country (Canada)

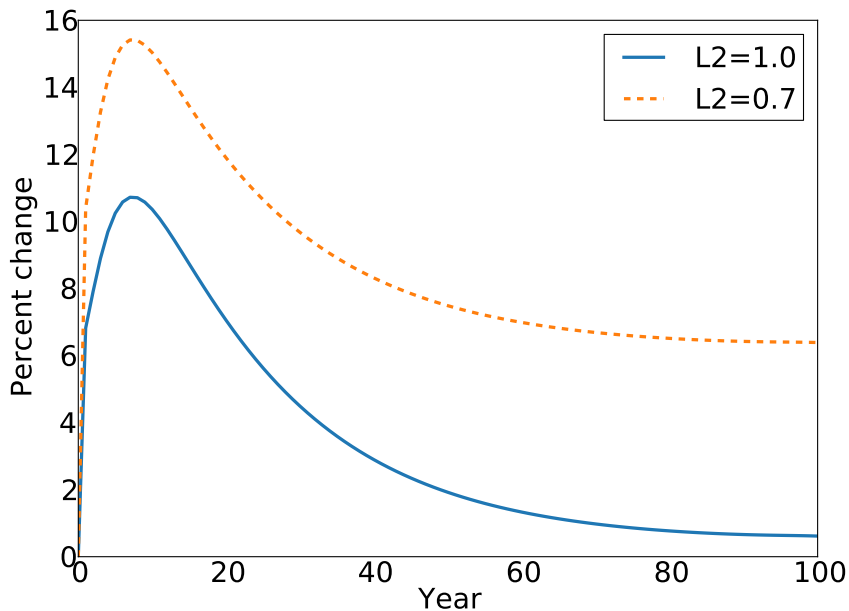
Steady-state welfare gains larger in small country (standard result)

Q: How does consumption transition path in small country differ from symmetric case?

Q: How does tariff reduction affect trade balance/RER?

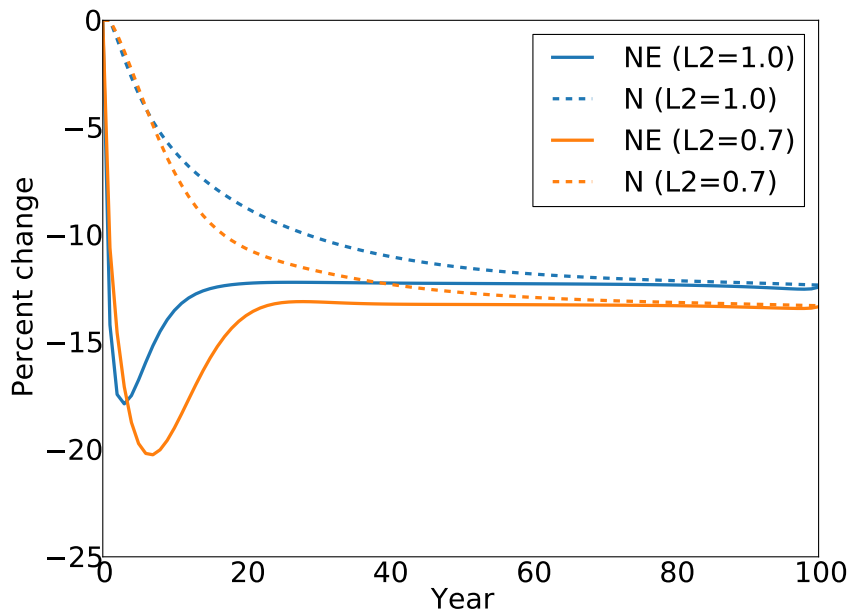
Q: How does financial autarky change results?

## Consumption paths (symmetric vs. asymmetric)

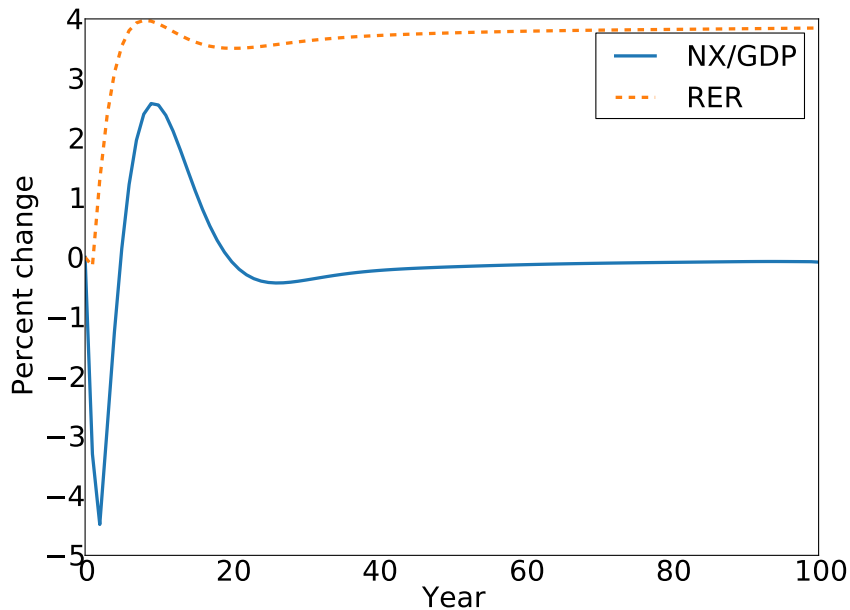




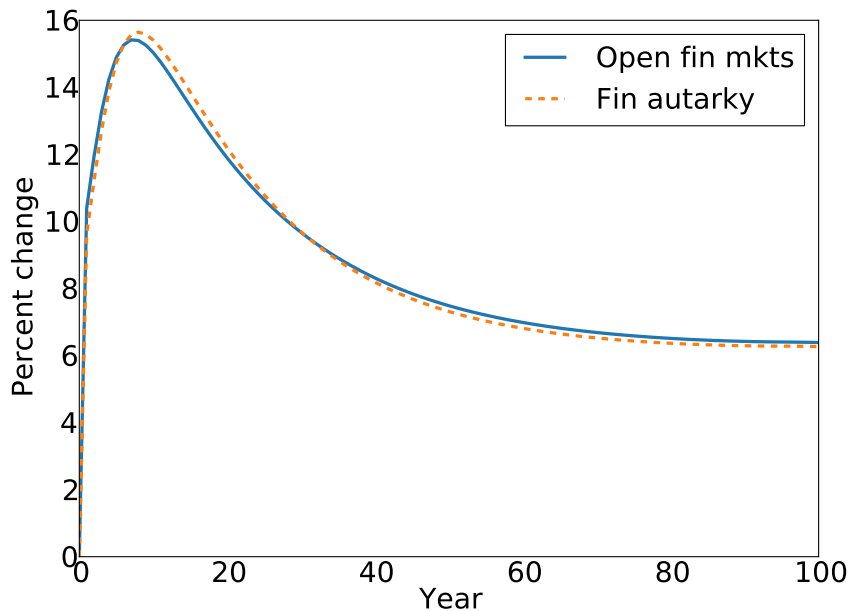
## Entry dynamics (symmetric vs. asymmetric)



## Trade balance and real exchange rate (asymmetric)



## Consumption: open vs. closed financial markets (asymmetric)



## Conclusion: Nice paper

Macro approach to trade question

Calibration disciplined with micro data

Compelling quantitative results

Empirical support for mechanism: fewer firms after trade reforms

Symmetric model limits assessment of real-world trade reforms