

Summary: With the stalling of the Doha talks, a lot of policy liberalization has been done in the recent past either within preferential trade agreements (PTAs) or unilaterally, without much say-so by the GATT or the WTO. A good case can be made that unilateral liberalization over next decade will erase a great many tariffs on intermediate goods and reduce nontariff barriers on business services. But for many barriers liberalization is only likely to occur within the WTO or PTAs. If the major G20 countries want to invigorate the process of trade creation and extend the scope of common commercial rules, they have little choice but to forge deals with each other. Once several emerging economies come on board, the stage will be set for a new WTO round that eliminates a flock of residual tariffs, establishes global service and investment rules, and harmonized many of the WTO-plus rules found in PTAs.

## Trade Policy after Doha

by Gary Hufbauer and Dean DeRosa

*There's an old saying that victory has 100 fathers and defeat is an orphan.*

– J. F. Kennedy News Conference 21 April 1961, in *Public Papers of Presidents of U.S.* (1962) 312

This old saying will find new voices when the Doha Development Round stumbles to outright failure, indefinite suspension, or slim results. As of June 2011, the least likely outcome is a robust agreement that delivers hundreds of billions of dollars of new trade opportunities to justify ten long years of hard negotiations.

In all likelihood, no one outside Geneva will proclaim victory. Indeed, as if to hasten defeat, cheerleaders for failure are found in respectable journals — Arvind Subramanian, Aaditya Mattoo, and Susan Schwab in the pages of *Foreign Affairs* and Martin Wolf and Alan Beattie in the *Financial Times*.

But the sources of failure are found neither in the skepticism of well-disposed commentators nor in the harsh criticism of observers,<sup>1</sup> but rather in structural flaws that plagued the negotiations from the outset, compounded by new tensions as the talks dragged on:

- Successful emerging countries, led by Brazil, India, China, and South Africa (the BICS), did not see their interests served either by slashing tariffs to Organisation for Economic Co-operation and Development (OECD) levels (under 4 percent *ad valorem*), by reducing formidable barriers to a wide range of service markets, or by opening government procurement to international competition.
- Led by the United States and the European Union, most OECD countries conceived the Doha Development Round as entailing one-way concessions just for the poorest developing countries, exemplified by Bolivia and Burundi. From the outset, the United States and Europe expected *greater* concessions from the BICS than from the OECD, since market access barriers were much higher among the BICS.
- Apart from Australia and Brazil, few WTO members are willing to expose sensitive swaths of their agricultural production

<sup>1</sup> Two of these observers, well known in Washington, are Lori Wallach of Public Citizen, and U.S. Senator Sherrod Brown of Ohio. There are many others, in Washington and around the world.

to world markets. The eruption of food crises in the 2000s added export restraints to the formidable array of import barriers.

- In November 2001, when Doha was launched, no one expected China, then the sixth largest exporter, to become the world's largest exporter in 2010.<sup>2</sup> In 2001, China's tariff profile — dramatically lowered in the course of its accession to the WTO — was not a concern to other members, the value of the renminbi was hardly noticed, and no one had heard of “indigenous innovation.” Ten years later, these matters aggravate other players in the multilateral trading system, not just the United States, the European Union, and Japan, but also Brazil, India, and South Africa.
- Meanwhile, over the course of a decade, new challenges loom large. To name a few: food security in times of drought, enormous fossil fuel subsidies, curbing greenhouse gas emissions, border controls to thwart terrorists, and undervalued exchange rates that act as massive export subsidies.

Burdened by these disabilities, Doha talks staggered from one unsuccessful ministerial to the next, but trade policy was not dormant. Continuing a trend that took wings in the early 1990s, preferential trade agreements (PTAs) — a term that encompasses free trade agreements (FTAs), regional trade agreements (RTAs), customs unions (CUs), and economic partnership arrangements (EPAs) — soared from less than 100 to more than 300. Commitments in some of the new PTAs were far more ambitious than anything contemplated in the WTO, covering services, intellectual property, investment, and government procurement.<sup>3</sup> Responding to their own economic self-interest, many countries also engaged in unilateral liberalization, both for

trade and investment barriers. Trade policy was not tethered to the uncertain fortunes of WTO talks.

Hufbauer and Adler (2009) examined the merchandise trade experience of the United States between 1980 and 2006.<sup>4</sup> Over this period, policy liberalization explained nearly all the growth in two-way merchandise trade that could not be accounted for by the rising tide of world income. Liberalization of nontariff barriers (NTBs) may have accounted for almost half of the “extra growth”; multilateral tariff cuts were responsible for about a tenth of the “extra growth,” while preferential agreements (foremost NAFTA) and unilateral liberalization were each responsible for about a fifth of the “extra growth.”

In other words, a lot of policy liberalization has been done in the recent past either within PTAs or unilaterally, without much say-so by the GATT or the WTO. This is especially true when one considers that a good deal of NTB liberalization was initiated in PTAs, but then extended to all countries, if only because rules of origin are not easily applied to NTBs on investment and services.<sup>5</sup>

**A lot of policy liberalization has been done in the recent past either within PTAs or unilaterally, without much say-so by the GATT or the WTO.**

A good case can be made that unilateral liberalization over next decade will erase a great many tariffs on intermediate goods and reduce NTBs on business services, because in these spheres the political sway of industrial users (including multinational corporations) will overpower the protectionist instincts of purely domestic suppliers. But

<sup>4</sup> Matthew Adler and Gary Hufbauer, “Policy liberalization and U.S. merchandise trade growth,” Peterson Institute for International Economics, Working Paper 09-02, May 2009.

<sup>5</sup> Elaborating this point, see Richard Baldwin, *op. cit.*

<sup>2</sup> China's rank as number one compares China with individual European countries, not with the European Union as a single exporter to external destinations.

<sup>3</sup> See, for example, Sherry Stephenson and Maryse Robert, “Innovations of Regionalism in Services in the Americas,” draft, World Trade Institute, May 7, 2011; Leonard Baccini, Andreas Dur, Manfred Elsig, and Kaorina Milewicz, “The Design of Preferential Trade Agreements: A New Dataset in the Making,” *WTO Working Paper*, May 2011; Craig VanGrasstek, “The Political Economy of Services in Regional Trade Agreements,” *OECD Trade Policy Working Papers* No. 112, 2011; and Richard Baldwin, “21<sup>st</sup> Century Regionalism: Filling the Gap between 21<sup>st</sup> Century Trade and 20<sup>th</sup> Century Trade Rules,” Graduate Institute Geneva, April 2011.

for many barriers — for example those affecting consumer goods, product safety, educational and health services, and government procurement — liberalization is only likely to occur within the WTO or PTAs. If the WTO is effectively out of market access liberalization for the next decade, that leaves PTAs to carry the ball. Table 1 (page 6) provides a matrix of PTAs among the G20 trading countries as well as sketches trade arrangements with the rest of the world. The interesting feature of this table is the amount of blank space — underscoring the room for new PTAs over the next decade between major players in the world economy.

An old and strong argument against PTAs between the major players is that, for example, a U.S.-Europe or a U.S.-Japan PTA would fatally injure the GATT/WTO system. But now that the system has demonstrated its inability to liberalize market access, the old argument has lost its punch.

**Table 2. Gravity Model Estimates for Merchandise Trade, 2001-2005**

Ln bilateral trade regressed on	Estimate
Ln distance	-1.57
Ln joint GDP	1.02
Common language	0.74
Preferential trading arrangements	0.84
(Lower-bound PTA estimate)	(0.72)
Constant	-30.44
R-squared	0.72
Observations	89,978
Clusters	20,683

Source and Notes: Regression estimates are found using pooled ordinary least squares, assuming robust standard errors and including export and import country fixed-effects. The dependent variable is one-way bilateral trade, measured in natural log (real) terms. Distance and joint real GDP are measured in natural log terms. Clusters are the number of ordered country pairs in the panel data set. All reported estimates of the gravity model coefficients are significant at the one percent level. Country fixed-effects are not reported. In addition to the European Union (EU), trade agreements represented by the preferential trading arrangements variable are the European Free Trade Area, European Union bilateral free trade agreements, North American Free Trade Area, Southern Common Market, Chile, Mexico, Australia, and Singapore bilateral free trade agreements, ASEAN Free Trade Area, South Asia Preferential Trading Arrangement, and all other customs unions and free trade agreements. The lower bound estimate for the preferential trading arrangements (PTA) variable is determined at the one percent level of confidence.

Accordingly we have applied the Peterson Institute gravity model to a couple of thought experiments. Table 2 displays the gravity model coefficients used for these experiments (the coefficients were estimated excluding intra-EU trade), and Box 1 gives a thumbnail explanation of the model.

Our first thought experiment asks how much trade might expand if the PTA network between the G20 countries was filled in. Our second experiment asks how much trade might expand if just a “coalition of the willing” G20 countries negotiated PTAs among themselves. For reference, the 2010 matrix of merchandise trade among the G20 countries appears in Table 3 (page 7).

### Box 1. Sketch of the Gravity Model

The basic gravity model is based on a least squares regression equation, pitting bilateral trade flows expressed in dollars (adjusted for inflation) against the gravitational mass of explanatory variables that describe the trading partners. The two core variables are geographic proximity and combined GDP. Andrew Rose popularized the model with a dataset covering aggregate bilateral merchandise trade between 178 trading countries during the period 1948-1999.<sup>1</sup> In the Peterson Institute gravity model, Rose’s dataset is concurred with bilateral merchandise trade data at the 1-digit Standard International Trade Classification (SITC) level, and extended to cover 170 countries from 1976 to 2005. The dataset is augmented by more comprehensive information about bilateral and regional trade agreements, and by additional explanatory variables, such as the integrity of business practices among pairs of trading countries. Gravity models invariably find that two-way trade between countries is significantly greater, the larger their combined GDP and the shorter the distance between them. Additional explanatory variables show, for example, how much two-way bilateral trade expands or contracts from the quantity predicted by the basic core variables on account of PTAs or a common language.

<sup>1</sup> Andrew K. Rose, “Do We Really Know that the WTO Increases Trade?” *American Economic Review*, 94 (1): 98-114, March 2004.

The estimates from our thought experiments, which appear in Table 4 (page 8), are decidedly conservative for three reasons. First, the gravity model data set is limited to merchandise trade, and excludes services, importantly business services. Moreover, it does not cover foreign investment, which is often liberalized by PTAs and is closely related both to merchandise and services trade. Second, the estimates in Table 4 assume a lower-bound value of the PTA coefficient to calculate trade that might be created. The lower bound value of the logarithmic coefficient is 0.72, meaning that a PTA approximately doubles two-way trade between the partners; with 99 percent confidence we can say that the true impact is larger. The third reason the estimates are conservative is that we assume no new PTAs among countries in the rest of the world, but of course some of these are quite active PTA proponents (Chile, Peru, and Singapore come to mind).

Table 4 indicates potential export and import levels if the PTA matrix were entirely filled in for the G20 alone. The dollar calculations are scaled up from 2010 merchandise trade levels and do not, of course, reflect normal trade growth that will happen as the world economy expands over the next decade. The percentage expansion of the 2010 trade base, shown in parentheses in the table, provide a good summary of our “what if” experiments.

As shown in Table 4, world exports might expand by 24 percent, from the 2010 base of \$14.9 trillion to \$18.4 trillion with a complete matrix of PTAs among G20 countries. U.S. exports might expand by 44 percent, from \$1.3 trillion to \$1.8 trillion; EU external exports might expand by 16 percent, from \$5.0 trillion to \$5.8 trillion; and Japanese exports might expand by 66 percent, from \$0.8 trillion to \$1.3 trillion.

Of course, if political reality allowed the matrix of PTAs between G20 countries to be filled in, the Doha Round would have been a smashing success year ago. Every prime minister and president could be the father of victory, to recall President Kennedy’s remark after disaster at the Bay of Pigs.

But given the reality of failure, we now turn to our “Coalition of the Willing” calculations, also shown in Table 4. The

If political reality allowed the matrix of PTAs between G20 countries to be filled in, the Doha Round would have been a smashing success year ago.

coalition consists of the eight OECD countries shown in boldface italics. These nations were, at one time, eager to conclude a mercantilist bargain in Geneva — market access traded for market access. The idea of a deep PTA agreement between OECD countries is hardly new.<sup>6</sup> But after the Uruguay Round was concluded at Marrakech, in 1994, OECD trade ministers fondly but idly hoped that emerging economic powers (later known as the BRICS) likewise embraced the goal of free trade and investment. When 2014 rolls around, two decades will have been devoted to the prolonged launch and negotiation of the ill-fated Doha Round, based on that forlorn hope.

The calculations in Table 4 contemplate a gradual filling in of the PTA matrix between the coalition partners. While the agreements would cover much more than tariff barriers, the calculations are limited to merchandise trade and, as explained earlier, are very conservative. World trade in the coalition scenario might expand by 9 percent, U.S. exports by 29 percent, EU exports by 9 percent, and Japanese exports by 41 percent.

Table 5 (page 9) concludes our numerical exercises by showing the new matrix of world trade assuming PTAs between all coalition pairs. U.S. exports to the European Union, for example, are \$494 billion compared to the actual 2010 level of \$241 billion; U.S. exports to Japan are \$124 billion, compared to the actual 2010 level of \$61 billion; and so on — a doubling of trade between PTA partners.

<sup>6</sup> See, for example, Gary Clyde Hufbauer, “Background Paper,” in *The Free Trade Debate: Reports of the Twentieth Century Fund Task Force on the Future of American Trade Policy*, Priority Press Publications, 1989.

How realistic is our coalition-of-the-willing scenario? It seems less likely than a continued pattern of recent PTA accretion — large countries forging deals with smaller partners. On the other hand, the payoff from the recent pattern is dwindling as the hunting ground for prospective partners thins out. If the major G20 countries want to invigorate the process of trade creation and extend the scope of common commercial rules, they have little choice but to forge deals with each other.

There are at least three other payoffs from this strategy. First, many of the rules adopted in new PTAs will be nondiscriminatory, opening commercial opportunities for nonmembers. As Richard Baldwin has cogently explained, nondiscriminatory rules are the hallmark of 21<sup>st</sup> century regionalism, not a widening of tariff preferences.<sup>7</sup> Second, over time, the reluctant BICS may decide to join the party. And third, once several BICS come on board, the stage will be set for a new WTO round that eliminates a flock of residual tariffs, establishes global service and investment rules, and harmonizes many of the WTO-plus rules found in PTAs.

<sup>7</sup> Richard Baldwin, *op. cit.*

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**Table 1. Preferential Trading Arrangements (PTAs) between the G20 Countries and with the Rest of the World, 2010**

Exporting Country	Importing Country																
	Argentina	Australia	Brazil	Canada	China	European Union	India	Indonesia	Japan	Korea	Mexico	Russian Fed.	Saudi Arabia	South Africa	Turkey	United States	Rest of the World
Argentina			PTA				PTA	PTA		PTA	PTA						R, CC
Australia								PTA								PTA	R
Brazil	PTA						PTA	PTA		PTA	PTA				PTA		R, CC
Canada											PTA					PTA	S
China							PTA	PTA		PTA							R
European Union						PTA					PTA			PTA	PTA		R, CC
India	PTA		PTA		PTA			PTA		PTA	PTA						R, CC
Indonesia	PTA	PTA	PTA		PTA		PTA		PTA	PTA	PTA						R, CC
Japan								PTA			PTA						R
Korea	PTA		PTA		PTA		PTA	PTA			PTA				PTA		R, CC
Mexico	PTA		PTA	PTA		PTA	PTA	PTA	PTA	PTA					PTA	PTA	R, CC
Russian Fed.																	R
Saudi Arabia																	R
South Africa						PTA											R
Turkey			PTA			PTA				PTA	PTA						R, CC
United States		PTA		PTA							PTA						S
Rest of the World	R, CC	R	R, CC	S	R	R, CC	R, CC	R, CC	R	R, CC	R, CC	R	R	R	R, CC	S	R, CC

Source: World Trade Organization, Regional Trade Agreements, available at [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm) (accessed May 13, 2011).

Notes: For the rest of the world, R, CC, and S denote regional, cross-continental, and select preferential trading arrangements, respectively.

**Table 3. World Merchandise Trade, 2010 (US\$Bn)**

Exporting Country	Importing Country																	World
	Argentina	Australia	Brazil	Canada	China	European Union	India	Indonesia	Japan	Korea	Mexico	Russian Fed.	Saudi Arabia	South Africa	Turkey	United States	Rest of the World	
Argentina	...	0	14	2	6	11	1	1	1	1	1	1	0	1	0	4	21	64
Australia	0	...	1	1	53	17	15	4	40	19	1	1	1	2	0	8	47	212
Brazil	19	1	...	2	31	43	3	2	7	4	4	4	3	1	1	19	58	202
Canada	0	2	2	...	13	33	2	1	9	4	5	1	1	0	1	290	23	387
China	6	27	24	22	...	311	41	22	120	69	18	30	10	11	12	284	573	1,580
European Union	9	31	37	30	130	3,352	44	8	51	33	27	106	27	26	79	272	727	4,987
India	0	2	4	2	18	39	...	3	5	3	1	1	4	2	3	27	93	208
Indonesia	0	4	2	1	16	17	10	...	26	13	1	1	1	1	1	14	51	158
Japan	1	16	6	9	150	87	9	16	...	62	10	8	6	4	3	120	265	772
Korea	1	7	8	6	125	44	9	7	26	...	7	4	4	1	4	46	143	442
Mexico	1	1	4	21	6	15	1	0	3	1	...	0	0	0	0	211	18	284
Russian Fed.	0	0	2	2	23	180	5	1	15	6	0	...	0	0	20	24	125	404
Saudi Arabia	0	0	2	2	30	18	18	4	33	19	0	0	...	4	2	30	60	222
South Africa	0	1	1	1	10	21	3	0	7	1	0	0	0	...	1	8	18	72
Turkey	0	0	1	0	2	53	1	0	0	0	0	5	2	0	...	4	45	114
United States	7	22	35	248	92	241	19	7	61	39	163	6	12	6	11	...	310	1,278
Rest of the World	5	63	39	44	570	729	133	66	215	102	15	41	18	18	36	419	955	3,467
World	50	177	185	394	1,276	5,211	313	142	618	374	253	208	91	76	174	1,780	3,531	14,853
Memorandum item: Intra-G20 trade																		8,809.5

Source: International Monetary Fund, Direction of Trade Statistics, available at <http://www2.imfstatistics.org/DOT/> (accessed May 12, 2011).

Notes: Trade values are exports recorded on a freight-on-board (fob) basis. Trade values in blue are IMF estimates, and values for the rest of the world are values imputed by the authors.

**Table 4. Summary of Potential “After Doha” Trade Levels (US\$billion)**

	After Doha								
	Actual 2010		Potential			"Coalition of the Willing" PTAs			
	G20	World	G20	World	Percent of	G20	World	Percent of	
					2010			2010	Potential
					World	World	World	World	
<b>Exports</b>									
Argentina	43	64	70	91	(142)	43	64	(100)	(70)
Australia	165	212	325	372	(176)	247	294	(139)	(79)
Brazil	144	202	262	320	(159)	144	202	(100)	(63)
Canada	364	387	438	461	(119)	415	438	(113)	(95)
China	1,008	1,580	1,931	2,504	(158)	1,008	1,580	(100)	(63)
European Union	4,261	4,987	5,080	5,807	(116)	4,699	5,426	(109)	(93)
India	114	208	204	297	(143)	114	208	(100)	(70)
Indonesia	107	158	144	195	(124)	107	158	(100)	(81)
Japan	507	772	1,015	1,280	(166)	821	1,086	(141)	(85)
Korea	299	442	444	587	(133)	435	578	(131)	(98)
Mexico	266	284	274	292	(103)	267	285	(100)	(98)
Russian Federation	279	404	279	404	(100)	279	404	(100)	(100)
Saudi Arabia	162	222	162	222	(100)	162	222	(100)	(100)
South Africa	54	72	89	107	(148)	54	72	(100)	(68)
Turkey	69	114	86	130	(114)	74	119	(105)	(91)
United States	968	1,278	1,531	1,841	(144)	1,337	1,647	(129)	(89)
Rest of the World	2,513	3,467	2,513	3,467	(100)	2,513	3,467	(100)	(100)
World	11,322	14,853	14,847	18,378	(124)	12,720	16,251	(109)	(88)
<b>Imports</b>									
Argentina	45	50	71	75	(151)	45	50	(100)	(66)
Australia	114	177	206	269	(152)	174	236	(134)	(88)
Brazil	145	185	259	299	(162)	145	185	(100)	(62)
Canada	349	394	430	474	(120)	399	443	(113)	(93)
China	706	1,276	1,226	1,796	(141)	706	1,276	(100)	(71)
European Union	4,482	5,211	5,372	6,101	(117)	4,927	5,656	(109)	(93)
India	180	313	278	411	(131)	180	313	(100)	(76)
Indonesia	76	142	93	160	(112)	76	142	(100)	(89)
Japan	403	618	747	962	(156)	599	815	(132)	(85)
Korea	272	374	438	540	(144)	437	539	(144)	(100)
Mexico	238	253	258	273	(108)	239	254	(100)	(93)
Russian Federation	167	208	343	384	(185)	167	208	(100)	(54)
Saudi Arabia	74	91	151	168	(185)	74	91	(100)	(54)
South Africa	58	76	88	107	(140)	58	76	(100)	(72)
Turkey	138	174	171	207	(119)	153	189	(109)	(91)
United States	1,362	1,780	2,204	2,623	(147)	1,828	2,247	(126)	(86)
Rest of the World	2,576	3,531	2,576	3,531	(100)	2,576	3,531	(100)	(100)
World	11,386	14,853	14,911	18,378	(124)	12,784	16,251	(109)	(88)

Notes: The “Coalition of the Willing” consists of the eight OECD countries in blue: Australia, Canada, European Union, Japan, Korea, Mexico, Turkey, and the United States.

**Table 5. Way Forward for World Trade after Doha Assuming “Coalition of the Willing” PTAs (US\$Bn)**

Exporting Country	Importing Country																	
	Argentina	Australia	Brazil	Canada	China	European Union	India	Indonesia	Japan	Korea	Mexico	Russian Fed.	Saudi Arabia	South Africa	Turkey	United States	Rest of the World	World
Argentina	...	0	14	2	6	11	1	1	1	1	1	1	0	1	0	4	21	64
Australia	0	...	1	2	53	35	15	4	82	39	1	1	1	2	1	8	47	294
Brazil	19	1	...	2	31	43	3	2	7	4	4	4	3	1	1	19	58	202
Canada	0	3	2	...	13	68	2	1	18	7	5	1	1	0	2	290	23	438
China	6	27	24	22	...	311	41	22	120	69	18	30	10	11	12	284	573	1,580
European Union	9	63	37	61	130	3,352	44	8	104	67	27	106	27	26	79	559	727	5,426
India	0	2	4	2	18	39	...	3	5	3	1	1	4	2	3	27	93	208
Indonesia	0	4	2	1	16	17	10	...	26	13	1	1	1	1	1	14	51	158
Japan	1	33	6	19	150	179	9	16	...	128	10	8	6	4	5	248	265	1,086
Korea	1	13	8	12	125	91	9	7	54	...	7	4	4	1	4	94	143	578
Mexico	1	3	4	21	6	15	1	0	3	1	...	0	0	0	0	211	18	285
Russian Fed.	0	0	2	2	23	180	5	1	15	6	0	...	0	0	20	24	125	404
Saudi Arabia	0	0	2	2	30	18	18	4	33	19	0	0	...	4	2	30	60	222
South Africa	0	1	1	1	10	21	3	0	7	1	0	0	0	...	1	8	18	72
Turkey	0	1	1	1	2	53	1	0	1	0	0	5	2	0	...	8	45	119
United States	7	22	35	248	92	494	19	7	124	80	163	6	12	6	22	...	310	1,647
Rest of the World	5	63	39	44	570	729	133	66	215	102	15	41	18	18	36	419	955	3,467
World	50	236	185	443	1,276	5,656	313	142	815	539	254	208	91	76	189	2,247	3,531	16,251

Source: Authors' calculations assuming the lower-bound coefficient estimate for the PTA variable in the gravity model results in Table 2. Levels of trade affected by the bilateral PTAs initiated by the eight blue “Coalition of the Willing” OECD countries are in orange.