Table 1. Stylized "Gravity" Effects on Trade Propensity

Trade-inhibiting Factor	Percentage reduction of intensity of cross-border trade compared to domestic trade
Presence of Border	33 %
Not adjacent	50 %
Separate currency	33 %
Exchange rate volatility	87 %
Different language	50 %
No FTA	33 %
Gravity effect, excl. distance and tariffs	0.8 %
Gravity effect with FTA	2.4 %

This is not to discount entirely the costs of trade diversion; there is some evidence of reasonably significant trade diversion, particularly in the case of agreements where there are high external tariff to third parties. For example, Mercosur is thought to have had comparatively significant trade diversion effects. The European Union's agricultural policy has clearly had diversionary effects.[26] With regard to NAFTA, the low average tariffs to third parties suggests general trade diversion has been minimal; that being said, issues have been raised in connection with rules of origin.[27] Moreover, the relatively high textiles tar-

[26] For example, Canadian and U.S. (Washington State) Macintosh apples have been replaced in the U.K. by higher-priced, (and, to some tastes, lower-quality) Granny Smith apples from France.

[27] For example, auto sector rules of origin (ROOs) have been a bone of contention for Japan over the years. Even as the role of tariffs in defining regional blocs has diminished, the role of ROOs has increased. In this regard, an adverse consequence of multinationals shifting production from their home bases in industrialized countries to developing countries is that they have tended to promote special access to their home markets for countries in which they invest. This leads to an insidious use of ROOs, as in the United States' recent Africa Bill, to favour sourcing of intermediate products from the multinationals' home market. How significant is this latter trend? Probably quite large; producers in Mexico and the Caribbean Basin reached a watershed in 1997, when they accounted for a larger volume of U.S. apparel imports than those in the Far East. And for every dollar worth of textile and apparel products imported from countries in the Western Hemisphere in 1999, the United States exported to them 58 cents worth of prod-