Lecture 25
International Trade: Economics 181
Regional Trade Agreements (Wrap-Up); the US and Global Framework for Trade Policy

I. Finishing Up on Regional Trade Agreements.

A. Analytical Framework

The basic economic analysis of regional trading agreements is based on the concept of trade creation and trade diversion. The intuition is as follows: these agreements are welfare enhancing if they encourage more trade with the least cost producers of the good. These arrangements are welfare worsening if they divert trade to members of the union who are less efficient than those outside the union. In both cases, there will be more trade within the region once the union is formed. However, with trade diversion, this is "bad".

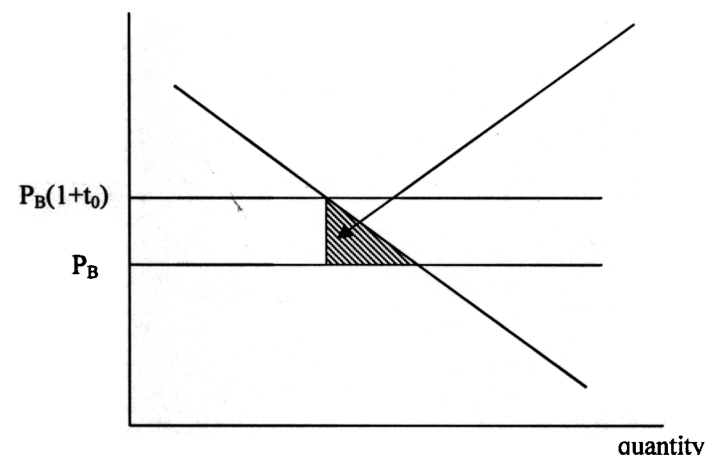
See the diagrams below. Country A starts out with initial tariff to against countries B and C. It forms a union with B and they agree on a common tariff against C given by t1.

(I). Case $P_B < P_c$

Then $P_B(1+t_0) < P_c(1+t_0)$ and $P_B < P_c(1+t_1)$, i.e., B is this supplier before and after union. Trade expands and can occur at true opportunity cost. Net gain = Cons. surplus gained – Tariff revenue lost. This is <u>trade creation</u>.

Net Gain

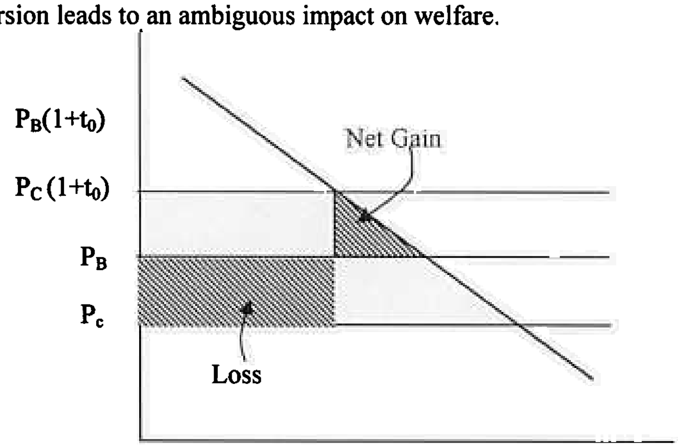
CASE Trade Creation



(II). Case $P_c < P_B < P_c(1+t_1)$

The supplier switches from C to B, i.e., <u>trade diversion</u>. Possible gain to consumers from lower price must be set against higher cost of buying from .B. The case in the Figure shows a net loss.

CASE II: Trade Diversion leads to an ambiguous impact on welfare.



When is trade creation more likely?

* The union covers many countries
* The tariffs imposed on those outside the union are kept low.

What are other gains from these unions (aside from the above welfare gains)

(1) Increased competition for those in the union.
(2) Increased benefits from a large market: economies of scale
(3) Lower transaction costs (ie border controls, transport costs)
(4) More negotiating power vis-vis third parties
(5) Terms of trade gains
(6) Joint projects like communications
(7) Greater product diversity

<u>Implications for Business Strategy</u>

(1) If you are outside the regional agreement, need to make sure you will not be shut out when internal tariffs fall and make your goods artificially more expensive (ie trade diversion). In that case, it may make sense to move in via foreign investment (joint venture or subsidiary) if the region constitutes a large share of your export market.
(2) If you are already inside, you could still lose from the additional competition. You may need to restructure to face the additional competition.
(3) As an outsider to the bloc (Japan, the developing countries vis-a-vis NAFTA and the EEC) it makes sense to try to keep blocs from growing or to form your own bloc in "retaliation".

B. Impact of NAFTA on US jobs, Mexican wages, and Mexico's poor

C. Summarizing Gains and Losses from Regionalism

III. The US Trade Policy Apparatus

Players

US trade representative (USTR)
Negotiates international trade agreements for the US
US Department of Commerce
It determines whether a foreign trade practice is unfair (examples:
Dumping, subsidies). And assesses antidumping and countervailing duties
US International Trade Commission (USITC)
It determines whether import competition has injured domestic firms
US Congress
Constitutional right to "regulate commerce with foreign nationals and
Between several states"
Ratifies into law trade agreements negotiated by USTR, can pass other trade legislation.

Important provisions of the Legal framework of the US Trade Policy:

US Industries can seek special protection from imports through various channels:

Escape Clause

- Provides temporary protection to US industries hurt by import competition (injury to domestic industry must be serious, imports must be the most important cause of injury)
- Foreign trade practices do not have to be unfair
- USITC rules and recommends the protection to the president, the measure must be ratified by congressional legislation

Anti-dumping duties and countervailing duties

- Import-competing firms file a complaint to the Commerce Department and USITC

- Material injury and foreign dumping or subsidies must be proven
- Commerce department ascertains the existence of foreign dumping or subsidy, US ITC rules on the injury.

Section 301 of Trade Act

- Covers actions of foreign governments—exporters can complain that foreign markets are closed and get USTR and the president to impose retaliatory duties.

Fast Trade authority:
US president has a right to negotiate trade agreements and then ask Congress to pass the necessary legislation without amendment within 90 working days

Why does it matter?

III. The World Trading Environment.
Some Terms you should know:

General Agreement on Tariffs and Trade (GATT) Originally negotiated in 1947 - 48 to promote expanded trade among its members and avoid the protectionism which exacerbated the prewar depression years.

The Uruguay Round The latest round of trade negotiations conducted by the GATT. Began in 1986 and was ratified by the US in 1994. Went into effect on January 1, 1995. The Uruguay round established the WTO (defined below) as the new body which would implement the multilateral trade agreements adhered to by all members. The WTO currently more than 140 members.
[NOTE: for the latest info on members go to the WTO web site at www.wto.org]

World Trade Organization (WTO) Established by the Uruguay round to police the trade and investment practices of its members. Creates the ITO that never was. It formalizes the rules and procedures of the GATT and extends them to the new agreements on services and intellectual property rights. The WTO's dispute settlement body (DSB) is supposed to have the final say on any international trade disputes arising between members.

Most Favored Nation (MFN) principle means that any tariff reduction agreed to by any two members of the WTO must be conferred on all other members of the organization.

Question: Suppose you import vinyl dolls from China. Why should its MFN status matter to you?

IV. What did the Uruguay Round Accomplish?

The Uruguay Round went into effect on January 1, 1995. What were its principle achievements? How does it change world trade?

A. Changes in Tariffs
B. Agriculture.
C. Textiles and Clothing: elimination of Multi-Fibre Agreement (MFA) on January 1, 2005.
D. TRIMS (Trade related investment measures)
E. TRIPS (Trade-related Intellectual Property Rights).
F. Services. The GATS (General Agreement on Trade in Services)
G. Anti-dumping and countervailing duties.

V. The new round (The Doha Round)

A Ministerial conference in Seattle in November 1999 was supposed to launch the next round of trade negotiations, the Millennium Round. But massive protects from anti-globalization forces cut it short. The round was finally launched in Doha in November 2001. It was supposed to address agricultural trade and export subsidies. Another big focus was on opening up DC markets to emerging markets exports. Poorest country exports account for only ½ of 1 percent of world trade. So this was supposed to be the "Development Round". The Round "failed" because countries could not agree on cutting agricultural subsidies. There is hope to revive it next year, but this will be difficult for the US because of the upcoming elections.

Table 1.2 US merchandise trade with NAFTA partners, 1989–2004 (billions of US dollars)

Partner	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	Percent change, 1989–2004	Percent change, 1993–2004	Percent change, 2000–04
Canada																			
Exports	78.3	83.0	85.1	90.2	100.2	114.3	126.0	132.6	150.1	154.2	163.9	176.4	163.7	160.8	169.5	187.7	139.8	87.4	6.4
Imports	88.2	91.4	91.1	98.5	110.9	128.9	145.1	156.5	168.1	174.8	198.3	229.2	217.0	210.6	224.2	255.9	190.1	130.7	11.7
Total	166.5	174.3	176.3	188.7	211.1	243.2	271.1	289.1	318.2	329.0	362.2	405.6	380.7	371.4	393.6	443.6	166.5	110.1	9.4
Balance	–9.9	–8.4	–6.0	–8.3	–10.7	–14.7	–19.1	–23.9	–17.9	–20.7	–34.4	–52.8	–53.2	–49.8	–54.7	–68.2			
Mexico																			
Exports	25.0	28.4	33.3	40.6	41.6	50.8	46.3	56.8	71.4	79.0	87.0	111.7	101.5	97.5	97.5	110.8	343.7	166.1	–0.8
Imports	27.2	30.2	31.2	35.2	39.9	49.5	61.7	73.0	85.9	94.7	109.7	135.9	131.4	134.7	138.1	155.8	473.3	290.3	14.7
Total	52.2	58.6	64.5	75.8	81.6	100.3	108.0	129.8	157.3	173.7	196.8	247.6	232.9	232.3	235.5	266.6	411.2	226.9	7.7
Balance	–2.2	–1.8	2.1	5.4	1.7	1.3	–15.4	–16.2	–14.5	–15.7	–22.7	–24.2	–29.9	–37.2	–40.6	–45.1			
World																			
Exports	363.8	393.0	421.9	447.5	464.9	512.4	583.0	622.8	687.6	680.5	692.8	780.4	731.0	693.3	723.7	816.5	124.5	75.7	4.6
Imports	473.4	473.4	496.0	488.8	532.1	580.5	663.8	743.5	870.2	913.9	1,024.8	1,216.9	1,142.0	1,163.5	1,259.4	1,469.5	210.4	176.2	20.8
Total	837.2	866.4	917.9	936.3	997.0	1,092.9	1,246.9	1,366.3	1,557.8	1,594.4	1,717.6	1,997.3	1,873.0	1,856.8	1,983.1	2,286.0	173.1	129.3	14.5
Balance	–109.6	–80.4	–74.1	–41.3	–67.2	–68.1	–80.8	–120.7	–182.6	–233.4	–331.9	–436.5	–410.9	–470.3	–535.7	–652.9			
NAFTA																			
Exports	103.2	111.3	118.4	130.8	141.8	165.1	172.3	189.3	221.5	233.2	251.0	288.2	265.2	258.3	266.9	298.5	189.1	110.5	3.6
Imports	115.4	121.5	122.3	133.7	150.9	178.4	206.8	229.5	253.9	269.6	308.0	365.1	348.4	345.3	362.2	411.8	256.8	173.0	12.8
Total	218.6	232.9	240.8	264.4	292.7	343.5	379.2	418.8	475.4	502.7	559.0	653.3	613.6	603.7	629.2	710.3	224.9	142.7	8.7
Balance	–12.2	–10.2	–3.9	–2.9	–9.1	–13.3	–34.5	–40.1	–32.4	–36.4	–57.1	–77.0	–83.2	–87.0	–95.3	–113.3			
Non-NAFTA																			
Exports	260.5	281.6	303.4	316.7	323.0	347.3	410.7	433.5	466.1	447.3	441.9	492.3	465.8	434.9	456.8	518.1	98.8	60.4	5.2
Imports	358.0	351.9	373.7	355.2	381.2	402.0	457.0	514.0	616.3	644.3	716.7	851.8	793.6	818.2	897.2	1,057.7	195.4	177.5	24.2
Total	618.5	633.5	677.1	671.9	704.2	749.4	867.7	947.5	1,082.4	1,091.6	1,158.6	1,344.0	1,259.3	1,253.2	1,354.0	1,575.8	154.8	123.8	17.2
Balance	–97.5	–70.2	–70.3	–38.5	–58.2	–54.7	–46.3	–80.5	–150.2	–197.0	–274.9	–359.5	–327.8	–383.3	–440.4	–539.6			

Source: USITC Interactive Tariff and Trade Dataweb, http://dataweb.usitc.gov (accessed on March 15, 2005).

Table 1.11 Income inequality and poverty in Mexico

Country	Percent of population below $2/day[a]		Human Poverty Index rank[b]	Gini coefficient[c]		
	1995	2000	2003	1990	1997	2002
	n.a.	14.3	n.a.	50.1	53.0	59.0
	n.a.	22.4	18	62.7	63.8	63.9
	20.3	9.6	3	55.4	55.3	55.9
	42.5	26.3	12	53.6	53.9	51.4
	n.a.	n.a.	12	40.0	43.0	42.0
	n.a.	n.a.	17	42.8	45.9	45.0

Percentage of population in Mexico living below 1,2,3, and 4 dollars a day
(Source: World Bank)

1$	2$	3$	4$	YEAR
.0832005	.2500005	5921005	.7108005	1989
.1577005	.4127005	4142005	.5375005	1992
.0839005	.2596005	.3982005	.5258005	1995
.0646005	.2393005	.3850005	.5049005	1996
.0798005	.2435005	.4097005	.5293005	1998
.0985005	.2630005	.	.	2000

Table 1: Percent of Mexico's Population with Per Capita Income below Threshold Needed to Achieve Minimum Caloric Intake

Area	1992	1994	1996	1998	2000
Urban Households	10.2	7.2	20.1	16.4	9.8
Rural Households	29.5	30.0	43.3	43.8	34.1
Source: Cortés, et.al (2003).					

Table 5: Changes in Mexico-U.S. Relative Wages, 1990-2000

	Males		Females	
	Mean	St. Dev.	Mean	St. Dev.
Change in Log Wages 1990-2000:				
Nominal Mexico Wages	0.291	0.205	0.474	0.258
Real Mexico Wages (GDP Defl.)	-0.169	0.205	0.014	0.258
Real Mexico Wages (CPI)	-0.190	0.205	-0.006	0.258
Nominal U.S. Wages	0.260	0.050	0.300	0.055
Real U.S. Wages (GDP Defl.)	0.047	0.050	0.087	0.055
Real U.S. Wages (CPI)	-0.016	0.050	0.024	0.055
Change in Log Mexico/U.S. Wages 1990-2000:				
Nominal Wages	0.031	0.192	0.175	0.242
Real Wages (GDP Defl.)	-0.216	0.192	-0.072	0.242
Real Wages (CPI)	-0.173	0.192	-0.030	0.242
Change in Log Mexico/U.S. Real Exchange Rate 1990-2000:				
GDP Deflator	0.205			
CPI	0.247			

This table shows changes in wages for a panel of synthetic cohorts in Mexico and the United States based on two years (1990, 2000), four 1990 age categories (16-25, 26-35, 36-45, and 46-55 years), seven education categories (0-4, 5-8, 9-11, 12, 13-15, and 16+ years of schooling), and Mexico's 32 states (U.S. cohorts are defined for the nation as a whole). Nominal Mexico and U.S. wages are in terms of current U.S. dollars.

Table 5.3

GATT Negotiating Rounds

Negotiating Round	Dates	Major Accomplishments
1. Geneva	1947	GATT established. Tariff reduction of about 20 percent negotiated
2. Annecy	1949	Accession of 11 new contracting parties. Minor tariff reduction (about 2 percent)
3. Torquay	1950–51	Accession of 7 new contracting parties. Minor tariff reduction (about 3 percent)
4. Geneva	1955–56	Minor tariff reduction (about 2.5 percent)
5. Dillon Round	1960–61	Negotiations involving external tariff of European Community. Minor tariff reduction (4 percent)
6. Kennedy Round	1964–67	Tariff reduction of about 35 percent.
7. Tokyo Round	1973–79	Tariffs reduction of about 33 percent. Six codes negotiated (subsidies, technical barriers, etc.)
8. Uruguay Round	1986–94	WTO established. Additional tariff reductions. New agreements on dispute settlement, agriculture, clothing, services, investment, and intellectual property
9. Doha Round	2001–	To be determined.

Table 6.1

Average Applied Tariffs for Selected Countries after the Uruguay Round

	Industrial Tariffs	Agricultural Tariffs	Textiles and Clothing
Developed countries			
United States	3.1	2.2	14.8
European Union	2.9	3.7	8.7
Japan	1.4	10.5	7.2
Canada	2.6	1.5	14.2
Australia	9.7	3.3	21.6
Developing countries			
Argentina	10.6	4.9	12.1
India	29.0	60.1	42.4
Korea	7.6	11.6	13.0
Thailand	26.8	26.5	28.9

Source: Finger, Ingco, and Reincke 1996.

Table 6.2

Border Protection for Selected Agricultural Goods, 1986–1988, 1995, and 2000 (%)

	Wheat			Sugar		
	Actual Protection	As Bound in Uruguay Round		Actual Protection	As Bound in Uruguay Round	
Country/Region	1986–88	1995	2000	1986–88	1995	2000
European Union	106	170	82	234	297	152
United States	20	6	4	131	197	91
Japan	651	240	152	184	126	58
Brazil	98	45	45	—	55	35
Mexico	−1	74	67	−58	173	156
Other Latin America	−17	34	34	41	85	80
Sub-Saharan Africa	10		133	44		100

Source: Ingco 1996, 437.

Russia in agreement with US on WTO entry

By Neil Buckley in Moscow, Alan Beattie in London and Eoin Callan in Washington

Russia and the US yesterday agreed in principle on the terms for Russian entry into the World Trade Organisation, giving a significant boost to Moscow's hopes of joining the 149-nation body after 13 years of talks.

US and Russian officials are set to sign the deal in Hanoi on November 18 at the Asia-Pacific Economic Co-operation summit, following final consultations in coming days.

"Delegations from both sides have reached agreement on all the principal conditions of this agreement," the Russian economy ministry said in a statement.

Susan Schwab, US trade representative, said agreement had been reached "in principle".

Russia is the last big market outside the aegis of the WTO. The US was the last big nation with which Moscow had still to conclude a bilateral entry deal.

Many US businesses, enjoying rapid growth in Russia, have lobbied hard for a deal. Vladimir Putin made WTO membership a priority early in his presidency.

Andrew Somers, president of the American Chamber of Commerce in Moscow, said the agreement was a "major positive milestone in relations between our two countries". Analysts had warned that any deal could face difficulties winning approval in Congress, particularly after both houses came under Democrat control this week.

Congress must repeal the 1974 Jackson-Vanik amendment, which subjects Russia's trading status to annual review, to ensure that Russia is granted permanent normal trading relations by the US. But a Bush administration official characterised meetings with Democrat leaders yesterday to brief them on the deal as "positive".

Max Baucus, likely Democratic chair of the Senate finance committee, welcomed the accord, saying: "Russia's WTO membership on commercially meaningful terms is an important goal."

Russia must still reach a bilateral agreement with Costa Rica and confirm agreements with Moldova and Georgia, which could be complicated by its tense relations with Tbilisi, and complete multilateral talks. That could push the date for Russian entry well into next year.

Talks with the US had stalled over disagreements surrounding the liberalisation of financial services and Russia's commitment to combat counterfeiting and piracy.

US mid-term elections, Page 3
Editorial Comment, Page 8

Economic populism pays for Democrats

By Edward Luce and Alim Remtulla in Washington

Defeated Republicans have found solace in the fact that many of their victorious Democratic opponents are "social conservatives". They point to Jim Webb, who surprised everyone by winning the bitter and close Senate race in Virginia on Thursday, giving his party a majority of one in the upper house to complement its decisive victory in the House of Representatives.

However, neither Mr Webb nor the majority of the Democratic freshmen who won elections this week can so easily be fitted into that category. Punching the air and holding up the dusty boots of his son who is serving in Iraq, Mr Webb told cheering supporters in Arlington that his election was as much a vote for economic fairness as it was for a change of course in Iraq.

Although Mr Webb supports the right to bear arms – a virtual necessity for anyone wanting to represent the Commonwealth of Virginia – the Vietnam veteran is pro-abortion and only lukewarm in his opposition to homosexual marriage.

One or two of his colleagues, including Bob Casey, the new senator for Pennsylvania, and Heath Shuler, a Democratic representative for North Carolina, are "pro-life" but the large majority of new Democrat lawmakers support the woman's right to choose.

More significantly, a majority of the intake, including Mr Webb, are economic populists who are deeply suspicious of free trade and quick to blame China and other developing countries for the loss of US jobs. Some, such as Sherrod Brown, the new Democratic senator for the key Midwest state of Ohio, which has lost 200,000 manufacturing jobs since Mr Bush came to power, won the election virtually on that issue alone.

"We will focus on economic fairness in a country divided too much by class in an age of the internationalisation of American corporations," said Mr Webb in a victory rally speech that devoted more to the economy than all other themes combined. "At a time when profits are at a record high and wages are at a low, we will focus on bridging the class divide."

Labelled the "middle-class squeeze" by Democrats and "median wage stagnation" by economists, the incomes of median American households have barely shifted since George W. Bush was elected on a ticket of "compassionate conservatism" in 2000. However, in important parts of America, including large swathes of the Midwest and the north-east, which provided a majority of the Democratic gains, economic anxiety came a close second to the Iraq war in motivating voter turnout.

In a study of the election campaign, Robert Borosage, head of the liberal Campaign for a Fairer America, said there were more political advertisements "painting big oil [companies] and big pharma as threats than advertisements warning about bin Laden". According to Stan Greenberg, a Democratic pollster, 41 per cent of those who voted Democrat cited their disquiet over the Iraq war as their main reason for voting compared with 26 per cent on jobs and the economy. However, if the 23 per cent citing "corruption in Washington" is included, then domestic concerns trumped Iraq.

Democratic campaigns overwhelmingly linked middle-class economic anxieties to the Republican Congress's promiscuous use of tax breaks for large companies in exchange for campaign finance. "On the economy, Democrats ran remarkably populist campaigns," said Mr Borosage. "Democrats linked corruption to economic woes, charging incumbents with being in the pockets of big oil and doing nothing about gas prices and being in the pockets of big pharma and doing nothing about drugs prices."

The most obvious economic consequence of the Democratic victory is that it will be virtually impossible for Mr Bush to renew his fast-track trade negotiating authority next year in order to revive the dormant Doha round of world trade talks. However, the administration's bilateral trade initiatives could run aground far more quickly.

Many leading Democrats, including Mr Brown and Mr Webb, campaigned for "fair trade" and "putting Americans first", which is code for including labour standards in bilateral trade agreements and being more critical of companies that "outsource" manufacturing jobs to China and service sector jobs to India. They are likely to be aggressive in pushing for tougher scrutiny of explicit and hidden tax breaks for large energy and pharmaceutical companies – known as "corporate welfare".

As the world focuses on the brewing debate over Iraq between the Bush administration and a Democratic Capitol Hill, the battle to define America's response to globalisation is also hotting up. "Both the Democrats and the Bush administration will want the other side to get the blame if their mutual promise of bipartisanship falls apart," said a senior Democratic strategist. "It could be over Iraq, it could be over the economy."

Editorial Comment, Page 8
Woman in the News, Page 9