Lecture 9a:

Trade Agreements

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C181 – International Trade

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Introduction

International agreements:

1) Trade agreements
   - WTO
   - Regional trade agreements

2) Agreements on labor issues

3) Agreements on environmental issues

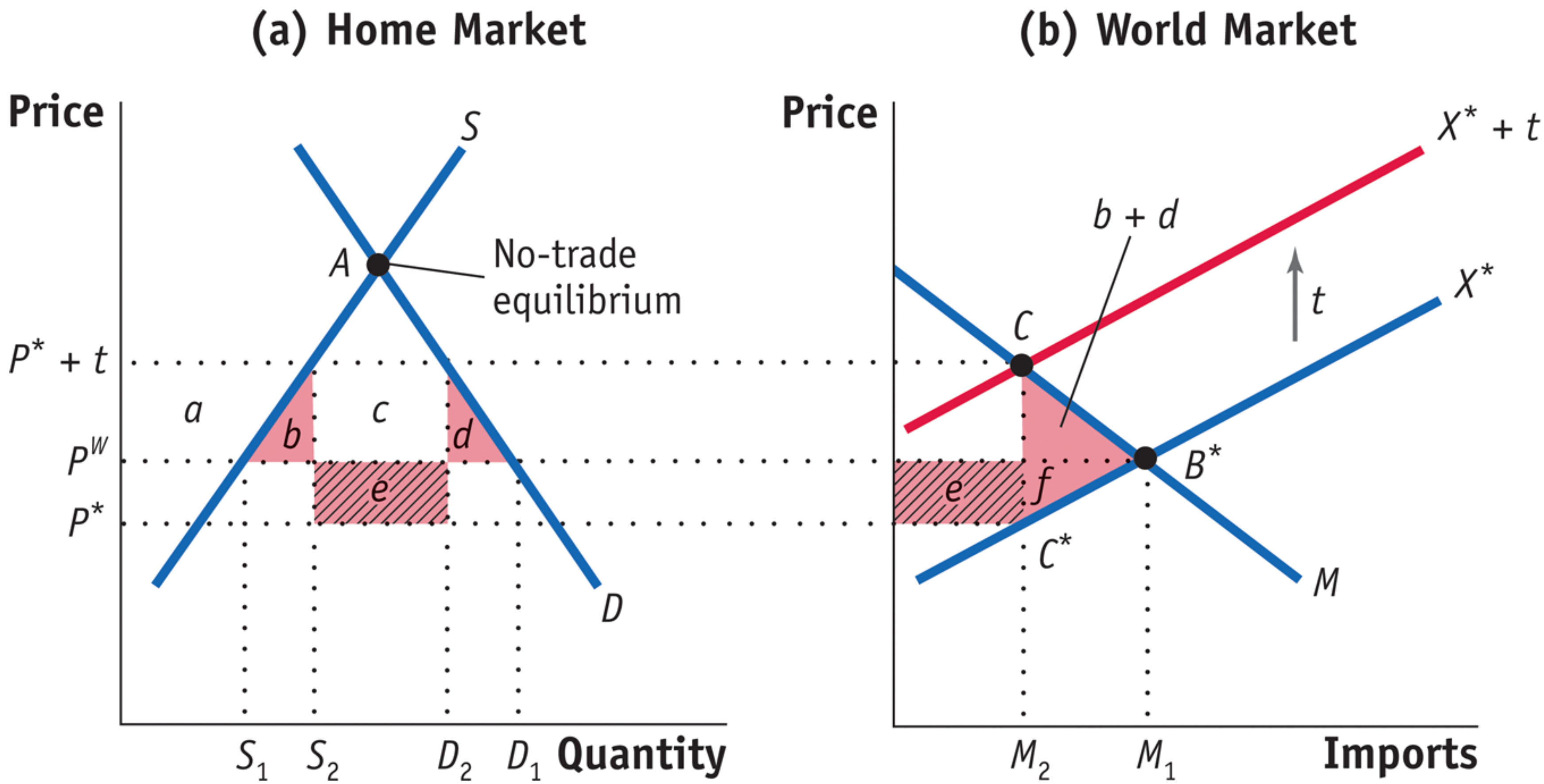
Introduction

Trade agreements: Motivation

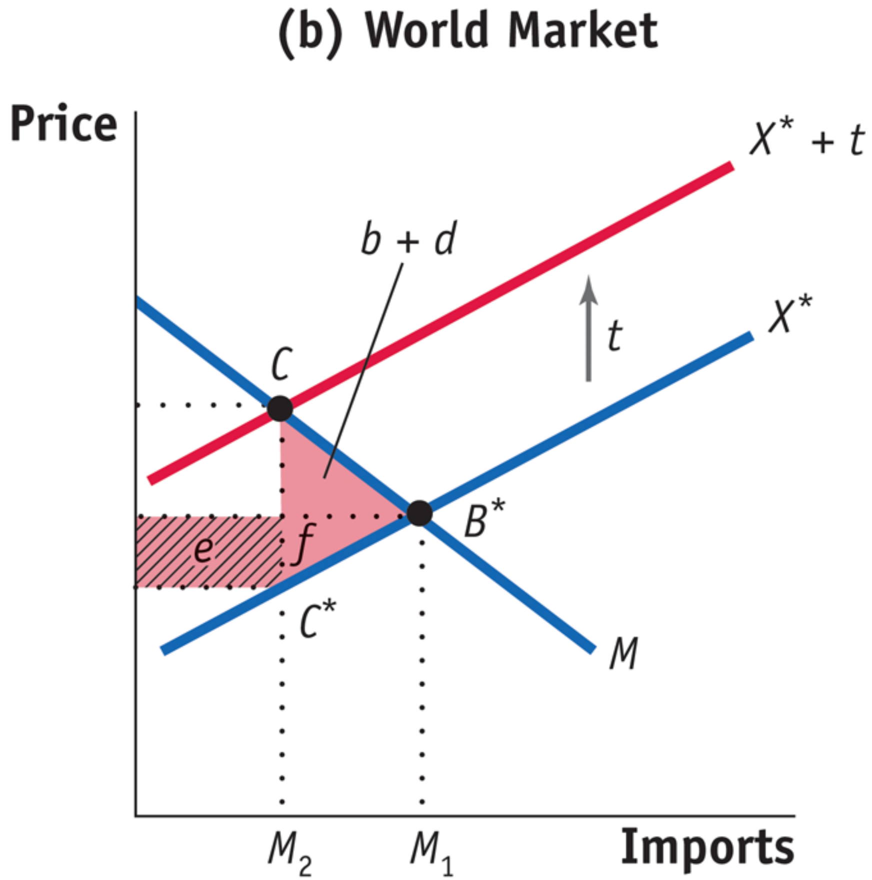
- A large country applying a tariff sees an improvement of its **terms-of-trade**, which can generate welfare gains

- However, if two trade partners apply a tariff, **both loose**

➔ **Trade agreements** can generate gains for both parties



Home gains = e - (b + d)



Foreign gains = - (e + f) < 0

(i.e. loss: decrease in producer surplus!)

Introduction

Global effect of tariff:

- Home gains:

  $= e - (b + d)$

- Foreign loss:

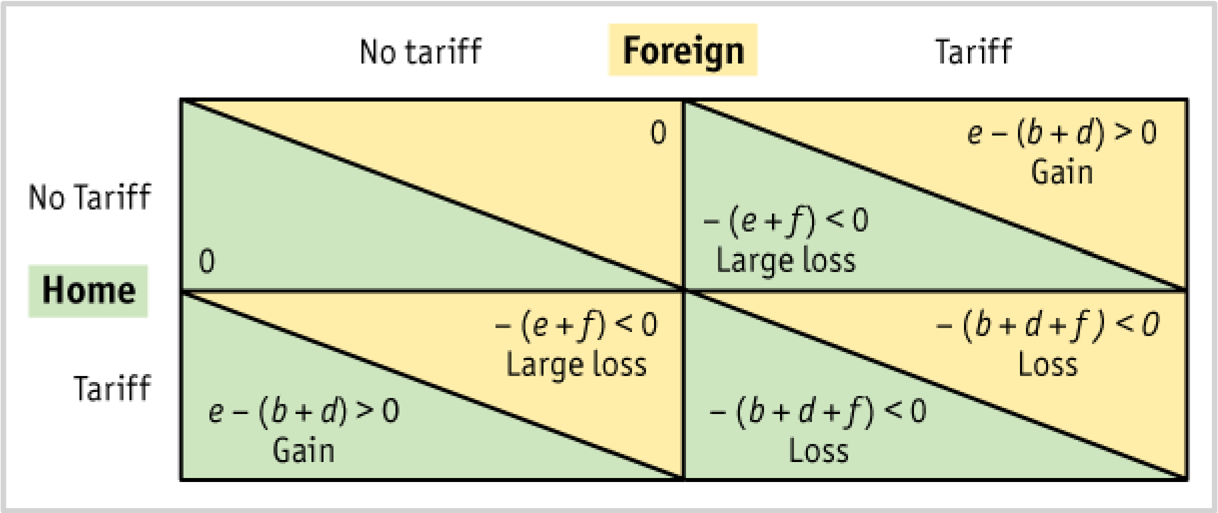
  $= - (e + f)$

- Net gains if both apply tariffs on imports:

  $= - (f + b + d) < 0$

Introduction

Trade war payoff matrix



Payoffs in a Tariff Game This payoff matrix shows the welfare of the Home and Foreign countries as compared with free trade (upper-left quadrant in which neither country applies a tariff). Welfare depends on whether one or both countries apply a tariff.

1- Trade Agreements

Nash equilibrium:

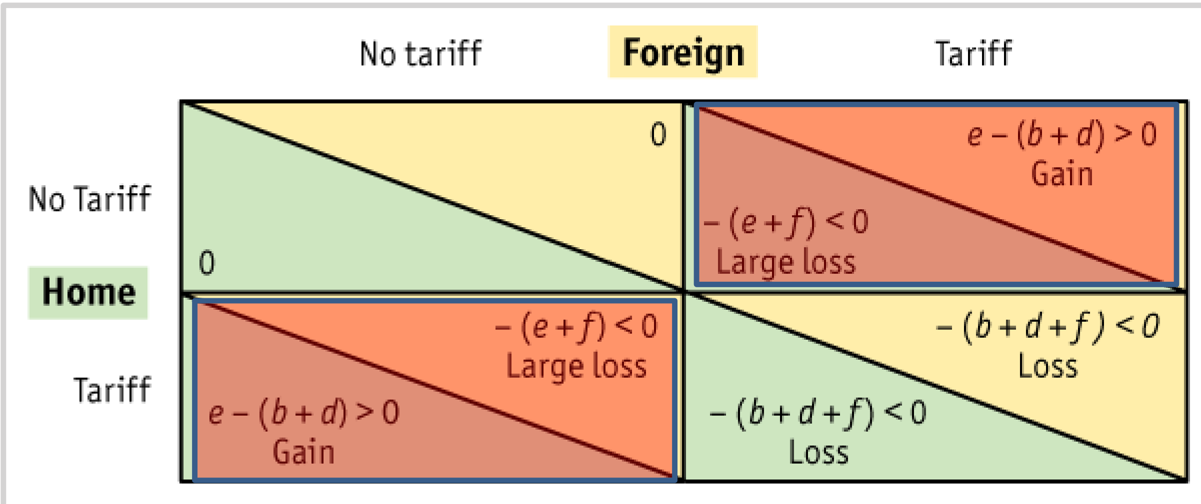
- All countries apply a tariff!
- Outcome similar to the **prisoner's dilemma**

Goal of the GATT: remove off-diagonal cell:

- By removing off-diagonal cells, the Nash equilibrium is now free trade

1- Trade Agreements

Trade war payoff matrix



By imposing reciprocity and removing off-diagonal cells, the GATT has successfully induced lower tariffs among its members. Free trade is now the only Nash equilibrium.

2- A brief history of the WTO

After World War II, representatives of the Allied countries met on several occasions to discuss issues such as high trade barriers and unstable exchange rates.

In 1947 the General Agreement on Tariffs and Trade (GATT) was established. The purpose of which was to reduce barriers to international trade between nations.

Now: World Trade Organization (WTO)

2- A brief history of the WTO

Some of the GATT’s main provisions are as follows:

1. A nation must extend the same tariffs to all trading partners that are WTO members.

2. Tariffs may be imposed in response to unfair trade practices such as dumping.

2- A brief history of the WTO

GATT's provisions:

3. Countries should not limit the quantity of goods and services that they import.

4. Countries should declare export subsidies provided to particular firms, sectors, or industries.

Article XVI deals with export subsidies, and states that countries should notify each other of the extent of subsidies and discuss the possibility of eliminating them.

2- A brief history of the WTO

GATT's provisions:

5. Countries can temporarily raise tariffs for certain products. Article XIX, called the safeguard provision or the escape clause, is our focus in this chapter.

   The importing country can temporarily raise the tariff when domestic producers are suffering due to import competition.

2- A brief history of the WTO

Some of the GATT's main provisions are as follows:

6. Regional trade agreements are permitted under Article XXIV of the GATT.

   The GATT recognizes the ability of blocs of countries to form two types of regional trade agreements:

   (i) free-trade areas, in which a group of countries voluntarily agree to remove trade barriers between themselves

   (ii) customs unions, which are free-trade areas in which the countries also adopt identical tariffs between themselves and the rest of the world

2- A brief history of the WTO

Key Provisions of the GATT

Article I	General Most-Favored-Nation Treatment
Article VI	Anti-Dumping and Countervailing Duties
Article XI	General Elimination of Quantitative Restrictions
Article XVI	Subsidies
Article XIX	Emergency Action on Imports of Particular Products
Article XXIV	Territorial Application—Frontier Traffic—Customs Unions and Free-Trade Areas

3- Regional Trade Agreements

Regional Trade Agreements

Under regional trade agreements, several countries eliminate tariffs among themselves but maintain tariffs against countries outside the region.

Regional trade agreements are sometimes called “preferential” trade agreements, to emphasize that the member countries are favored over other countries.

Free-Trade Area A free-trade area is a group of countries agreeing to eliminate tariffs (and other barriers to trade) among themselves but keeping whatever tariffs they formerly had with the rest of the world.

3- Regional Trade Agreements

Regional Trade Agreements

Customs Union A customs union is similar to a free-trade area, except that in addition to eliminating tariffs among countries in the union, the countries within a customs union also agree to a *common* schedule of tariffs with each country outside the union.

Rules of Origin Free-trade areas have complex rules of origin, which specify what type of goods can be shipped duty-free within the free-trade area. These rules are not needed in a customs union.

Other international agreements:

2) Agreements on labor issues

3) Agreements on environmental issues

4- International agreements on labor issues

We use the term labor standards to refer to all issues that directly affect workers, including occupational health and safety, child labor, minimum wages, and so on.

Labor Side Agreement under NAFTA

The labor side agreement negotiated under NAFTA does not change the existing labor laws in these countries but is meant to improve the *enforcement* of such laws.

Sample A	
Consumers who say they care about the condition of workers who make the clothing they buy:	
A lot	46%
Somewhat	38%
Only a little	8%
Not at all (or no response)	8%
Consumers willing to pay more for an item if assured it was made under good working conditions:	81%
Additional amount willing to pay for $10 item	$2.80
Additional amount willing to pay for $100 item	$15
Sample B	
Would choose an alternative to a T-shirt "with a nice logo" that local students say is made under poor working conditions if alternative is the same price	84%
Would not buy T-shirt made under poor working conditions at all	65%
Would buy T-shirt made under poor working conditions at average discount of	$4.30
Would pay more for T-shirt if came with assurance it was made under good conditions	78%
Average additional amount would pay (including as zeros those who did not offer to pay more or were inconsistent)	$1.83

4- International agreements on labor issues

Other Labor Agreements

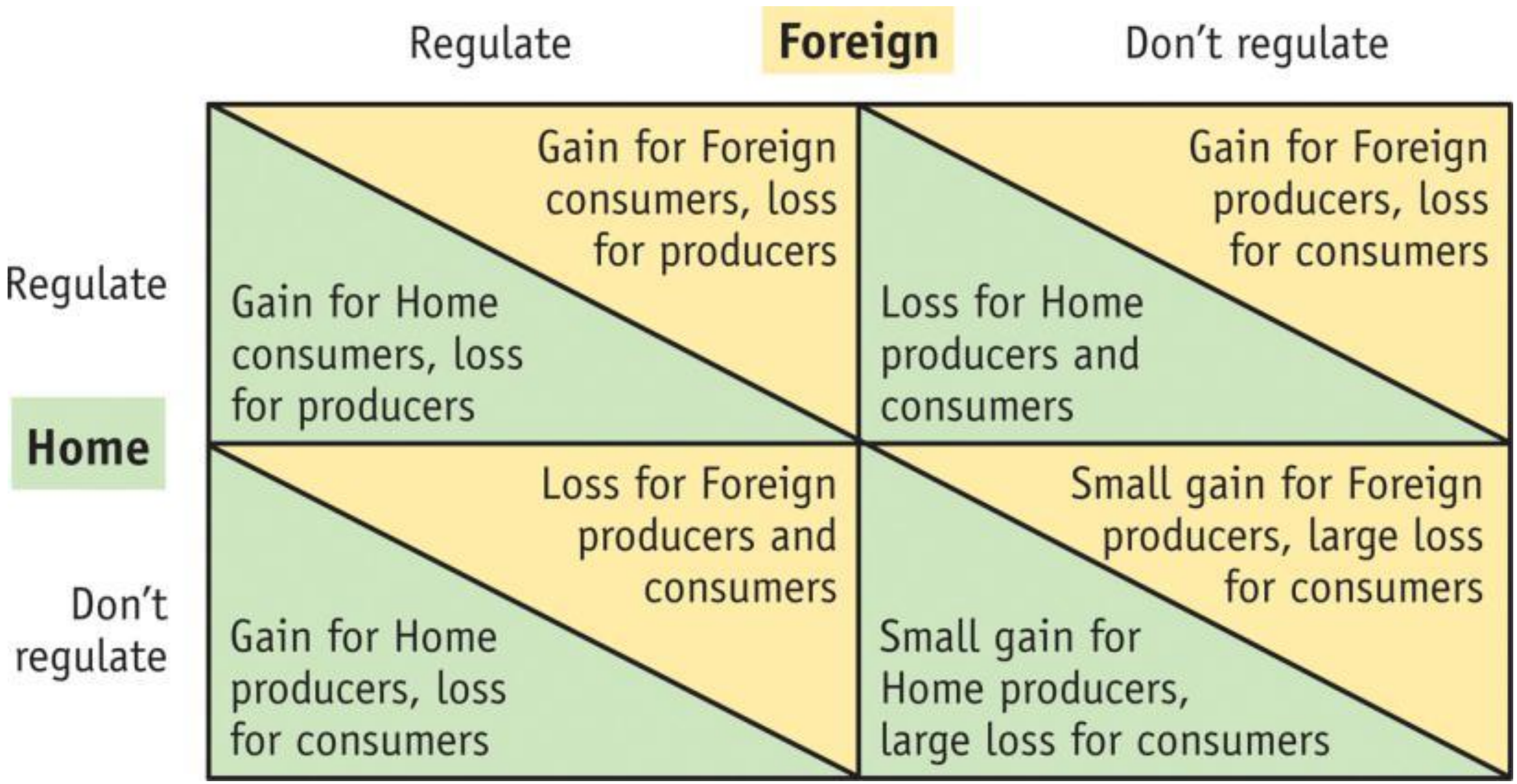
Corporate Responsibility Because of the pressure from consumers and unions, corporations have started to monitor and improve the conditions in their overseas plants and the plants of their overseas subcontractors.

Country Responsibility Several U.S. trade laws give the president the power to withhold trade privileges from countries that do not give their workers basic rights, including the right to organize.

Living Wage Is it fair to expect foreign firms to pay a living wage to their workers, that is, a wage above the norm in the developing country? Economists have a ready answer: the wages should be as high as the market will allow, and not any higher.

Environmental Issues and the prisoner's dilemma

Need for agreements:



5- Agreements on environmental issues

Environmental Issues in the GATT and WTO

- The WTO does not directly address environmental issues;

- Other international agreements, called multilateral environmental agreements, deal specifically with the environment.

5- Agreements on environmental issues

CASE	ISSUE	OUTCOME
Tuna-Dolphin		
In 1991 mexico appealed to the GATT against a U.S. ban on mexican tuna imports.	The United States put a ban on imports of tuna from Mexico that were not caught with nets that were safe for dolphins (as required in the united states under the Marine Mammal Protection Act).	In 1992 the gatt ruled in favor of Mexico that the U.S. import ban violated GATT rules. But the strong consumer response led to labeling of imported tuna as "dolphin friendly."
Shrimp-Turtle		
In 1996 India, Malaysia, Pakistan, and Thailand appealed to the WTO against a U.S. ban on shrimp imports.	The United States put a ban on imports of shrimp from India, Malaysia, Pakistan, and Thailand that were not caught with nets safe for sea turtles (as required in the United States under the Endangered Species Act).	In 1998 the WTO ruled in favor of India, Malaysia, Pakistan, and Thailand that the U.S. import ban violated WTO rules. But the United States could still require these countries to use turtle-safe nets, provided that adequate notice and consultation were pursued.

Other examples:

- Gasoline imports from Brazil and Venezuela;
- Exports of genetically-modified crops and food to the E.U.

5- Agreements on environmental issues

The Kyoto Protocol and the Copenhagen Accord

The Kyoto Protocol built on the United Nations' 1992 treaty on climate change, established specific targets for reduction in greenhouse gas emissions: the industrial countries should cut their emissions of greenhouse gases by a collective 5.2% less than their 1990 levels.

5- Agreements on environmental issues

There are four reasons often given to explain why the United States did not join the *Kyoto Protocol*:

(1) although the evidence toward global warming is strong, we still do not understand all the consequences of policy actions;

(2) while the United States is the largest emitter of greenhouse gases, meeting the Kyoto targets would negatively affect its economy;

(3) Kyoto failed to include the developing countries, especially China and India;

(4) there are other ways to pursue reductions in greenhouse gas emissions.

Trade policy quiz

1- The most efficient trade policy tool to maximize domestic welfare is:

a) Tariff

b) Quota

c) Voluntary export restraint

d) Anti-dumping laws

Trade policy quiz

2- Tariffs were historically the highest during:

a) The Great Recession, 2008-2010

b) The post-war period, 1950-1970

c) Around late 19th century

d) Early 19th century

Trade policy quiz

3- Countries would set up a positive tariffs in order to:

a) Maximize consumer surplus

b) Maximize the sum of consumer and producer surplus

c) Improve the terms of trade

d) Improve global welfare

Trade policy quiz

4- About the World trade organization (WTO):

A- The WTO prohibited all sorts of tariffs in most industries:

a) True

b) False

Trade policy quiz

4- About the World trade organization (WTO):

B- The WTO prohibited all sorts of quotas in most industries

a) True

b) False

Trade policy quiz

4- About the World trade organization (WTO):

C- The WTO does not require countries to remove subsidies

a) True

b) False

Trade policy quiz

4- About the World trade organization (WTO):

D- The WTO does not require to remove anti-dumping laws

a) True

b) False

Trade policy quiz

4- About the World trade organization (WTO):

E- Countries are not allowed to impose higher tariffs to some member countries than others, with the exception of free trade agreements

a) True

b) False