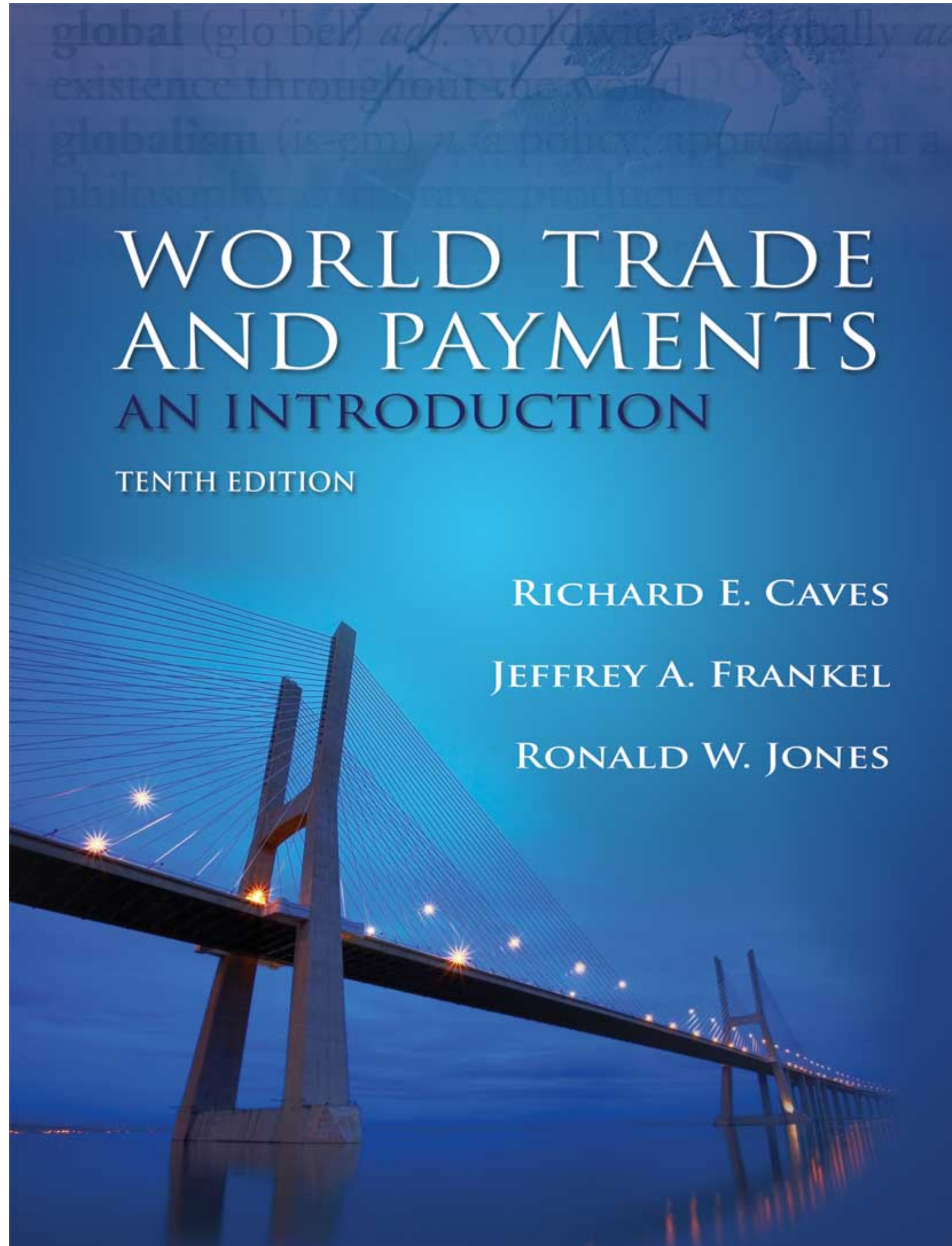
GATT/WTO



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Which Industries Are Protected?

- **Agriculture**: in the US, Europe and Japan farmers make up a small fraction of the electorate but receive generous subsidies and trade protection.
  - Examples: European Union’s Common Agricultural Policy, Japan’s 1000% tariff on imported rice, America’s sugar quota.

Which Industries Are Protected? (cont.)

- **Clothing**: textiles (fabrication of cloth) and apparel (assembly of cloth into clothing).
  - Import licenses for textile and apparel exporters are specified in the Multi-Fiber Agreement between the US and many other nations.
  - MFA: U.S. assigned import licenses to exporting countries.
  - Hence, most of the welfare cost came not from the distortion of consumption and production but from the transfer of quota rents to foreigners.

Why Agricultural Protection so Notorious?

- Special characters:
  - Protection happens in rich countries but not in poor ones.
  - It is hard to phase out.
- Economic Rationale
  - The inelastic supply of agricultural goods.
  - Peasants and the district congressional election
  - The minority is easy to form a group to lobby the government.
  - The majority has severe “free-rider” problem.
- Different Patterns:
  - Import restriction: Japan, Korea, and China
  - Export subsidy: US, CA, EU (supporting price)

Which Industries Are Protected? (cont.)

TABLE 9-3 Effects of Protection in the United States ($ billion)

Effect	Apparel	Textiles	All Industries
Consumer cost	21.16	3.27	32.32
Producer gain	9.90	1.75	15.78
Tariff revenue	3.55	0.63	5.86
Quota rent	5.41	0.71	7.12
Producer and consumer distortion	2.30	0.18	3.55
Overall welfare loss	7.71	0.89	10.42

Source: Gary Hufbauer and Kimberly Elliott, *Measuring the Costs of Protection in the United States* (Washington, D.C.: Institute for International Economics, 1994), pp. 8–9.

International Negotiations of Trade Policy

- The average US tariff rate on dutiable imports has decreased substantially from 1920–1993.
- Smoot-Hawley Act deepens the Great Depression.
- Bilateral trade negotiations helped reduce the average duty on U.S. imports from 59% in 1932 to 25% shortly after WWII.
- Since 1944, much of the reduction in tariffs and other trade restrictions came about through international negotiations.
  – The **General Agreement of Tariffs and Trade** was begun in 1947 as a provisional international agreement and was replaced by a more formal international institution called the **World Trade Organization** in 1995.

International Negotiations of Trade Policy (cont.)

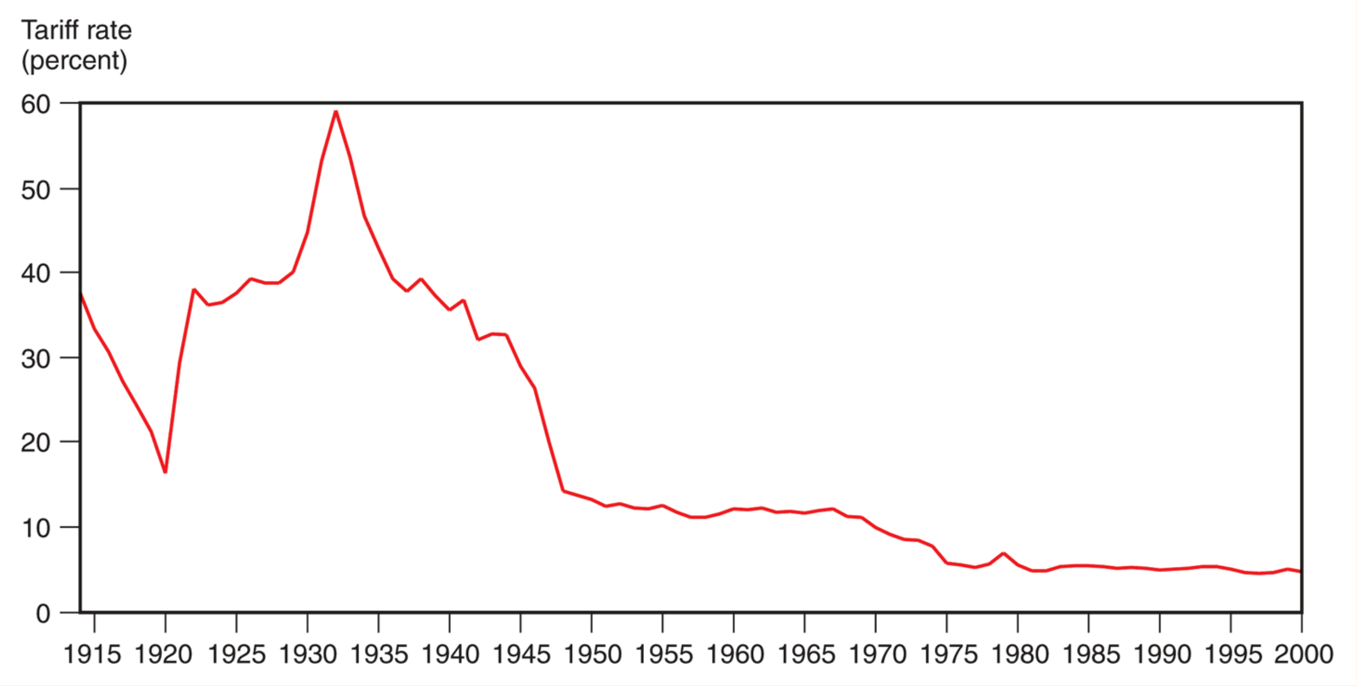


Figure 9-5

The U.S. Tariff Rate

After rising sharply at the beginning of the 1930s, the average tariff rate of the United States has steadily declined.

International Negotiations of Trade Policy (cont.)

- Multilateral negotiation mobilizes exporters to support free trade if they believe export markets will expand.
  - This support would be lacking in a unilateral push for free trade.
  - This support counteracts the support for restricted trade by import-competing groups.

International Negotiations of Trade Policy (cont.)

- Multilateral negotiations also help avoid a trade war between countries, where each country enacts trade restrictions.
- If each country has a political interest (due to political pressure) to protect domestic producers, *regardless of what other countries do,*
  - then all countries could enact trade restrictions, *even if it is in the interest of all countries to have free trade*.
- Let's use a simple example to illustrate this point.

International Negotiations of Trade Policy (cont.)

TABLE 9-4 The Problem of Trade Warfare

U.S. \ Japan	Free trade	Protection
Free trade	U.S.: 10, Japan: 10	U.S.: –10, Japan: 20
Protection	U.S.: 20, Japan: –10	U.S.: –5, Japan: –5

International Negotiations of Trade Policy (cont.)

- In this simple example, each country acting individually would be better off with protection, but both would be better off if both chose free trade.
- If Japan and the US can establish a binding agreement to maintain free trade, both can avoid the temptation of protection and both can be made better off.

World Trade Organization

- The WTO negotiations address trade restrictions in at least 3 ways:

1. **Reduction of tariff rates** through multilateral negotiations.
2. **Binding**: a tariff is "bound" by having the imposing country agree not to raise it in the future.

World Trade Organization (cont.)

3. **Prevention of non-tariff barriers**: quotas and export subsidies are changed to tariffs because the costs of tariff protection are more apparent.
   – Subsidies for agricultural exports are an exception.
   – Exceptions are also allowed for “market disruptions” caused by a surge in imports.

World Trade Organization (cont.)

- The World Trade Organization was founded in 1995 on a number of agreements
  - General Agreement on Tariffs and Trade: covers trade in goods
  - General Agreement on Tariffs and Services: covers trade in services (e.g., insurance, consulting, legal services, banking).
  - Agreement on Trade-Related Aspects of Intellectual Property: covers international property rights (e.g., patents and copyrights).

World Trade Organization (cont.)

- The dispute settlement procedure: a formal procedure where countries in a trade dispute can bring their case to a panel of WTO experts to rule upon.
- The cases are settled fairly quickly: even with appeals the procedure is not supposed to last more than 15 months.
- The panel uses previous agreements by member countries to decide which ones are breaking their agreements.

World Trade Organization (cont.)

  - A country that refuses to adhere to the panel’s decision may be punished by allowing other countries to impose trade restrictions on its exports.

- Example: U.S.—Venezuela
  - New U.S. air pollution standard makes the imported gasoline producers unhappy.
  - In 1995, Venezuela argued that the rules violated the principle of “national treatment”
  - The panel appointed by the WTO ruled in Venezuela’s favor.
  - U.S. appealed but rejected, therefore, revised its rules.

Banana Saga

- Several small central American nations are “banana republics”.
- Historically, UK and France purchased banana from their previous western Indian colonies in the Caribbean.
- Therefore, to protect benefits of such islands’ producers, the EU impose import quota for “dollar banana” of Central America, which are 40% cheaper than the West Indian product.
- Germany, which has never had West Indian colonies, allowed free entry to dollar bananas.
- To avoid the arbitrage from Germany to other EU countries, EU tried to impose a new common European import quota against dollar bananas.

Banana Saga

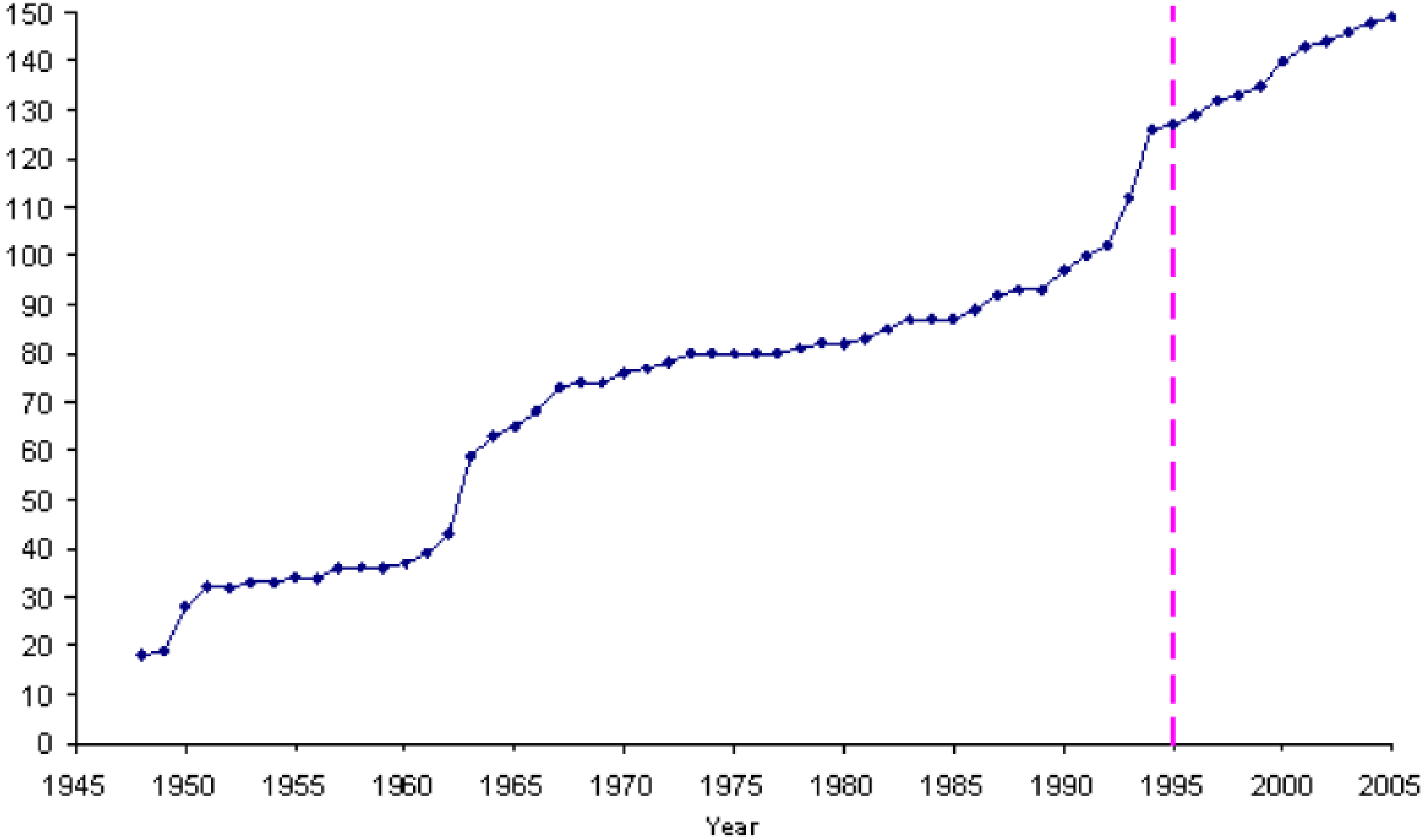
- Germany angrily protested the move and pointed out that its position is warranted in law in the "banana protocol" of Treaty of Rome.
- Why so angry? A symbol of freedom.
- In 1995, the U.S. enters the fray by pointing out the quota harms the interest of the U.S. corporation, The Chiquita Banana company.
- Its CEO walks both sides of the street to lobby politicians.
- Retaliation from the United States: It imposes high tariffs on designer handbags and pecorino cheese.
- In 2001, EU phased out the banana import quotas
- In 2005, EU claimed to triple tariff on banana that do not come from the ACP countries (Africa, Caribbean, and Pacific)

Various Rounds of GATT/WTO

表 11—2 关税与贸易总协定的多边贸易谈判

	时　间	持续时间	地　点	国家数
第一轮	1947 年 4 月—10 月	6 个月	瑞士日内瓦	23
第二轮	1949 年 4 月—10 月	6 个月	法国安纳西	33
第三轮	1950 年 10 月— 4 月	6 个月	英国托奎	39
第四轮	1956 年 1 月— 5 月	4 个月	瑞士日内瓦	28
第五轮(迪龙回合)	1960 年 9 月—1962 年 7 月	22 个月	瑞士日内瓦	45
第六轮(肯尼迪回合)	1964 年 5 月—1967 年 6 月	37 个月	瑞士日内瓦	54
第七轮(东京回合)	1974 年—1979 年 4 月	64 个月	瑞士日内瓦	102
第八轮(乌拉圭回合)	1986 年 10 月—1993 年 12 月	86 个月	乌拉圭塔斯特角城	108

Figure 1: Number of GATT/WTO members



Notes:

1. Vertical line marks the year of 1995 when the WTO was formed.

6^{th} Kennedy Rounds of GATT/WTO

- 6^{th} Kennedy Round (completed in 1967):

(1)It reduces tariffs by about 35%

(2)First anti-dumping agreement

(3)Give some exemptions to developing countries

(4)Allow central-planning-economy country as a member.

E.g., Poland becomes a member after 7 years' application

It imports 7% of its GDP from other countries each year, but the trade sanction is cancelled by other member countries.

7^{th} Tokyo Rounds of GATT/WTO

- 7^{th} Tokyo Round (1973-1979):

(1) It reduces tariffs by a formula more complex than before. Since 1980, the average tariffs of all commodities reduced 33% within 8 years.

(2) But it doesn't cover textile, footwear, and steel.

(3) In addition, new codes (9 items) were established in an effort to control the proliferation of NTBs like anti-dumping, VERs, government procurement, technical barrier, and so on.

8^{th} Uruguay Round (1986-1994)

1. Trade liberalization:

- the average tariff imposed by rich countries will fall almost 40%. Tariffs will fall from 6.3% to 3.9%.
- the average tariff imposed by poor countries reduced from 20.5% to 14.4%.

2. Reduce some of the NTBs
3. Signs the GATS—General Agreements on Trade and Services
4. Signs the TRIPs (initial stage)
5. Form the WTO

-- one of the trinity of the world economy.

-- the valid dispute settlement mechanism.

World Trade Organization (cont.)

- The GATT/WTO multilateral negotiations ratified in 1994
  – agreed that all quantitative restrictions (e.g., quotas) on trade in textiles and clothing as previously specified in the Multi-Fiber Agreement were to be eliminated by 2005.
  – Agricultural subsidies should be reduced by 36% in value, and 21% in volume over a six-year period.
  – But as the restrictions were eliminated (mostly in 2005), political pressure to again restrict trade in textiles and clothing has grown.

WTO

- First Principle: Non-discrimination
- Second principle: Free Trade
- Third principle: Fair trade

- 9^{th} Doha Round (started in 2001): Agriculture, Services, TRIPS (Trade-Related Aspects of Intellectual Properties)

WTO

- Non-discrimination Rule:

  (1) Most Favored Nation Treatment (MFN): Each country in the WTO promises that all countries will pay tariffs no higher than the nation that pays the lowest.

  – An exception to this principle is allowed only if the lowest tariff rate is set at zero (like the preferential trade agreements).

  – It is unconditional to WTO's member countries.

  – It has to go through the bilateral negotiations between member country and a non-member country

MFN: China vs the U.S.

- In 1979, China signed the bilateral MFN agreement with the U.S.
- According to Jackson-Vanik Amendment, the states had annual investigation to non-marketing economy like China and former Soviet Union after 1980.
- Investigation Issues: Immigration policy, human rights, environment, and weapon
- First challenge in 1990: the U.S. congress agree to terminate the MFN with China, but President Bush denied it.
- In 1991, Congress passed the proposal to terminate it again due to the human rights issue, but it was denied again.

MFN: China vs the U.S.

- In 1993, Clinton changed its initial position to support for China's MFN.
- In 1999, whether to pass China's permanent national trade relation (PNTR) becomes a hot debate issue.
- Before the vote with the 426 House Representatives:
  - Yes– 157
  - No—150
  - Undecided—119
- Voting results: 237 representatives agree to pass the PNTR.
- China accessed to the WTO in 2001.

WTO

- Non-discrimination Rule:

  (2) National Treatment: “not worse than the domestic firms”

  – But could be better.

  – True in some developing countries for absorbing FDI.

Framework

图 11—1　WTO 组织结构图

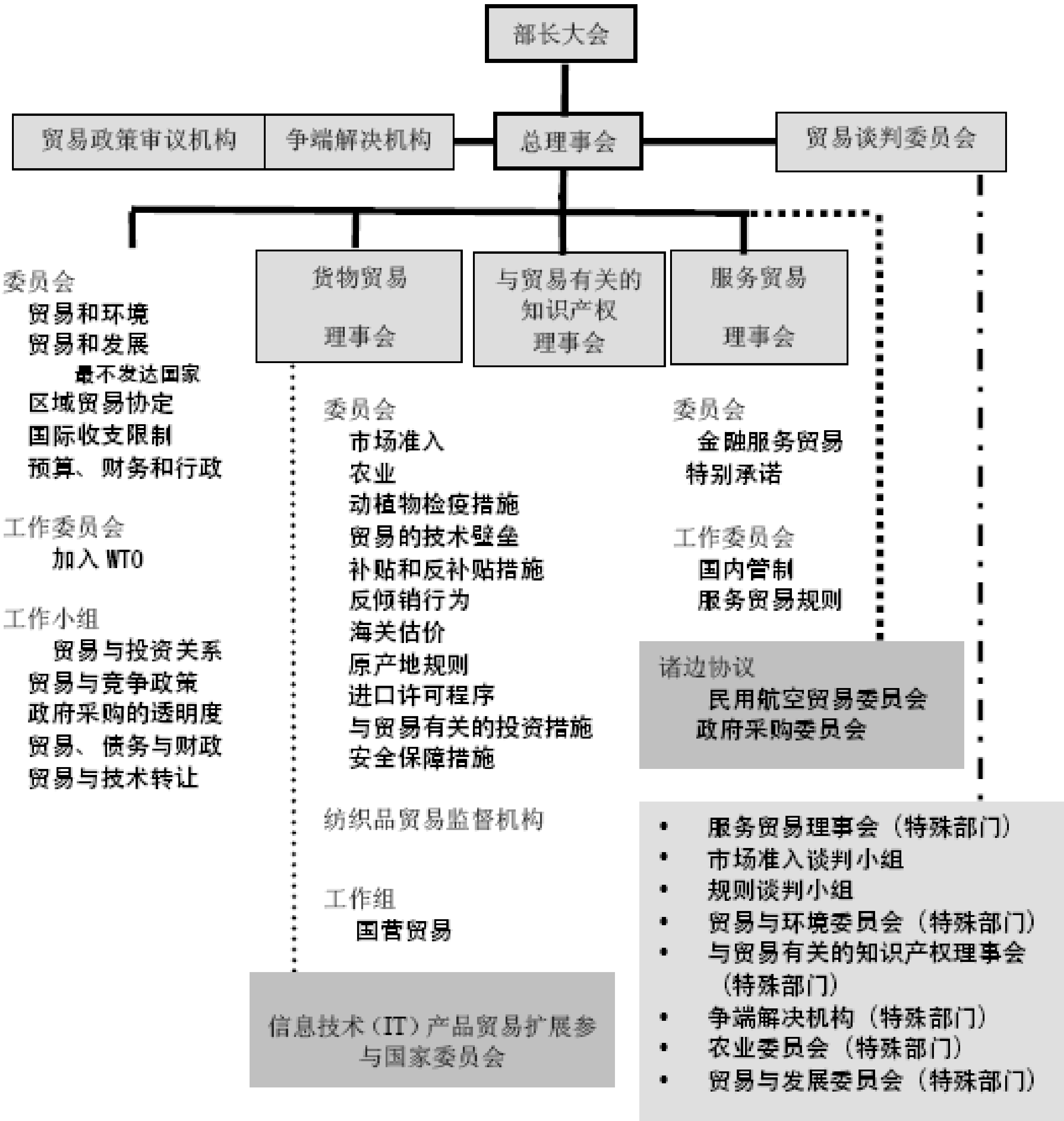
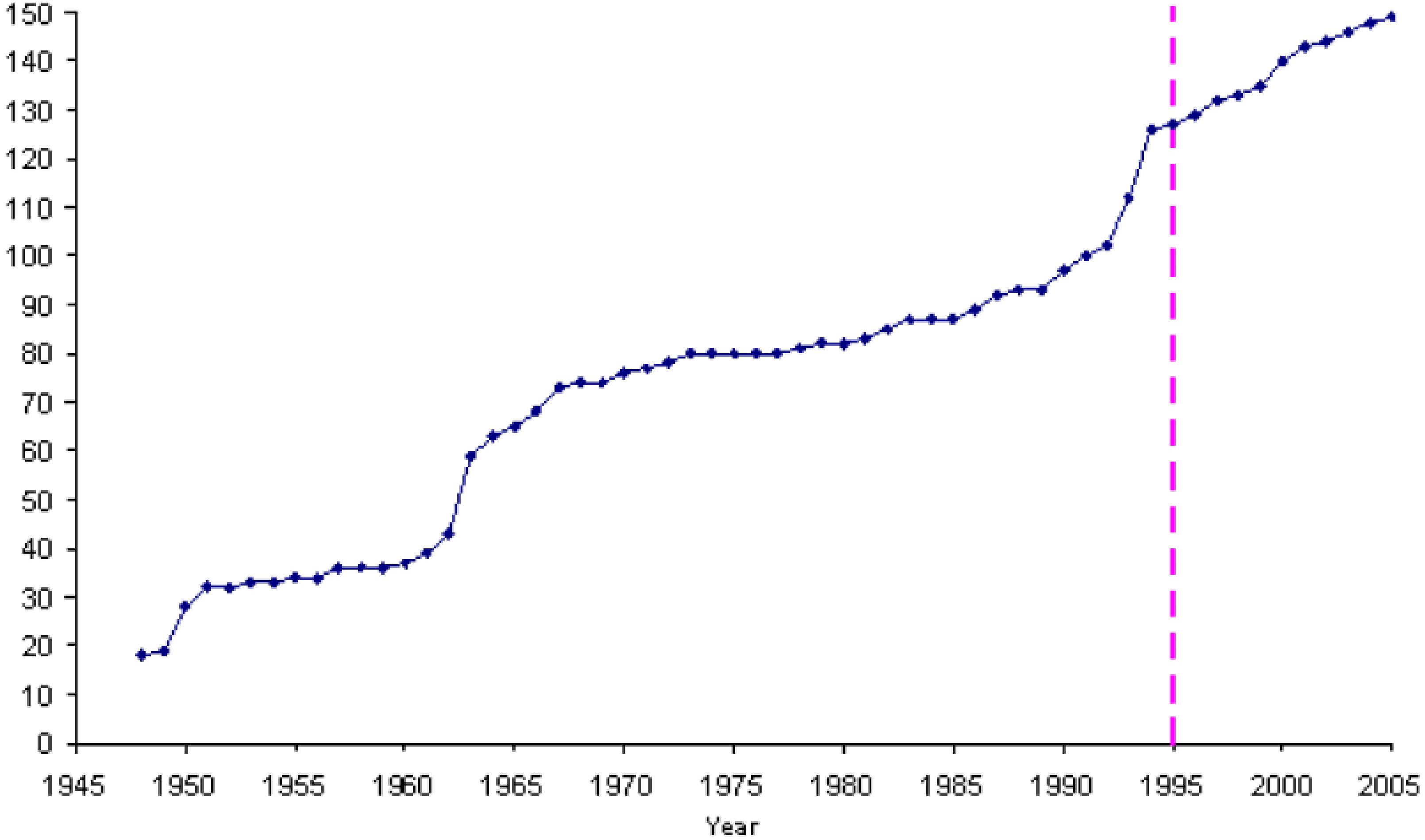


Figure 1: Number of GATT/WTO members



Notes:

1. Vertical line marks the year of 1995 when the WTO was formed.

Accession

Figure 2: Steps to accede to GATT/WTO

Formal request from the applicant

↓

Working party established
(any GATT/WTO members are eligible to join)

↓

Applicant submits memorandum

↓

Working party examines the memorandum and conduct a Q&A sessions with applicant

↓

Multilateral negotiations with the WP and bilateral negotiations with individual WP members on applicant's concessions and commitments on market access

↓

Final accession package consists of
(a) Working Party report that contains a summary of proceedings and conditions of the entry and a Protocol of Accession.
(b) Schedules of market access commitments in goods and services

↓

Working Party adopts the accession package

↓

Approval by the General Council or the Ministerial Conference

↓

Applicant signs the Protocol of Accession

↓

Applicant becomes a full member

Preferential Trading Agreements

- Preferential trading agreements are trade agreements between countries in which they lower tariffs for each other but not for the rest of the world.
- Under the WTO, such discriminatory trade policies are generally not allowed:
  - Each country in the WTO promises that all countries will pay tariffs no higher than the nation that pays the lowest: called the "most favored nation" (MFN) principle.
  - An exception to this principle is allowed only if the lowest tariff rate is set at zero.

Preferential Trading Agreements (cont.)

- There are two types of preferential trading agreements in which tariff rates are set at or near zero:

1. A **free trade area**: an agreement that allows free trade among members, but each member can have its own trade policy towards non-member countries
   – An example is the North America Free Trade Agreement (NAFTA).

Preferential Trading Agreements (cont.)

2. A **customs union**: an agreement that allows free trade among members and requires a common external trade policy towards non-member countries.
   – An example is the European Union.

Preferential Trading Agreements (cont.)

- Are preferential trading agreements necessarily good for national welfare?
- No, it is possible that national welfare decreases under a preferential trading agreement.
- How? Rather than gaining tariff revenue from inexpensive imports from world markets, a country may import expensive products from member countries but not gain any tariff revenue.

Preferential Trading Agreements (cont.)

- Preferential trading agreements increase national welfare when new trade is created, but not when existing trade from the outside world is diverted to trade with member countries.
- Trade creation
  - occurs when high cost domestic production is replaced by *low cost imports from other members*.
- Trade diversion
  - occurs when low cost imports from non-members are diverted to *high cost imports from member nations*.

Trade Creation

- Three countries: Britain($8)>French($6)>US($4) for wheat production.
- Suppose British Import tariff =$5.
- Suppose Britain and French forms a customs union.
- British consumer will buy products domestically since 8<9<11 without a customs union
- With a CU, then British consumer will purchase from his member country—French since 6<8.
- This is trade creation since Britain only needs to pay $6 to foreign country compared to its own initial cost $8.

Trade Diversion

- Three country: Britain($8)>French($6)>US($4) for wheat production.
- Suppose British Import tariff =$3.
- Suppose Britain and French forms a customs union.
- British consumer will buy products from U.S. since 7<8 without a customs union
- With a CU, then British consumer will purchase from his member country—French since 6<7.
- Trade diversion: (1) US wheat is really cheaper than French; (2) Import Tariffs revenue disappear.

Summary

1. The cases for free trade are that
   - It allows consumers and producers to allocate their resources freely and efficiently, without price distortions.
   - It may allow for economies of scale.
   - It increases competition and innovation.
2. The cases against free trade are that trade restrictions may allow
   - terms of trade gains
   - a government to address a market failure when better policies are not feasible

Effective Rate of Protection

- The **effective rate of protection** measures how much protection a tariff or other trade policy provides domestic producers.
  - It represents the change in value that an industry adds to the production process when trade policy changes.
  - The change in value that an industry provides depends on the change in prices when trade policies change.
  - Effective rates of protection often differ from tariff rates because tariffs affect sectors other than the protected sector, a fact which affects the prices and value added for the protected sector.

Effective Rate of Protection (cont.)

- For example, suppose that an automobile sells on the world market for $8000, and the parts that made it are worth $6000.
  - The value added of the auto production is $8000-$6000
- Suppose that a country puts a 25% tariff on imported autos so that domestic auto assembly firms can now charge up to $10000 instead of $8000.
- Now auto assembly will occur if the value added is up to $10000-$6000.

Effective Rate of Protection (cont.)

- The effective rate of protection for domestic auto assembly firms is the change in value added:

$$(\$4000 - \$2000)/\$2000 = 100\%$$

- In this case, the effective rate of protection is greater than the tariff rate.