A Level Economics Theme 4
A Global Perspective
2020-2021

Course Companion **3**

Specialisation and comparative advantage

Restrictions on free trade - Protectionism

The role of the WTO in trade liberalisation

Name: **Teacher: Rob Vaulter**

Index

Specification 4.1.2 – Specialisation and trade

a) Absolute and comparative advantage (numerical and diagrammatic): assumptions and limitations relating to the theory of comparative advantage

b) Advantages and disadvantages of specialisation and trade in an international context

International trade can be defined as buying and selling of goods across international boundaries. Many goods and services are traded internationally. Britain has been a trading nation for centuries. However, the UK's recent record in international trading has been poor, running a large current account deficit on the Balance of Payments.

Key terms:

Absolute Advantage	A country has an absolute advantage over another if it is able to produce a good using fewer resources, i.e. cheaper
Comparative Advantage	A country has a comparative advantage over another if it can produce a good at a lower opportunity cost.
Specialisation	When households or nations are not self-sufficient but concentrate on producing certain goods and services and trading the surplus with others
Protectionism	Protectionism is the use of trade barriers, e.g. tariff to favour domestic suppliers at the expense of foreign suppliers
Tariff	A tax on imports, sometimes called an import or customs duty
Quota	A physical limit on the quantity of a good that can be imported
Subsidies (to domestic producers)	A grant given to firms which lowers the price of a good, usually designed to encourage production or consumption of a good
Non-tariff barriers	These are regulations which increase cost to foreign producers and therefore act as barriers to trade
Infant industry	An industry that has a potential comparative advantage but which is as yet too underdeveloped to be able to realise this potential
Dumping	The sale of goods at less than cost price by foreign producers in the domestic market
Trade liberalisation	The process of making trade free from protectionist barriers

Introductory task

WTO clip – 'trade matters' https://www.youtube.com/watch?v=Crby5WYko0g

Why do countries trade? Discuss in pairs why countries import goods from the rest of the world rather than be self-sufficient and try to produce everything themselves. Write your ideas below:

Can you think of any disadvantages of trading with other countries? Write your ideas below:

The Theory of Comparative Advantage

In the 19th century, David Ricardo developed the theory of comparative advantage to show how two countries could benefit from specialisation and trade. In order to understand this theory it is important to know the difference between absolute advantage and comparative advantage.

60 Second Adventures in Economics. https://www.youtube.com/watch?v=U12yZXBmQmY

Absolute advantage

Definition:
A country has an absolute advantage over another if it is able to produce a good using fewer resources.

Example
For this example, make the following assumptions:
1. There are only 2 countries – England and Portugal
2. There are only 2 products – wheat and wine
3. The only production cost is labour

Suppose that the 2 countries can produce the following output using 1 unit of labour:

	units of wine	units of wheat
England	10	50
Portugal	30	40

Questions

1. Which country has an absolute advantage in producing wheat?

2. Which country has an absolute advantage in producing wine?

3. How could England and Portugal benefit from trade?

*NOTE: David Ricardo realised that specialisation and trade would be beneficial even if one country has an absolute advantage in producing both goods. This would happen if countries specialise according to comparative advantage.

Comparative advantage

Definition:
A country has a comparative advantage over another if it can produce a good at a lower opportunity cost.

What does the term opportunity cost mean?

Example
Making the same assumptions as before, suppose that the 2 countries can produce the following output using 1 unit of labour:

	units of wine	units of wheat
England	10	30
Portugal	20	40

Task

Fill in the gaps and then answer the questions

In England the opportunity cost of producing 1 unit of wine is ____ units of wheat

In Portugal the opportunity cost of producing 1 unit of wine is ____ units of wheat

In England the opportunity cost of producing 1 unit of wheat is ____ units of wine

In Portugal the opportunity cost of producing 1 unit of wheat is ____ units of wine

1. Which country has a comparative advantage in producing wheat?

2. Which country has a comparative advantage in producing wine?

3. Which country has an absolute advantage in producing both goods?

Why will trade between England and Portugal be beneficial?

Example

Suppose that England has 100 units of labour and Portugal has 60 units of labour

1. What is the output of wheat and wine before trade if both countries allocate half of their resources to the production of each good?

	units of wine	units of wheat
England		
Portugal		
World output		

2. What is the output of wheat and wine if both countries specialise and allocate all of their resources to the good for which they have a comparative advantage?

	units of wine	units of wheat
England		
Portugal		
World output		

3. What can you conclude from this?

Example of comparative advantage

SHARING OUT THE JOBS

A parable of comparative advantage

Imagine that you and a group of friends are fed up with the rat race and decide to set up a self-sufficient community. So you club together and use all your savings to buy an old run-down farmhouse with 30 acres of land and a few farm animals.

You decide to produce all your own food, make your own clothes, renovate the farmhouse, make all the furniture, provide all your own entertainment and set up a little shop to sell the things you make. This should bring in enough income to buy the few items you cannot make yourselves.

The day comes to move in, and that evening everyone gathers to decide how all the jobs are going to be allocated. You quickly decide that it would be foolish for all of you to try to do all the jobs. Obviously it will be more efficient to specialise. This does not necessarily mean that everyone is confined to doing only one job, but it does mean that each of you can concentrate on just a few tasks.

But who is to do which job? The answer would seem to be obvious: you pick the best person for the job. So you go down the list of tasks. Who is to take charge of the renovations? Pat has already renovated a cottage, and is brilliant at bricklaying, plastering, wiring and plumbing. So Pat would seem to be the ideal person. Who is to do the cooking? Everyone agrees on this. Pat makes the best cakes, the best quiches and the best Irish stew. So Pat is everyone's choice for cook. And what about milking the sheep? 'Pat used to keep sheep', says Tarquin, 'and made wonderful feta cheese.' 'Good old Pat!' exclaims everyone.

It doesn't take long before it becomes obvious that 'clever-clogs' Pat is simply brilliant at everything, from planting winter wheat, to unblocking drains, to doing the accounts, to tie-dyeing. But it is soon realised that, if Pat has to do everything, nothing will get done. Even Chris, who has never done anything except market research, would be better employed milking the sheep than doing nothing at all.

So what's the best way of allocating the jobs so that the work gets done in the most efficient way? Sharon comes up with the solution. 'Everyone should make a list of all the jobs they could possibly do, and then put them in order from the one they are best at to the one they are worst at.'

So this is what everyone does. And then people are allocated the jobs they are *relatively* best at doing. Chris escapes milking the sheep and keeps the accounts instead. And Pat escapes with an eight-hour day!

?

If Pat took two minutes to milk the sheep and Tarquin took six, how could it ever be more efficient for Tarquin to do it?

Questions

1. In this example, who has the absolute advantage in every task?

2. How did the friends specialise according to comparative advantage?

3. Why are the friends better off after specialisation?

4. Why do individuals, companies and economies have an incentive to specialise in a market economy?

Comparative Advantage and the terms of trade

Suppose there are 2 countries: Britain and Australia
Suppose there are 2 goods: Tractors and Wool

The table shows the output of tractors and wool using 1 unit of labour:

	Tractors	Wool
Britain	2	1
Australia	4	8

1. __________ has an absolute advantage in producing both goods

2. In Britain the opportunity cost of producing 1 tractor is __________
3. In Australia the opportunity cost of producing 1 tractor is __________

4. __________ has a comparative advantage in producing tractors

5. In Britain the opportunity cost of producing 1 unit of wool is __________
6. In Australia the opportunity cost of producing 1 unit of wool is __________

7. __________ has a comparative advantage in producing wool

The benefits from trade

Suppose Britain has 400 units of labour and Australia has 100 units of labour

8. What is the output of both goods if each country divides labour equally between the 2 goods?

	Tractors	Wool
Britain		
Australia		
World		

9. What is the output of both goods if each country specialises in producing the good in which it has a comparative advantage?

	Tractors	Wool
Britain		
Australia		
World		

Conclusion

The exchange rate

Before trade, the prices of the two goods are likely to reflect the opportunity cost of producing each good.

In Britain 2 tractors will exchange for 1 unit of wool. The exchange rate is 2:1.
In Australia 1 tractor will exchange for 2 units of wool. The exchange rate is 1:2

Both countries will benefit from trade if the exchange rate is between 2:1 and 1:2. This would mean that each country could obtain goods from abroad at a lower opportunity cost than if the goods were produced domestically. For example, suppose the exchange rate between Britain and Australia was 1:1. This means that one tractor would exchange for one unit of wool.

Britain is better off after trade because before trade Britain had to give up _________ to obtain a unit of wool. However, after trade, Britain must give up only _________ to obtain a unit of wool.

Australia is better off after trade because before trade Australia had to give up _________ to obtain a tractor. However, after trade, Australia must give up only _________ to obtain a tractor.

We can illustrate how countries can benefit from trade using diagrams. A Production Possibility Frontier (PPF) can be used to illustrate all possible combinations of goods that can be produced in an economy before trade. A Trading Possibility Curve (TPC) can be used to represent all the possible combinations of goods that may be consumed if a country specialises and trades.

TASK

1. Draw a PPF for Britain by calculating the maximum output of tractors that could be produced if all units of labour are used to produce tractors. Then calculate the maximum output of wool that could be produced if all units of labour are used to produce wool. Join these 2 points together on a graph to create a straight line PPF. Plot tractors on the y-axis and wool on the x-axis.

2. Do the same for Australia. (Note: Draw the y-axis up to 800 tractors)

3. Draw a TPC for Britain by calculating how much of each good could be consumed if Britain specialises in producing tractors and is able to exchange one tractor for one unit of wool.

Limitations/evaluation of the theory of comparative advantage

1. **It assumes there are only two countries and two traded goods**
   The theory will also apply to a world with many countries and many traded goods. However, it becomes more complicated to explain which goods countries will produce if there are many countries and many goods.

2. **It assumes all traded goods are homogeneous**
   In reality goods produced in one country may be very different from competing goods from another country. For example, a car produced in Germany may be different from a car produced in Japan. Therefore, it is sometimes difficult to make comparisons between the cost of production in the two countries. The theory of comparative advantage may be better at explaining the pattern of trade of commodities such as wheat, copper and coffee than manufactured goods such as cars. This is because commodities are more likely to be homogeneous than cars

3. **It ignores transport costs**
   In reality, transport costs may reduce and sometimes eliminate any comparative cost advantages. For example, Poland may have a comparative advantage over Britain in the production of bricks. However, if it is very expensive to transport bricks from Poland to Britain, then Poland's comparative cost advantage will be eliminated.

4. **It assumes there are no barriers to trade**
   Many countries place tariffs (taxes) or quotas or other restrictions on imported goods. This prevents countries from exporting and benefiting from any comparative advantage.

5. **It assumes there are no economies of scale.**
   If a country specialises in producing a particular good, then the average cost of producing this good may fall. The existence of economies of scale will reinforce the benefits from trade.

6. **Assumes factors of production can be easily switched from producing one good to another** (ie. assumes constant opportunity cost)
   If all factors of production are equally well suited to producing a good there will be a constant opportunity cost. For example, the opportunity cost of producing the first unit of wheat is the same as the opportunity cost of producing the 10 millionth unit of wheat. In reality, all factors of production are **not equally well suited** to producing a particular good. Therefore as more and more of a good is produced, resources must be used that are less and less well suited to producing that good. Therefore, the opportunity cost of producing a particular good will increase as more and more is produced. The comparative advantage in this good may be lost. Protectionism can distort the pattern of world trade.

7. **Ignores external costs.** Identify the external costs arising from trade:

Restrictions on free trade - Protectionism

Specification: 4.1.6 Restrictions on free trade
a) Reasons for restrictions on free trade
b) Types of restrictions on trade:

- tariffs
- quotas
- subsidies to domestic producers
- non-tariff barriers

c) Impact of protectionist policies on consumers, producers, governments, living standards, equality

Key terms: types of restrictions on free trade

Protectionism: the use of economic policies to regulate trade between countries mainly to reduce imports.

Trade barrier: any measure which artificially restricts international trade.

Tariff, import duty or customs duty: a tax on imported goods which has the effect of raising the domestic price of imports and thus restricting demand for them.

Quota: A physical limit on the quantity of an imported group. (Quotas have a similar effect as tariffs, because shortages are created, driving up price, but no tax revenue is raised).

Subsidies (to domestic producers): A grant given to firms which lowers the price of a good, usually designed to encourage production or consumption of a good. (Subsidy reduces production costs, therefore lowering prices, and making the country's products more competitive internationally, but incur a cost for government).

Non-tariff barriers: These are regulations which increase costs to foreign producers and therefore act as barriers to trade, e.g. product specifications, health and safety regulations, environmental regulations and labelling of products.

One reason for protectionism is to prevent dumping:

Dumping: The sale of goods at less than cost price by foreign producers in the domestic market.

Use the above box and your macro knowledge to give reasons for governments wishing to restrict free trade

The effects of a tariff on the UK wheat market

A tariff is a tax on imports. The effect of imposing a tariff can be analysed using a diagram. The following assumptions are made when drawing the tariff model:

1. **All goods are homogeneous** (the same). The wheat produced in the UK is the same as the wheat produced in the rest of the world.

2. **The domestic supply curve is upward sloping**. As the price of wheat rises in the UK market, UK farmers have the incentive to grow more wheat.

3. **The price of imported wheat is determined in the world market**. This assumes that the UK is a relatively small part of the world economy. Changes in UK demand or supply have no significant effect on world demand or supply. Therefore, the UK market will not affect the world price. This means that the supply curve of imported wheat is perfectly elastic in the UK market:

1. World wheat market

2. UK Wheat market

3. UK Wheat market with a tariff

What is the equilibrium price if no wheat is imported into the UK?

Suppose wheat is imported at the world price WP. In this case UK farmers must also sell their wheat at this price to be competitive.
What is the domestic quantity supplied?
What is the domestic quantity demanded?
What is the level of imports?

Suppose a tariff is imposed on imported wheat. This will raise the price in the UK market to WP + Tariff. In this case UK farmers will raise their prices to this level as they can make more revenue and profit.
What is the domestic quantity supplied?
What is the domestic quantity demanded?
What is the level of imports?

Summarise the effect of a tariff:

Practice Question 1 – Impact of a tariff

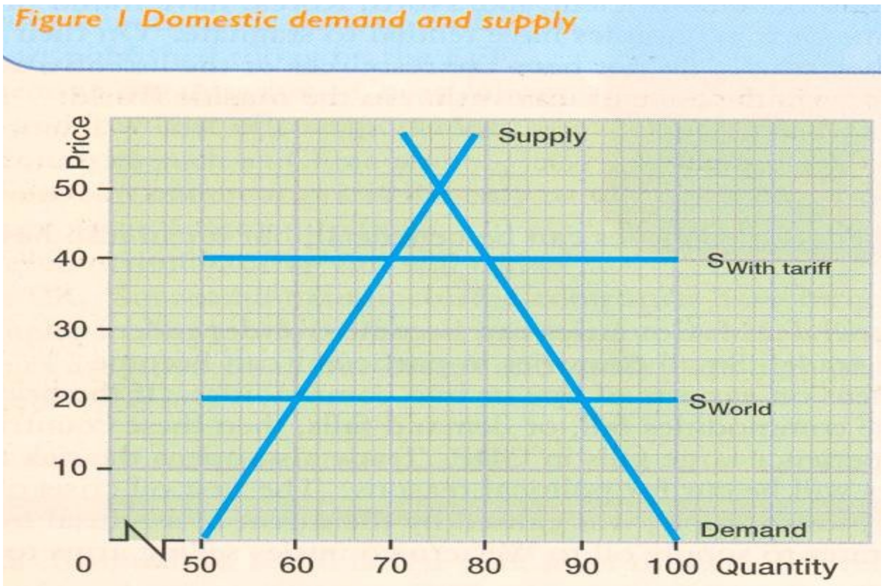


Figure 1 shows the domestic demand and supply curve for a good.

(a) What is the equilibrium price and quantity demanded and supplied domestically?

(b) The country starts to trade internationally. The international price for the product shown is 20. The country can import any amount at this price. What is:
- (i) the new level of demand
- (ii) the new level of domestic supply;
- (iii) the quantity imported?

(c) The government, alarmed at the loss of jobs in the industry, imposes a tariff of 20 per unit. By how much will:
- (i) domestic demand fall;
- (ii) domestic supply rise;
- (iii) imports fall?

(d) What would happen if the government imposed a tariff of 40 per unit?

Extension questions using figure 1

1. What is the government's tax revenue with the 20 per unit tariff?
   (government tax revenue = value of the tariff * level of imports)

2. What is the revenue of domestic producers:
   A. Before the tariff?
   B. After the tariff?

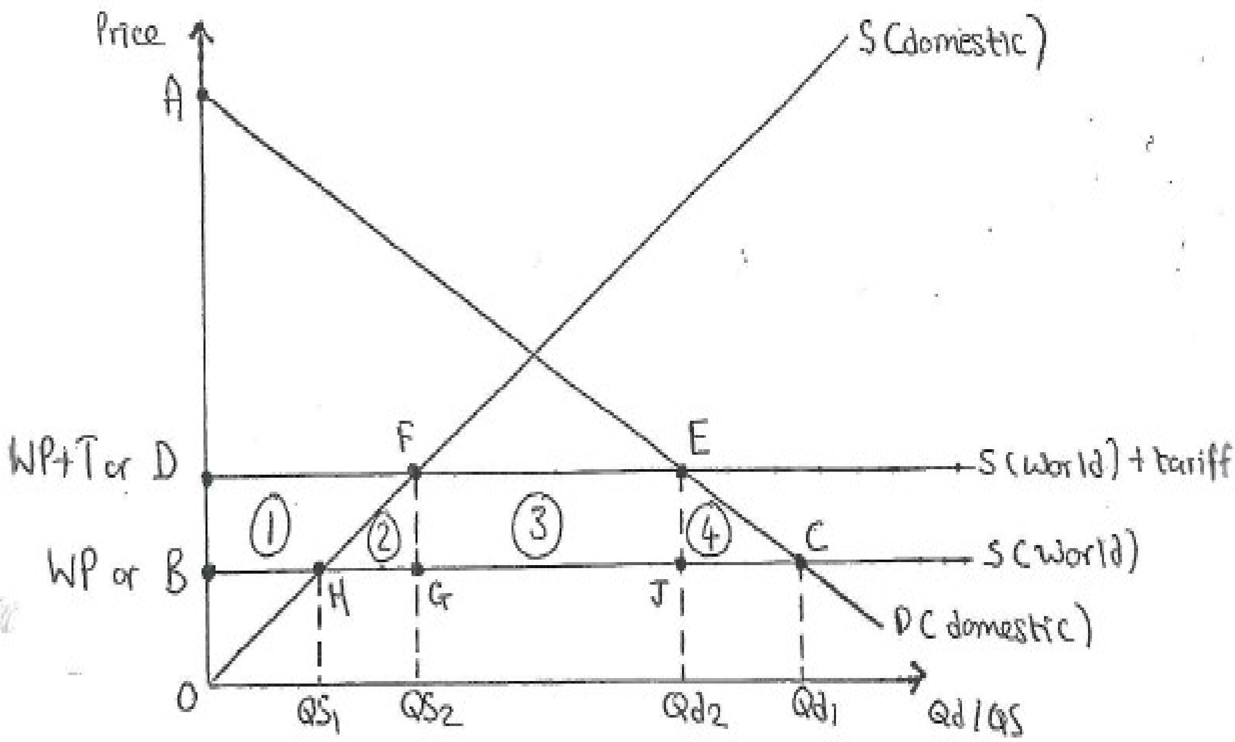
3. What is the change in revenue of domestic producers?

4. What is the revenue of importers
   A. Before the tariff?
   B. After the tariff?

5. What is the change in revenue of importers?

Practice Question 2 – Impact of a tariff

Suppose the following diagram shows the UK market for wheat:



1. What is the domestic equilibrium if the UK does not trade at all with the rest of the world?

2. Why is the world supply curve assumed to be horizontal or perfectly elastic?

3. What is the domestic quantity supplied and quantity demanded if the UK imports wheat at the world price PW?

4. What is the level of imports if the UK imports wheat at the world price PW?

5. What is the domestic quantity supplied and quantity demanded if the UK imposes a tariff on imported wheat which raises the price to PW+T?

6. What is the level of imports if the UK imposes a tariff on imported wheat which raises the price to PW+T?

Welfare gains and losses from the tariff

1. Define the term consumer surplus

2. Draw a supply and demand diagram to illustrate total consumer surplus

3. Define the term producer surplus

4. Draw a supply and demand diagram to illustrate total producer surplus.

5. Using the diagram on the previous page which area represents the loss of consumer surplus after the tariff is imposed?

6. Which area represents the increase of producer surplus after the tariff is imposed?

7. Which area represents the government's revenue from the tariff?

8. Is society better off or worse off after the tariff?

Reasons for restrictions on free trade

Class work: Complete the following reasons for protectionism:

Protect employment and incomes
If governments restrict imports this may preserve particular domestic Industries and the jobs which they provide. A fall in the value of imports is also likely to cause an increase in aggregate demand and a rise in national income.

Evaluation:

1. How might businesses be affected if they depend on imports?

2. How might other countries respond?

3. How might poor developing countries be affected?

The infant industry argument

- Country may wish to develop new industries to diversify the econo
- Start-up industry faces higher costs than foreign competitors who l f scale.
- There is a 'learning curve' for new industry – takes time for manag efficient operational/working practices.
- Therefore infant industry protected by tariff barriers, which are late

Protect "fledgling" - infant sectors

Evaluation:

The sunset or senile industry argument
To protect old industries which have become uncompetitive, e.g. the US steel industry which was protected by the US government to regain international competitiveness.

Evaluation:

To diversify the economy
Some countries are very dependent on particular exports (e.g. 80% of Zambia's exports are copper) – this is known as

primary product dependency. This means that the domestic economy is very vulnerable to changes in the price of that commodity. If the world price of copper plunges then this may have a potentially damaging effect on Zambia's economy. Also, if the demand for copper is income inelastic, then as the world economy grows Zambia will have a smaller and smaller share of world GDP.

How could protectionist measures help a country to diversify?

Evaluation:

To prevent dumping: the sale of goods at less than cost price by foreign producers in the domestic market.
Foreign firms may sell products 'at a loss' for various reasons:

- Over-production and failure to sell so dumped in a countries market in 'distress sale'.
- In the short run, firm has excess capacity, so sells below average total cost as long as price at least covers average variable cost.
- Foreign producer deliberately prices at a loss, to drive domestic producers out of business, so it can then raise prices and enjoy monopoly profits.

Response to import "Dumping"

Evaluation:

To reduce competition from countries with cheap labour and poor labour/environmental laws

Explain:

Evaluation:

To correct imbalances of the current account of the balance of payments: restrictions on imports might help to reduce the imbalance between the value of imports and the value of exports.

Response to chronic trade gap / deficits

Explain:

Evaluation:

To retaliate against restrictions imposed by another country

Explain:

Evaluation:

Preserve strategic industries e.g. defence, food production, electricity generation

Explain:

Protect key / politically strategic industries

Evaluation:

Raise extra revenues for governments with budget deficits

To raise tax revenue: tariffs might be an important source of tax revenue for developing countries.

Evaluation:

Preserve a way of life, e.g. rural communities
Many regions are dependent on one or two key industries. If these industries decline then the local population may be forced to leave to find work and traditional ways of life may be lost. For example:

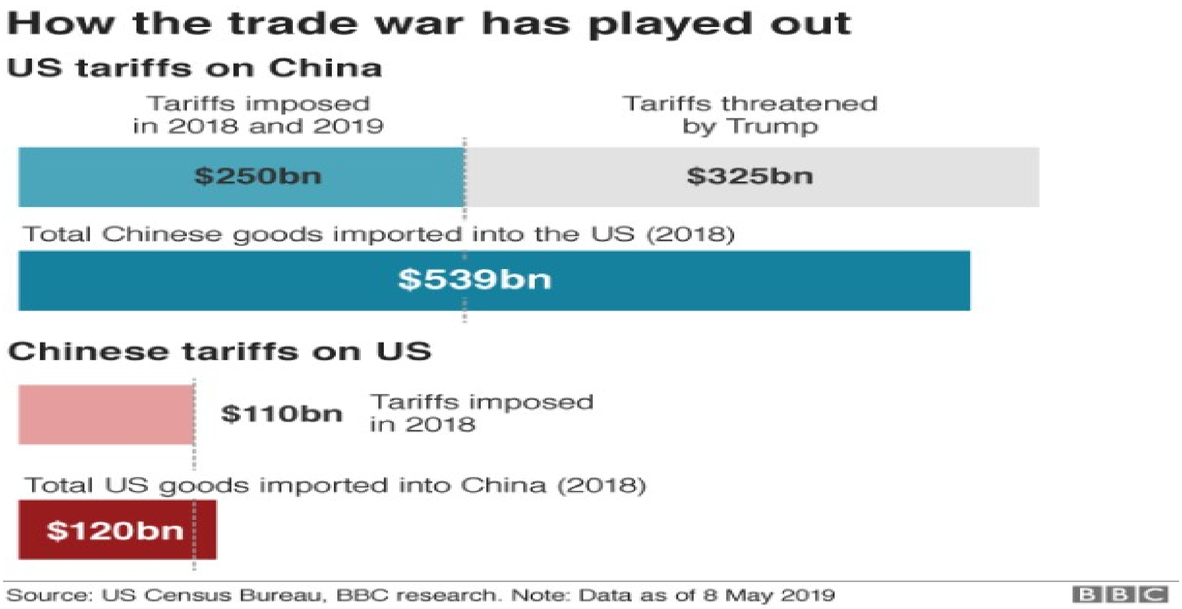
Evaluation:

<u>A quick guide to the US-China trade war</u>
<u>BBC website – 2nd October 2019</u>

The US and China are locked in a bitter trade battle. Over the past year, the world's two largest economies have imposed tariffs on billions of dollars worth of one another's goods. US President

Donald Trump has long accused China of unfair trading practices and intellectual property theft. China has been a frequent target of Donald Trump's anger, with the US president criticising trade imbalances between the two countries where Chinese exports to America are much greater than American exports to China. In China, there is a perception that the US is trying to curb its rise. Negotiations are ongoing but have proven difficult. The two sides remain far apart on issues including how to roll back tariffs and enforce a deal. The uncertainty is hurting businesses and weighing on the global economy.

What tariffs have been imposed?
Mr Trump's tariffs policy aims to encourage consumers to buy American by making imported goods more expensive. So far, the US has imposed tariffs on more than $360bn (£296bn) of Chinese goods, and China has retaliated with tariffs on more than $110bn of US products. Washington delivered three rounds of tariffs last year, and a fourth one in September. The latest round targeted Chinese imports, from meat to musical instruments, with a 15% duty. Beijing has hit back with tariffs ranging from 5% to 25% on US goods. Its latest tariff strike included a 5% levy on US crude oil, the first time fuel has been hit in the trade battle.



What's next?
Both sides have threatened to take more action with new tariffs and hikes to existing duties in the coming months. On 1 October, the US plans to raise an existing 25% tariff on some Chinese products to 30%. Washington then plans to deliver a wave of new tariffs on Chinese goods, ranging from footwear to telephones, on 15 December. If this happens, effectively all Chinese goods imported to the US will be subject to tariffs. China also plans to hit another 3,000 American products with tariffs by the end of the year.

What will be the impact of the tariff rise?
Even though Mr Trump has downplayed the impact of tariffs on the US economy, the rise is likely to affect some American companies and consumers as firms may pass on some of the cost to consumers by raising prices. If the Chinese retaliate by imposing higher tariffs on US goods sold in the Chinese market this could harm US businesses that export to China.

Questions:
1. Why is the US President imposing higher tariffs on Chinese goods?

2. How do you think a trade war between the United States and China would affect consumers in China and America?

3. How do you think a trade war between the United States and China would affect businesses in China and America?

4. Do you think the US president is right to put higher tariffs on Chinese goods?

Country example: Australia

Australian car industry

Australia once had ambitions to be a major car manufacturer. To protect its industry, it erected tariff and quota barriers. However, the cost of producing cars in Australia was high because manufacturing failed to achieve sufficient economies of scale. Protectionist barriers also led to X-inefficiencies in production. The lack of competition meant that local manufacturers were not under pressure to reduce costs to a minimum.

In the mid-1980s, the Australian government decided to bring down trade barriers to boost the efficiency of its car industry. By 2000, quotas had been abolished and tariffs had been reduced from more than 50 per cent to 15 per cent. Imports rose whilst domestic manufacturing shrank. By 2015, there was intense competition in the market with 67 brands selling 350 different models of car. There are more brands and models sold in Australia with an annual market of 1.1 million cars than in more protected markets such as the US with 17 million sales last year and China with 23 million sales.

A series of regional trade agreements with the US, Thailand, South Korea and Japan have now virtually eliminated tariffs on imported cars. There is still a five per cent tariff on EU imports but a trade deal is under discussion which would eliminate this.

Australian consumers have benefited from the abolition of protectionist measures in the car market. They now have unprecedented choice and price competition is fierce. Australia's motor vehicle production industry has suffered. Plants have closed. Toyota, Ford and Holden have all recently decided to close their remaining Australian car plants by 2017. For international companies like Toyota and Ford, shifting production from Australia to one of their other factors round the world is not a major cost. However, car workers in Australia will lose their jobs. The Australian government will lose tax revenues from the Australian car manufacturing industry. But, assuming that the workers are employed elsewhere in the economy, this will only be a short-term loss. Overall, the Australian economy should gain as it shifts resources out of less competitive car manufacturing to more competitive industries such as mining.

19 October 2017. Edited from https://www.bbc.co.uk/news/world-australia-41675196?

Australian carmaking runs out of road

Australia's final locally made car left the production line on Friday when Holden stopped manufacturing in the nation. It is considered the end of an era, after similar exits by Ford and Toyota.

A 1970s advert featuring a Holden car

1. Why did the Australia protect its car industry with tariff and quota barriers?

2. Use a diagram to show the impact of removing the tariff on cars. Label and explain your diagram fully.

3. Complete the table below to discuss the benefits and disadvantages of removing these trade barriers:

Benefits of removing trade barriers	Evaluation: Disadvantages, limitations, depends on…

Impact of protectionist policies

Benefits of protectionist policies for:	Evaluation: Disadvantages, limitations, depends on…
Consumers	
Producers	
Government	
Equality	

World Trade Organisation (WTO)

Specification: 4.1.5 – Trading blocs and the WTO

c) Role of the WTO in trade liberalisation

The **World Trade Organization (WTO)** based in Geneva, Switzerland, was set up to **promote trade liberalisation (free trade)** so that countries could gain from the advantages of **specialisation** and **economies of scale.**
It does this by:

- Attempting to get member countries to reduce protectionist barriers
- Providing a mechanism for the settlement of trade disputes.

History:
The WTO was established in 1995 and was preceded by the **General Agreement on Tariffs and Trade** (GATT).

GATT, then WTO, organised negotiations or 'rounds' aimed at reducing tariffs/quotas

Membership of the WTO has expanded with the successful admission of China, India and latterly, Russia to the WTO as an event of huge significance.

Countries that join the WTO have to introduce a large number of economic and legal changes and agree to abide by established global trade rules

The WTO oversees the rules of international trade:
It provides a forum for **settling trade disputes** between governments: initially through negotiation, then WTO ruling, which allows for fines or trade sanctions to be imposed on losing country.

Countries that join the WTO are required to achieve sustained reductions in average import tariffs. After WTO entry in July 2012 Russia's average import tariffs will decline from 9.4% to 6.4% on industrial goods and from 15.6% to 11.3% for agricultural goods.

Is the influence of the WTO reducing?
There has been rapid growth of **bi-lateral trade agreements** between countries rather than through **multi-lateral trade agreements**. **Non-tariff barriers proliferate** and the WTO does not seem to have been effective in curbing these types of protectionism. The WTO has found it hard to make progress in dismantling entrenched systems of agricultural protection / financial support especially farm policies in advanced nations. This has led many critics of the WTO to argue that the WTO is run in the interests of manufacturers and farmers in the developed world - there are strong protectionist interests within the WTO framework.

Tariff cuts during the Uruguay Round (from 1995)
40% cut in developed countries tariffs on industrial products, from an average of 6.3% to 3.8%.

The value of imported industrial products that receive duty-free treatment in developed countries will jump from 20% to 44%.

Fewer products charged high duty rates. The proportion of imports into developed countries from all sources facing tariffs rates of more than 15% will decline from 7% to 5%. The proportion of developing country exports facing tariffs above 15% in industrial countries will fall from 9% to 5%. Developed countries increased the number of imports whose tariff rates are "bound" (committed and difficult to increase) from 78% of product lines to 99%. For developing countries, the increase was considerable: from 21% to 73%. Economies in transition from central planning increased their bindings from 73% to 98%. This all means a substantially higher degree of market security for traders and investors.

Tariffs on all agricultural products are now bound. Almost all import restrictions that did not take the form of tariffs, such as quotas, have been converted to tariffs — a process known as "tariffication". Tariffs on agricultural products have been cut but remain high as many countries want to protect rural communities. *Source: WTO*

The Doha round of negotiations

This began in 2001. The Doha round of talks is also called the *development round,* reflecting its emphasis on promoting free trade for the benefit of developing nations. In particular, talks focussed on three areas: reducing agricultural subsidies and industrial tariffs imposed by developed nations, which limit the market access of developing nations; harmonising competition rules within different countries; and helping poor countries.

The talks collapsed for a number of reasons. Significantly, while the US and EU failed to agree reductions in agricultural support, many developing countries refused to agree new investment rules which would make it easier for multinationals to invest in their countries. Since the collapse, the USA and EU have returned to bilateral agreements with *favoured nations*, rather than entering into multilateral agreements. This highlights a major limitation of the WTO in not gaining a complete consensus that *multilateral* negotiations should be the method of choice of its members.

The failure of the Doha round means that the rich countries of the world still protect themselves from goods produced by the poor nations. By 2005, average agricultural tariffs imposed by the USA and EU were 60%, against average industrial tariffs of only 5%. *Source: economicsonline*

Criticisms of WTO

Many argue that the WTO has failed to confront ethical issues, such as the use of child labour and poor working conditions in developing economies, and has failed to tackle environmental issues. Critics also argue that the WTO has an inbuilt bias favouring developed and powerful nations and trading blocs such as the USA and the EU, and operating against weaker, developing ones. They argue that it promotes free trade which leads to workers in developing countries being exploited with low wages and poor working conditions.

Critics complain that the WTO takes too long to arbitrate and settle disputes. For example, it can take over five years from the initial receipt of a complaint from one member to the final panel ruling.

Despite the WTO operating as a multilateral organisation, many member countries and trading blocs favour bilateral discussions with partners or competitors. This is because bilateral negotiations can be fully focussed and relatively quick to complete. The result is that many countries prefer to bypass the WTO process, and deal directly with other countries. The failure of the most recent round of WTO negotiations, the Doha round, is widely regarded as evidence of the inherent problems of multilateral discussions. While the WTO is likely to argue that it encourages such agreements when they do not have a negative impact on third parties, it is very difficult to find cases where third-party countries are not, at least indirectly, negatively affected by a specific bilateral agreement.

Summarise the purpose and outcome of the Doha round


Read the text above and summarise discussion of the WTO:

Benefits of WTO	 Weaknesses, disadvantages, depends on..

WORLD TRADE ORGANIZATION

What is it?

The World Trade Organization (WTO) is an international body whose purpose is to promote f_______ ______ by persuading countries to abolish import tariffs and other barriers. Because of this it has become closely associated with ___________________.

It is based in Geneva and decisions are binding on all members. The WTO is the only international agency overseeing the rules of _________________ _______________. It polices free trade agreements, settles trade disputes between governments and organises trade ____________________.

WTO decisions are absolute and every member must _______ by its rulings. So, when

the US and the European Union are in dispute over bananas or beef, it is the WTO which acts as ________ and jury. WTO members are empowered by the organisation to enforce its decisions by imposing trade sanctions against countries that have breached the rules.

Criticisms of the WTO

1. WTO is run by the rich for the rich and does not give significant weight to the problems of ______________ countries. For example, rich countries __________ their farmers and restrict free trade, so preventing poor countries from competing in this market.
2. WTO is ________________ to the impact of free trade on workers' rights, child labour, the environment and health.

Supporters of the WTO say:

1. By expanding world trade, the WTO in fact helps to _________ living standards around the world.
2. Global economic growth would be damaged if countries were allowed to impose ________ ____________ to 'protect' their workers/industries.

Developing, judge, trade barriers, international trade, negotiations, raise, subsidise, globalisation, indifferent, abide, free trade

It’s the end of the World Trade Organisation as we know it

Edited from The Economist Nov 28th 2019

Winter is coming,” warned a Norwegian representative on November 22nd, at a meeting of the World Trade Organisation (WTO). The multilateral trading system that the WTO has overseen since 1995 is about to freeze up. On December 10th two of the judges on its appellate body, which hears appeals in trade disputes and authorises sanctions against rule-breakers, will retire—and an American block on new appointments means they will not be replaced. With just one judge remaining, it will no longer be able to hear new cases.

The WTO underpins 96% of global trade. By one recent estimate, membership of the WTO or General Agreement on Tariffs and Trade (gatt), its predecessor, has boosted trade among members by 171%. When iPhones move from China to America, or bottles of Scotch whisky from the European Union to India, it is the WTO’s rules that keep tariff and non-tariff barriers low and give companies the certainty they need to plan and invest.

The system is supposed to be self-reinforcing. Mostly, countries follow the WTO’s rules. But if one feels another has transgressed, then instead of starting a one-on-one trade spat it can file a formal dispute. If the WTO’s ruling displeases either party, it can appeal. The appellate body’s judgments pack a punch. If the loser fails to bring its trade rules into compliance, the winner can impose tariffs up to the amount the judges think the rule-breaking cost it. It is that punishment that deters rule breaking in the first place.

It is no surprise that President Donald Trump has axed these foreign arbiters, given his general distaste for internationally agreed rules. On November 12th he declared himself “very tentative” on the WTO. But the problems run far deeper than dislike of multilateral institutions. They stem from a breakdown in trust over the way international law should work, and the more general failure of the WTO’s negotiating arm. Had the Americans felt that they could negotiate away their grievances, resentment towards the appellate body might not have built up. But with so many members reluctant to liberalise, including smaller countries fearful of opening up to China, that has been impossible.

America has had some wins at the WTO: against the European Union for subsidies to Airbus, an aircraft-maker; and against China for its domestic subsidies; theft of intellectual property; controls on the export of rare earths, which are used to make mobile phones; and even its tariffs on American chicken feet. But it has also been dragged before the appellate body repeatedly, in particular by countries objecting to its heavy-handed use of “trade remedies”: tariffs supposed to defend its producers from unfair imports. Time after time, it has lost. In such cases, it has generally sought to become compliant with the rules rather than buy the complainant off.

Though previous administrations had grumbled, and occasionally intervened in judges’ appointments, the Trump administration went further. Its officials complained that disputes often dragged on much longer than the supposed maximum of 90 days, and—more seriously—that the appellate body made rulings that went beyond what WTO members had signed up to. They made it clear that unless such concerns were dealt with, no new judges would be confirmed.

Judicial overreach is in the eye of the beholder. Losers will always feel hard done by, and America has been quick to celebrate the WTO’s rulings when it wins. But plenty of others think that the appellate body had overstepped its remit. A recent survey of individuals engaged with the WTO, including national representatives, found that 58% agreed with that verdict.

Under the gatt, which lacked a proper enforcement system, ambiguities were hashed out in smoke-filled rooms. But the WTO was supposed to make naked power politics over trade obsolete. Had it worked as intended, there would have been a balance between settling disputes and writing new rules. Policy is best made with a vibrant judiciary interpreting the law, and a functioning legislative arm to fix any mistakes. Whenever the appellate body made decisions that annoyed members, they could have resolved their differences at the negotiating table. Perhaps America could have got others to agree to higher tariffs on imported steel, or been granted some flexibility in its defensive duties.

But the WTO's negotiating arm has been broken for years. With the current count of members at 164, it has become more inclusive, but is unable to get much agreed. Each member has a veto over any further multilateral trade liberalisation. And without new negotiations, resentment towards the appellate body has built up.

Had the multilateral system been more effective at dealing with the rise of China, perhaps the single biggest issue of its times, then calls to save it might be louder in Washington. Although various American administrations pursued and won several cases, the process was slow and occasionally frustrating. America can justly claim that, when it tried to hold China to account for its breaches of trade rules, it got little support. America has been responsible for more than half of all complaints against China. And other WTO members' complaints were generally copycat, filed in America's wake.

Now that the Trump administration has bypassed the WTO and taken the fight straight to China, there is nothing remaining that it particularly wants from the WTO. And so the chances that it will relent and allow nominations to the appellate body by December 10th are slim to none. In response to proposals from other members to change the body's rules, an American representative said that they were not persuaded that the rules would be stuck to.

Of the WTO's 163 other members, 117 have signed a joint letter calling upon America to end the impasse. Although America has been the heaviest user of the dispute-settlement system, others will miss it too. Some have already begun preparing, for example by agreeing at the start of any disputes to forgo the right to appeal. The eu, Canada and Norway have agreed on an interim arbitration mechanism that will use retired members of the appellate body as judges. And the eu is considering beefing up its own enforcement mechanism to fill the hole left by the appellate body, though it would probably cleave more closely to the outcomes of first-stage rulings in WTO disputes.

But some members are likely to shun such alternatives—especially those that expect to be sued a lot. And it is unclear how robust they will be if disputes turn nasty. Some WTO members may try to choose their dispute-settlement mechanism case by case. An organisation as ambitious as the WTO, for all its faults, will be easier to break than replace.

All this means that global trade is about to become a lot less predictable and a lot more contentious. Without the appellate body to act as honest broker, disputes between the biggest members may escalate. Under the gatt America acted as global trade sheriff, launching investigations at will and bullying disputatious countries into submission. It is not impossible that it will resume this role. On November 27th the Trump administration announced that it had nearly finished an investigation into a French tax on digital services, which America reckons discriminates against its tech giants. That could lead to tariffs.

In the 1980s American unilateralism was no fun for countries on the receiving end. But at least back then Uncle Sam could point to the lack of any other power even theoretically capable of doing the job. Now the absence of independent referees is America's own doing. And of all Mr Trump's trade policies, it may prove the hardest to reverse and have the longest-lasting effects. ■

Questions

1. How much global trade does the WTO underpin?

2. Why is the USA so upset with the appeals process of the WTO?

3. What has The US President done to disrupt the WTO appellate process?

4. Why is the USA unlikely to relent in its treatment of the WTO even with a new President?

Further reading: Anderton unit 66: WTO