

Preferential Trade Agreements and International Economic Order

Course “Text-as-data analysis of international trade”

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- ① **Preferential Trade Agreements and International Economic Order**
- ② Gravity and Gravitas
- ③ Text factorisation — I: Bag-of-words methods
- ④ Text factorisation — II: distributive semantics
- ⑤ Welfare effects of Preferential Trade Agreements

Outline

- 1 International trade governance
 - First and Second Unbundling
 - GATT/WTO mission and principles
 - Why was GATT/WTO successful?

- 2 Preferential trade agreements
 - In search for a definition
 - A troubling taxonomy
 - Why should we care about PTAs?

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Figure 1: World exports (log scale) (Baldwin, 2016, p. 50)

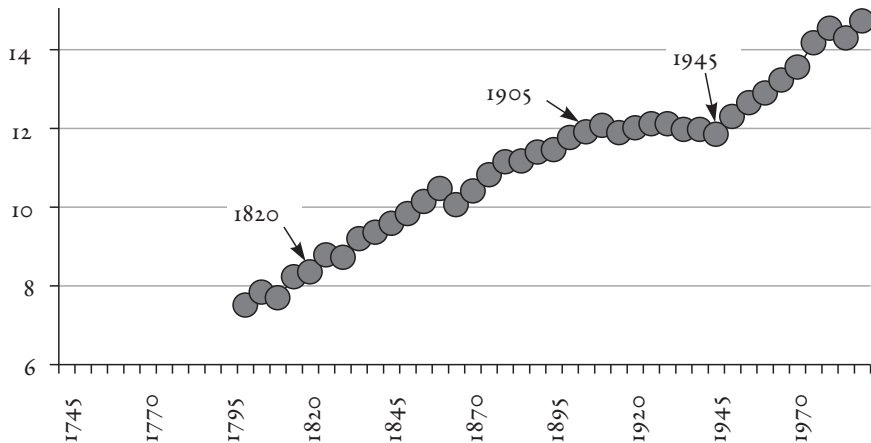
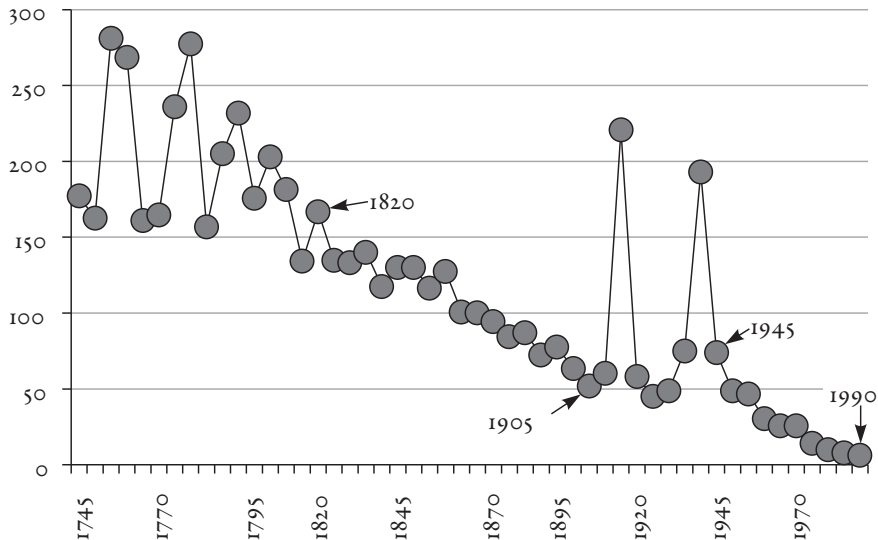


Figure 2: Real trade costs (1860 = 100) (Baldwin, 2016, p. 50)



Acts of globalisation

- Starting from ~ 1820 we have observed convergence of local prices (O’rourke and Williamson, 2002)¹
- Law of one price holds \Rightarrow local consumption no longer depends on domestic production \Rightarrow divergence of national production, specialisation
- Years 1820–1913 saw unprecedented fall in trade costs (steam ships), production costs (industrialisation), soaring income
- 1913–1945: World War I \Rightarrow dramatic rise in trade costs. Great Depression \Rightarrow Smoot-Hawley Tariff Act (1930) \Rightarrow trade war \Rightarrow world split into trade blocks.
- **Post-WWII problem:** international economic order has no institutional support \Rightarrow UN, International Court of Justice, Bretton-Woods institutions, General Agreement of Trade and Tariffs (GATT) in lieu of the British Navy

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Figure 3: Tariffs on manufactured goods (Baldwin, 2016, p. 56)

	circa 1820	1875	1913
Austria-Hungary	prohibition	15–20	13–20
Belgium	n / a	9–10	9
Denmark	30	15–20	14
France	prohibition	12–15	20–21
Germany	n / a	4–6	13
Italy	n / a	8–10	18–20
Portugal	15	20–25	n / a
Russia	prohibition	15–20	84
Spain	prohibition	15–20	34–41
Sweden (Norway)	prohibition	3–5	20–25
Switzerland	10	4–6	8–9
Netherlands	7	3–5	4
United Kingdom	50	0	0
United States	45	40–50	44

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 - **GATT/WTO mission and principles**
 - Why was GATT/WTO successful?
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 - In search for a definition
 - A troubling taxonomy
 - Why should we care about PTAs?

GATT/WTO mission

- Unlike World Bank's mission (ending extreme poverty & building shared prosperity), GATT (1947) mission was **not** to increase members' welfare through trade but rather²
 - to establish a transparent and stable rules-based global trading system
- “the GATT-based trading system has been establishing the international rule of law in international trade—rule by rule, and case by case” (Bacchus, 2003)
- In 1995 GATT was transformed into a formal international organisation, World Trade Organisation (WTO)

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GATT/WTO core principles

- **Nondiscrimination:**
 - most-favoured-nation treatment (MFN) — a tariff applied to any should be applied to all
 - national treatment — imported goods should be treated as domestic in terms of regulation or taxes
- **Transparency:** trade restrictions are made in writing and are public (e.g. <http://tariffdata.wto.org/>)
- **Reciprocity:** member states reducing tariffs can expect other members to reciprocate
- **Consensus decision-making** (sovereign equality principle)
- **Flexibility:** tariffs can be imposed under exceptions

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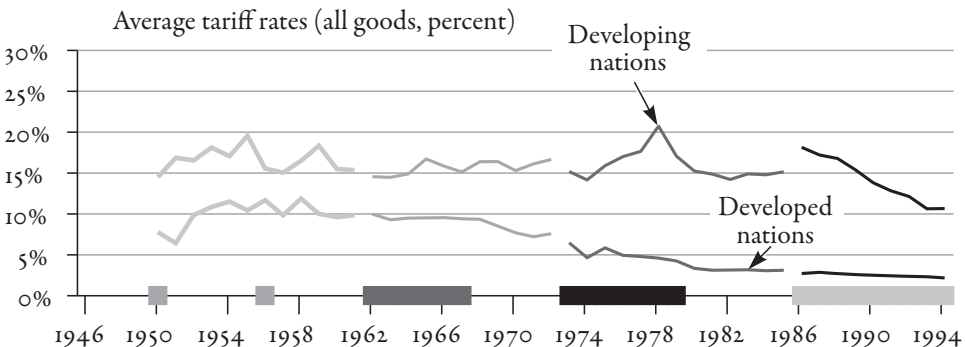
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Figure 4: Tariffs on all goods and rounds of negotiations (Baldwin, 2016, p. 72)



Why was GATT/WTO successful?

- Any prospective reduction in tariffs faces two lobbies at home:
 - exporters: interested in cutting tariffs with rest of world (ROW); don't care about domestic tariffs
 - import-competing producers: higher domestic tariffs for protection; don't care about tariffs with ROW
- Before GATT, producers' lobby was the most potent one
- Reciprocity principle changed that: exporters can push for liberalisation at every member state in the course of trade talks
- *Juggernaut effect*: pro-protection lobby is offset at home by liberalisation lobby \Rightarrow more imports \Rightarrow reduction of domestic producers competing with imports, upsizing of exporters \Rightarrow more powerful tariff-cutting lobby \Rightarrow more tariffs cuts
- Flexibility principle made a comparable contribution:
 - Generalized System of Preferences: MFN exception for members lowering tariffs for the least developed countries
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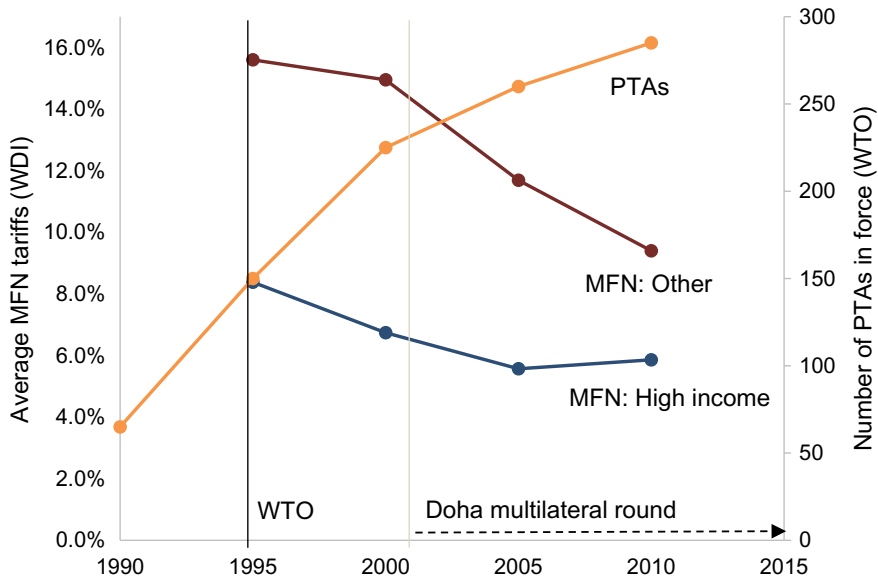
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Figure 5: PTAs and MFN tariffs (Limão, 2016, p. 281)



Raison d'être of PTAs

- As a derogation to the non-discrimination principle, GATT Article XXIV:5 stipulates

Accordingly, the provisions of this Agreement shall not prevent, as between the territories of contracting parties, the formation of a customs union or of a free-trade area <...>; Provided that: <...>

(b) with respect to a free-trade area <...> the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the formation of such free-trade area <...> to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free trade area

Enabling clause and PTAs

- Furthermore, the Enabling Clause established at the Tokyo round (1979) stipulates:

1. Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favourable treatment to developing countries, without according such treatment to other contracting parties.

2. The provisions of paragraph 1 apply to the following:

<...>

c) Regional or global arrangements entered into amongst less-developed contracting parties for the mutual reduction or elimination of tariffs

Narrow definition of PTAs & its problems

- One can therefore define a PTA as any arrangement that constitutes an Exception to GATT Article I (most-favoured-nation treatment)
 - under Article XXIV or
 - the Enabling Clause
- However, “even in 2010 about 10% of trade between PTA pairs included at least one non-WTO member” (Limão, 2016)
- A PTA which does not meet GATT/GATS conditions will give rise to an MFN claim, but it will not be invalid as such (Pauwelyn and Alschner, 2015)
- What about “double PTAs” — multiple PTAs that govern the same bilateral relationship (ibid.)?

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Economic theory-based definition?

- Consider a classification of Baier and Bergstrand (2009), rooted in Balassa (1961)'s theory of stages of economic integration (adopted from Limão, 2016, p. 285–86):
 - Nonreciprocal PTAs (NRPTA), providing one way preferential tariffs, e.g., the GSP.
 - Reciprocal PTAs (RPTA) providing two-way preferences on only part of the trade, e.g., the Latin American free trade area started in 1960.
 - Free Trade Areas (FTAs) providing two-way preferences and eliminating tariffs on a substantial part of the trade, e.g., NAFTA.
 - Customs Unions (CU), which are FTAs with common external tariffs, e.g., Mercosur.
 - Common markets (CM) such as the European Union, which adds free movement of capital and labor to a CU.
 - Economic Unions (EU), which are CM with additional monetary and fiscal policy coordination such as the Economic and Monetary Union of Central Africa (1999) and the Euro area countries.

Economic theory-based definition — problems

- Problems with this definition:
 - what about mega-regional PTAs (e.g. TPP) giving rise to “minimum floor liberalisation”, where the level of tariffs is that of the less liberalising signatory
 - How are RPTA substantially different from FTA with carve-outs?
 - Are accessions to the Common Market / Customs/ Economic Union PTAs in itself?
 - what about preferences under GATS?

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Content-based definition

- One can read PTAs and classify them inductively instead:

Figure 6: Tree map of word counts per PTA chapter category in ToTA,
<http://maptreati.es/rta/areas>



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Why are PTAs important?

- Proliferation: “an increase in the share of world trade between their members from 22% in 1965 to 60% in 2010.” (Limão, 2016)
- Overlap: “every fifth bilateral relationship governed by a PTA tie is subject to more than one PTA” (Pauwelyn and Alschner, 2015)
- Scope: wordiest chapters of PTAs are on non-trade issues (Investment)
- Large trade and welfare effects (Anderson and Yotov, 2016)

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Take-aways

- The First Unbundling of 1820–1913 was possible due to global price convergence, specialisation of production, and reduction in trade costs
- The backlash of 1914–1945 necessitated the creation of rules-based international trade system, GATT
- GATT, operating under the reciprocity and flexibility principle, was immensely successful during the Second Unbundling, reducing the power of domestic producers lobbies
- PTAs are growing in importance ever since the 1990s, albeit being hard to define legally or substantively

Thank you for your attention!

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