

# EC 380: Lecture 9

## Trade Policy: International Agreements

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# Prologue

# Recap

## Previously

- Quotas similar to tariffs but yield greater economic losses
- Domestic producers tend to prefer quotas to tariffs
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## Today

Trade agreements, joint policy outcomes and assessing recent history with our new knowledge

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- Free Trade Agreement
- Preferential Trade Agreements

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- Free Trade Agreement
- Preferential Trade Agreements
- Customs Unions

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- Harmonized Product Standards

U.S. has 14 FTAs with 20 countries which comprise about 40 percent of U.S. goods' exports, with a main goal of **eliminating tariffs**

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The US maintains Preferential Trade Agreements with approximately 187 countries.

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UK exit from the European Union and the Customs Union **changed rules** for British businesses doing business in Europe. Rare case of **reversal** of trade liberalization.

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- Trade increases between countries through **two types**
- **Trade creation** occurs if member country imports product from other member that it originally produced for itself
- **Trade diversion** occurs when a member country imports a product from another member that it formerly imported from a country *outside the new trade region*



# Creation and Diversion

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Since good was not traded before, these results are directly translatable from **Ricardian** and **HO** model predictions.

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Consider the following numerical example.

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## Numerical Example

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- Mexico and the US negotiate a regional trade agreement that lowers tariffs
- China loses **producer surplus**, whereas Mexico gains
- Mexico may not be the most efficient (lowest-cost) producer of parts

In fact, we know China was the **most efficient source** due to the precise reliance the US had on China.



# Creation and Diversion

Consider the following table:

	<b>0%</b>	<b>10%</b>	<b>20%</b>
From MEX, before PTA	\$20		
From CHN, before PTA	\$19		
From MEX, after PTA	\$20		
From CHN, after PTA	\$19		
From the US	\$22		

Under this free trade scenario Chinese costs are the lowest, and their goods would be imported

# Creation and Diversion

	<b>0%</b>	<b>10%</b>	<b>20%</b>
From MEX, before PTA	\$20	\$22	
From CHN, before PTA	\$19	\$20.90	
From MEX, after PTA	\$20	\$20	
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Under the **10% tariff** scenario, switching into a PTA makes Mexican goods suddenly become the cheapest option.

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	<b>0%</b>	<b>10%</b>	<b>20%</b>
From MEX, before PTA	\$20	\$22	\$24
From CHN, before PTA	\$19	\$20.90	\$22.80
From MEX, after PTA	\$20	\$20	\$20
From CHN, after PTA	\$19	\$20.90	\$22.80
From the US	\$22	\$22	22

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PTA keeps Mexican auto part costs fixed at \$20.

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- US gains from cost reduction relative to its previous scenario. Mexican exports rise.
- Chinese welfare neither gains or losses due to lack of pre-existing trade.

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- US gains 90c on lower costs but loses 1.90 in tariff revenue, per unit welfare loss
- Producer surplus falls in China due to loss of pre-existing trade.

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Although no tariffs are applied to trade, UK exporters have to prove they meet EU standards

- Was not previously necessary
- Leads to extra charges, taxes, paperwork and the halt of some exports to EU



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- Infeasible if we need border control to check whether goods have appropriate documentation
- Compromise met by keeping NI in the European Single Market and allowing the Irish Sea to act as a trade border.
- Goods are checked upon route between NI and rest of the UK. Politically sensitive decision for ardent UK supporters in NI.

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- FDI inflows are unlikely to return to levels reached in the 1990s and 2000s
- A less diverse workforce and lower FDI levels can also hamper productivity growth

# Unconventional Hidden Protection

## THE BIPARTISAN "OCEAN SHIPPING REFORM ACT" WILL:

- ✓ ENSURE FAIR TRADE AND A COMPETITIVE GLOBAL SHIPPING INDUSTRY
- ✓ PROTECT AMERICAN CONSUMERS AND BUSINESSES FROM PRICE GOUGING
- ✓ SUPPORT GOOD-PAYING AMERICAN MANUFACTURING JOBS AND AGRICULTURAL EXPORTS
- ✓ ADDRESS GLOBAL SUPPLY CHAIN ISSUES

**Rep. John Garamendi**

California's 3rd District



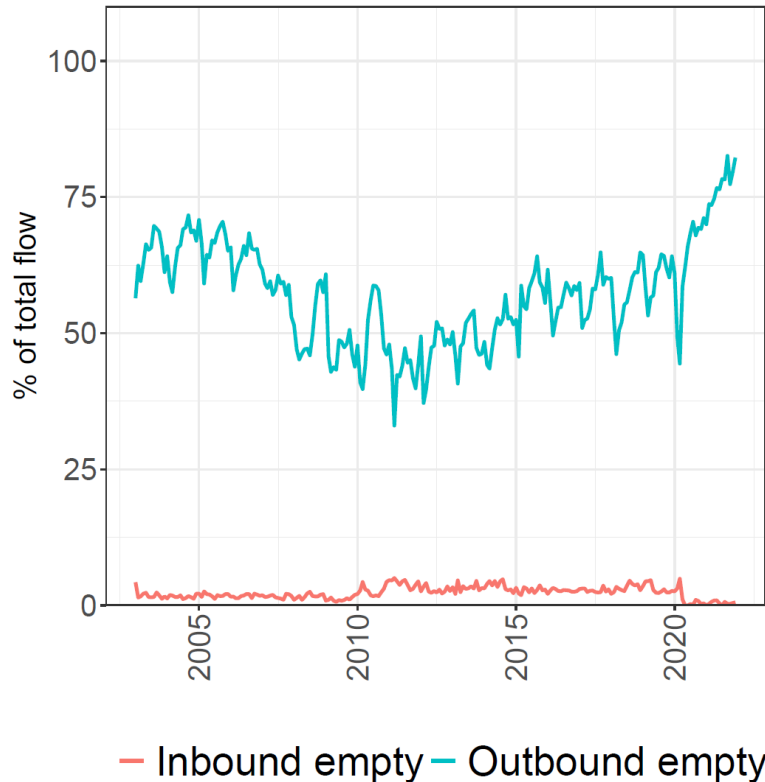
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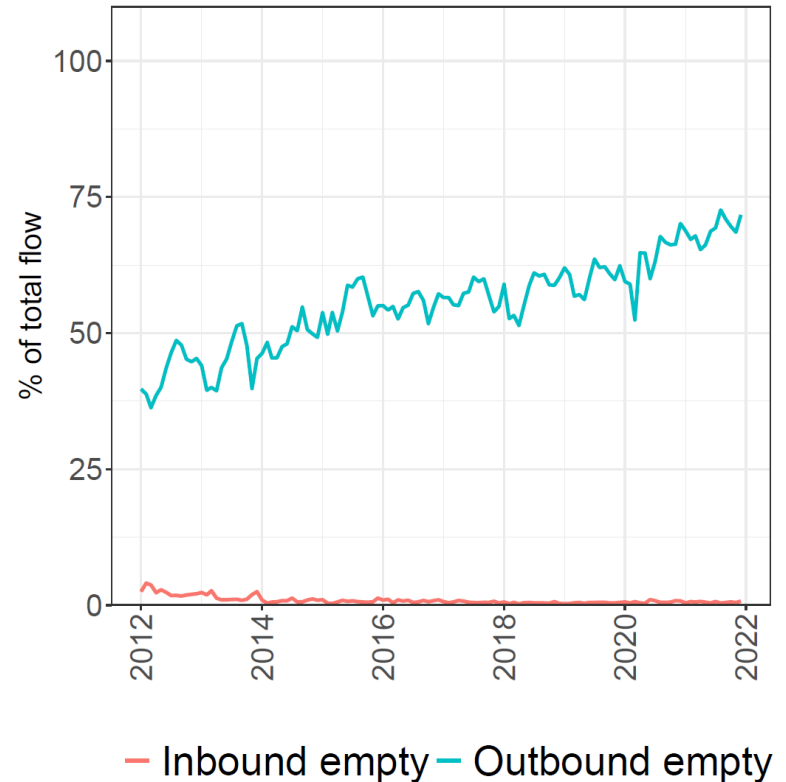
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Los Angeles, CA



Port of NY & NJ



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**Less imports narrow gains from trade.**

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- Many countries objected to US impositions of tariffs
- Even before WTO ruling on legitimacy of tariffs, countries responded by applying tariffs to US exports

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Given recent epidemic, triggering this kind of adoption of US goods has been **near-impossible to achieve**.

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- With the December 31, 2021 deadline for the \$200 billion of purchase commitments now past, US policymakers are seeking a different approach
- United States working with other major economies, e.g. Trade and Technology Council

## In Summary

- A variety of trade agreements exist under current international norms
- Agreements riddled with uncertainty and not always welfare enhancing
- Multi-year negotiations can make or break a domestic economy
- Even if policymakers agree multilateral purchase commitments with respect to China, they should learn right lessons from US experiences

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## Next time!

- How do international agreements fare with respect to the environment?