International Trade Institution

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Outline

- World Trade Organization
  - Objectives
  - Main Principles
  - Important Agreements
- Regional Agreements
- Bilateral Agreements
- Read: Understanding the WTO.pdf at

www.wto.org/english/thewto_e/whatis_e/tif_e/understanding_e.pdf

WTO

- General Agreement on Tariffs and Trade: GATT
  - took effect in 1947.
  - There were 8 rounds of trade negotiations
- World Trade Organizations was established as a conclusion of the Uruguay Round (1986-1993) on Jan 1, 1995.
- There were 81 initial members, now 153 members.
- Cover more than 97% of world trade.

Objectives

- To develop free trade system
- To oversee that trade is according to trade rules
- A forum for governments to negotiate trade agreements.
- A place to settle trade disputes.

Main Principles

1. Trade without discrimination
2. Freer trade: gradually, through negotiation
3. Predictability: Through Binding and Transparency
4. Promoting fair competition
5. Encouraging development and economic reform

Main Principles

1. Trade without discrimination

1.1 **Most Favored Nation (MFN):** treating imports from a country on the same basis as that given to the most favored other nation.

- Applies before a product enter the importing country
- every country gets the lowest tariff that any member country gets, and reductions in tariffs to one country are provided also to other members.
- some exceptions: FTAs, Generalize System of Preference (GSP) for developing countries.

Main Principles

1.2 **National Treatment (NT):** providing foreign producers and sellers the same treatment provided to domestic firms.

- applies once a product, service or item of intellectual property has entered the market. Thus, charging customs duty on an import is not a violation of NT.
- Example: charging different VAT for domestic goods and imports would violate NT.

Main Principles

2. Freer trade: gradually, through negotiation

- allow members to reduce trade restriction gradually, through "progressive liberalisation". Developing countries are usually given longer to fulfil their obligations.

3. Predictability: Through Binding and Transparency

- trade barriers should not be raised arbitrarily.
- tariff rates and market-opening commitments are "bound" in the WTO.

Main Principles

4. Promoting fair competition

– discouraging “unfair” practices such as export subsidies and dumping products at below cost to gain market share.

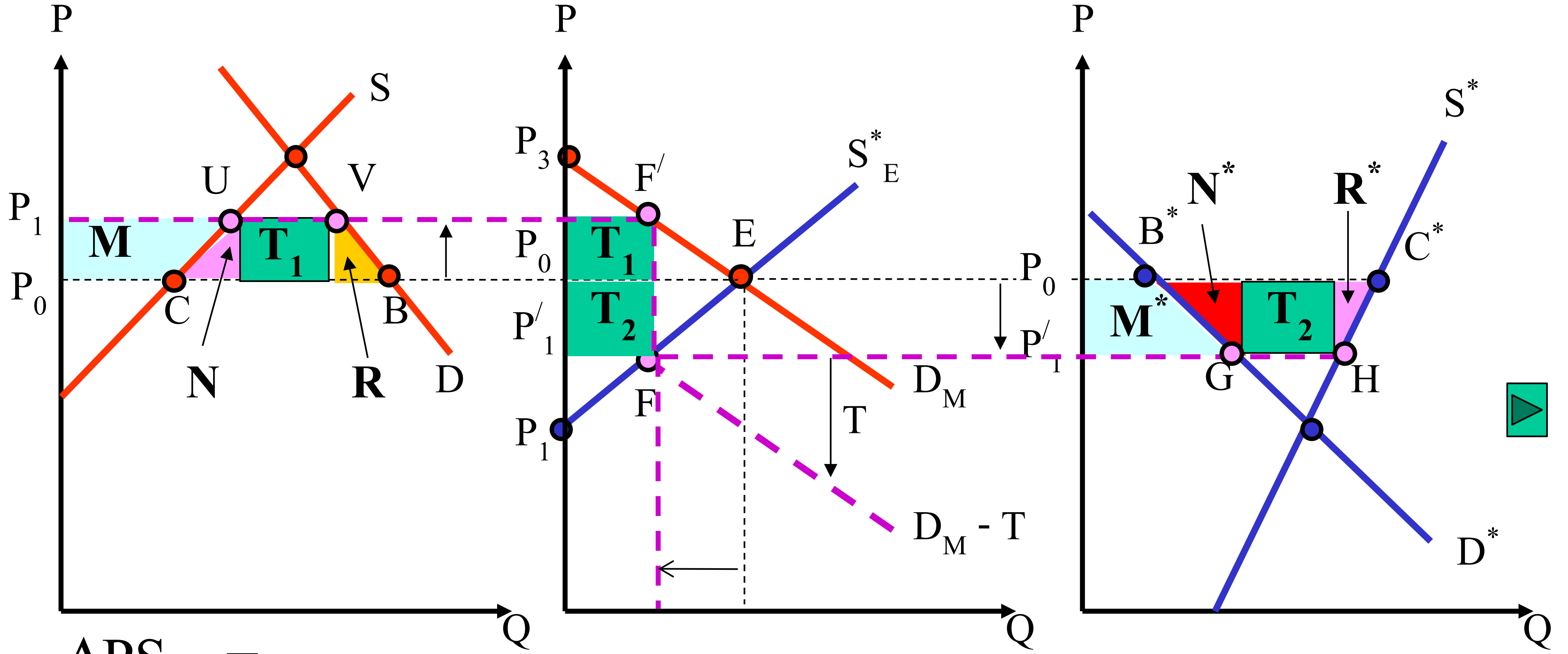
5. Encouraging development and economic reform

– giving less developed countries more time to adjust, greater flexibility, and special privileges (e.g.; GSP)

The Logic of Multilateral Trade Agreements

- It is optimal for large countries to impose small tariffs, but that did not consider strategic interactions between multiple large countries.
- Is it still optimal behavior for these countries if every country imposes a small optimal tariff?
- We can use the payoff matrix to determine the Nash equilibrium outcome for each country's tariff level.
- Assume the two countries are the same size so payoffs are symmetrical.
- Payoffs will be measured in any other situation as *relative to* free trade.

The impact of an import tariff: large country case



$\Delta PS =$

$\Delta CS =$

$\Delta GR =$

Net $=$

$\Delta CS^* =$

$\Delta PS^* =$

Net $=$

Prisoner's dilemma of tariff war

14

		Foreign: No Tariff	Foreign: Tariff
Home	No Tariff	0 , 0	$-[T^*_2+N+R]<0,\ T^*_2-[N^*+R^*]>0$ Large loss , Gain
	Tariff	$T_2-[N+R]>0,\ -[T_2+N^*+R^*]<0$ Gain, Large loss	$-[N+R+N^*+R^*],\ -[N+R+N^*+R^*]$ Loss, Loss

The Logic of Multilateral Trade Agreements

– Free Trade

- The upper left hand cell is when neither country imposes a tariff.
- The payoff for the two countries is 0.

– Tariffs

- Suppose Home imposes a tariff but Foreign does not.
- Home payoff is T_2-[N+ R]>0, and Foreign's is $-[T_2+N^*+R^*]<0$.
- This is the lower-left quadrant.
- If the opposite occurs, the payoffs are exactly opposite, and this is the upper-right cell.

The Logic of Multilateral Trade Agreements

– Tariffs

- If both countries impose the optimal tariff and they are the same size.
- Terms-of-trade gain for each country is cancelled out by the terms-of-trade loss it suffers because of the other country's tariff.
- Both countries suffer DWL: $-[N+R+N^{*}+R^{*}]$.

– Their own DWL, plus DWL from the other country's tariff.

- This is the lower right cell of the matrix.

The Logic of Multilateral Trade Agreements

- The pattern of payoffs we just saw has a special structure called the "prisoner's dilemma".
- This is a game where two accomplices are caught in a crime and each has to decide whether or not to confess, when locked in separate rooms unable to communicate.
- The best result for both is to not confess. However, since they cannot communicate and do not know what the other is doing, the best option for each is to confess.
- This is similar to our situation where each country acting on its own has an incentive to apply the tariff, but doing so makes both worse off.

Prisoners' Dilemma

- Solving the problem with
  - Dominant strategy,
  - Nash, or
  - Maximin
- All give the same solution "confess", "confess" = (-6,-6)
- Playing this game sequentially give the same equilibrium

		Prisoner B	
		Confess	Don't Confess
Prisoner A	Confess	$\boxed{-6}, \boxed{-6}$	$\boxed{-1}, -12$
	Don't Confess	$-12, \boxed{-1}$	-2, -2

Pareto Efficient Solution

- Nash equilibrium is not Pareto efficient since at least one can be better of if they don't confess
- Need outside mechanism to maintain corporation

The Logic of Multilateral Trade Agreements

- Nash Equilibrium
  - The only Nash equilibrium is the lower right cell—both countries apply a tariff.
  - To move from that point would increase the countries' loss, so the Nash equilibrium for both countries is to apply the tariff.
  - The Nash equilibrium leads to an undesirable outcome for both countries, even though it is the best choice if the other country imposes a tariff.

The Logic of Multilateral Trade Agreements

- Free Trade Agreement
  - The bad outcome can be avoided if the countries enter into some type of free trade agreement.
  - The WTO provides a mechanism to eliminate the prisoner's dilemma by giving an incentive to remove tariffs.
  - Those who join the WTO must agree to remove some tariffs, but in return they get lower tariffs from other members.
  - This allows us to move closer to free trade.
  - It is then more likely to end up in the upper left quadrant of the payoff matrix instead of the lower right.

Important Agreements:

The rules and commitments apply to

- **market access** — various trade restrictions confronting imports
- **domestic support** — subsidies and other programmes, including those that raise or guarantee farm gate prices and farmers' incomes
- **export subsidies** and other methods used to make exports artificially competitive

Important Agreements: Market Access

- Industrial and Fishery
  - tariff cuts on average 33% within 5 years (2000)
  - special surcharges are prohibited unless already applied and informed.
- Textile: Agreement on Textiles and Clothing (ATC) took over from the Multifibre Arrangement
  - abolish import quotas within 10 years (2005).
- Agriculture
  - prohibit import quotas and changes to tariffs.

Targets for agriculture

Targets for agriculture	**DCs (1995-2000)**	**Developing (1995 -2004)**
Tariffs		
- average cut	-36%	-24%
- minimum cut per product	-15%	-10%
Domestic support	-20%	-13%
Exports		
- value of subsidies	-36%	-24%
- subsidized quantities	-21%	-14%

Important Agreements: Trade Rules

- **Sanitary and Phytosanitary Measures Agreement** (SPS)
- allows to set their own standards to govern imports.
- are encouraged to use international standards, guidelines and recommendations where they exist.
- regulations must be based on science.
- should applied only to protect human, animal or plant life or health.
- should not arbitrarily or unjustifiably discriminate between countries where identical or similar conditions prevail.
- allow temporary “precautionary” measures.

Fruit exports to Japan

- Q: What process the Thai fruit, such as mango and mangosteen, need to go through before they are allow to export to Japan?

- A: Vapor-heat treatment
  - 47^{O}C for 20 minutes for mango
  - 46^{O}C for 58 minutes for mangosteen

Important Agreements: Trade Rules

- **Technical Barriers to Trade Agreement (TBT)**
- recognizes countries' rights to adopt the appropriate standards
  - for human, animal or plant life or health, for the protection of the environment or to meet other consumer interests.
- national standards have to be fair and equitable
- discourages any methods that would give domestically produced goods an unfair advantage
- encourages countries to recognize each other's testing procedures

Important Agreements: Intellectual property

- **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)**
- Creators can be given the right to prevent others from using their inventions, designs or other creations
- and to use that right to negotiate payment in return from others who use them

- copyrights, patents, trademarks, industrial designs, integrated circuit designs, geographical indications
- governments can take action to prevent anti-competitive licensing that abuses intellectual property rights

Important Agreements: Investment measures

- **Trade-Related Investment Measures (TRIMs) Agreement**
- Abolish investment measures that restrict or distort trade
  - Local content requirement
  - Export performance requirement
  - restrictions in quantities
- should not discriminates against foreigners or foreign products

Important Agreements: Trade in Services

- **General Agreements on Trade in Services (GATS)**
- Services require instant consumption since they are
  - intangible
  - non-durable
  - non-transferable
- Why do we need special rules?
  - GATT has been reducing the usage of tariffs
  - Member countries switch to services
  - Services have different mode of supply from goods

Important Agreements: Trade in Services

Service Provider	Mode of Supply	Example
Locate outside of the nation of the consumers	Cross-boarder supply	Postal and telecom services
	Consumption abroad	Tourism, Education
Locate inside of the nation of the consumers	Commercial Presence	Foreign branches: banks, insurance
	Presence of Natural Persons	Medical and legal services

GATS: General Obligations

- **Most-Favored-Nation (MFN) Treatment.**
- **Transparency of regulations.**
- **Mutual qualifications recognition.**
- **Rules governing monopolies and Business practices.**

The Doha round

- Launched in November, 2001, in Doha, Qatar.
- Agenda included:
  - Further liberalization of production and trade in agriculture, industrial products, and services.
  - Further tightening of antidumping regulations, investment and competition policies.
- Intended to conclude by end of 2004, but still continues as of 2016.

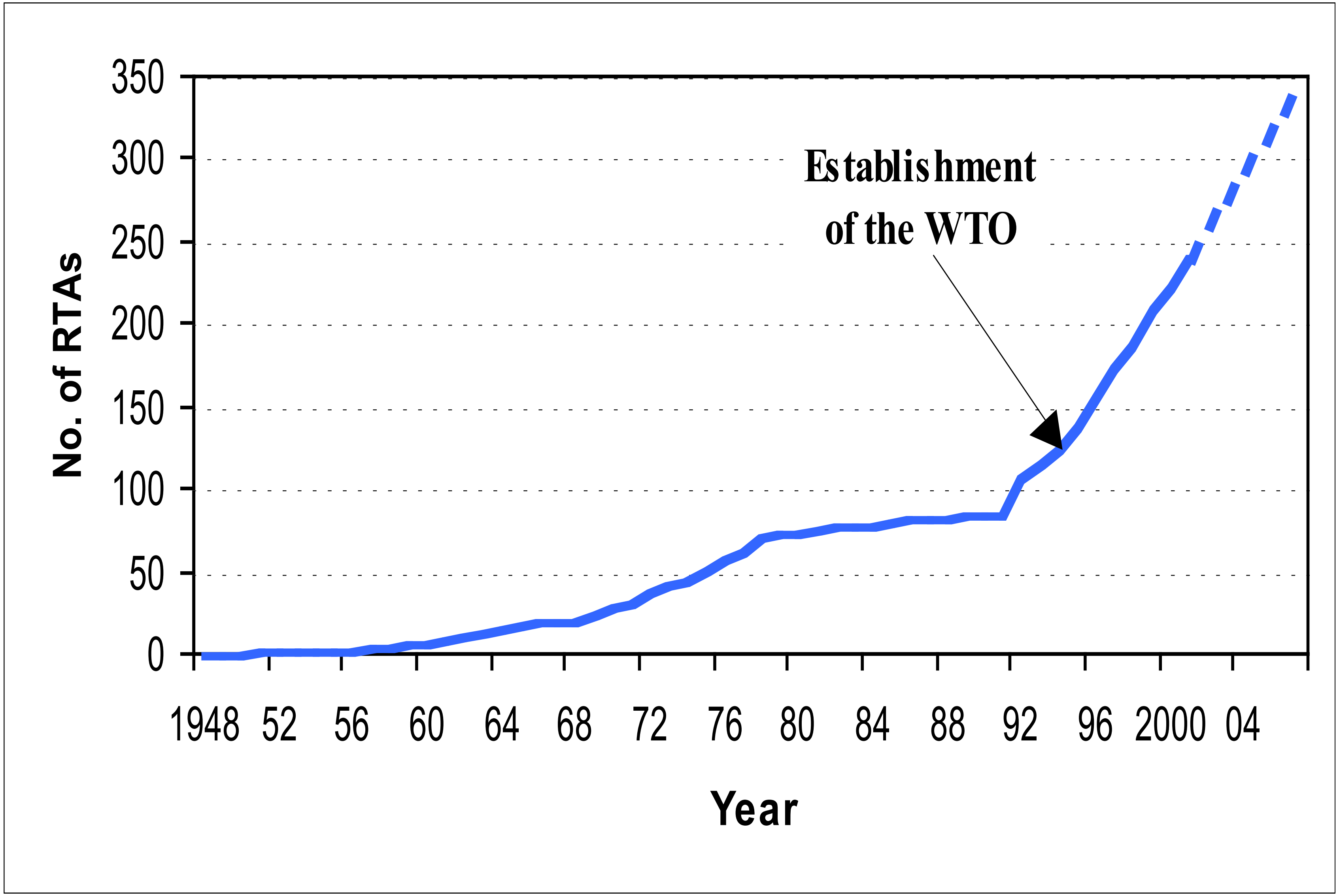
Types of Economic Integration

1. Preferential Trade Arrangements: lower tariffs for specific countries (British Common Wealth)
2. Free Trade Area (FTA): lower tariffs among members but tariff rates for non-members aren't the same (AFTA, NAFTA)
3. Customs Union: lower tariff for member and common tariff rates for non-members (Benelux)
4. Common Market: same as 3 and common trade policy and free factor mobility (EC 1958-1993)
5. Economic Union: same as 4 and common economic policies (EU 1993-) ->Monetary Union: same as 4 and same currency.

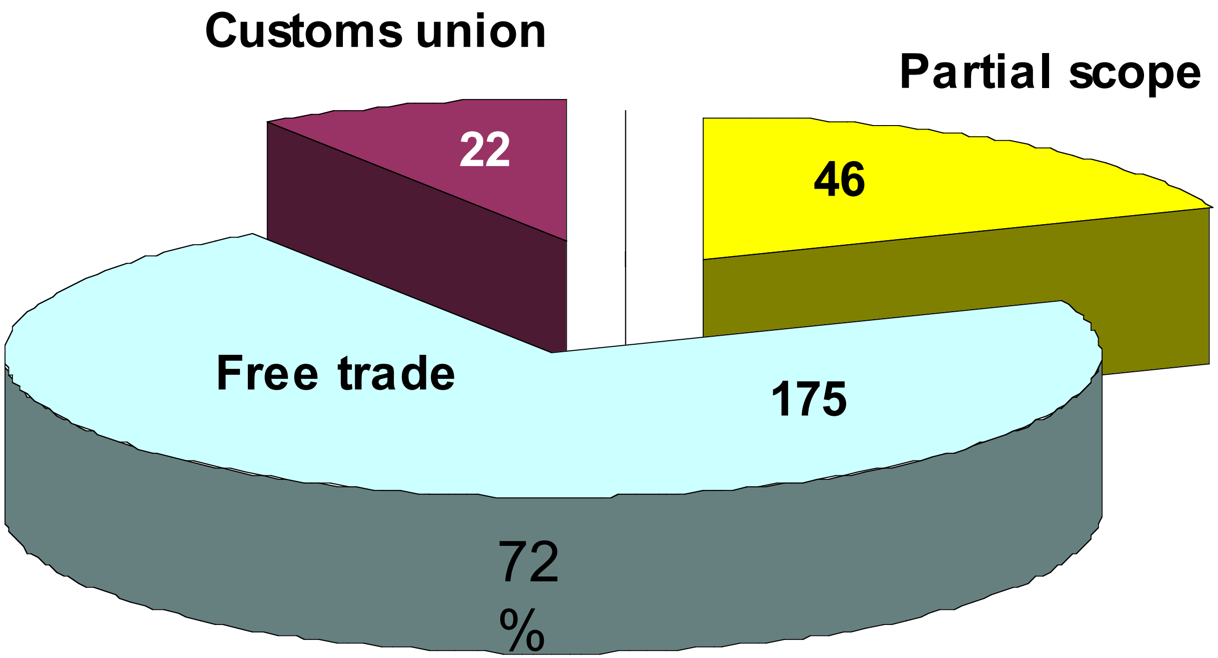
Regional Trade Agreements

- an RTA is an international, inter-governmental legal instrument or a treaty.
- Concluded by neighbouring states, or countries located in a given geographical region.
- Aiming at the mutual liberalization of border impediments to trade in goods and services between the parties

RTAs notified to the GATT/WTO (1948-2002), cumulative



RTAs in force, as of June 2002, by type of agreement

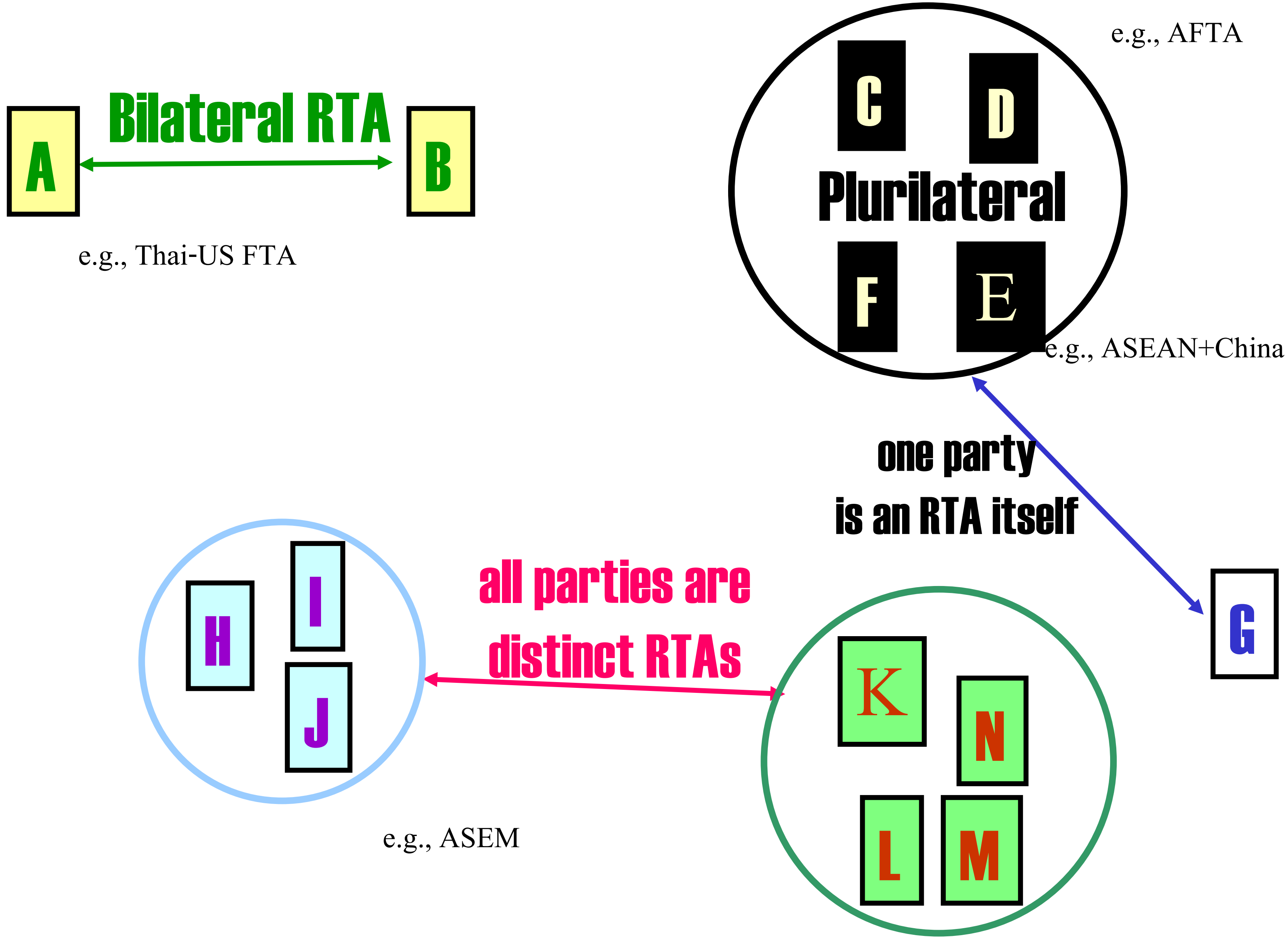


Proliferation of FTAs in East Asia

Year	No. of FTAs	Status of FTAs		
		Concluded	Under Negotiation	Proposed
1976	1	1	0	0
1986	1	1	0	0
1996	4	3	0	1
2000	7	3	1	3
2001	10	5	2	3
2002	14	6	4	4
2003	23	9	5	9
2004	42	14	16	12
2005	67	21	30	16
2006	96	31	42	23
2007	102	36	41	25

Source: Kawai and Wignaraja (2007).

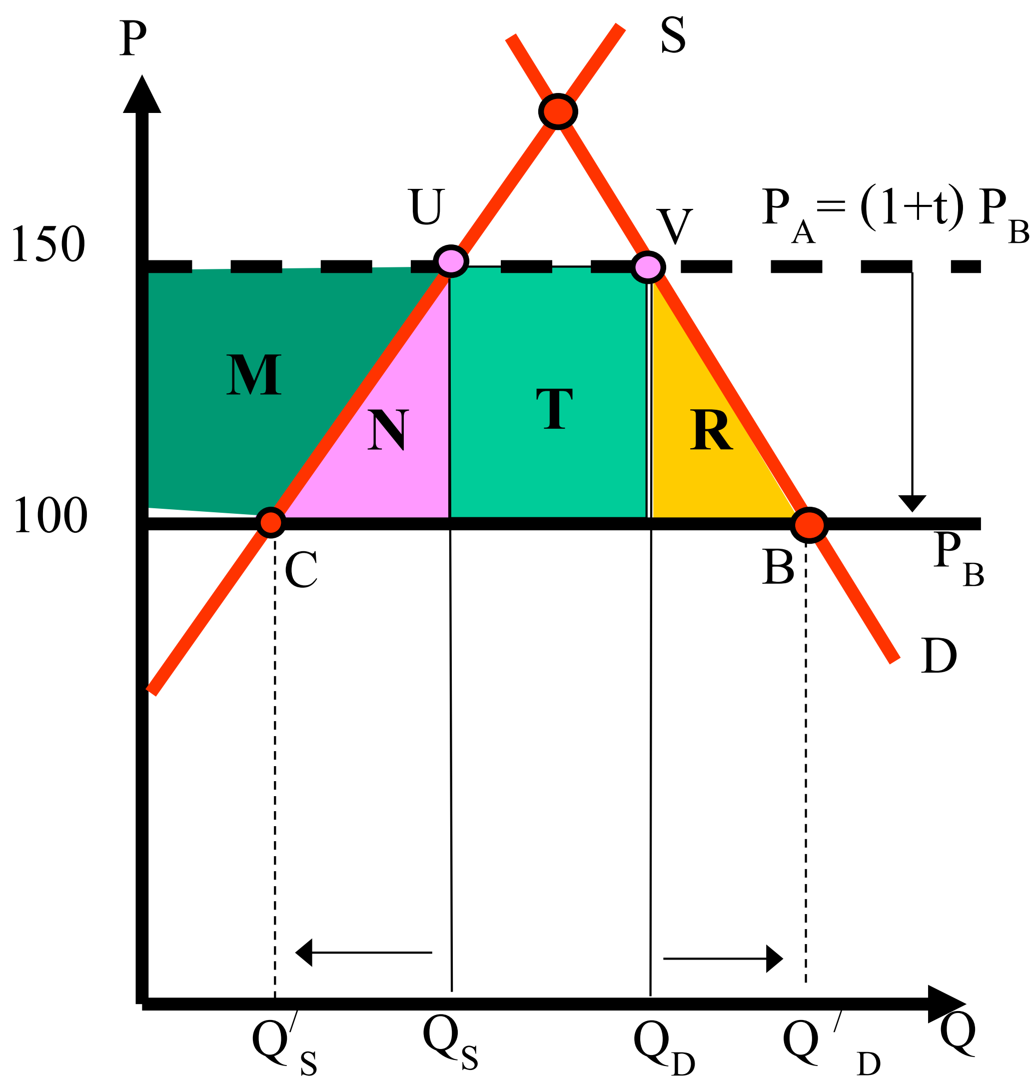
Types of RTAs



Examples of Economic Integration

Name	Year	Current Member	Liberalization & Integration
APEC (21)	1989	US, Canada, Mexico, Chili, Peru, China, H.K., Taiwan, Japan, S. Korea, Russia ASEAN7 (Indonesia, Malaysia, Philippine, Singapore, Thailand, Brunei, Vietnam) Papua New Guinea, Australia, New Zealand	Free trade & investment by 2010 for industrialized countries by 2020 for developing countries
ASEAN (10)	1967	Indonesia, Malaysia, Philippines, Singapore Thailand, Brunei, Vietnam, Laos, Myanmar & Cambodia	AFTA (ASEAN free trade area) by 2003
EU (25)	1993 (1958)	Germany, France, Italy, ,Belgium, The Netherlands, Luxembourg, Denmark, UK, Ireland, Greece, Portugal, Spain, Austria, Finland, Sweden, Cyprus, Czech, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia	Single market & Customs Union Economic Monetary Union by 1999
NAFTA (3)	1994	US, Canada, Mexico	Free trade area

Impacts of FTA: Trade Creation



- Before integration, $P_A = (1+t)P_B$
- With integration, the tariff is removed and price drops to P_B and imports increase.

$\Delta PS =$

$\Delta CS =$

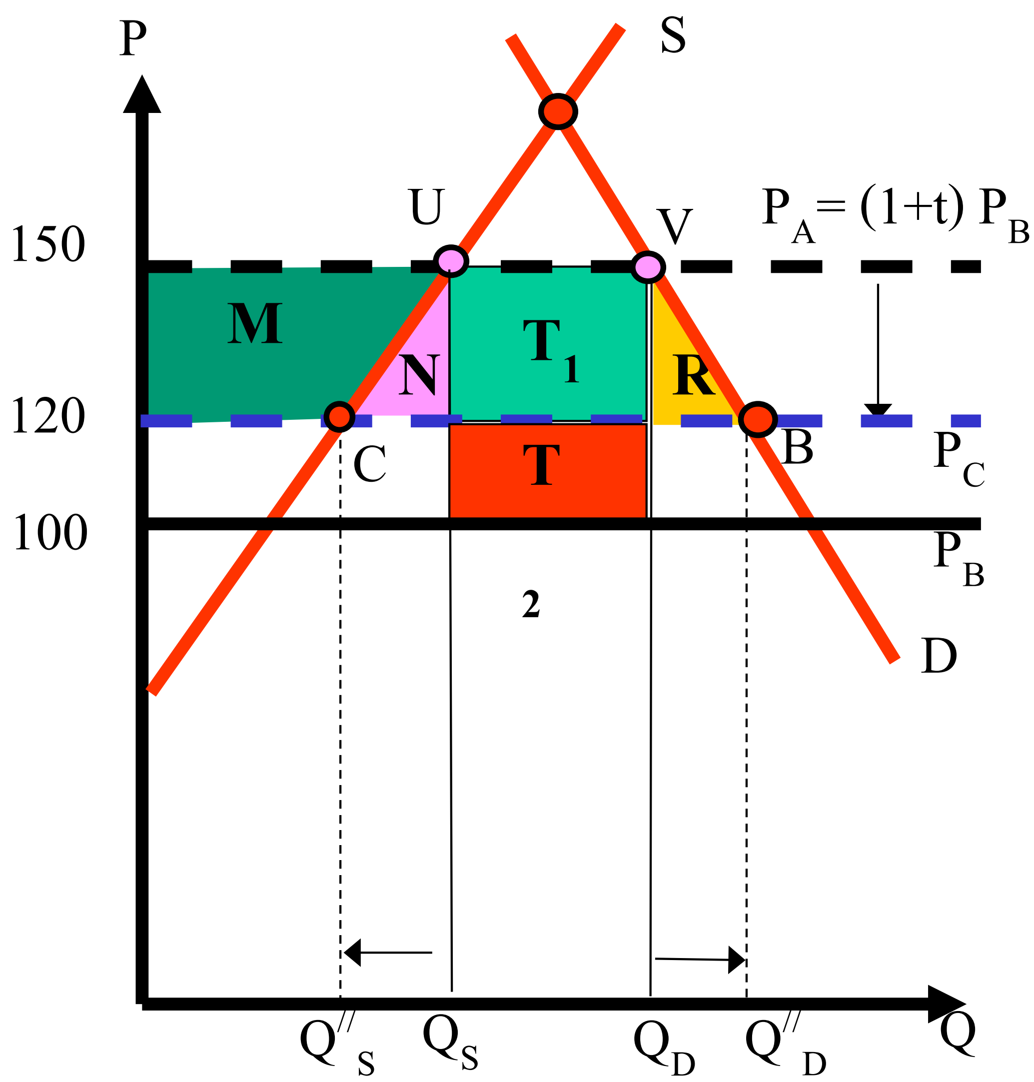
$\Delta GR =$

Net $=$

trade creation.

Impacts: Trade Creation and Trade Diversion

- Before integration, $P_A = (1+t)P_B$, $P_C > P_B$.



- A integrates with C, the tariff is removed and price drops to P_C and imports increase.

$\Delta PS =$

$\Delta CS =$

$\Delta GR =$

Net $=$

N + R is trade creation

T_2 is the trade diversion

FTA may lead to welfare reduction

The Second Best Theory

- First Best: when all market imperfections are removed, the economy will be in a Pareto optimality situation.
- Second Best: when only some of the market imperfections are removed, the social welfare of the economy may or may not be improved.
- Example: The alcohol market is sufferred from monopoly and externality problems. Allowing competition removes the inefficiency from monopoly power but increases the external costs.
- FTAs may face the second best problem.

Other Benefits on members

- Trade and investment creation: cheaper import from member countries
  - Economies of scale
  - Larger market attracts investment
- Improve efficiency via competition from abroad
- Increase negotiation power in WTO

Other Costs on members

- Trade and investment diversion: change from cheapest sources outside the group to more expensive source within the group
- Tax revenue forgone
- Loss of autonomy in trade policy
- Unequal distribution of benefits among members
- Dependence on particular export markets
- Complex trade relationship and burden on customs processes --> Spaghetti-bowl effect

Benefits and Costs on non members

Benefits

- Increased export opportunities, through higher demand
- Prospect of freer global trade
- Testing ground for global trade disciplines

Costs

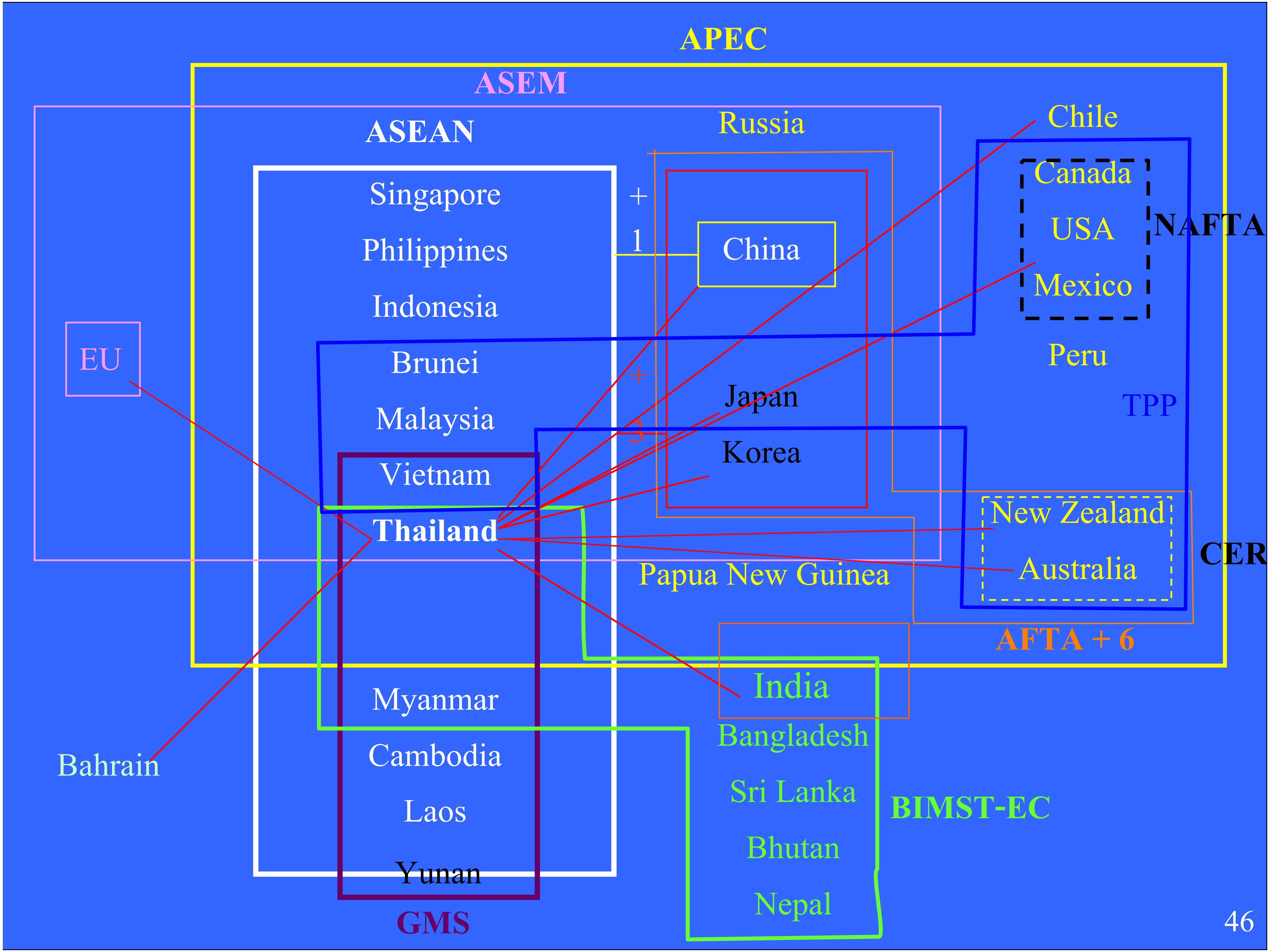
- Trade and investment diversion
- Potential frictions between trade blocks
- Confused and complex trade relations
- Less commitment to WTO

Rules of Origin (ROO)

- If China is looking to export a good to Thailand, but Thailand has high tariffs on that good, but Singapore has low tariffs, why not export to Singapore and then trade it freely to Thailand?
- Free trade areas have complex **rules of origin.**
  - Specifies what type of goods can be shipped duty-free within the free trade area.
- The good from China to Thailand via Singapore would not get duty-free access to Thailand unless it has enough "ASEAN content" to qualify for duty-free access.

Rules of Origin

- ROO specifies, for each and every product, how much of its production has been done in the free trade area.
- These rules are clearly not needed in a customs union since all the countries have common tariffs with outside countries.
- So why not just create a customs union and make it easier?
- Because tariffs with outside countries are a political issue, of which many countries wish to maintain control.



APEC
ASEM
ASEAN
Russia
Chile
Singapore
+
Canada
Philippines
1
China
USA
NAFTA
Mexico
Indonesia
EU
Brunei
Peru
+
Japan
Malaysia
3
TPP
Korea
Vietnam
Thailand
New Zealand
CER
Australia
Papua New Guinea
AFTA + 6
India
Myanmar
Bangladesh
Cambodia
Bahrain
Sri Lanka
BIMST-EC
Laos
Bhutan
Yunan
Nepal
GMS

Thailand FTA strategy

- Market Strengthening: Japan, USA.
- Market Broadening and Deepening
  - High Potential Markets: China, Australia, New Zealand.
  - Gateway: Bahrain, Peru
  - Regional markets: The Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation or BIMST-EC

Bilateral FTA

Country	Year	Name	Objective
Bahrain	2002	Thai-Bahrain Framework on Closer Economic Partnership	654 categories 0-3% Others by 2010
China	2003	Thailand China Free Trade Agreement on Vegetables & Fruits	108 categories vegetable 0% 80 categories fruits 0%
India	2004	Thailand India Closer Economic Relations Framework Agreement	0% on 82 categories by 2006 0% 6000 categories by 2010
Australia	2005	Thailand Australia Free Trade Agreement (comprehensive)	Thailand on Australia 0% 53% now, 95% 2010, 100%, 2020 Australia on Thailand 0% 83% now, 96% 2010, 100% 2015
New Zealand	2005	Thailand New Zealand Closer Economic Partnership FTA (comprehensive)	Complete liberalization 2015
Japan	2007	Japan-Thailand Economic Partnership Agreement	Trade & investment, Service &Financial, bilateral cooperation

ASEAN Free Trade Area (AFTA)

- ASEAN initially consisted of Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand. Established in 1967.
- Cambodia, Myanmar, Laos, and Vietnam joined later.
- Including more than 500 million people.
- Set a free trade area, AFTA, in Jan 1992.
- ASEAN is the largest export market for Thailand (22% in 2005).
- Original target: remove tariffs down to 0-5% and remove NTBs within 15 years (on Jan 1, 2008)

ASEAN Free Trade Area (AFTA)

- In 1994 moved the target to 10 years
  - Finish liberalization on January 1, 2003
  - remove some goods in the temporary exclusion list.
- Liberalize trough Agreement on the Common Effective Preferential Tariff (CEPT) Scheme.
- As of Jan 1, 2005, 92.99% of tariff lines is in the Inclusive List (IL) under CEPT scheme has an average tariff rate 0 – 5% (98.98% for the original 6 ASEAN members and 86.91% for the new members.

Average AFTA / CEPT Tariff Rates

	1998	1999	2000	2001	2002	2003
Brunei	1.35	1.29	1.00	0.97	0.94	0.87
Indonesia	7.04	5.85	4.97	4.63	4.20	3.71
Laos		5.00	5.00	5.00	5.00	5.00
Malaysia	3.58	3.17	2.73	2.54	2.38	2.06
Myanmar	4.47	4.45	4.38	3.32	3.31	3.19
Philippines	7.96	7.00	5.59	5.07	4.80	3.75
Singapore	0.00	0.00	0.00	0.00	0.00	0.00
Thailand	10.56	9.75	7.40	7.36	6.02	4.64
Vietnam	6.06	3.78	3.30	2.90	2.89	2.02
ASEAN	5.37	4.77	3.87	3.65	3.25	2.68

Source : ASEAN Secretariat

Common Effective Preferential Tariff (CEPT)

Trends in Average Applied Tariff Rates in ASEAN (unweighted %), 1996-2007

Country	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Cambodia	35.0		18.0	18.0	17.0	16.7	16.3	16.3	15.6	14.1		12.5
Lao, PDR	9.5			9.5	9.3	9.5			8.7	7.0	6.5	5.8
Myanmar	4.5	4.8	4.5	4.7	4.7	4.6	4.7	4.7	4.5	4.5	4.4	4.1
Vietnam		13.0	13.0	15.6	15.1	15.2	14.2	13.7	13.9	13.0	13.1	11.7
Indonesia	10.8			9.9	7.8	6.1	6.4	6.0	6.1	6.0	6.0	6.6
Malaysia	8.4	8.9		8.2	8.0	7.5	7.5	7.4		7.4	6.2	5.8
Philippines	14.0	12.7	10.4	9.5	7.1	6.9	5.3	4.5	5.5	5.4	5.4	5.3
Thailand				16.9	16.4	14.7		13.6		10.5	10.8	10.0
Singapore	0.4	0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Brunei	3.1	3.1	3.1	3.1	3.1	3.1	3.0	2.9	2.9	3.0	2.9	2.9

Source: UNCTAD TRAINS database and WTO IDB database

Thangavelu and Chongvilaivan (2009)