

Public Affairs 856
Trade, Competition, and Governance
in a Global Economy

Lecture 23
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Instructor: Prof. Menzie Chinn
UW Madison
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Outline

- NAFTA
- Brexit

The First Big RTA for the US

Table 1.

Characteristics of Partner Countries of U.S. Trade Agreements Before the Year of Implementation

Percent

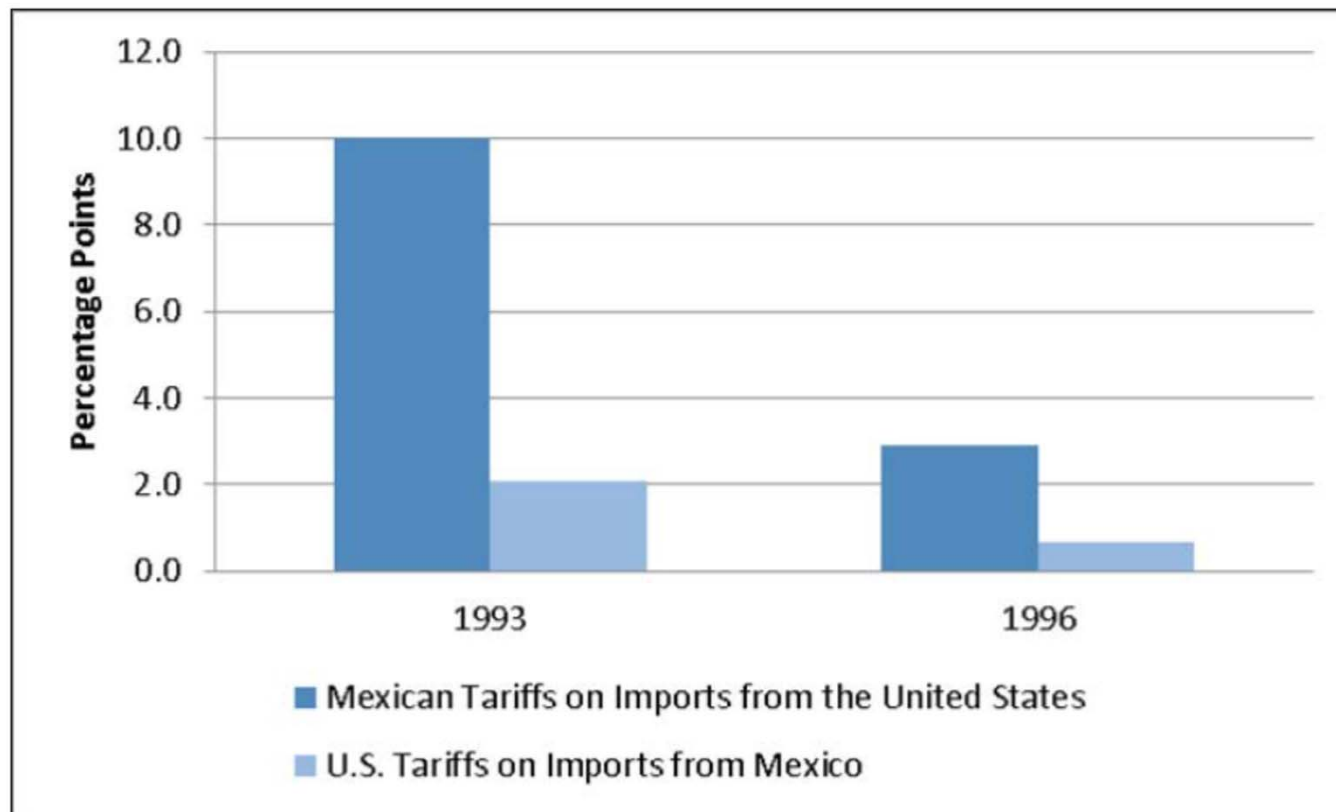
Partner Countries	Year in Which Agreement Was Implemented	Cumulative GDP of Partner Countries (Percentage of U.S. GDP)	Share of Total U.S. Trade	Trade-Weighted Average MFN Import Tariff Rates of Partner Countries	Trade-Weighted U.S. Average MFN Import Tariff Rates
Israel	1985	0.7	n.a.	n.a.	n.a.
Canada	1989	9.7	19.9 ^a	8.2 ^b	n.a.
NAFTA ^c	1994	16.3	28.0	n.a.	4.7
Jordan	2001	0.1	*	18.9	2.8
Australia	2004	5.3	1.0	4.0	2.8
Chile	2004	0.9	0.3	6.0	2.8
Singapore	2004	0.9	1.6	*	2.8
CAFTA-DR ^d	2005	0.9	1.5	6.6	2.5
Bahrain	2006	0.1	*	5.6	2.4
Morocco	2006	0.5	*	19.9	2.4
Oman	2006	0.2	*	4.7	2.4
Peru	2007	0.6	0.3	6.8	2.4
Colombia	2012	1.4	1.0	9.1	2.6
Panama	2012	0.2	0.3	6.8	2.6
South Korea	2012	8.2	2.7	7.3	2.6

Source: Congressional Budget Office.

NAFTA Provisions

- Reduction in trade barriers - tariffs

Figure I. Average Applied Tariff Levels in Mexico and the United States (1993 and 1996)



Source: Executive Office of the President, *Study on the Operation and Effects of the North American Free Trade Agreement*, July 1997, p. 7.

Textiles

- Textiles and Apparel Industries. NAFTA phased out all duties on textile and apparel goods within North America meeting specific NAFTA rules of origin over a 10-year period. Prior to NAFTA, 65% of U.S. apparel imports from Mexico entered duty-free and quota-free, and the remaining 35% faced an average tariff rate of 17.9%. Mexico's average tariff on U.S. textile and apparel products was 16%, with duties as high as 20% on some products.

Automobiles

- Automotive Industry. NAFTA phased out Mexico's restrictive auto decree. It phased out all U.S. tariffs on imports from Mexico and Mexican tariffs on U.S. and Canadian products as long as they met the rules of origin requirements of 62.5% North American content for autos, light trucks, engines and transmissions; and 60% for other vehicles and automotive parts. Some tariffs were eliminated immediately, while others were phased out in periods of 5 to 10 years. Prior to NAFTA, the United States assessed the following tariffs on imports from Mexico: 2.5% on automobiles, 25% on light-duty trucks, and a trade-weighted average of 3.1% for automotive parts. Mexican tariffs on U.S. and Canadian automotive products were as follows: 20% on automobiles and light trucks, and 10%-20% on auto parts.

Agriculture

- Agriculture. NAFTA set out separate bilateral undertakings on cross-border trade in agriculture, one between Canada and Mexico, and the other between Mexico and the United States. As a general matter, U.S.-Canada FTA provisions continued to apply on trade with Canada. Regarding U.S.-Mexico agriculture trade, NAFTA eliminated most non-tariff barriers in agricultural trade, either through their conversion to tariff-rate quotas (TRQs) or ordinary tariffs. Tariffs were phased out over a period of 15 years with sensitive products such as sugar and corn receiving the longest phase-out periods. Approximately one-half of U.S.-Mexico agricultural trade became duty-free when the agreement went into effect. Prior to NAFTA, most tariffs, on average, in agricultural trade between the United States and Mexico were fairly low though some U.S. exports to Mexico faced tariffs as high as 12%. However, approximately one-fourth of U.S. agricultural exports to Mexico (by value) were subjected to restrictive import licensing requirements

Other Provisions

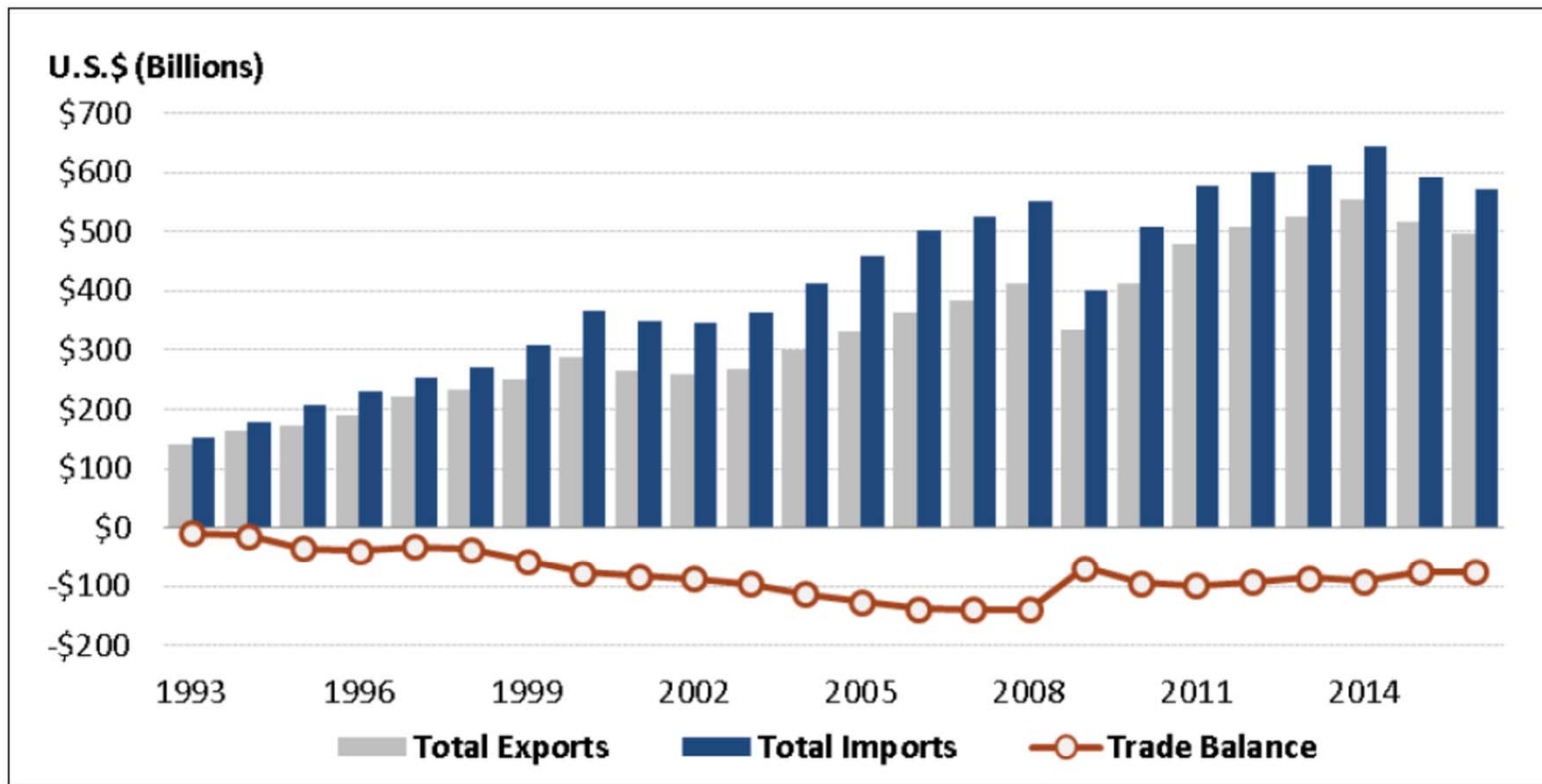
- “Foreign Investment. NAFTA removed significant investment barriers, ensured basic protections for NAFTA investors, and provided a mechanism for the settlement of disputes between investors and a NAFTA country”
- IPR – in line with TRIPS
- Dispute Settlement Procedures – NAFTA Trade Commissions, arbitral panel proceedings
- Government procurement – nondiscrimination, exclusions for SOEs.

Side-Agreements

- Two trade adjustment programs
- Labor and environmental side agreements required enforcement of national laws, with monetary damages allowed
- Bilateral border environmental agreement

Trade

Figure 2. U.S. Merchandise Trade with NAFTA Partners: 1993-2016
(billions of nominal dollars)



Source: Compiled by CRS using trade data from the U.S. International Trade Commission's Interactive Tariff and Trade Data Web, at <http://dataweb.usitc.gov>.

Table 2.

Estimated Effects of NAFTA on U.S. Trade With Canada and Mexico

Percent

Study	Period Examined	Trading Partner	Growth of Trade		Share of Growth
			Attributable to NAFTA	Total Growth	Attributable to NAFTA (Percentage points)
U.S. Imports From Partner Country					
Caliendo and Parro (2015)	1994–2005	Canada	6.1	144.2	4.2
		Mexico	105.9	302.4	35.0
		Combined	32.4	185.9	17.4
Rimmer and Dixon (2015)	1992–1998	Canada	4.8	67.8	7.0
		Mexico	143.9	240.9	59.7
		Combined	41.4	113.3	36.5
U.S. Exports to Partner Country					
Caliendo and Parro (2015)	1994–2005	Canada	10.5	104.8	10.0
		Mexico	127.8	180.1	71.0
		Combined	44.9	126.9	35.4
Rimmer and Dixon (2015)	1992–1998	Canada	16.9	63.4	26.6
		Mexico	27.9	77.6	35.9
		Combined	20.3	67.8	29.9
Total U.S. Trade With Partner Country					
Romalis (2007) ³	1994–2000	Canada	-0.3	62.5	-0.5
		Mexico	23.2	154.6	15.0
		Combined	6.0	88.1	6.9
Caliendo and Parro (2015)	1994–2005	Canada	8.2	125.7	6.5
		Mexico	117.0	240.6	48.6
		Combined	38.4	157.7	24.4
Rimmer and Dixon (2015)	1992–1998	Canada	10.6	65.7	16.1
		Mexico	81.8	153.5	53.3
		Combined	30.9	90.8	34.1

Source: Congressional Budget Office, using foreign trade data from the Census Bureau.

Impact on US Trade

Table 3.

Estimated Effects of NAFTA on Total U.S. Trade

Percent

Study	Period Examined	Growth of Total U.S. Trade Attributable to NAFTA	Growth of Total U.S. Trade	Share of Growth Attributable to NAFTA (Percentage points)
Romalis (2007) ^a	1994–2000	1.7	61.7	2.8
Caliendo and Parro (2015)	1994–2005	10.7	136.3	7.9
Rimmer and Dixon (2015)	1992–1998	4.6	62.2	7.5

Source: Congressional Budget Office, using foreign trade data from the Census Bureau.

FDI

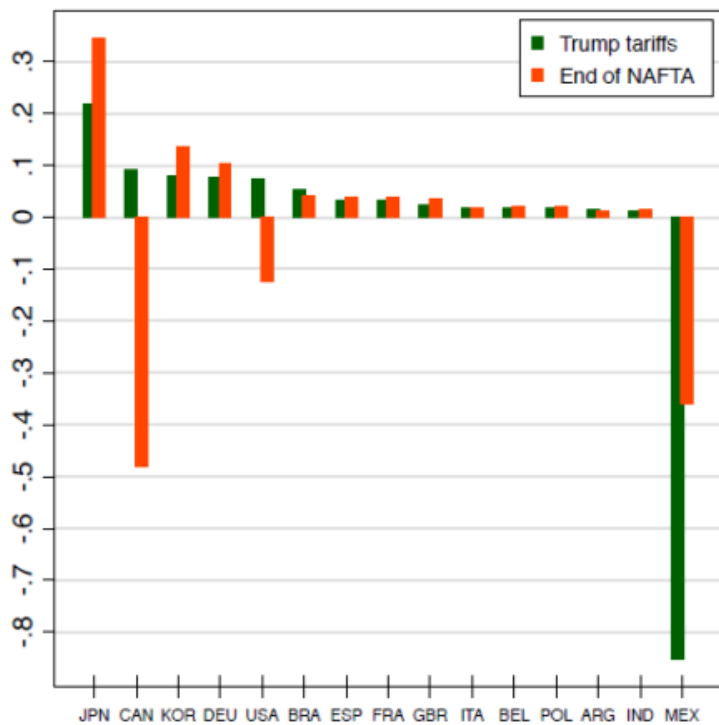
- Lower trade barriers reduce motivation for investment within RTA, but increase for those sources outside.
- Stronger protection for foreign investors
- Stronger intellectual property protections

Other Indirect Effects

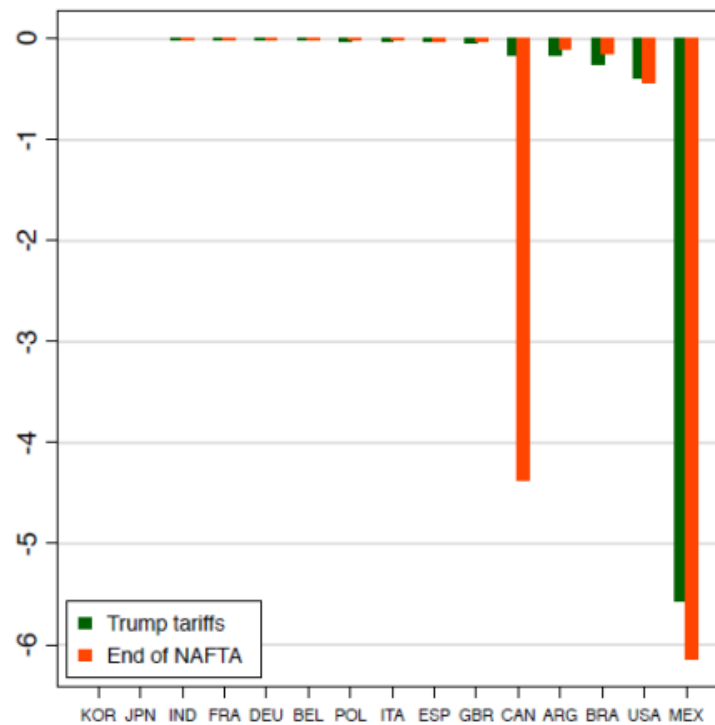
- Productivity - nil
- Total employment and average wages - nil
(possible increase in latter through price declines)
- Worker outcomes
 - Negative for low skilled workers and
 - Displaced workers (permanent hit to wages)

Sectoral Impacts Could Be Large

Figure 7: Dismantling NAFTA



(a) Change in % share of world output



(b) % Change in consumer surplus














Head and Mayer, “Brands in motion: How frictions shape multinational production,” (2016)

Brexit: Issue Areas

- Trade
- Investment
- Financial services/Passporting
- Immigration
- Budget

How Could the UK's Relationship With the EU Change?

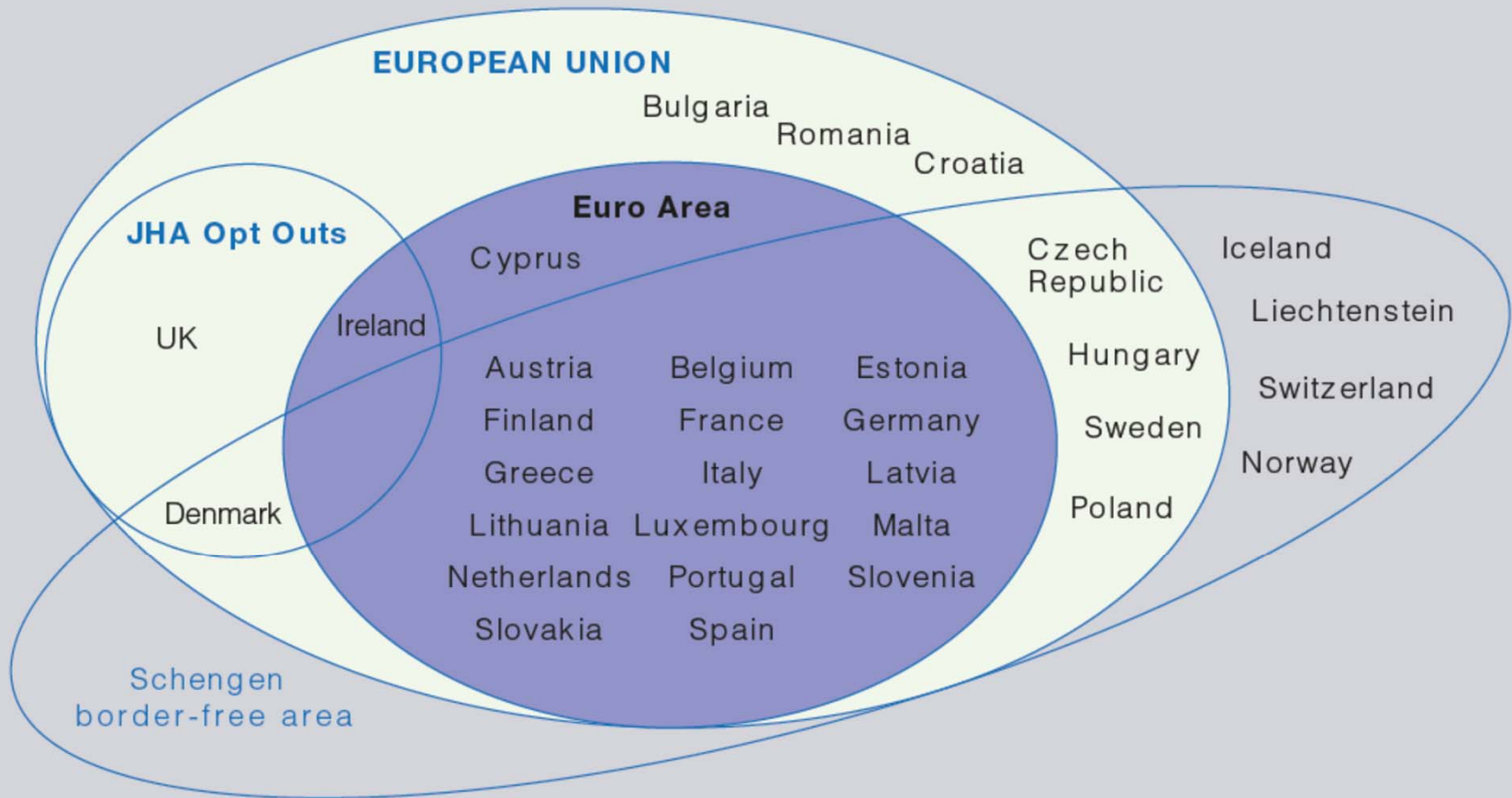
The UK already opts out from parts of the EU. If it leaves, its future could look like Norway, Switzerland, or Turkey, nonmembers with partial participation in the EU.

	 FULL PARTICIPATION	 PARTIAL PARTICIPATION <small>Indicates a negotiated special arrangement.</small>	 SINGLE MARKET	 FREE MOVEMENT OF PEOPLE	 CONTRIBUTE TO EU BUDGET	 VOTE ON EU LAW	 EUROZONE	 "EVER CLOSER UNION"
 STANDARD EU*	●		●	●	●	●	●	●
 CURRENT UK MEMBERSHIP	●		●	●	○	●		
POTENTIAL POST-BREXIT SCENARIOS								
 EUROPEAN ECONOMIC AREA (NORWAY)		○		●		○		
 BILATERAL DEAL (SWITZERLAND)		○		●				
 CUSTOMS UNION (TURKEY)		○						

COUNCIL *on*
FOREIGN
RELATIONS

*Except for the UK Sources: UK Government, *The Economist* Credits: James McBride, David Foster

Box 2: Europe and the European Union¹⁰



https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/504604/Alternatives_to_membership_-_possible_models_for_the_UK_outside_the_EU.pdf

Britain and the EU* : By the Numbers



EU BUDGET

£8.5 billion: 2015 UK contribution to EU budget
1%: EU contributions as share of total UK budget



TRADE

45%: UK exports going to the EU
53%: UK imports coming from the EU
60%: Trade in the overall UK economy



FOREIGN DIRECT INVESTMENT

48%: Foreign investment coming from the EU
40%: British foreign investment going to the EU



FINANCIAL SERVICES

10%: Financial services in the overall economy
40%: Financial services exports going to the EU



JOBS

3 million: UK jobs associated with EU trade
10%: Trade-related jobs in the overall UK workforce



MIGRATION

1.2 million: British citizens living in the EU
3 million: EU citizens living in the UK



COUNCIL on FOREIGN RELATIONS

*Except for the UK Sources: UK Parliament, UK Treasury, UK Office for National Statistics, Centre for Economics and Business Research, FullFact.org, Bloomberg Credits: James McBride, David Foster

Table I. Comparison of recent studies on the impact of leaving the EU on the United Kingdom

	OECD	LSE/CEP		HM Treasury			NIESR		
	WTO/FTA	FTA	WTO	EEA	FTA	WTO	EEA	FTA	WTO
Near term	2020	Static		2020			2020		
GDP (%)	-3.30	-1.30	-2.60	n.a.	n.a.	n.a.	-1.9	-2.1	-2.9
Real wages (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-2.3	-2.6	-4.2
Longer term	2030	Dynamic		2030			2030		
GDP (%)	-5.1	-7.9	n.a.	-3.8	-6.2	-7.5	-1.8	-2.1	-3.2
Range (%)	-2.7 to -7.7	-6.3 to -9.5	n.a.	-3.4 to -4.3	-4.6 to -7.8	-5.4 to -9.5	-1.5 to -2.1	-1.9 to -2.3	-2.7 to -3.7
Real wages (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-2.7	-3.4	-5.5
Range (%)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-2.2 to -3.2	-3.1 to -3.8	-4.6 to -6.3
Implied multiplier on trade to get long-run GDP effects	0.27 – 0.39	0.5 to 0.75	n.a.	0.42	0.33 – 0.41	0.32 – 0.40	0.13	0.14	0.13
Method	NiGEM	Estimated trade elasticities (1)	n.a.	NiGEM			NiGEM		
				Channels					
Short-term uncertainty	x						x	x	x
Reduced trade with EU	x	x	x	x	x	x	x	x	x
Productivity losses from reduction in trade	x	x (1)	x	x	x	x			
Reduction in FDI	x		x	x	x	x	x	x	x
Productivity losses from reduced FDI	x		x	x	x	x			
Lower contributions to EU	x		x	x	x	x	x	x	x
Change in migration	x								
Productivity gains from deregulation	x								
Lower or zero contributions to the EU budget	x			x	x	x		x	x

Sources: OECD calculations: LSE/CEP study: Dhingra, S., Ottaviano, G., Sampson, T. and Van Reenen, J. (2016), *The Consequences of Brexit for UK Trade and Living Standards*, Centre for Economic Performance (CEP), London School of Economics and Political Science (LSE); and Treasury: HM Treasury (2016), *HM Treasury Analysis: the Long-Term Economic Impact of EU Membership and the Alternatives*, April 2016.

Note: The LSE/CEP analysis uses econometric estimates of the relationship between trade and GDP to estimate the impact of a given reduction in trade on GDP. These estimates would, in principle, capture any and all impact of trade on GDP, including productivity gains from increases to openness.