

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

Lecture 24
4/22/2019

Instructor: Prof. Menzie Chinn
UW Madison
Spring 2019

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

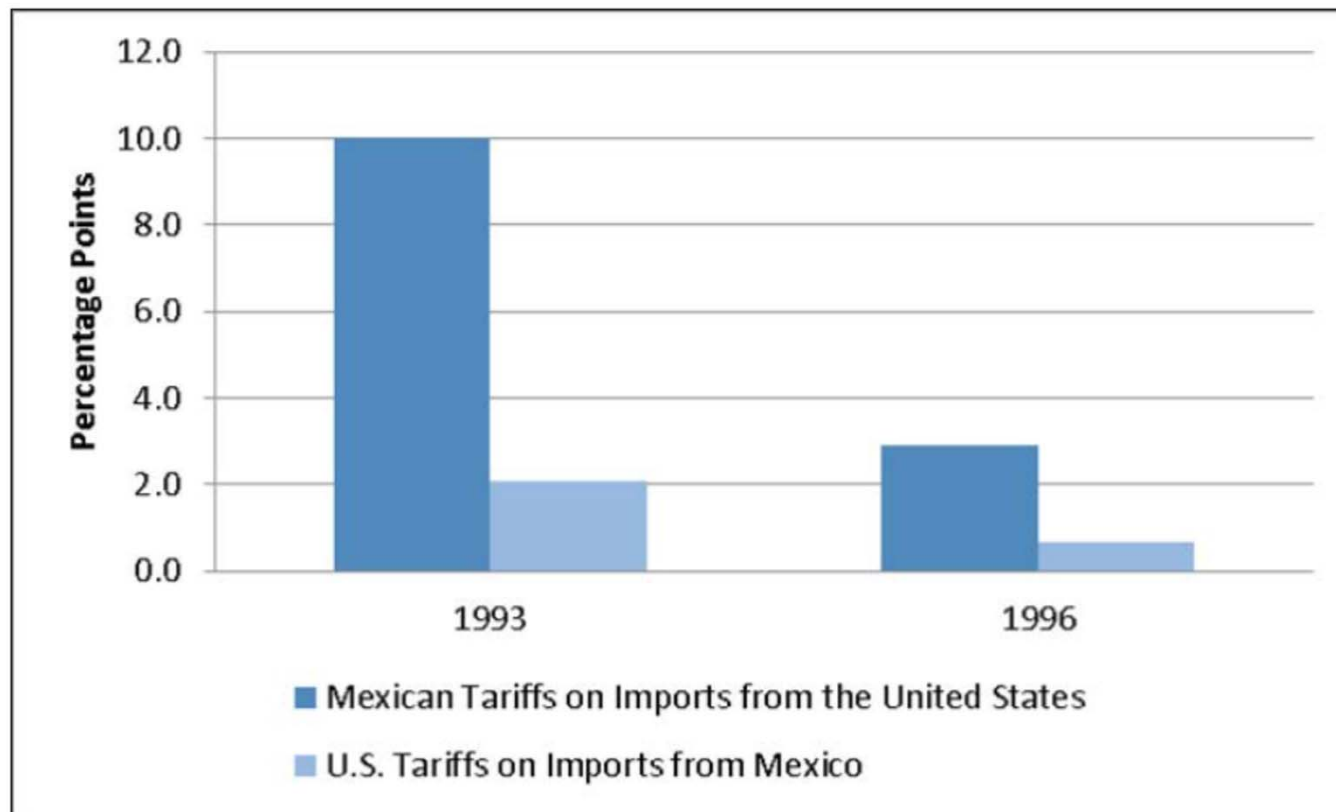
Partner Countries	Year in Which Agreement Was Implemented	Cumulative GDP of Partner Countries (Percentage of U.S. GDP)	Share of Total U.S. Trade	Trade-Weighted Average MFN Import Tariff Rates of Partner Countries	Trade-Weighted U.S. Average MFN Import Tariff Rates
Israel	1985	0.7	n.a.	n.a.	n.a.
Canada	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

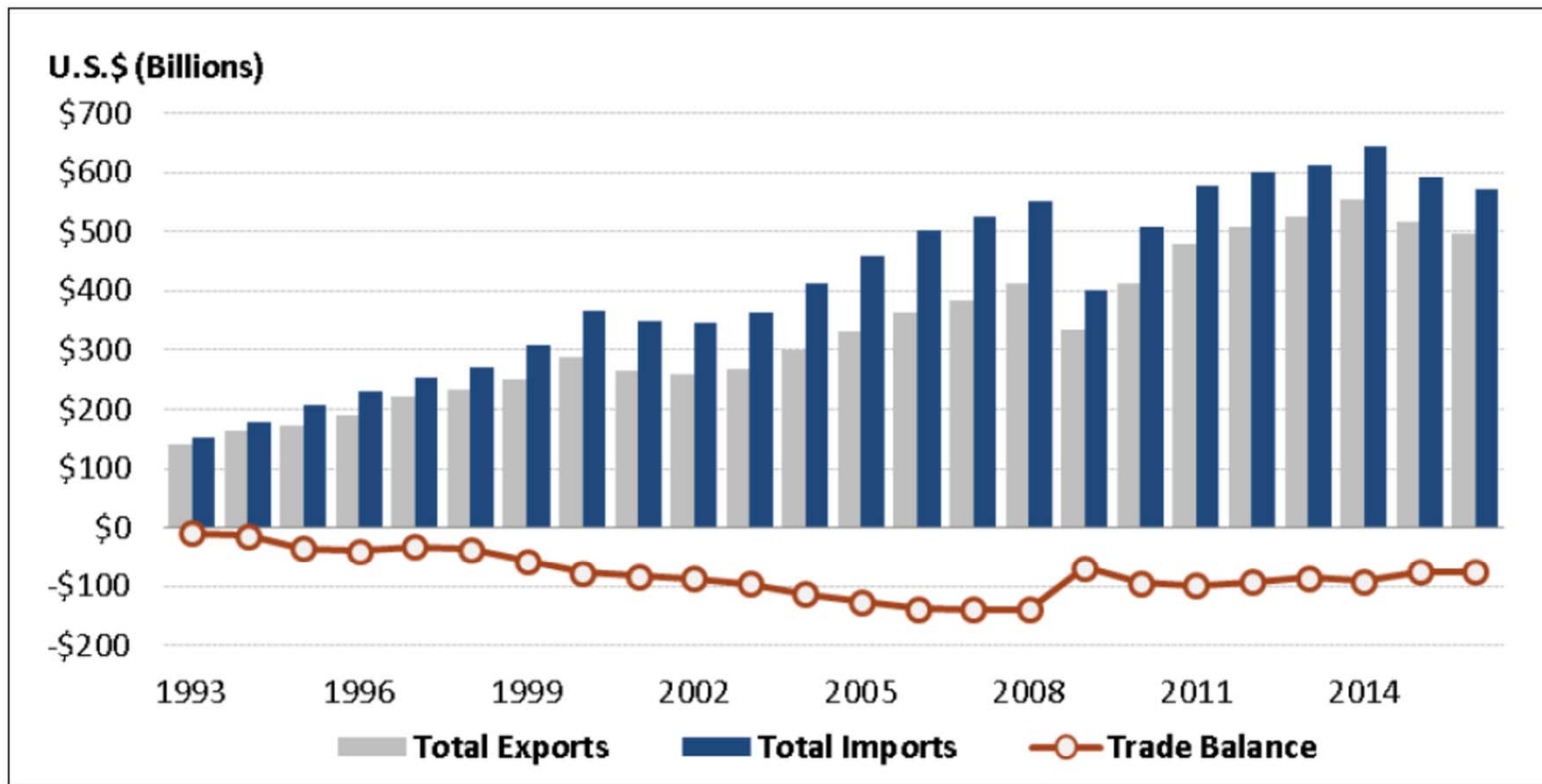
- “Foreign Investment. NAFTA removed significant investment barriers, ensured basic protections for NAFTA investors, and provided a mechanism for the settlement of disputes between investors and a NAFTA country”
- IPR – in line with TRIPS
- Dispute Settlement Procedures – NAFTA Trade Commissions, arbitral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

USMCA (ITC Report)

- The elements of the agreement that would have the most significant effects on the U.S. economy are (1) provisions that reduce policy uncertainty about digital trade and (2) certain new rules of origin applicable to the automotive sector.
- Because NAFTA has already eliminated duties on most qualifying goods and significantly reduced nontariff measures, USMCA's emphasis is on reducing remaining nontariff measures on trade and the U.S. economy

USMCA (US ITC Report)

- The agreement would establish commitments to open flows of data, which would positively impact a wide range of industries that rely on international data transfers. USMCA would reduce the scope of the investor-state dispute settlement (ISDS) mechanism...
- strengthen labor standards and rights, including those related to collective bargaining in Mexico...

USMCA (US ITC Report)

- New intellectual property rights provisions would increase protections ...
- The Commission's model estimates that USMCA would raise U.S. real GDP by \$68.2 billion (0.35 percent) and U.S. employment by 176,000 jobs (0.12 percent). The model estimates that USMCA would likely have a positive impact on U.S. trade, both with USMCA partners and with the rest of the world. U.S. exports to Canada and Mexico would increase by \$19.1 billion (5.9 percent) and \$14.2 billion (6.7 percent), respectively. U.S. imports from Canada and Mexico would increase by \$19.1 billion (4.8 percent) and \$12.4 billion (3.8 percent), respectively.

USMCA (US ITC Report)

Table 2.6 Impact of modeled provisions that reduce policy uncertainty on the economy-wide effects of USMCA (percent changes relative to the baseline)

Impact of provisions reducing policy uncertainty	None	Moderate	High
U.S. real GDP	-0.12	0.35	1.21
U.S. real output			
Agriculture	-0.22	0.18	0.88
Manufacturing and mining	0.37	0.57	0.88
Services	-0.13	0.17	0.71
U.S. employment			
Agriculture	-0.15	0.12	0.58
Manufacturing and mining	0.28	0.37	0.51
Services	-0.07	0.09	0.38
U.S. wages			
Agriculture	-0.18	0.23	0.94
Manufacturing and mining	0.25	0.50	0.94
Services	-0.10	0.23	0.84

Source: USITC estimates.

Note: Columns reflect different simulation specifications as follows:

None: Does not incorporate the impact of provisions that reduce policy uncertainty for international data transfer, cross-border services, and market access and nonconforming measures in investment.

Moderate: Reproduces the results of this study as previously shown in table 2.2.

High: Gives additional weight to provisions that reduce policy uncertainty for international data transfer, cross-border services, and market access and nonconforming measures in investment, as suggested by some economic research.

USMCA Autos

Table 3.8 Estimated changes in the production of and trade in U.S. vehicles due to the USMCA's automotive rules of origin (ROOs) (thousands of vehicles; percent changes relative to the baseline)

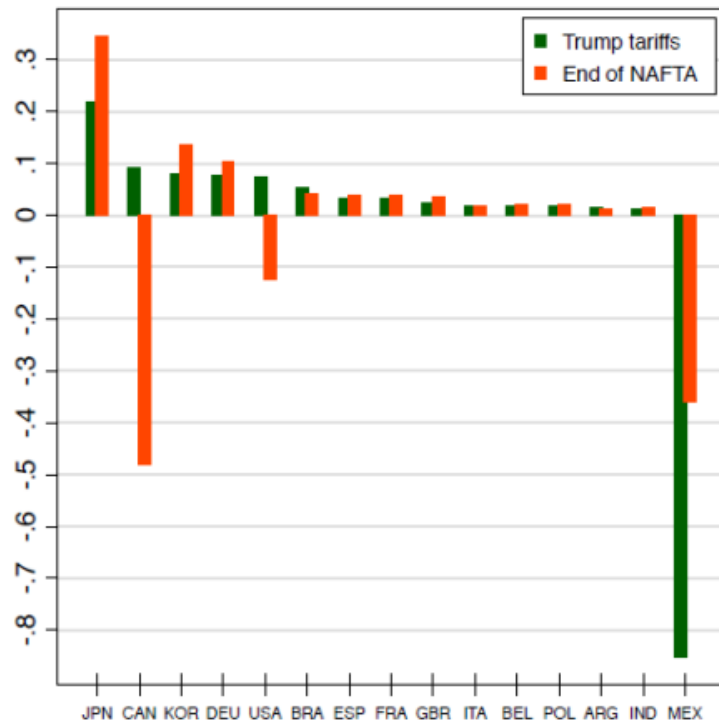
	Small cars	Mid- to full-size cars	Multi-passenger vehicles	Pickup trucks
Change in U.S. vehicle production for North America	-33.2 -2.96%	-24.2 -1.23%	-43.5 -0.94%	-2.0 -0.07%
Change in U.S. exports of vehicles to Canada	-4.3 -3.53%	-1.1 -1.24%	-5.4 -1.21%	(a) 0.02%
Change in U.S. exports of vehicles to Mexico	-2.1 -5.99%	-0.4 -2.42%	-0.4 -0.52%	(a) 0.03%
Change in U.S. imports of vehicles from Canada	-7.7 -2.15%	3.0 1.00%	-8.3 -0.72%	(a) 0.00%
Change in U.S. imports of vehicles from Mexico	-82.0 -9.55%	-2.1 -0.88%	-19.3 -3.31%	-12.7 -2.26%
Change in U.S. imports of vehicles from the rest of the world	40.8 3.92%	4.8 1.04%	32.5 1.33%	(a) 0.00%

Source: USITC estimates.

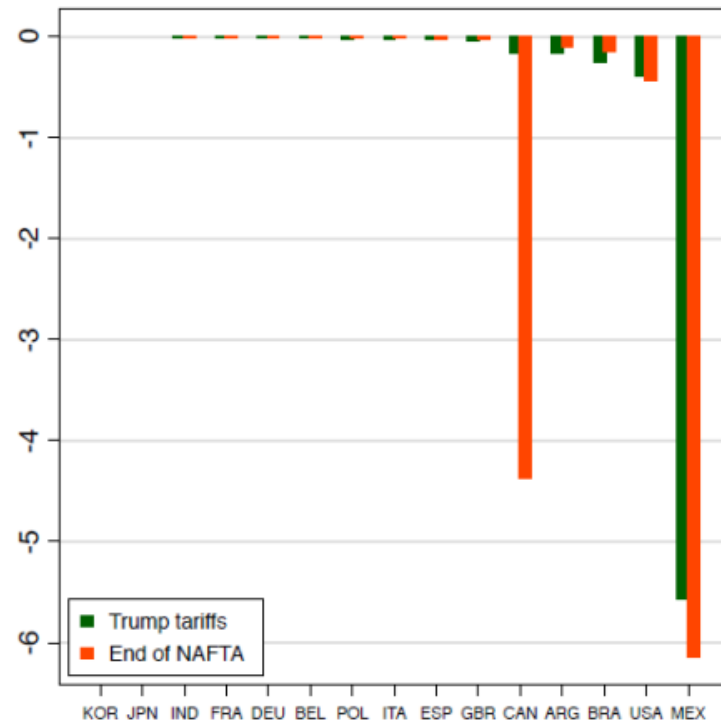
^a Less than 0.1.

Nexit: 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?

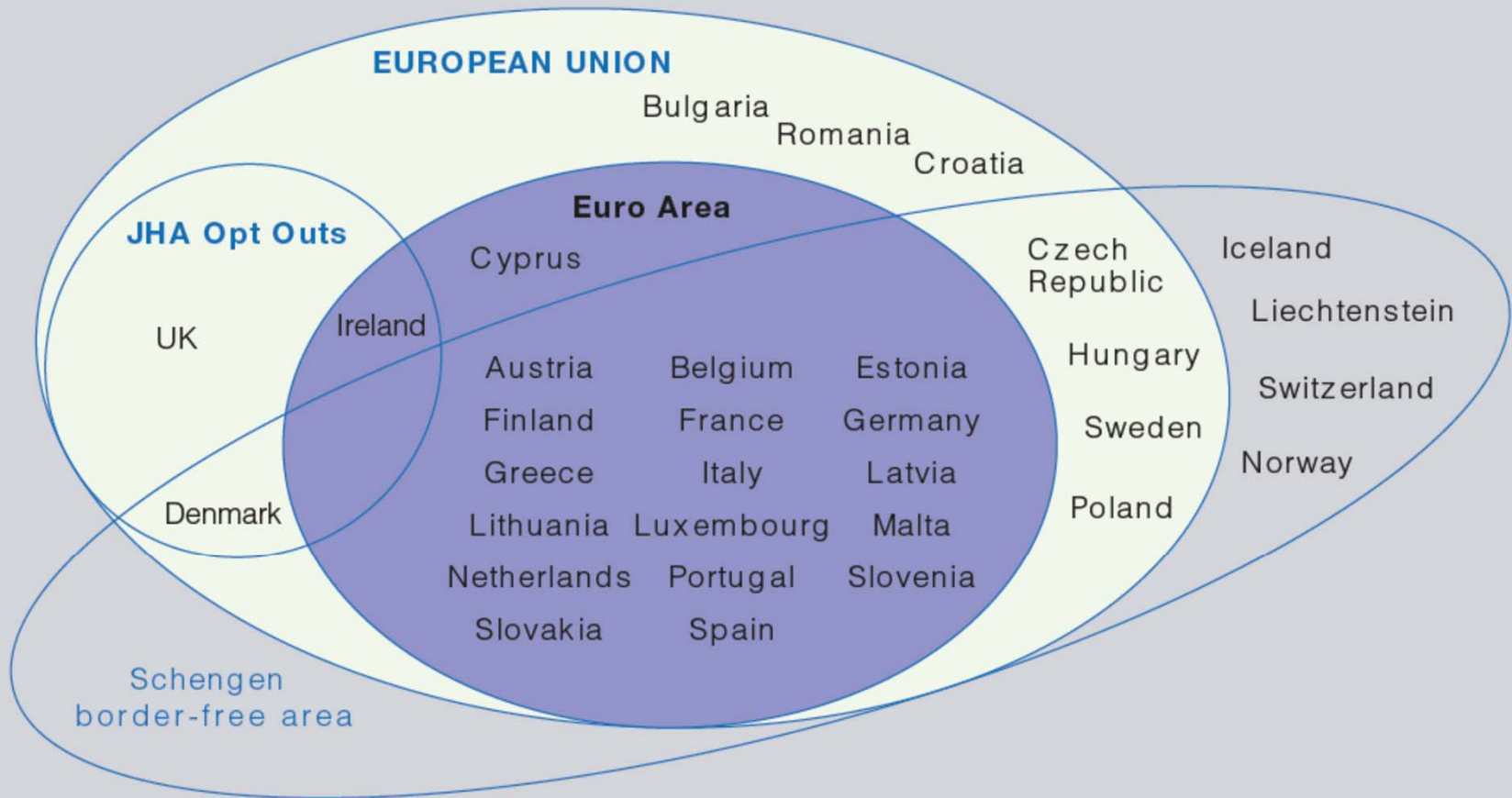
The UK already opts out from parts of the EU. If it leaves, its future could look like Norway, Switzerland, or Turkey, nonmembers with partial participation in the EU.

	 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

Latorre, Olekseyuk, Yonezawa, & Robinson (2019)

Table 3 Comparison of recent computable general equilibrium (CGE) studies on Brexit (percent change relative to no-Brexit scenario)

	Booth et al. (2015) (Open Europe study)				Ciurlak et al. (2015)				Jafari and Britz (2017)	Minford et al. (2016)	Latorre, Olekseyuk, and Yonezawa (2018)				Ortiz and Latorre (2018a)				Pricewaterhouse Coopers (2016) ^a	
	soft	Hard	FTAEU+ ROW+ Dereg ^a		soft	Hard		UK	UK	Soft	Hard		Soft		Hard		soft	Hard		
			UK	EU-27		UK	EU-27				UK	UK alone	EU-27	UK	EU-27	UK			EU-27	UK
	Impact on GDP	-0.81	-2.23	0.64	1.55	-0.24	-0.97	-0.65	-2.54	-4.45	4.00	-0.16	-1.23	-0.35	-2.53	-0.07	-0.50	-0.14	-1.15	-1%
Sectoral effects considered																				
Sectoral productivity shocks à la Melitz (2003)									√											√
Imperfect competition and variety effects									√											√
Perfect competition			√				√			√									√	√
Value chains			√				√		√	√			√						√	√
Barriers considered																				
Tariffs			√				√		√	√			√						√	√
Nontariff barriers to trade			√				√		√	√			√						√	√
Nontariff barriers to foreign direct investment			√				√						√							
Rules of origin			√				√													
Macro shocks																				
Foreign direct investment			√				√		√				√							
Migration									√									√		√
EU budget			√						√											√
Exchange rate			√				√													
Changes in unemployment rate																				√
Risk premia/uncertainty																				√
Dynamics			√				√													√

a. See text for explanation of this scenario.

Source: Authors' revision.

Table 4 Comparison of recent macroeconometric studies on Brexit (percent change relative to no-Brexit scenario)

	Alchele and Felbermayr (2015)				Dhingra et al. (2017)				HM Treasury (2016a)		HM Treasury (2016b)			OECD (2016)	
	Soft		Hard		Soft		Hard		UK		UK			Hard	
	EU-27	UK	EU-27	UK	EU-27	UK	EU-27	UK	Soft	Hard	EEA	FTA	WTO	EU-27	UK
Impact on	Real income				Private consumption				GDP		GDP			GDP	
	-0.1	-0.64	(-0.36;-0.24)	(-2.8;-1.54)	-0.32	-1.34	-0.82	-2.66	-3.60	-6.00	-3.80	-6.20	-7.50	-1.0	-3.3
Overall approach	New quantitative trade model (NQTM)				NQTM				VAR and NiGEM		Gravity and NiGEM macroeconomic model			CGE and NiGEM	
Sectoral effects considered															
Sectoral productivity shocks à la Melitz (2003)															
Imperfect competition & variety effects															
Perfect competition			√				√			√		√			√
Value chains			√				√								√
Barriers considered															
Tariffs			√				√								√
Nontariff barriers to trade			√				√								√
Nontariff barriers to foreign direct investment															
Rules of origin															
															√
Macro shocks															
Foreign direct investment															
															√
Migration															
															√
EU budget															
							√			√		√			√
Exchange rate															
										√		√			√
Changes in unemployment rate															
										√					√
Risk premia/uncertainty															
										√		√			√
Dynamics															
										√		√			

EEA = European Economic Area; FTA = free trade agreement; WTO = World Trade Organization

Source: Authors' revision.

Latorre, Olekseyuk, & Yonezawa. (2018)

Table 2 Impact of Brexit on macroeconomic aggregates in 2020
(percent change relative to initial levels)

Item	Soft (Norway case)		Hard (WTO case)	
	EU-27	UK	EU-27	UK
GDP				
Nontariff barriers	-0.10	-0.82	-0.18	-1.47
Foreign direct investment	-0.06	-0.41	-0.12	-0.83
Tariffs			-0.06	-0.39
Total	-0.16	-1.23	-0.35	-2.53
Private consumption (change in billions of dollars)				
Nontariff barriers	-15.616	-18.950	-29.016	-34.741
Foreign direct investment	-10.585	-11.915	-20.309	-23.485
Tariffs			-9.908	-6.527
Total	-26.178	-30.818	-57.977	-62.701
Wages				
Nontariff barriers	-0.12	-0.97	-0.22	-1.75
Foreign direct investment	-0.05	-0.29	-0.09	-0.63
Tariffs			-0.10	-0.88
Total	-0.17	-1.26	-0.39	-2.83
Capital remuneration				
Nontariff barriers	-0.14	-0.98	-0.24	-1.76
Foreign direct investment	-0.07	-0.61	-0.13	-1.11
Tariffs			-0.11	-0.93
Total	-0.21	-1.59	-0.43	-3.34

Aggregate exports				
Nontariff barriers	-1.47	-7.63	-2.52	-12.86
Foreign direct investment	-0.07	0.08	-0.13	0.15
Tariffs			-1.48	-7.98
Total	-1.54	-7.54	-3.48	-16.94
Aggregate imports				
Nontariff barriers	-1.68	-6.23	-2.87	-10.55
Foreign direct investment	-0.01	-0.22	-0.02	-0.37
Tariffs			-1.66	-6.63
Total	-1.69	-6.44	-3.82	-14.42
Consumer price index				
Nontariff barriers	-0.08	0.31	-0.16	0.57
Foreign direct investment	0.02	0.02	0.04	0.08
Tariffs			-0.12	0.89
Total	-0.06	0.33	-0.20	1.14

WTO = World Trade Organization

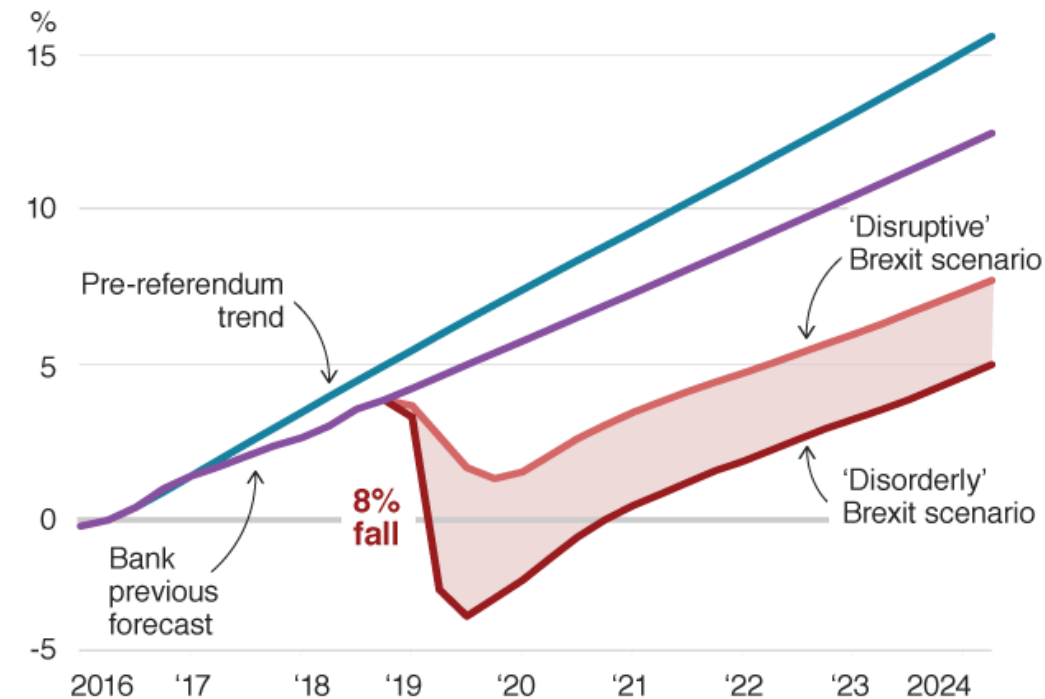
Note: Shaded cells denote losses.

Source: Latorre, Olekseyuk, and Yonezawa (2018).

BoE on “No Deal” Brexit

What does the Bank think could happen to UK growth?

UK GDP under different scenarios



Source: Bank of England

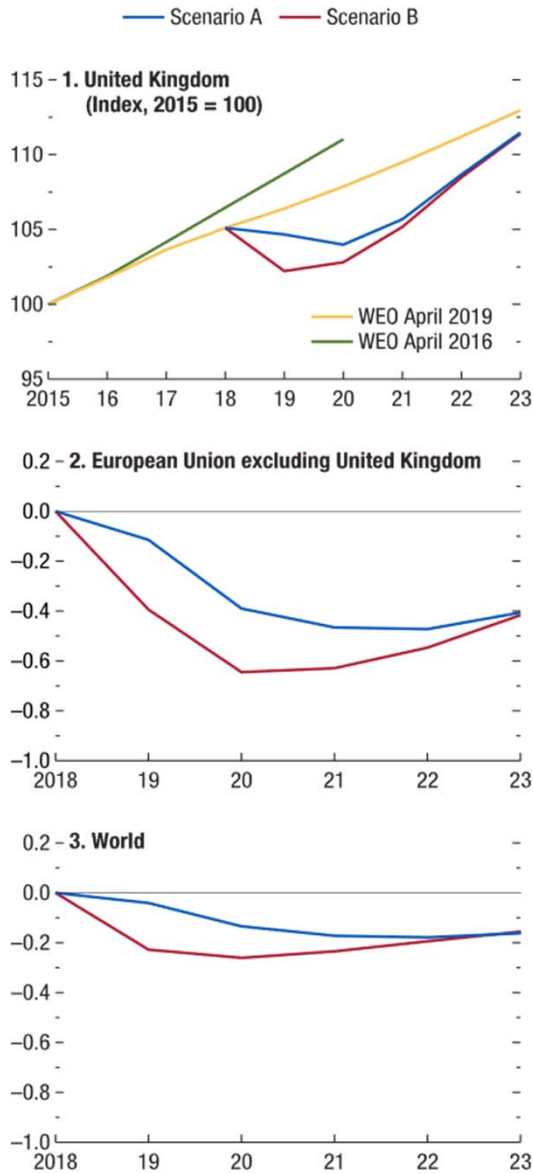
BBC

IMF on “No Deal” Brexit

Scenario Table 1. Trade Assumptions in the Baseline, Scenario A, and Scenario B

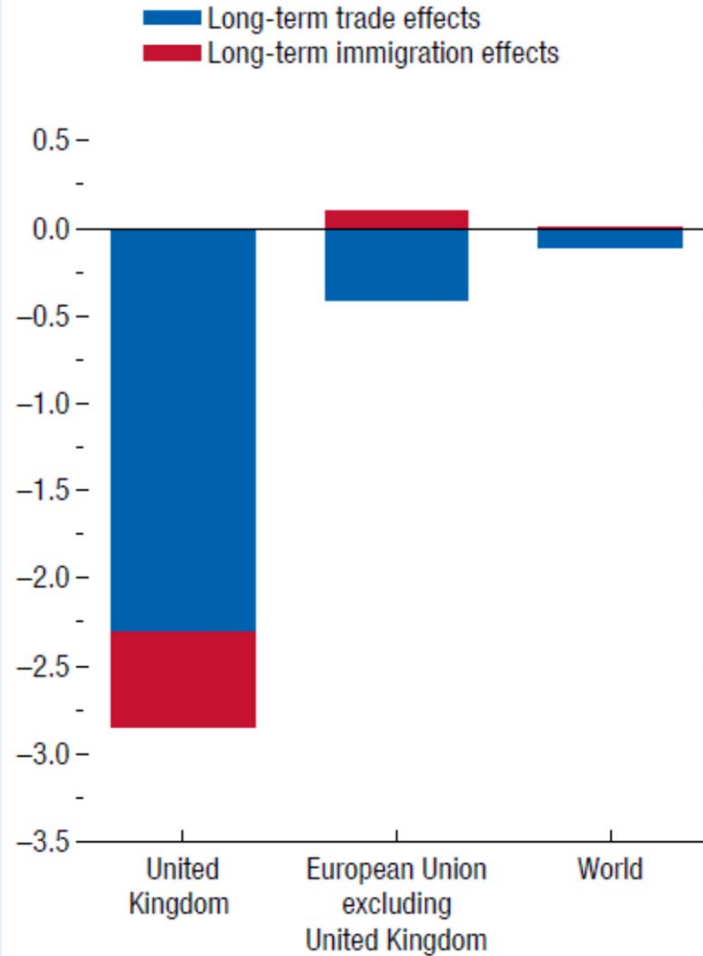
		The WEO Baseline	No-Deal Scenarios	
			A	B
Trade arrangements	Trade with third countries	The United Kingdom retains access to existing agreements between EU and third countries	The United Kingdom sets tariffs unilaterally to zero on 87 percent of its imports from mid-2019 to mid-2020; the United Kingdom loses access to most existing agreements, secures new agreements by 2021	
	Trade with the European Union	No tariff increases; nontariff barriers gradually increase by 10 percent in tariff equivalent terms	Tariffs increase by 4 percent in mid-2019 (mid-2020 for UK imports subject to temporary tariff regime); nontariff barriers increase gradually by an additional 14 percent (in tariff equivalent terms) relative to baseline	
Border disruption		No	No	Yes
Tightening of financial conditions		No	Small	More severe

Scenario Figure 1. Real GDP in Brexit Scenario
 (Percent deviation from control, unless noted otherwise)



Source: IMF staff estimates.
 Note: WEO = *World Economic Outlook*.

Scenario Figure 2. Brexit Long-Term Real GDP Effects
 (Percent deviation from April 2019 WEO baseline)



Source: IMF staff estimates.
 Note: WEO = *World Economic Outlook*.