Lecture 8: A Little Trade History

Benjamin Graham
Today’s Plan

• Housekeeping
• Reading quiz
• Consumer gains from trade
• A Brief History of Global Trade
  • Including the GATT and WTO
Housekeeping

- Homework 2 due next Thursday (September)
  - Late papers not accepted
  - Will go up on my website ASAP
Reading Quiz (1)

• A consequence of the Smoot-Hawley Act was:
  • A. Foreign countries cut tariffs on U.S. exports.
  • B. The U.S. economy improved by increasing demand for domestic products.
  • C. U.S. trade with other nations collapsed.
  • D. U.S. trade with other nations prospered.
Reading Quiz (2)

2) Which of the following is NOT a responsibility of the World Trade Organization (WTO)?

A. Resolve trade disputes that occur between countries
B. Define and enforce the policies of international trade
C. Promote liberalized trade policies
D. Protect infant industries from unfair foreign competition
E. Trick Question. All of the above are responsibilities of the WTO
Reading Quiz (3)

• Most Favored Nation (MFN) status is
• A. also known as normal trade relations
• B. When two nations do not impose any trade barriers on each other
• C. agreement to apply tariffs at rates as low as those applied to other nations having MFN status
• D. Both A and C
• E. Both A and B
Consumption Gains from Trade

• We’ve talked about what types of PRODUCERS gain or lose from trade
  • But people also vary in what they consume
• If you’re poor, you consume mostly goods
  • If you’re rich, your consume more services

• In terms of consumption, free trade benefits the poor individuals more than rich individuals (within a given country)
  • Walmart is an amazing anti-poverty force in the US
  • It doesn’t raise wages, but it increases purchasing power
Mercantilism (1500ish-1850ish)

- Belief that trade is zero-sum
  - Trade surpluses are the path to national wealth
  - Colonialism: Get natural resources cheap, maintain a trade monopoly
- Adam Smith, *Wealth of Nations*, 1776
- David Ricardo published about comparative advantage in 1819
- By the mid 1800s, Europe was moving away from Mercantilism
The Corn Laws

- Corn laws were tariffs on the import of Corn into Britain
  - Passed in 1804
- Who do you think wanted the corn laws passed?
  - Manufacturers or Farmers?
  - Urban vs. Rural
- As British industry grew, and grew more powerful, support for free trade grew
  - Britain was a very efficient producer of manufactured goods
  - Local price was below the “world” price
- Corn laws were repealed in 1849 -- Britain was on the path to free trade
First Wave of Globalization (1870-1914)

- Steam ships
- The “Pax Brittanica”
- The Gold Standard
- Falling trade barriers
  - Treaty between Britain and France in 1860
  - Germans open up trade in 1870s
- WWI put an end to all that
The Great Depression

• Beggar-Thy-Neighbor policies
• Smoot-Hawley Tariff (1930)
  • Raised US tariff rates to an average of 53%
  • Prompted retaliation by 25 other countries
  • World trade collapsed
The Great Depression
The General Agreement on Tariffs and Trade

- Countries shouldn’t discriminate between trading partners
  - Most-Favored-Nation status (now called normal trade relations)
- Tariffs should be as low as possible
- Multilateral framework tries to protect against another spiral of protectionism
The General Agreement on Tariffs and Trade (GATT)

<table>
<thead>
<tr>
<th>Negotiating Round and Coverage</th>
<th>Dates</th>
<th>Number of Participants</th>
<th>Tariff Cut Achieved (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Addressed tariffs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Geneva</td>
<td>1947</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td>Annecy</td>
<td>1949</td>
<td>13</td>
<td>2</td>
</tr>
<tr>
<td>Torquay</td>
<td>1951</td>
<td>38</td>
<td>3</td>
</tr>
<tr>
<td>Geneva</td>
<td>1956</td>
<td>26</td>
<td>4</td>
</tr>
<tr>
<td>Dillon Round</td>
<td>1960–1961</td>
<td>26</td>
<td>2</td>
</tr>
<tr>
<td>Kennedy Round</td>
<td>1964–1967</td>
<td>62</td>
<td>35</td>
</tr>
<tr>
<td><strong>Addressed tariff and nontariff barriers</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tokyo Round</td>
<td>1973–79</td>
<td>99</td>
<td>33</td>
</tr>
<tr>
<td>Uruguay Round</td>
<td>1986–93</td>
<td>125</td>
<td>34</td>
</tr>
<tr>
<td>Doha Round</td>
<td>2002–</td>
<td>149</td>
<td>—</td>
</tr>
</tbody>
</table>
The General Agreement on Tariffs and Trade (GATT)

<table>
<thead>
<tr>
<th>Country</th>
<th>Pre-Uruguay Round</th>
<th>Post-Uruguay Round</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Industrial countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australia</td>
<td>20.1</td>
<td>12.2</td>
</tr>
<tr>
<td>Canada</td>
<td>9.0</td>
<td>4.8</td>
</tr>
<tr>
<td>European Union</td>
<td>5.7</td>
<td>3.6</td>
</tr>
<tr>
<td>Japan</td>
<td>3.9</td>
<td>1.7</td>
</tr>
<tr>
<td>United States</td>
<td>5.4</td>
<td>3.5</td>
</tr>
<tr>
<td><strong>Developing countries</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Argentina</td>
<td>38.2</td>
<td>30.9</td>
</tr>
<tr>
<td>Brazil</td>
<td>40.7</td>
<td>27.0</td>
</tr>
<tr>
<td>Chile</td>
<td>34.9</td>
<td>24.9</td>
</tr>
<tr>
<td>Colombia</td>
<td>44.3</td>
<td>35.3</td>
</tr>
<tr>
<td>India</td>
<td>71.4</td>
<td>32.4</td>
</tr>
</tbody>
</table>
The World Trade Organization

• Formed in 1995, replaced the GATT with a formal organization
• Big Change: Settling trade disputes
  • If you bring a complaint and you win, you’re allowed to implement retaliatory tariffs
• Other recent change: focus shifting to non-tariff barriers to trade related intellectual property rights
  • Poor countries now more organized pushing for opening on ag and textiles
But the rich countries have it pretty good right now...
Beyond Tariffs

• The GATT (and WTO) have been extremely successful lowering Tariffs
• But there are other ways to engage in protectionism

• Labor and environmental standards make excellent barriers to trade
  • This is not their only purpose -- protecting workers rights and the environment are noble goals
  • But these regulations can also be cover for protectionism
The Race to the Bottom

• Environmental and labor regulations can be expensive for foreign firms to comply with

• The fear is that developing countries will compete with one another to reduce regulations to attract investment

• Empirically, the evidence is mixed
  • Skilled labor, stable policy, and good infrastructure are more important than lax regulation
  • Generally, governments that provide stable policy, education, and infrastructure also protect their citizens (i.e. have labor and environmental regulations)
  • Exporters are more likely to adopt environmental regs if the countries they export to have those regs
The Race to the Bottom (2)

- Economic openness, however, does put downward pressure on the size of the welfare state in developing countries
  - Low taxes, low govt. spending
  - However, this primarily hurts the middle class, b/c they received more of these benefits than the poorest individuals in developing countries
Group Questions

• Tariffs were once 95% of U.S. government revenue. They are now about 1%. Why did we rely so heavily on tariffs early in our history? What challenges do low tariffs pose for governments in developing countries?

• The Doha round of WTO negotiations is stalled, so many countries are negotiating bilateral and free trade agreements instead. What are some implications of this?