

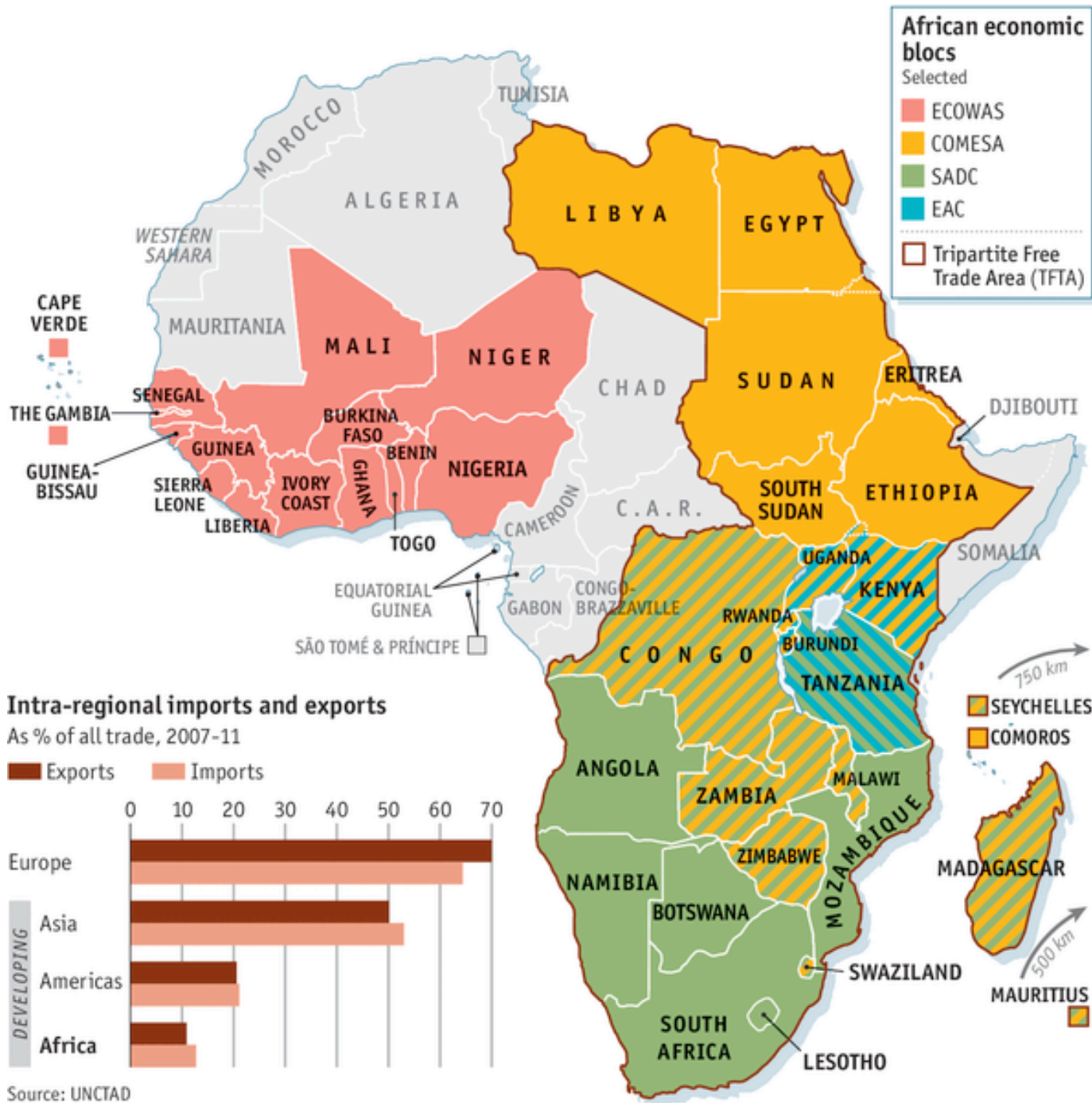
The Dangers of Sensitive Sectors in FTAs

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One More Mega-FTA

- TFTA: Tripartite Free Trade Area
 - 26 countries in Africa
 - EAC: East African Community
 - SADC: Southern African Development Community
 - COMESA: Common Market for Eastern and Southern Africa



Source: UNCTAD
Economist.com

Pros and Cons of all FTAs

- Preferential tariff cuts
 - Pro: trade creation
 - Similar to the classic “gains from trade”
 - Cons:
 - Trade diversion
 - Rules of origin (ROOs)
 - Exemption of sensitive sectors
 - Sensitive = Most likely to be trade-creating if included

Effects of FTAs

- Market-diagram Illustration

- Suppose Country A can import a good from either Country B or Country C at prices

$$P_C < P_B$$

- And Country A has a tariff greater than the price difference:

$$t > (P_B - P_C)$$

- What happens when Country A forms a PTA with high-cost Country B, lowering its tariff to zero on imports from Country B?

Effects of FTAs

Before FTA

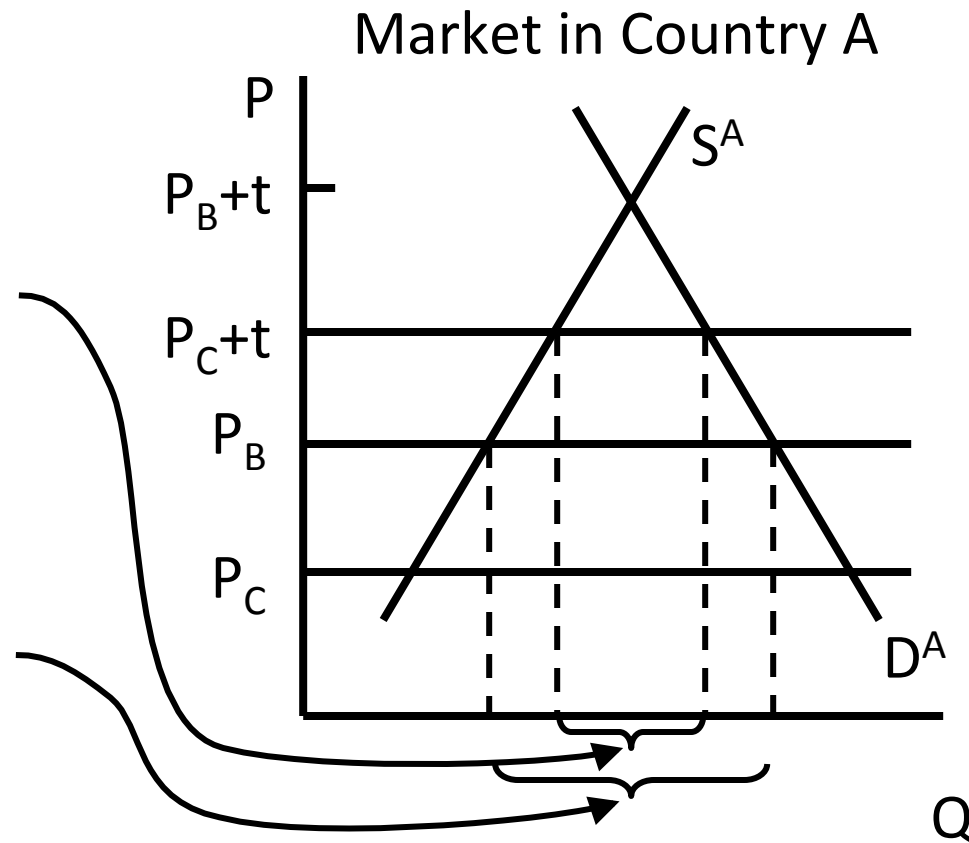
$$P_C + t < P_B + t, \text{ so}$$

A imports from C

With FTA

$$P_B < P_C + t, \text{ so}$$

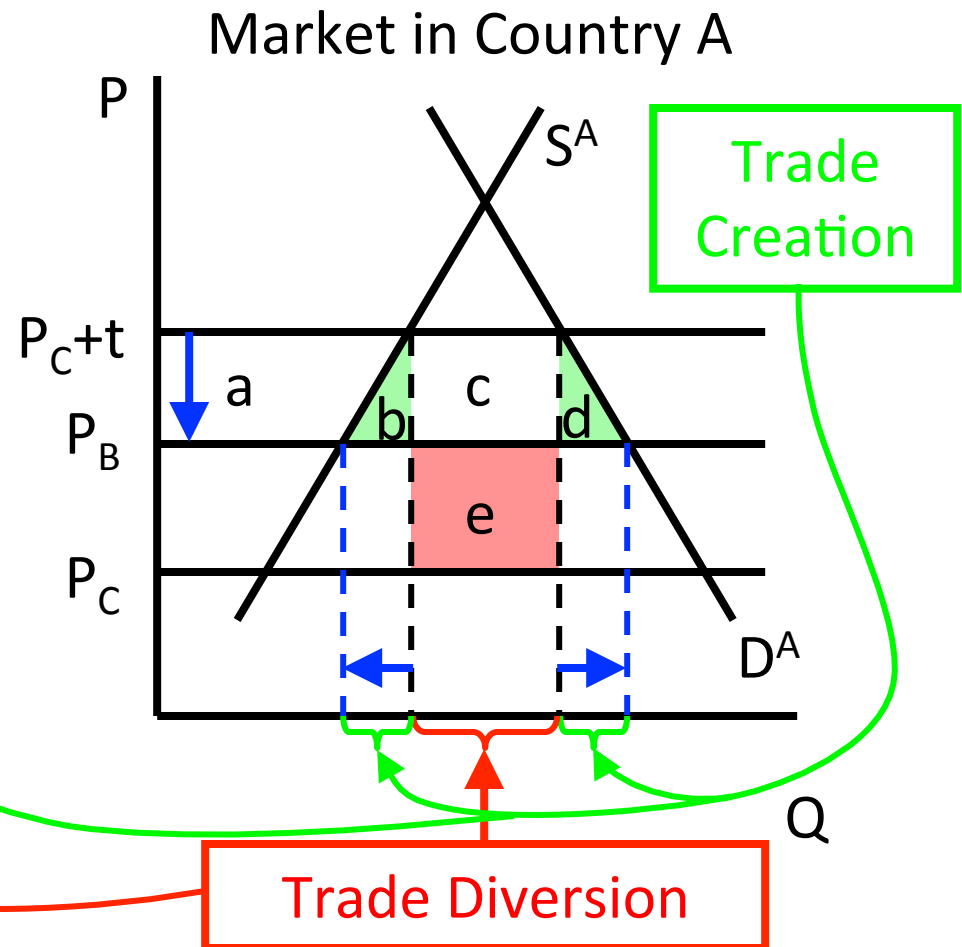
A imports from B



Effects of FTAs

FTA of Country A
and Country B:

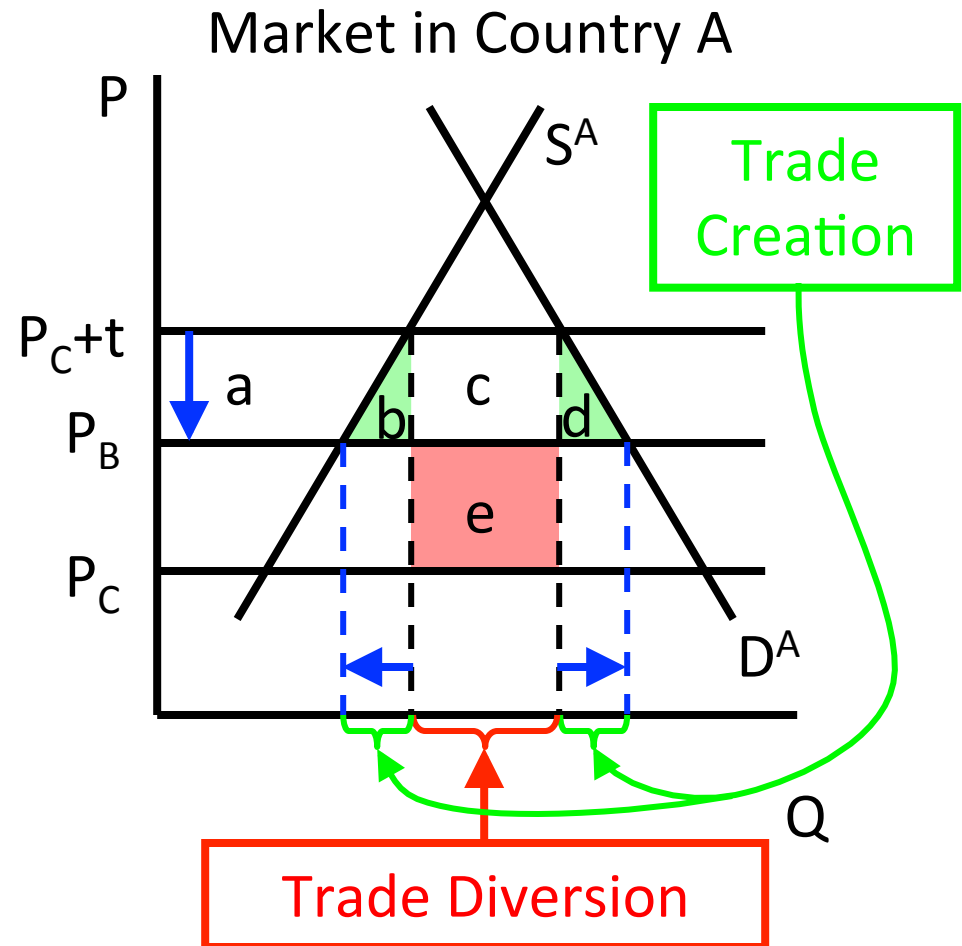
Welfare effects	
Producers lose	-a
Consumers gain	+(a+b+c+d)
Gov't loses	-(c+e)
<hr/>	
Net	+(b+d)-e



Effects of FTAs

FTA of Country A
and Country B:

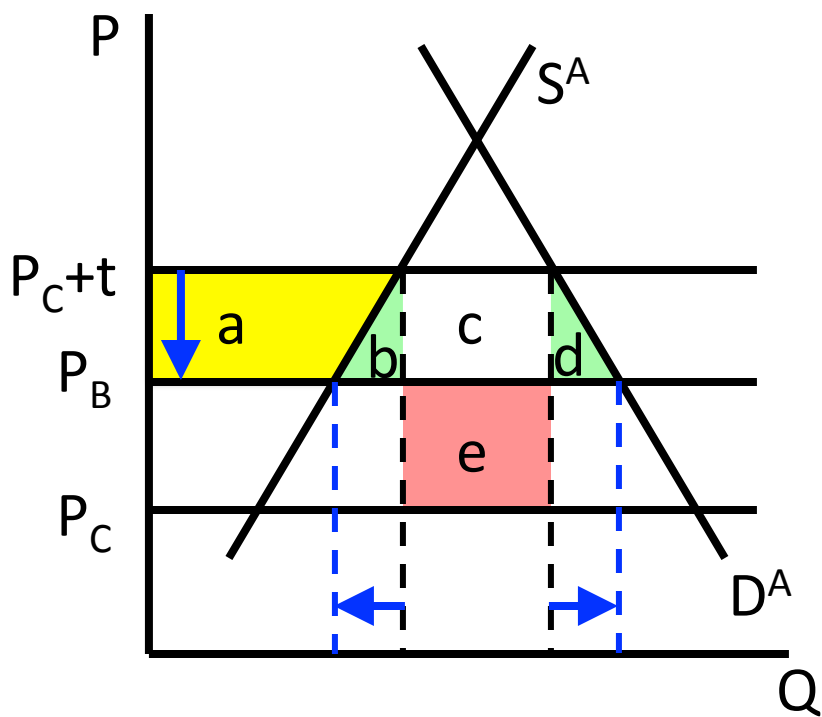
Implication:
Country A can lose from the
FTA in this market, if
 $e > (b+d)$
(as it is in this picture)



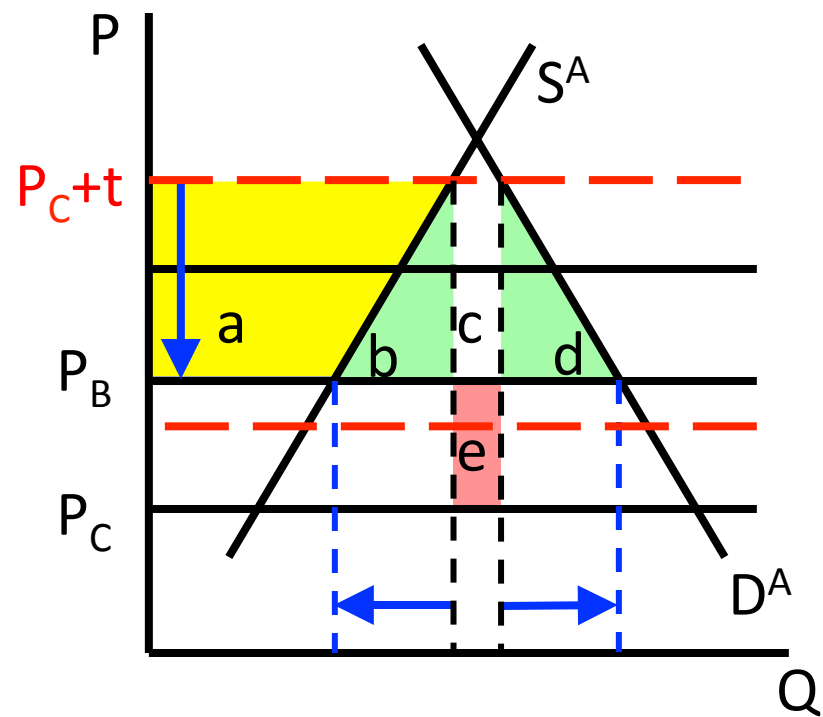
Effects of FTAs

- Sensitive sectors
 - Area a is
 - The loss to producers
 - Part of the gain to consumers
 - The main reason why a sector would lobby to be named “sensitive” and excluded from the tariff cut on country B
 - See how it, and the gains and losses from PTA, varies with changing costs:

Market in Country A

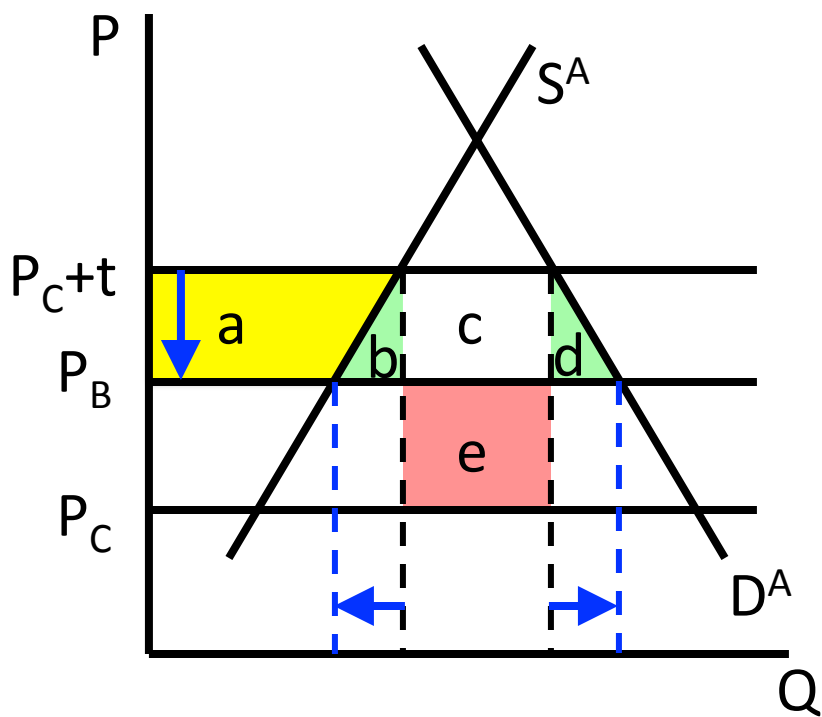


Higher P_C

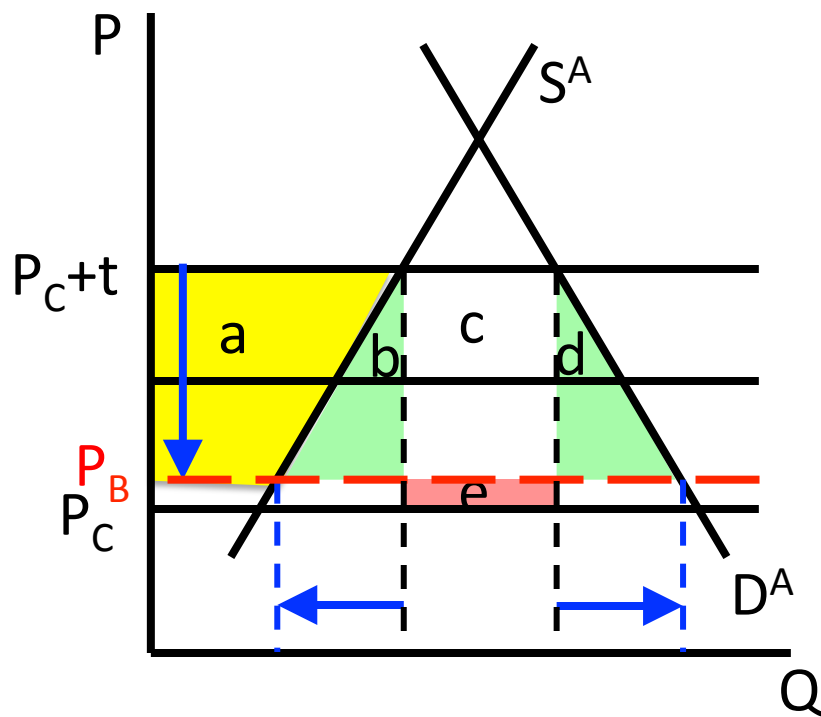


Higher price in outside country C (but still lower than price in partner, B):
 Increases Sensitivity, increases trade creation, reduces trade diversion.

Market in Country A



Lower P_B



Lower price in inside country B (but still higher than price in outside, C:
Increases Sensitivity, increases trade creation, reduces trade diversion.

Effects of FTAs

- Sensitive sectors
 - Thus the sectors that are most likely to claim that they are “sensitive” due to large losses from the PTA are also the ones that would have
 - The greatest gain from trade creation
 - The smallest loss from trade diversion
 - My fear is that if proliferating FTAs allow too many sensitive sectors, the gains will be squeezed out leaving only the losses.

Pros and Cons of all FTAs

- Other aspects of actual FTAs
 - Pros:
 - Extension to trade in services
 - Harmonization of regulations
 - Cons (?):
 - Extension of IP protection
 - Trade enforcement of labor standards
 - Trade enforcement of environmental standards
 - Investor-State Dispute Settlement

Additional Pros and Cons of Mega-FTAs

- Preferential tariff cuts
 - Pros:
 - Larger potential for trade creation
 - If ROOs are cumulative, less distorting
 - Potential for adding members
 - Replace multiple rules with a single set
 - Cons:
 - Though there are fewer outsiders, each is harmed more by trade diversion
 - In fact (in TPP) there is more complexity

Additional Pros and Cons of Mega-FTAs

- Other aspects of actual Mega-FTAs
 - Pros:
 - May contribute to broader and more uniform standards
 - Cons:
 - Their use as weapons of geopolitics

Implications of Mega-FTAs for the WTO

- Might have created pressure to complete Doha Round.
 - Possible, just as NAFTA motivated Uruguay Round
 - Didn't happen; Round is dead.

Implications of Mega-FTAs for the WTO

- By lowering trade barriers regionally, Mega-FTAs will
 - Hasten the decline of uncompetitive industries,
 - Thus gradually reduce political forces for protection
 - This may reduce the need to use WTO-sanctioned administrative protection (anti-dumping, etc.)

Implications of Mega-FTAs for the WTO

- Trade disputes will have alternative fora in which to be settled: Choice between WTO panels and FTA panels
 - This may lessen the role of the WTO Dispute Settlement Mechanism
 - But it will remain relevant

Implications of Mega-FTAs for the WTO

- WTO will continue to be important for plurilateral negotiations on issues that transcend the Mega-FTAs
- Some issues that lend themselves neither to plurilateral agreements nor to Mega-FTAs will remain unresolved
 - Most important: Subsidies

Implications of Mega-FTAs for China

- China must decide which Mega-FTAs
 - To join (TPP)
 - To create (RCEP)
 - To push for (FTAAP = Free Trade Area of Asia and the Pacific)
- Will China seek to use FTAs to
 - Wall itself off from other major countries?
 - Or join in economic integration with other major countries?

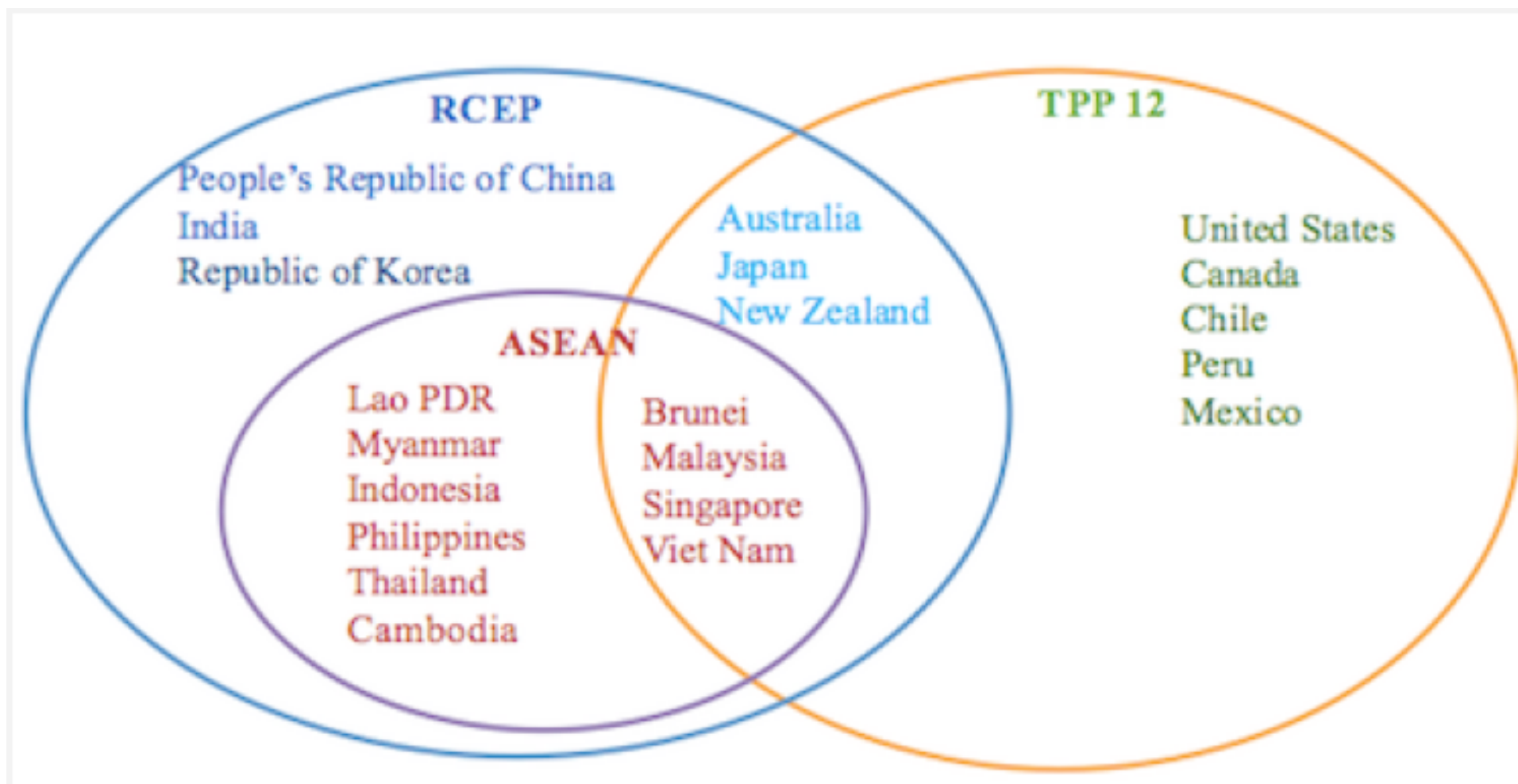


Figure 1: ASEAN, RCEP, and TPP member states

RCEP

TPP



India



Indonesia



Malaysia



Vietnam



Cambodia



Lao



Brunei



Singapore



Australia



Thailand



Philippines



New Zealand



Myanmar



Canada



USA



Mexico



Chile

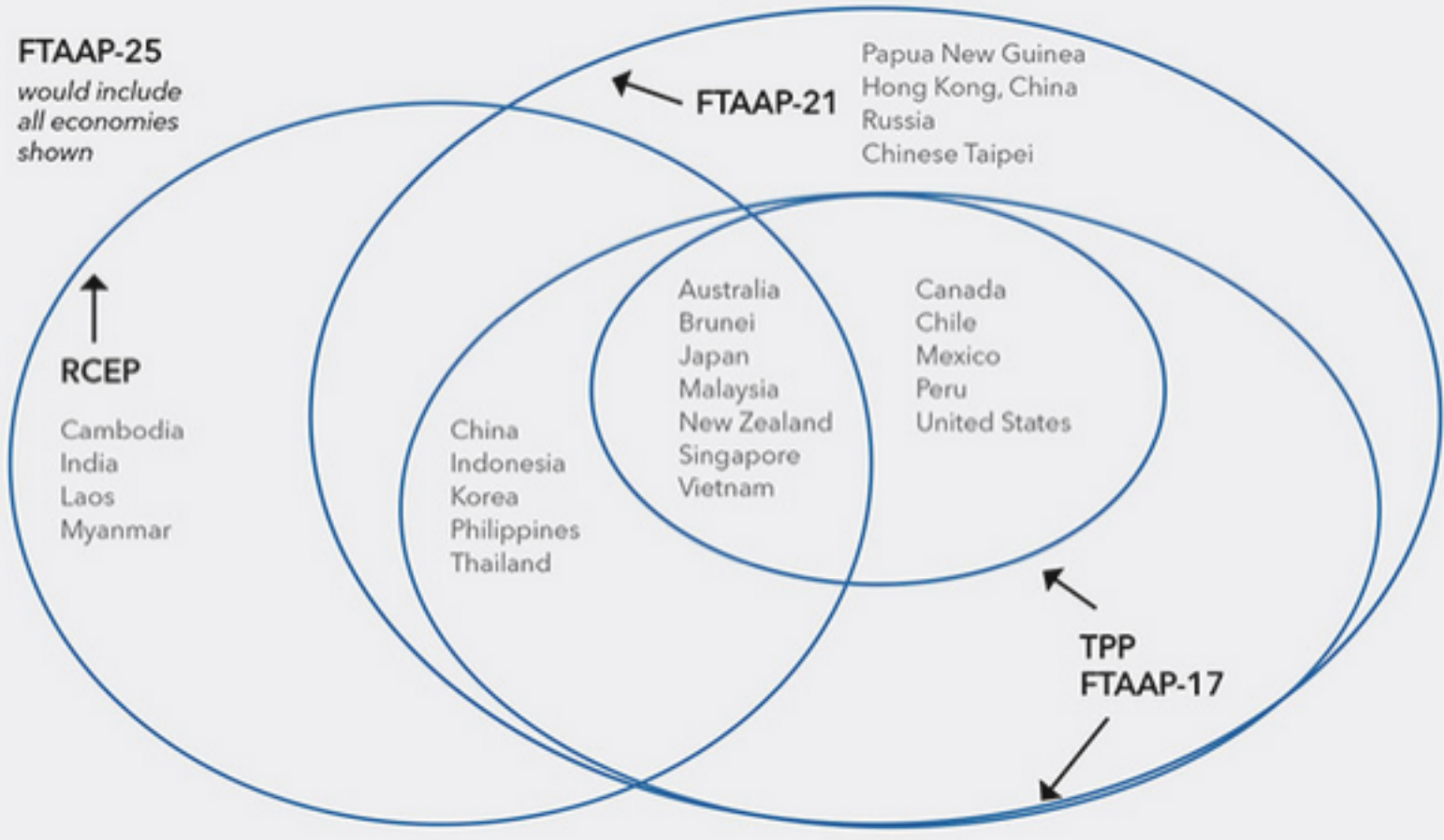


Peru



Taiwan

Figure 2.3: Membership of possible Asia-Pacific trade agreements



Implications of Mega-FTAs for China: TPP

- If China does not join TPP
 - Will suffer from trade diversion in countries without China FTAs
 - US, Japan
 - Others
 - Will suffer from trade diversion due to ROOs even in countries with China FTAs
 - Chile, Peru, members of ASEAN

Implications of Mega-FTAs for China: TPP

- If China does not join TPP
 - Will not be subject to non-trade requirements of TPP
 - State owned enterprises
 - Labor Standards
 - Environment
 - May not need to open trade as much as TPP requires

Implications of Mega-FTAs for China: RCEP

- If RCEP, including China, succeeds
 - Minimal trade creation/diversion, since China already has FTAs with ASEAN and some other RCEP members
 - S Korea
 - New Zealand
 - Largest effect will be FTA with Japan
 - Some trade creation
 - Reversal of prior trade diversion from Japan's other FTAs, including TPP.

Implications of Mega-FTAs for China: RCEP

- If RCEP, including China, succeeds
 - If it cumulates rules of origin, RCEP will reduce trade and investment diversion due to ROOs.
- Though initiated by ASEAN, RCEP will be viewed as a political triumph of China in building a China-centered economic bloc.