15.15: Trade Policy- Organizations and Agreements

Learning Objectives

- Explain the origin and role of the World Trade Organization (WTO)
- Discuss the significance and provide examples of regional trading agreements
- Analyze trade policy and evaluate long-term trends in barriers to trade

How Trade Policy Is Enacted: Globally, Regionally, and Nationally

Nations participate in global and regional trade agreements. They also develop their own national trade policies. The purpose of these agreements is to define what constitutes fair trading practices in different contexts.

The World Trade Organization

The **World Trade Organization (WTO)** was established in 1995, as the successor to the General Agreement on Tariffs and Trade (GATT), which was discussed in the last section. The WTO is committed to lowering barriers to trade. The world's nations meet through the WTO to negotiate how they can reduce barriers to trade, such as tariffs. WTO negotiations happen in "rounds," where all countries negotiate one agreement to encourage trade, take a year or two off, and then start negotiating a new agreement. The current round of negotiations is called the Doha Round because it was officially launched in Doha, the capital city of Qatar, in November 2001. In 2009, economists from the World Bank summarized recent research and found that the Doha round of negotiations would increase the size of the world economy by $160 billion to $385 billion per year, depending on the precise deal that ended up being negotiated.

In the context of a global economy that currently produces more than $30 trillion of goods and services each year, this amount is not huge: it is an increase of 1% or less. But before dismissing the gains from trade too quickly, it is worth remembering two points.

- First, a gain of a few hundred billion dollars is enough money to deserve attention! Moreover, remember that this increase is not a one-time event; it would persist each year into the future.
- Second, the estimate of gains may be on the low side because some of the gains from trade are not measured especially well in economic statistics. For example, it is difficult to measure the potential advantages to consumers of having a variety of products available and a greater degree of competition among producers. Perhaps the most important unmeasured factor is that trade between countries, especially when firms are splitting up the value chain of production, often involves a transfer of knowledge that can involve skills in production, technology, management, finance, and law.

Low-income countries benefit more from trade than high-income countries do. In some ways, the giant U.S. economy has less need for international trade, because it can already take advantage of internal trade within its economy. However, many smaller national economies around the world, in regions like Latin America, Africa, the Middle East, and Asia, have much more limited possibilities for trade inside their countries or their immediate regions. Without international trade, they may have little ability to benefit from comparative advantage, slicing up the value chain, or economies of scale. Moreover, smaller economies often have fewer competitive firms making goods within their economy, and thus firms have less pressure from other firms to provide the goods and prices that consumers want.

The economic gains from expanding international trade are measured in hundreds of billions of dollars, and the gains from international trade as a whole probably reach well into the trillions of dollars. The potential for gains from trade may be especially high among the smaller and lower-income countries of the world.

Like the GATT before it, the WTO is not a world government, with power to impose its decisions on others. The total staff of the WTO in 2013 is 629 people and its annual budget (as of 2012) is $196 million, which makes it smaller in size than many large universities.

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Regional Trading Agreements

There are different types of economic integration across the globe, ranging from **free trade agreements**, in which participants allow each other's imports without tariffs or quotas, to **common markets**, in which participants have a common external trade policy as well as free trade within the group, to full **economic unions**, in which, in addition to a common market, monetary and fiscal policies are coordinated. Many nations belong both to the World Trade Organization and to regional trading agreements.

The best known of these regional trading agreements is the **European Union**. In the years after World War II, leaders of several European nations reasoned that if they could tie their economies together more closely, they might be more likely to avoid another devastating war. Their efforts began with a free trade association, evolved into a common market, and then transformed into what is nearly a full economic union, known as the European Union. (The EU, as it is often called, has not included a common fiscal policy.) The EU has a number of goals. For example, in the early 2000s it introduced a common currency for Europe, the euro, and phased out most of the former national forms of money like the German mark and the French franc, though a few have retained their own currency. Another key element of the union is to eliminate barriers to the mobility of goods, labor, and capital across Europe.

For the United States, perhaps the best-known regional trading agreement is the **North American Free Trade Agreement (NAFTA)**. The United States also participates in some less-prominent regional trading agreements, like the Caribbean Basin Initiative, which offers reduced tariffs for imports from these countries, and a free trade agreement with Israel.

The world has seen a flood of regional trading agreements in recent years. About 100 such agreements are now in place. A few of the more prominent ones are listed in Table 2. Some are just agreements to continue talking; others set specific goals for reducing tariffs, import quotas, and nontariff barriers. One economist described the current trade treaties as a "spaghetti bowl," which is what a map with lines connecting all the countries with trade treaties looks like.

There is concern among economists who favor free trade that some of these regional agreements may promise free trade, but actually act as a way for the countries within the regional agreement to try to limit trade from anywhere else. In some cases, the regional trade agreements may even conflict with the broader agreements of the World Trade Organization.

Table 2. Some Regional Trade Agreements

Trade Agreements	Participating Countries
Asia Pacific Economic Cooperation (APEC)	Australia, Brunei, Canada, Chile, People's Republic of China, Hong Kong, China, Indonesia, Japan, Republic of Korea, Malaysia, Mexico, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Chinese Taipei, Thailand, United States, Vietnam
European Union (EU)	Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom
North America Free Trade Agreement (NAFTA)	Canada, Mexico, United States
Latin American Integration Association (LAIA)	Argentina, Bolivia, Brazil, Chile, Columbia, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela
Association of Southeast Asian Nations (ASEAN)	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
Southern African Development Community (SADC)	Angola, Botswana, Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe

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National Trade Policies

Yet another dimension of trade policy, along with international and regional trade agreements, happens at the national level. Ideally, these policies do not conflict with the rules of the WTO and regional trade agreements. When there is an apparent conflict, the parent organization must adjudicate it. The United States, for example, imposes import quotas on sugar, because of a fear that such imports would drive down the price of sugar and thus injure domestic sugar producers. Why is sugar favored, while other products are not? Sometimes a product is protected because of historical practice. Sometimes it's because a product has a particularly strong lobby. Recall, though, that trade barriers always end up costing a nation more than the benefits received by the protected group.

One of the jobs of the United States Department of Commerce is to determine if imports from other countries are being traded fairly. A common complaint is dumping, which means that foreign imports are being sold at less than their fair market value, i.e. their cost. The Commerce Department estimates a dumping "margin," that is, the difference between price and cost. If Commerce determines that the import price is less than cost, they find that dumping has occurred. The United States International Trade Commission—another government agency—determines whether domestic industries have been substantially injured by the dumping, and if so, the President can impose tariffs in the amount of the dumping margin to offset the unfairly low price.

In the arena of trade policy, the battle often seems to be between national laws that increase protectionism and international agreements that try to reduce protectionism, like the WTO. Why would a country pass laws or negotiate agreements to shut out certain foreign products, like sugar or textiles, while simultaneously negotiating to reduce trade barriers in general? One plausible answer is that international trade agreements offer a method for countries to restrain their own special interests. A member of Congress can say to an industry lobbying for tariffs or quotas on imports: "Sure would like to help you, but that pesky WTO agreement just won't let me."

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This video provides more information about trade blocs and the ways in which nations make arrangements regarding trade.

A link to an interactive elements can be found at the bottom of this page.

Watch this next video for a recent news example of an actual trade agreement between the United States and South Korea.

A link to an interactive elements can be found at the bottom of this page.

Long-Term Trends in Barriers to Trade

In newspaper headlines, trade policy appears mostly as disputes and acrimony. Countries are almost constantly threatening to challenge the "unfair" trading practices of other nations. Cases are brought to the dispute settlement procedures of the WTO, the European Union, NAFTA, and other regional trading agreements. Politicians in national legislatures, goaded on by lobbyists, often threaten to pass bills that will "establish a fair playing field" or "prevent unfair trade"—although most such bills seek to accomplish these high-sounding goals by placing more restrictions on trade. Protesters in the streets may object to specific trade rules or to the entire practice of international trade.

Through all the controversy, the general trend for most of the last 60 years is clearly toward lower barriers to trade. The average level of tariffs on imported products charged by industrialized countries was 40% in 1946. By 1990, after decades of GATT negotiations, it was down to less than 5%. Indeed, one of the reasons that GATT negotiations shifted from focusing on tariff reduction in the early rounds to a broader agenda was that tariffs had been reduced so dramatically there was not much more to do in that area. U.S. tariffs have followed this general pattern: After rising sharply during the Great Depression, tariffs dropped off to less than 2% by the end of the century. Although measures of import quotas and nontariff barriers are less exact than those for tariffs, they generally appear to be at lower levels, too.

Thus, the last half-century has seen both a dramatic reduction in government-created barriers to trade, such as tariffs, import quotas, and nontariff barriers, and also a number of technological developments that have made international trade easier, like advances in transportation, communication, and information management. The result has been the powerful surge of international trade.

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Learning Objectives

[glossary-page][glossary-term]common market: [/glossary-term]
[glossary-definition]economic agreement between countries to allow free trade in goods, services, labor, and financial capital between members while having a common external trade policy[/glossary-definition]
[glossary-term]dumping: [/glossary-term][glossary-definition]selling imports at a price below fair market value, i.e. cost[/glossary-definition][glossary-term]economic union: [/glossary-term]
[glossary-definition]economic agreement between countries to allow free trade between members, a common external trade policy, and coordinated monetary and fiscal policies[/glossary-definition][glossary-term]free trade agreement:[/glossary-term]
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