Rose-Hulman Institute of Technology
K. Christ
GL458, International Trade & Globalization

Selected Week 9 Slides
Developing Nations’ Concerns

- Question whether gains from trade with industrial countries have been fairly distributed

- Face problems of unstable export markets
  - Concentration on one or a few primary-product exports combined with inelastic supply and demand conditions

- Argue that they face worsening terms of trade as relative value of primary products has fallen compared to manufactured goods they import

- Face limited market access for exports because of protectionism
  - Especially for agricultural and labor-intensive goods
Political Economy of Trade Policy

The “Washington Consensus”

- Fiscal discipline / austerity
- Tax reform (to lower marginal rates and broaden the tax base)
- Trade liberalization
- Liberalization of inflows of foreign direct investment
- Privatization
- Deregulation
- Primacy of property rights

Joseph Stiglitz, Globalization and Its Discontents (2003), offers a stinging criticism of the Washington Consensus in particular, and of how globalization has been managed in general.
Political Economy of Trade Policy

The “Washington Consensus”

Those who adopted it seem to have reaped very small benefits:

Notes: Regional GDP per capita. Asia includes Indonesia, Korea, Malaysia, Philippines and Thailand.
Import substitution: pros

- Risk of establishing home import-replacing industry is low because home market already exists

- Easier for developing nations to protect their own markets than to force industrial nations to open theirs

- Gives foreign firms an incentive to locate production in developing country, providing jobs
Import substitution: cons

• Trade restrictions shelter home industry from competition, giving no incentive for efficiency

• Small size of most developing country markets makes it difficult to benefit from economies of scale

• Protection of import-competing industries draws resources away from all other sectors, including potential exporters
Export-led growth: pros

• Encourages industries in which developing countries are likely to have a comparative advantage - such as labor-intensive manufactures

• Export markets allow domestic producers to utilize economies of scale

• Low level of trade restrictions forces domestic firms to remain competitive
Export-led growth: cons

- Main disadvantage to export-led growth is that it depends on the ability and willingness of industrial nations to absorb large quantities of manufactures from developing countries.
- In other words, it is sensitive to economic cycles and protectionist pressures in the export markets.
Preferential Trading Agreements …

Free Trade Agreements, Customs Unions

Free Trade Areas
A free trade agreement (or free trade area, FTA) is a formal arrangement or treaty between or among two or more countries that eliminates tariffs, quotas and preferences on most (if not all) goods and services traded between/among them.

Usually, members of an FTA do not maintain common trade policies to trading partners outside of the FTA.

Examples: NAFTA (U.S., Canada, Mexico).
MERCOSUR (Argentina, Paraguay, Uruguay, Brazil, Venezuela).
ALBA (Cuba, Nicaragua, Venezuela, Brazil, Argentina, Bolivia, Ecuador).

Customs Unions
Within a customs union, member countries maintain the same trade policies to non-member countries.

Example: European Union (EU)
### NAFTA Timeline

**November 13, 1979**
While declaring his candidacy for President, Ronald Reagan proposes a “North American Agreement” which will produce “a North American continent in which the goods and people of the three countries will cross boundaries more freely.”

**January 1981**
President Reagan proposes a North American common market.

**October 9, 1984**
The US Congress adopts the Trade and Tariff Act, an omnibus trade act that notably extends the powers of the president to concede trade benefits and enter into bilateral free trade agreements.

**January 2, 1988**
Prime Minister Mulroney and President Reagan sign the Canada – U.S. FTA.

**June 10, 1990**
Presidents George H. W. Bush and Carlos Salinas de Gortari announce that they will begin discussions aimed at liberalizing trade between the U.S. and Mexico.

**June 12, 1991**
Start of trade negotiations between Canada, the US and Mexico.

**August 12, 1992**
Signing of an agreement in principle on NAFTA.

**Fall 1992**
U.S. presidential election, won by Bill Clinton. The campaign was memorable for debates between Clinton, incumbent George H. W. Bush, and third-party candidate Ross Perot, who coined the phrase “giant sucking sound” to describe what he believed would be U.S. job losses to Mexico as a result of NAFTA.

**December 17, 1992**
Official signing of NAFTA by Canadian Prime Minister Brian Mulroney, U.S. president George Bush, and Mexican president Carlos Salinas de Gortari, subject to its final approval by the federal Parliaments of the three countries.

The “Spaghetti Bowl” of International Trade Policy

Trade Creation or Trade Diversion?

Fig. 5. The African spaghetti bowl; prepared by Arvind Panagariya, University of Maryland.

Legend:
- CBI: Cross Border Initiative
- COMESA: Common Market for Eastern and Southern Africa
- EAC: Commision for East African Co-operation
- SADC: Southern African Development Community
- SACU: Southern African Customs Union
Life is more complex than that. Assuming one could describe globalization as "good" or "bad" – ascribing a moral dimension, intentions and designs to it when in fact it has nothing but objects – we can nevertheless say that there are good ways and bad ways to make use of globalization. Good, if what is shared, what moves about and shapes our consciousness is information, knowledge, progress, understanding of others, the sharing of values and wealth alike. Bad, on the contrary, if it spells uniformity, reduction to a pre-established format or the lowest common denominator, or again, if it means the primacy of the laws of the marketplace, neglectful of that humanist culture which, by its very essence, unites us around certain ethical principles.

The response to globalization as cultural steamroller is cultural diversity. A diversity based on the conviction that each people has its own special message to deliver to the world, that each people can enrich humanity through its own singular truth and beauty.

M. Jacques Chirac, president of the France, in a speech at the United Nations, October 15, 2001
The Environmental Kuznets Curve

Pollution vs. Per Capita Income

- China
- U.S., Western Europe
### Common justifications for rejection of free trade / adoption of protection

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<td>• Industries that are just getting started (the <em>infant industry</em> argument)</td>
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<td>• Industries that are subject to unfair competition (<em>anti-dumping</em> measures)</td>
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<td>Promotion of positive externalities</td>
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<td>Attainment of a strategic advantage / capture a market [Rent capture in international markets]</td>
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