

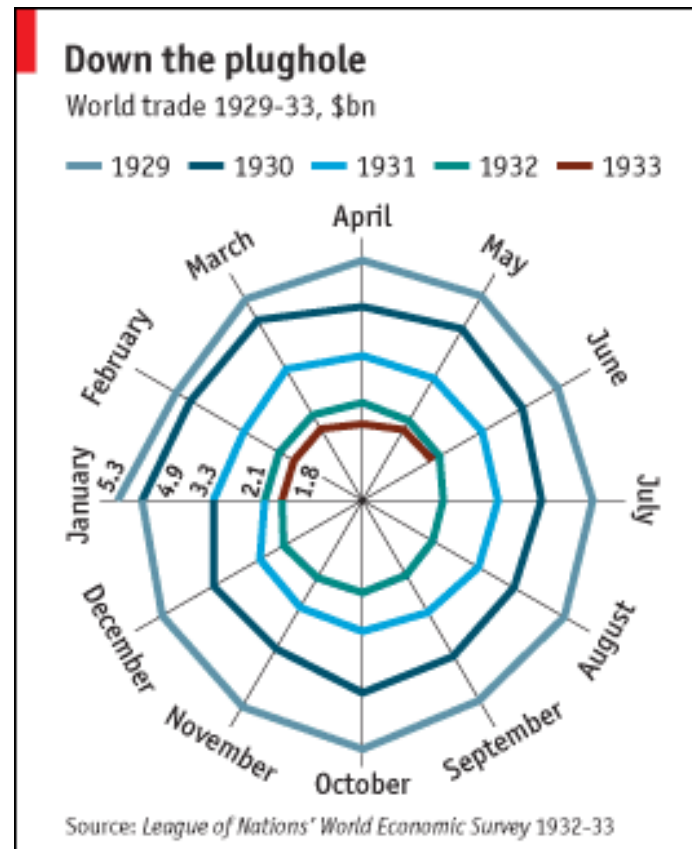


# Trade Talks and Trade Wars: How High are the Gains and the Costs?

Prof. Ralph Ossa

University of Zurich, Department of Economics

## Will history repeat itself?



Source: *The Economist*



## Today's presentation

### Background:

- Why are there gains from trade?
- How large are the gains?

### Main questions:

- Why are there trade wars and trade talks?
- How large are the losses and gains?

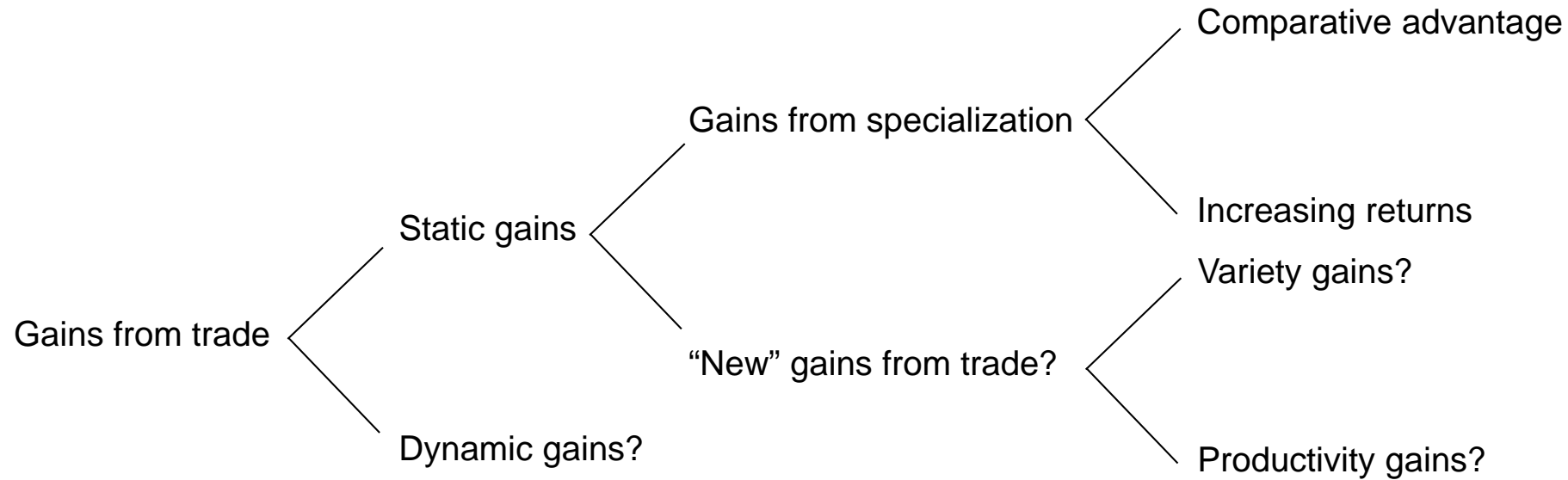
### Controversies:

- What are the effects of unconventional trade policies?
- How should we think about distributional effects?

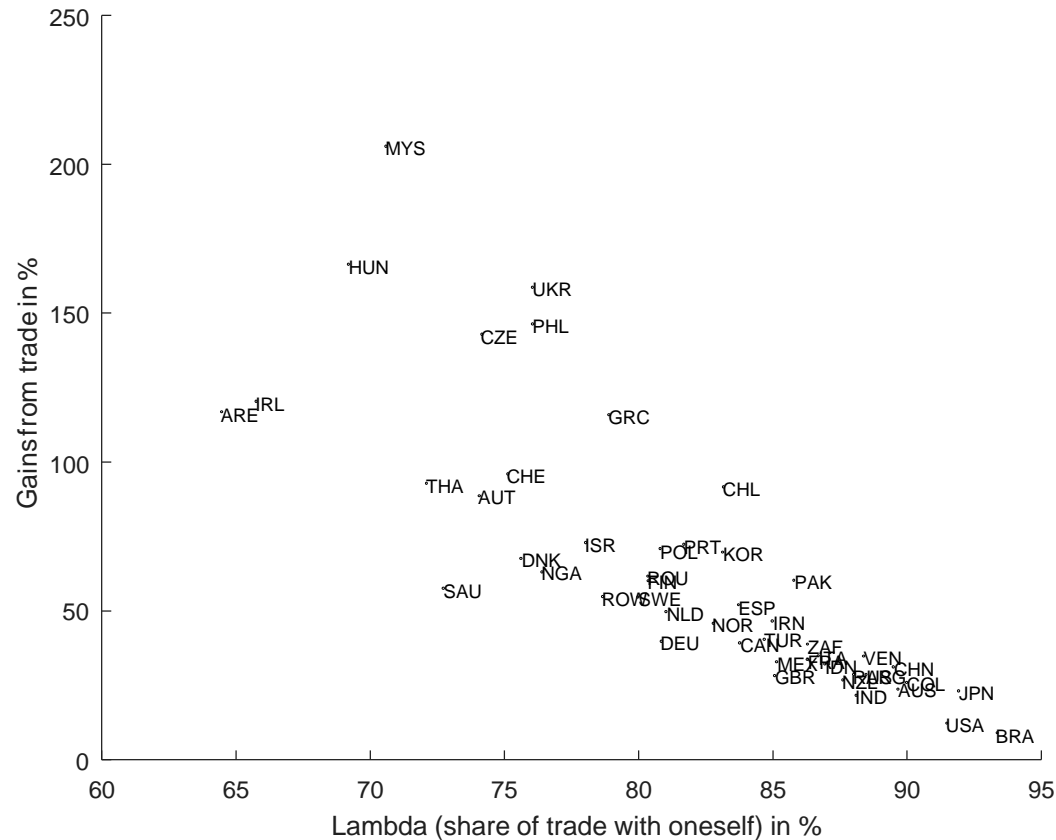


## Gains from Trade

## Sources of gains from trade



## Magnitude of the gains from trade



In total, around 1/4 of world GDP



On average, around 1/3 of country GDP



On average, a 1% increase in IMP/GDP increases real income by around 0.5%

Source: Ossa, R. 2015. *Why Trade Matters After All*. *Journal of International Economics*.

## Earlier evidence from regression analyses

TABLE 3—TRADE AND INCOME

	(1)	(2)	(3)	(4)
Estimation	OLS	IV	OLS	IV
Constant	7.40 (0.66)	4.96 (2.20)	6.95 (1.12)	1.62 (3.85)
Trade share	0.85 (0.25)	1.97 (0.99)	0.82 (0.32)	2.96 (1.49)
Ln population	0.12 (0.06)	0.19 (0.09)	0.21 (0.10)	0.35 (0.15)
Ln area	-0.01 (0.06)	0.09 (0.10)	-0.05 (0.08)	0.20 (0.19)
Sample size	150	150	98	98
$R^2$	0.09	0.09	0.11	0.09
SE of regression	1.00	1.06	1.04	1.27
First-stage $F$ on excluded instrument		13.13		8.45



The magnitudes are quite similar to the ones identified in earlier cross-country studies

*Notes:* The dependent variable is log income per person in 1985. The 150-country sample includes all countries for which the data are available; the 98-country sample includes only the countries considered by Mankiw et al. (1992). Standard errors are in parentheses.

*Source:* Frankel, J. and D. Romer. 1999. Does Trade Cause Growth? *American Economic Review*.



## Summary

- There are large static gains from trade
- They mainly capture gains from specialization
- We don't know much about the magnitude of dynamic gains





## Trade Wars and Trade Talks

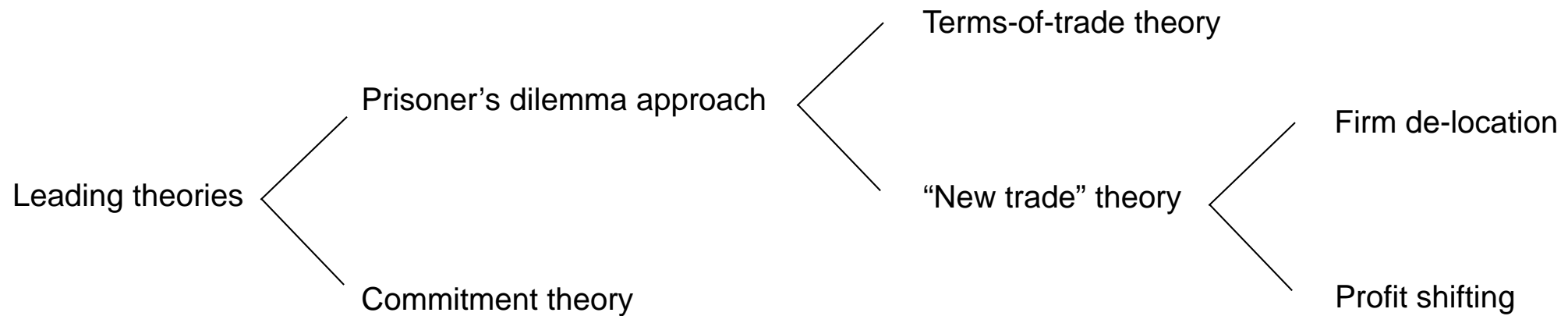
## What do trade negotiators negotiate about?

Paul Krugman famously argued that trade negotiations make no economic sense:

- *“If economists ruled the world, there would be no need for a World Trade Organization. The economist's case for free trade is essentially a unilateral case - that is, it says that a country serves its own interests by pursuing free trade regardless of what other countries may do.”*
- *“To make sense of international trade negotiations, one needs to remember three simple rules about the objectives of negotiating countries:*
  - 1) *Exports are good.*
  - 2) *Imports are bad.*
  - 3) *Other things equal, an equal increase in imports and exports is good.*

*In other words, GATT-think is enlightened mercantilism.”*

## Theories of trade wars and trade talks



## How costly would be a trade war?

Trade war vs. autarky			
	Δ Welfare		Tariff
	Nash	Autarky	Nash
<b>Brazil</b>	-1.9%	-9.9%	56.4%
<b>China</b>	-2.2%	-12.9%	58.6%
<b>EU</b>	-2.6%	-12.3%	59.1%
<b>India</b>	-2.2%	-10.8%	54.5%
<b>Japan</b>	-0.8%	-13.0%	58.5%
<b>RoW</b>	-5.0%	-20.8%	59.7%
<b>US</b>	-2.2%	-13.5%	59.6%
<b>Mean</b>	-2.4%	-13.3%	58.1%

- ➔ Almost 1/4 of the gains from trade
- ➔ \$340 billion in stylized example
- ➔ Extrapolation 1: \$542 billion
- ➔ Extrapolation 2: \$2.736 trillion

Source: Ossa, R. 2014. Trade Wars and Trade Talks with Data. American Economic Review.

## How beneficial would be further trade talks?

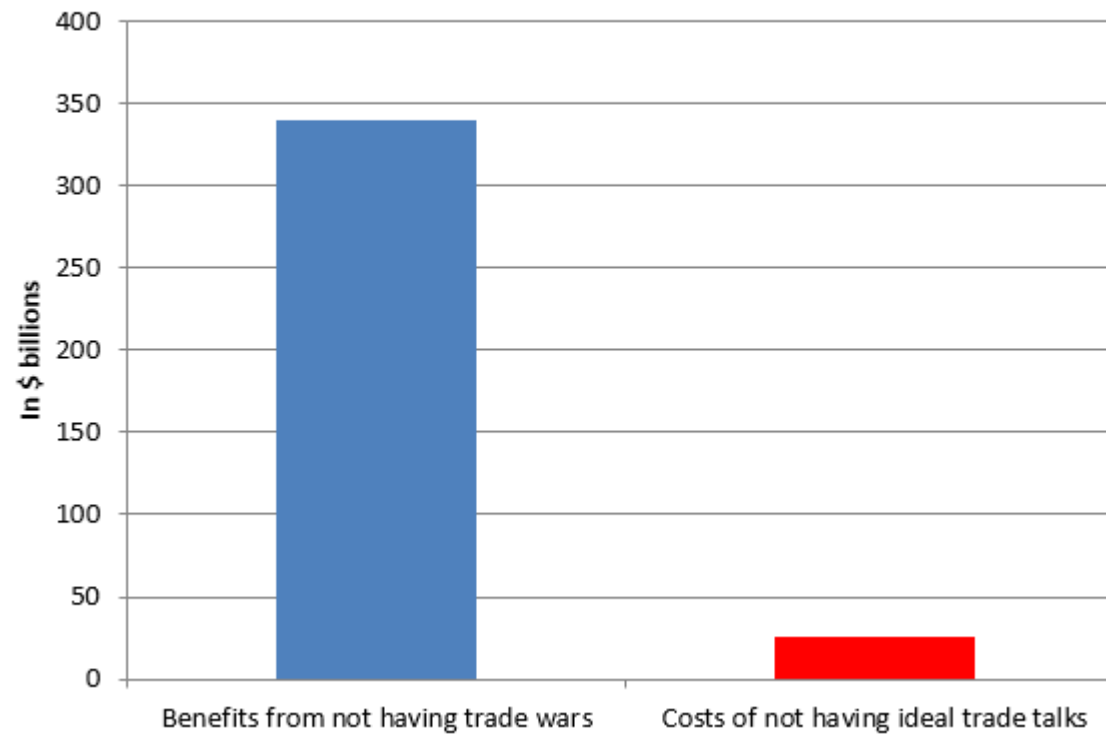
Trade talks			
	Δ Welfare		
	Factual	Nash	Free
Brazil	0.5%	3.4%	0.03%
China	0.5%	3.4%	0.03%
EU	0.5%	3.4%	0.03%
India	0.5%	3.4%	0.03%
Japan	0.5%	3.4%	0.03%
RoW	0.5%	3.4%	0.03%
US	0.5%	3.4%	0.03%
Mean	0.5%	3.4%	0.03%

- ➔ 85% of possible gains have been realized
- ➔ Additional \$26 billion in stylized example
- ➔ Extrapolation 1: \$41 billion
- ➔ Extrapolation 2: \$209 billion

Source: Ossa, R. 2014. Trade Wars and Trade Talks with Data. American Economic Review.

## Summary

**Figure 1.** Successes and failures of the WTO



Source: Ossa, R. 2015. *WTO success: No trade agreement but no trade war*. VOX.



# Controversies



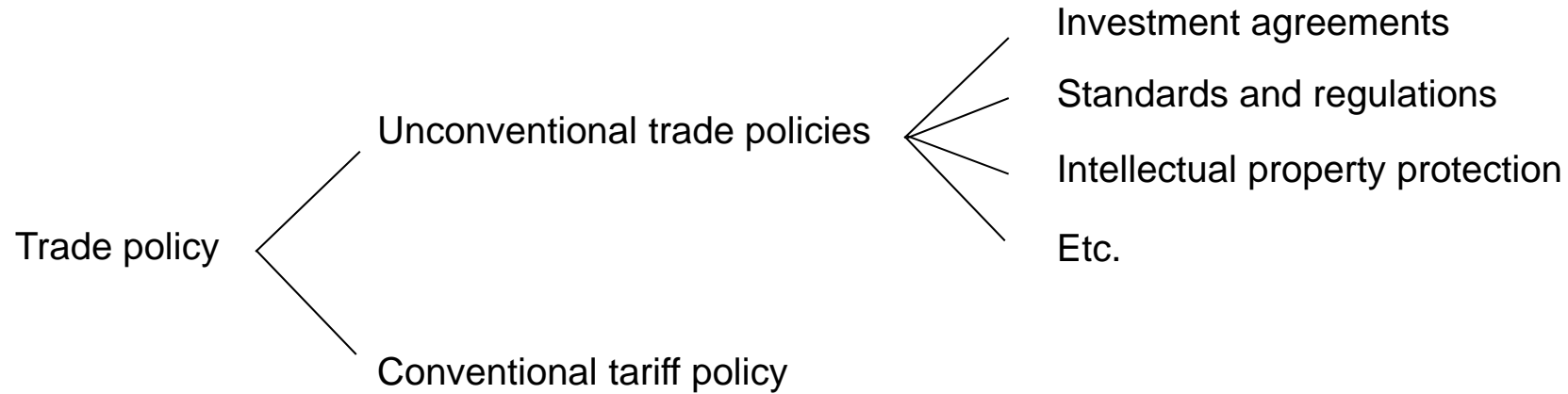
## Why have trade agreements become so controversial?

- There is a revival of classic protectionism which blames foreign trade (and immigration) for domestic problems
- But there are also reasonable concerns about complex unconventional trade policies which go beyond simple tariff policy
- Moreover, it has become clear that trade has economically significant effects on inequality, especially trade with China





## Unconventional trade policies





## Investment agreements

- There are currently around 3,000 BITs and 300 TIPs, with TIPs (such as NAFTA, CETA, TTIP, and TPP) becoming increasingly popular
- Most of them guarantee protection from discrimination and expropriation backed up by an ISDS mechanism
- A controversial aspect is that many agreements also cover regulatory expropriation which might undermine national legal systems and bring about regulatory chill
- The academic literature on investment agreements is still in its infancy and cannot be used to reliably endorse or condone them in their current form



## Standards and regulations

- Trade agreements have imposed more and more constraints on domestic regulations from the GATT, to the WTO, to recent RTAs
- There are concerns that this may excessively constrain national sovereignty and bring about a regulatory race to the bottom
- So far, the academic literature has shown that NTBs are large and made a credible case for shallow integration combined with market access commitments
- However, little is known about the potential gains from regulatory cooperation aimed at overcoming coordination externalities



## Intellectual property protection

- While TRIPS was preceded by many IPR agreements, it is the first to be backed by a potent dispute settlement mechanism
- Many argue that it is a bad deal for developing countries since it raises local prices, does not significantly boost global innovation, and inhibits imitation
- However, developing countries now account for around half of global GDP and stronger IPR protection is likely to encourage technology transfers by multinationals
- While there is an active academic literature on trade and IPR protection, it does not yet offer a conclusive verdict on TRIPS



## Trade and inequality

- It is well known from standard trade theory that trade liberalization typically generates winners and losers even though the winners win more than the losers lose
- Such distributional effects have received a lot of attention lately especially because the rapid rise of China had measurable effects in the US
- While I believe that this is a very important discussion, we should not forget that trade is just one of many shocks hitting the economy
- Moreover, the “China shock” was an unprecedented event in economic history which lifted hundreds of millions of people out of poverty



## Summary

- Why are trade agreements controversial despite the large gains from trade and the large losses from trade wars?
- One reason is that they include many unconventional trade policies whose welfare effects are still poorly understood
- Another reason is that trade liberalization tends to increase income inequality within countries as the “China shock” revealed



## Conclusion

- There are large gains from trade: In total, around 1/4 of world GDP; on average, around 1/3 of country GDP
- Overall, the WTO's tariff policy is a success: 85% of the possible gains from tariff negotiations have been reaped in past negotiations
- Modern trade agreements go far beyond tariff policy and more work is needed to reliably assess their welfare effects



**Thank you!**