

Economic Research and the Rationale for Trade Agreements

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December 10, 2018

Focus of this talk

- Question: *According to economic research, what is the problem that a trade agreement might solve?*
- Question (sharpened): *According to economic research, what can governments achieve with a trade agreement that they cannot achieve by setting policies unilaterally?*
- Framing the discussion:
 - Value to governments
 - No-agreement benchmark is unilateral behavior (Nash)
 - Focus on trade agreements over tariffs on goods (market access)
 - Primary emphasis on conceptual foundations
- Two main theoretical approaches:
 - International externalities (Prisoners' Dilemma)
 - Commitment

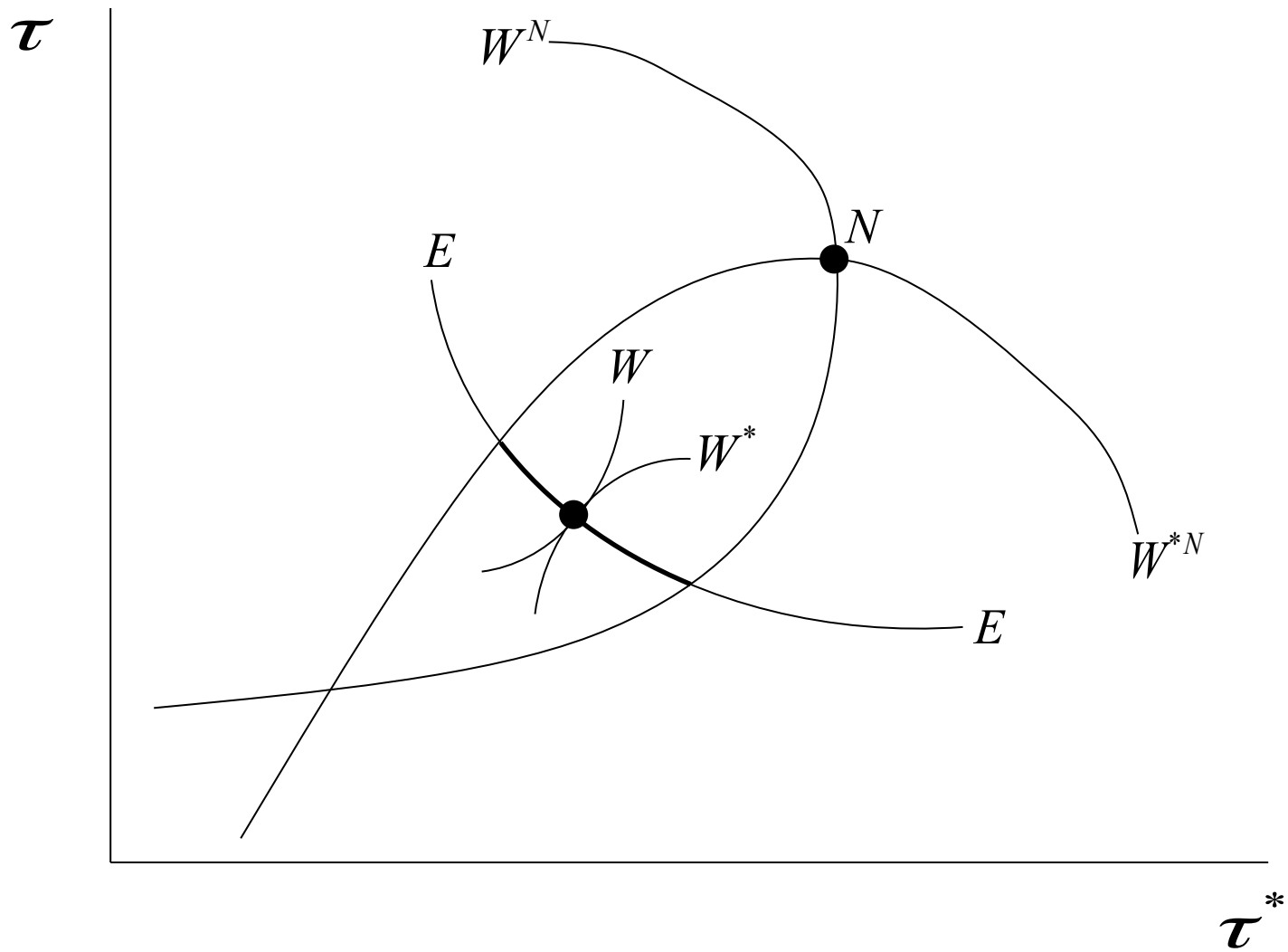
GATT objectives and approach

- GATT objectives as recorded in the GATT Preamble
 - *“...Recognizing that their relations in the field of trade and economic endeavor should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of the resources of the world and expanding the production and exchange of goods...”*
- GATT approach as recorded in the GATT Preamble
 - *“...Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce...”*

Theoretical Approaches

- **International Externality**
 - Terms-of-Trade Theory
 - Profit-Shifting Theory
 - Firm Delocation Theory
 - Trade Policy Uncertainty Theory
 - Offshoring Theory

- **Commitment Theory**



Problem for a trade agreement to solve

Theoretical Approaches

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Summary

- Mutual gains from a trade agreement exist when a problem arises under unilateral policy setting, due to
 - International externalities (terms of trade, profit shifting, firm delocation, trade policy uncertainty, bilateral bargaining)
 - Commitment (time-consistency) problems.
- Together, the theories provide a coherent perspective offering strong support of appropriately designed trade agreements.