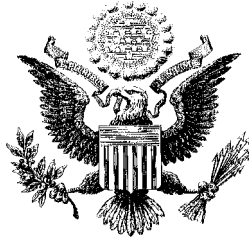


ECONOMIC BENEFITS FROM TRADE PROMOTION AUTHORITY



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Executive Summary

In the *Trade Act of 1974*, Congress sought to create a mechanism that would allow the President to negotiate meaningful reductions in non-tariff barriers while preserving the pre-eminent role of Congress in domestic legislation. This mechanism is called Trade Promotion Authority (TPA). TPA was used to negotiate the Free Trade Agreement with Canada, the North American Free Trade Agreement (NAFTA), and the Uruguay Round Agreements (URA). However, TPA lapsed in 1994 and has not subsequently been renewed.

Since TPA is an authorization to negotiate trade agreements rather than a trade agreement, the economic benefits of TPA are dependent upon what agreements the President may use TPA to negotiate. To overcome this problem, economists must look forward and project possible outcomes of future trade negotiations.

Using a variety of statistical models and data sets, economists have consistently found large GDP gains from international trade liberalization. A survey of relevant empirical studies of possible outcomes suggests that a conservative estimate for the maximum potential benefits from full international trade liberalization under TPA would be a \$750 billion increase in global GDP. Of course, the actual benefits from TPA will depend upon the precise terms of any international trade liberalization agreements negotiated under TPA.

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I. INTRODUCTION

Because tariffs were the primary revenue source for the United States immediately after the Revolutionary War, the Constitution assigned Congress with the primary responsibility for international trade policy under its taxing authority. In contrast, other countries have assigned their president or prime minister with the primary responsibility for international trade policy under his or her foreign affairs authority. The power of Congress to amend freely bills implementing international trade liberalization agreements severely limited the ability of early Presidents to negotiate international trade liberalization agreements. Understandably, the presidents and prime ministers of other countries were unwilling to negotiate international trade liberalization agreements with the U.S. President only to have such agreements rewritten through amendments on the House and Senate floors.

Realizing this problem, Congress enacted the *Reciprocal Trade Agreements Act of 1934*, authorizing President Franklin Roosevelt to negotiate and implement tariff reduction agreements with other countries without additional congressional action. Subsequent Presidents used this authority to negotiate six rounds of multilateral tariff reductions through the General Agreement on Tariffs and Trade (GATT), the predecessor of the World Trade Organization (WTO). As industrial tariffs among developed countries fell, however, non-tariff barriers such as quotas and discriminatory practices took a greater prominence as trade obstacles. Many of these discriminatory practices were deeply imbedded in domestic laws and regulations on subjects that were ostensibly unrelated to trade such as motor vehicle safety, professional licensing, and sanitation.

In the *Trade Act of 1974*, Congress sought to create a mechanism that would allow the President to negotiate meaningful reductions in non-tariff barriers while preserving the pre-eminent role of Congress in domestic legislation. This mechanism is Trade Promotion Authority (TPA), which was formerly known as “fast track.” Under TPA, Congress establishes the parameters for trade negotiations and requires the President to consult regularly with the appropriate committees as negotiations proceed. If an agreement negotiated falls within congressionally established parameters, then the President may submit implementing legislation to Congress for a straight up-or-down vote without amendments.

TPA was used to negotiate the Free Trade Agreement with Canada, the North American Free Trade Agreement (NAFTA), and the Uruguay Round Agreements (URA). However, TPA lapsed in 1994 and has not subsequently been renewed.

II. ECONOMIC BENEFITS

Economists use statistical modeling to estimate the benefits from international trade liberalization agreements. However, TPA is an authorization to negotiate trade agreements

rather than a trade agreement. Therefore, the economic benefits of TPA are more difficult to quantify and dependent upon what agreements the President may use TPA to negotiate.

To overcome this problem, economists may look back to past trade agreements negotiated under TPA. Alternatively, economists may look forward and project possible outcomes of future trade negotiations. This study focuses on the latter approach, looking at both partial and full trade liberalization scenarios. Some of these studies analyze the static gains from international trade liberalization (*i.e.*, assuming that the gains from trade liberalization come entirely from eliminating static inefficiencies and that trade liberalization does not affect productivity growth), while others analyze the dynamic gains from international trade liberalization (*i.e.*, allowing for trade-induced growth in productivity). International trade liberalization is likely to contribute to productivity growth in several ways. *E.g.*, international trade liberalization encourages firms to innovate and adopt new technologies more quickly, to improve their production processes to match international best practice, and to benefit from economies of scale as firms produce for a larger market. Generally, dynamic models magnify the static efficiency gains from trade liberalization by a factor of two to four depending upon the methodology.¹

A. Partial International Trade Liberalization Studies

University of Michigan. Using the Michigan Model of World Production and Trade, Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern (2001) estimated the static benefits from the URA when implementation is completed in 2005. Brown, Deardorff, and Stern found that the URA would add \$13 billion to U.S. gross domestic product (GDP) and \$75 billion to global GDP. Average real wages for U.S. workers would be 0.095 percent higher.² Brown, Deardorff, and Stern found that agriculture, mining, transportation equipment, and other manufacturing sectors of the U.S. economy would accrue the largest increase in employment and production as a result of implementing the URA.³

Brown, Deardorff, and Stern also examined the potential static benefits from a new round of WTO trade liberalization based upon a 33 percent reduction in agricultural and industrial tariffs as well as a 33 percent overall reduction in barriers against trade in services. This scenario would add \$177 billion to U.S. GDP and \$613 billion to global GDP. Average real wages for U.S. workers would be 0.622 percent higher.⁴ Brown, Deardorff, and Stern found that agriculture; mining; food, beverage, and tobacco; wood and wood products; chemicals; metal products; transportation equipment; and other manufacturing sectors of the U.S. economy would accrue the largest increase in employment and production as a result of this scenario.⁵

¹ *Global Economic Prospects and the Developing Countries: Making Trade Work for the World's Poor*, 2002 (Washington, D.C.: World Bank, 2001), 169.

² Drusilla K. Brown, Alan V. Deardorff, and Robert M. Stern, "CGE Modeling and Analysis of Multilateral and Regional Negotiating Options," *Research Seminar in International Economics* (Ann Arbor: University of Michigan, 2001), 32. Found at <http://www.spp.umich.edu/rsie/workingpapers/wp.html>.

³ Brown, Deardorff, and Stern, 34.

⁴ Brown, Deardorff, and Stern, 39.

⁵ Brown, Deardorff, and Stern, 42.

Centre for International Economic Studies and the Tinbergen Institute. Using a computable general equilibrium model, Joseph Francois (2001) estimated the benefits from a new round of multilateral trade liberalization negotiations through the World Trade Organization (WTO) based on hypothetical outcomes of a 20 percent and a 50 percent reduction in all forms of import protection for agricultural and industrial goods and services as well as a reduction in trading costs due to trade facilitation measures.⁶ For the global economy, Francois estimated annual long-run GDP gains of between \$127 billion and \$219 billion (1995 dollars) from a 20 percent reduction and between \$233 billion and \$385 billion (1995 dollars) from a 50 percent reduction.

For the United States, Francois estimated annual long-run GDP gains of between \$16 billion and \$28 billion (1995 dollars) from a 20 percent reduction and between \$28 billion and \$45 billion (1995 dollars) from a 50 percent reduction. Put another way, the annual real GDP growth rate in the United States would increase by between 0.3 and 0.5 percentage points from a 20 percent reduction and between 0.5 and 0.7 percentage points from a 50 percent reduction.⁷

B. Full International Trade Liberalization Studies

University of Michigan. Brown, Deardorff, and Stern estimated the static benefits from removing all trade barriers among WTO members. Brown, Deardorff, and Stern found that achieving truly free trade would increase global GDP by \$1.857 trillion. The United States would gain an additional \$537 billion to its GDP. Average real wages for U.S. workers would increase by 1.884 percent.⁸

World Bank. Using an applied general equilibrium model, World Bank economists estimated the static and dynamic benefits from phased elimination of all import tariffs, export subsidies, and domestic production subsidies between 2005 and 2010. The World Bank estimated that such trade liberalization would add \$355 billion annually to global GDP by 2015 on a static basis. When trade-induced productivity gains were included, the dynamic gains to global GDP rose to \$832 billion annually, of which \$293 billion would accrue to the United States and other developed countries.⁹ As a result of full trade liberalization, the World Bank found that average real wages for unskilled and skilled U.S. workers would increase by 0.5 percent and 1.0 percent, respectively.¹⁰

Organization for Economic Cooperation and Development (OECD). Using the OECD's Trade Policy Simulation Model, Sébastien Dessus, Kiichiro Fukasaku, and Raed Safadi (1999) estimated the static and dynamic benefits from the elimination of all tariffs on trade in goods. On a static basis, Dessus, Fukasaku, and Safadi found that this scenario would increase

⁶ Tariff reductions are from applied rates.

⁷ Joseph Francois, *The Next WTO Round: North-South Stakes in New Market Access Negotiations* (Adelaide: Centre for International Economic Studies and Rotterdam: Tinbergen Institute, 2001), 21.

⁸ Brown, Deardorff, and Stern, 40.

⁹ *Global Economic Prospects*, 166-167.

¹⁰ *Global Economic Prospects*, 173.

global GDP by \$82 billion (1995 dollars).¹¹ However, once dynamic factors were considered, Dessus, Fukasaku, and Safadi found that this scenario would increase global GDP by \$1.212 trillion (1995 dollars) by 2010. That represents a 3.1 percent in real global GDP. GDP in the NAFTA bloc (which includes the United States) would rise by \$231 billion (1995 dollars) by 2010. That represents a 2.1 percent increase in real GDP for the NAFTA bloc.¹²

III. CONCLUSION

Using a variety of statistical models and data sets, economists have consistently found large GDP gains from international trade liberalization. Dynamic models that allow for trade-induced growth in productivity show consistently larger gains from international trade liberalization than do models that confine gains to the reduction of static inefficiencies. Since both economic theory and data corroborate a positive relationship between openness to international trade and productivity growth, dynamic models provide more useful estimates for the economic gains from international trade liberalization. A conservative estimate for the maximum potential benefits from full international trade liberalization under TPA would be a \$750 billion increase in global GDP. Of course, the actual benefits from TPA will depend upon the precise terms of any international trade liberalization agreements negotiated under TPA.

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¹¹ Sébastien Dessus, Kiichiro Fukasaku, and Raed Safadi, *Multilateral Tariff Liberalization and the Developing Countries* (Paris: OECD Development Centre, Policy Brief No. 18, 1999), 16. Found at <http://www1.oecd.org/dev/ENGLISH/publication/Policy-B/pb18a.pdf>.

¹² Dessus, Fukasaku, and Safadi, 17-18.