

2016 Beijing G20: Possible Trade and Investment Priorities

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Introduction

- ◆ We all know that voluntary free trade benefits both the exporting and the importing countries. We also know that direct investment and long-term portfolio investment benefit both the investor and the investee countries. So both international trade and investment should be promoted.
- ◆ What can be done to enhance the growth of international trade and investment, and in so doing enhance the growth of the World economy as a whole?
- ◆ The U.S., as the largest trading nation in terms of goods and services, and China, as the largest trading nation in terms of goods, can jointly provide leadership in global trade promotion initiatives. Similarly, the U.S. and China, as the two largest countries of origin as well as destination of foreign direct investment can also jointly provide leadership in facilitating cross-border direct investment.
- ◆ This is the time for developing innovative ideas! This is the time to consider the next generation of enhancements of the World trade and investment system!

Intensification of Harmonisation of Standards

- ◆ Harmonisation of standards of goods, services, and intangible goods such as software (including apps) can facilitate and hence enhance international trade and lower transactions costs as well as production costs (through the realisation of economies of scale).
- ◆ Harmonisation can greatly increase cross-border cyber-trade, especially at the level of the individual consumers.
- ◆ Harmonisation can also assure product quality, enhance product safety, ensure compatibility and thereby facilitate consumer choice (e.g., food and beverages, drugs, vitamins).
- ◆ It may be worthwhile to promote the use of dual-voltage personal appliances and universal electrical outlets. Over time, all personal appliances should become usable everywhere without adaptors.

Re-Definition of the Rules of Origin

- ◆ With globalisation, the international fragmentation of production through geographically dispersed supply chains, and the growth of bilateral and multilateral free trade agreements, the rules of origin have become critical in determining whether a given good being imported is considered to have been produced in a given country. This determination has important implications on the applicable import tariff rates or quotas, which may make or break the importing of such a good into the importing country.
- ◆ Current rules of origin have been designed by lawyers rather than traders and economists. They are completely unwieldy and difficult to apply and frequently result in high transactions costs.
- ◆ For example, a pair of jeans could criss-cross between Hong Kong and the Mainland of China quite a few times in order to establish its Hong Kong origin during the period from 1974 through 2004 in which world trade in textiles and garments was governed by the Multi Fibre Arrangement (MFA).

Re-Definition of the Rules of Origin

- ◆ One fundamental principle for a set of innovative “Rules of Origin” is that they should reflect and correspond to the relative value-added in each “origin”. The wide divergence between the gross value of a finished product being exported and its value-added by the exporting country suggests that it would be unfair to treat such a product as originating from the country of final assembly for tariff, quota and trade surplus/deficit calculation purposes.
- ◆ Instead of a single country of origin, there will be “countries of origin”, reflecting the fact that the finished product being imported may have incorporated imported intermediate inputs or been processed elsewhere.

Re-Definition of the Rules of Origin

- ◆ For example, an Apple i-phone may have its core microprocessor made in South Korea, its screen made in Taiwan, its software and underlying intellectual property created in the U.S., and its final assembly in China. The value-added can hypothetically be as follows: U.S. 50%, South Korea, 20%, Taiwan, 15% and China 10%, and the rest of the World 5%.
- ◆ Thus, in this example, the countries of origin are the U.S., South Korea, Taiwan and China. Customs duty, if any, is to be assessed according to different rates applying to each of the different countries of origin. To simplify the calculations, any country of origin accounting for less than say 5% of the value-added will be ignored, with the shares of the remaining countries blown up to total 100%.
- ◆ Thus, when the i-phone is imported into any country or region other than the four above, the tariff rate will be based on the tariff rates applicable to the import of an electronic equipment like the i-phone from each of the four countries of origin, multiplied by the respective adjusted shares of value-added.

Re-Definition of the Rules of Origin

- ◆ When the i-phone is imported to one of the four countries of origin, the formula for the calculation of the applicable tariff rate is the same, except that the tariff rate is zero for imports of value-added back into the original country in which the value-added is created. Thus, for example, for imports of the i-phone back into the U.S., the tariff rate will be based only on the tariff rates of the imports of similar electronic equipment from the other three countries of origin into the U.S.
- ◆ With these estimates of value-added, the exports to and imports from one country to another, and the trade surplus/deficit between them, can be calculated entirely in terms of value-added rather than the more misleading gross value.

Re-Definition of the Rules of Origin

- ◆ Of course, for the World as a whole, the sum of all the value-added exports of the different countries should be the same as the gross value of total World exports.
- ◆ A question may be raised as to how the shares of value-added may be calculated. Since value-added taxes are used in many jurisdictions (with the major exception of the U.S.), the domestic value-added of each exported good is known. Moreover, the values of the imported intermediate goods or processed goods used in the production of the exported good are also known as claims will be filed for the reimbursement of the tariffs and value-added taxes paid at the time they were imported.

Reciprocal Exemption of Individual Cyber-Trade

- ◆ International trade is increasingly conducted on the internet. There is the question of whether this international cyber-trade should be subject to tariffs and quota. Moreover, how should the sales and purchases of intangible goods such as software (e.g., apps), e-books and e-music and e-movies (through downloading)?
- ◆ In principle, cyber-imports should be treated in the same way as regular imports. However, at the level of the individual consumers, the transaction costs of the data collection and tariff calculation and enforcement are probably so high that they will impede the growth of international e-commerce.

Reciprocal Exemption of Individual Cyber-Trade

- ◆ What I would like to propose for consideration is a bilateral or multilateral voluntary agreement among countries to exempt the purchases of each country's own individual citizens or residents from the cyber-vendors of the other countries through the internet for their own exclusive individual private use from the application of import tariffs and quotas.
- ◆ However, the exemption should be subject to a maximum value limit during a given period. For example, it should not be possible for an individual consumer to purchase an automobile across the border on the internet and thereby avoid the tariff and quota restrictions.

Open Accession to Free Trade Agreements

- ◆ There is now a proliferation of free trade agreements, many of which with over-lapping signatory countries, but they are not in general compatible or consistent with one another.
- ◆ Such fragmentation of free trade agreements can actually impede the growth of World trade. Provision should therefore be made for a country that is not an original signatory to accede to an existing free trade agreement without having to negotiate from scratch.

Open Accession to Free Trade Agreements

- ◆ How does open accession work? Starting from an existing bilateral free trade agreement, a third country should be able to voluntarily accede to the agreement by agreeing to comply with all the rules and regulations on imports to the two existing signatory countries (including those applying to tariffs and quotas) as provided in the existing agreement. Moreover, the restrictions on imports into the third country by the two existing signatory countries should be no more stringent than the less stringent of the restrictions imposed by the two existing countries on their imports.
- ◆ Then the only matters left to negotiate with the two existing signatory countries would be on goods (and services) not covered in the existing bilateral free trade agreement.

Open Accession to Free Trade Agreements

- ◆ What should be done if the existing free trade agreement is multilateral? The same principles should apply. The country wishing to accede to the agreement should accept all the import rules and regulations of each of the existing signatory countries under the agreement. Moreover, the acceding country should only maintain restrictions on its imports from the existing signatory countries that are no more stringent than the least stringent rules and regulations imposed by the existing signatory countries.
- ◆ Of course, for goods (and services) not covered in the existing free trade agreement, negotiations with the existing signatory countries would once again be necessary.
- ◆ With the possibility of open accession, there will be room for competition among free trade agreements. And hopefully, eventually the World may settle down to a small number of multilateral free trade agreements.

Investment Treaty Based on National Treatment

- ◆ A natural principle for bilateral investment treaties is “national treatment”. A foreign direct investor should be treated no differently from a domestic investor, no better, and no worse. This will assure a “level playing field” for all.
- ◆ There should however be a national security exclusion. For example, there may be restrictions on foreign direct investment in the domestic armament industry or telecommunication industry. This exclusion should be acceptable by all but should be specified explicitly a priori rather than applied on an ad hoc basis.

Concluding Remarks

- ◆ While I sincerely hope that the Doha Round of trade negotiations can be successfully completed, I think we should also begin to consider the next generation of enhancements for the World trade and investment system.