

Global Value Chains and 2nd Generation Free Trade Agreements

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Traditional trade theory and policy

Value chains are local (national production paradigm)

➔ Firms trade to gain access to new markets (*market access*)

➔ Mercantilist trade policy:

- *Export promotion* to increase competitiveness of domestic firms
- *Import protection* to reduce competition from foreign firms

New trade reality...

Today's Globalized Toy

Topper the Trick Terrier is a robotic dog that can do a real trick is where its parts come from. This year's Topper was made by Qualiman Industrial Co. in Nanhai, China. Its original customer, the Original San Francisco Toymaker

PLASTIC EYES:
Shenzhen, China

**Value chains global,
not local**

PLASTIC BODY:
Malaysia
MICROFIBER FABRIC:
Korea

MOTOR FOR LEGS:
Shaoguan, China
PLASTIC LEGS:
Taiwan

Sources: Qualiman Industrial Co. Ltd.; Li & Fung.



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**Vertical cost arbitrage
key motive for trade
(and investment)**

... New trade policy preferences

- Access to foreign inputs key driver of firms' international competitiveness (Kasahara and Rodrigue 2008; Kasahara and Lapham 2013)
- Rising demand for:
 - tariff reductions on imported intermediates
 - FDI liberalization
 - beyond-the-border trade facilitation and regulation harmonization
- Fear of race-to-the-bottom:
 - demand for labor and environmental standards

... New trade agreements

- WTO's shallow integration mandate not equipped for these new issues.

➡ Second-generation trade agreements with deep integration among coalition of the willing

➡ Countries that are integrated through GVCs are more likely to form PTAs with deep integration (Blanchard and Matschke, 2012; Orefice and Rocha 2013)

Core negotiating issues in CETA and TPP

- Market access for goods, agriculture and services (traditional)
- FDI liberalization
- IPR protection
- Competition policy
- Trade and investment facilitation
- Regulatory harmonization
- Environmental and labor standards

... New stumbling blocks

- **Territoriality:** 2nd generation trade agreements may create jurisdictional conflicts:
 - Trade negotiators vs. other governmental departments
 - Federal vs. provincial/state (Fafard and Leblond, 2012)
- **Fragmentation of traditional interests**

New Balance Wants its Tariffs, Nike Doesn't (Bloomberg Businessweek (03/05/2012))

- There are deep divisions between Nike and New Balance on whether the U.S. should uphold high tariffs on shoes imports from Vietnam.
- **New Balance**, which continues to have a large portion of its manufacturing in the New England area, fears the tariff cut will undermine its competitiveness
- **Nike**, who manufactures almost all its shoes abroad, indicates the elimination of the duties will lead to the creation of thousands of high-paying U.S. jobs, from designers to product engineers.