RESEARCH BRIEF

Public Policy Institute of California

JUNE 2003

ISSUE #73

What Will Tariff Reductions Mean for California Exporters?

The last 50 years have witnessed unparalleled efforts to reduce barriers to international trade and commerce around the world. As a result, these barriers are currently lower than at any time in modern history, and efforts to lower them further are well under way. The Bush administration, for example, is working energetically on a broad array of multilateral, regional, and bilateral trade liberalization agreements.

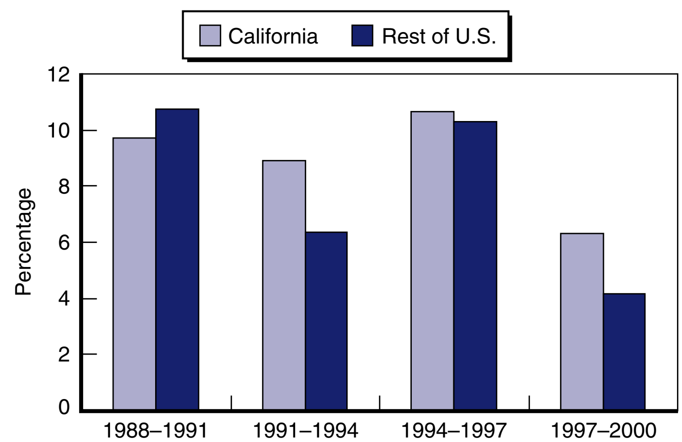
These trade negotiations are ambitious, but their potential consequences for California firms are not well known. In *Foreign Tariff Reductions and California Exports*, Jon Haveman estimates the export expansions that would result from each trade liberalization agreement currently on the agenda. He also measures the total value of new California exports in the event of the complete elimination of worldwide tariffs—the ostensible goal of the World Trade Organization negotiations. These estimates offer California's firms and policymakers some idea of what trade liberalization efforts might mean for the state's export-oriented industries.

If successful, Haveman notes, trade liberalization efforts would have other far-reaching effects—on imports, prices, and labor markets—that are not considered in this report. For this reason, the report's estimates are best regarded as one piece of a complicated policy mosaic. They are an important piece, however, insofar as no balanced view of trade liberalization proposals can emerge without some sense of the export growth these proposals are likely to generate.

What Accounts for California's Export Growth?

Haveman notes that California's export growth during the 1990s exceeded that of the rest of the nation (see Figure 1). He also identifies the reasons for that difference. For California, the most important factor in its export growth was the establishment of trade preferences, largely by Mexico. Despite the Mexican currency crisis in the mid-1990s, the average annual growth rate of California's manufacturing exports to Mexico exceeded 25 percent between 1993 and 2000—more than double the rate of growth in California's manufacturing exports to other countries during the same period. Domestic economic growth and tariff liberalization were the second and third leading contributors to California's export performance in the 1990s.

Figure 1—Average Annual Percentage Change in Exports, 1988–2000



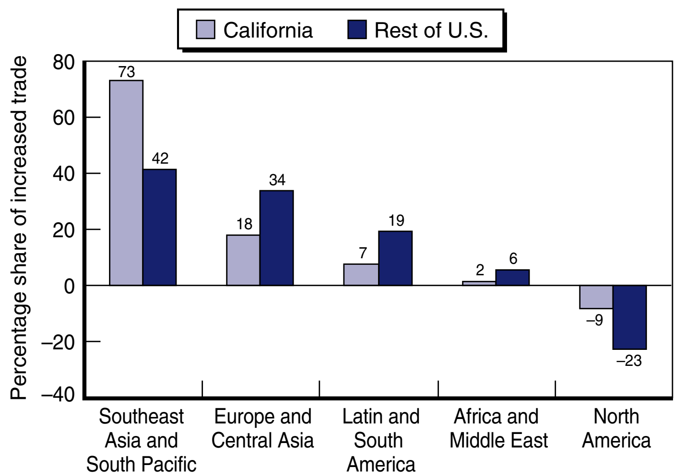
Throughout the 1990s, California's export growth outpaced the rest of the nation's.

With preferential trade agreements such as the North American Free Trade Agreement (NAFTA), first implemented in 1994, there is often a concern that new trade will be offset by a contraction of trade between the members and other countries. For California, however, this appears not to be the case. Since 1993, California's export growth to both Mexico and other countries has been significantly higher than it was in the five years before the institution of the NAFTA. Hence, the NAFTA appears to have provided a significant boost to overall California exports.

Tariff Elimination and Its Consequences

Having identified the engines of California's export growth, the report estimates the effects of tariff elimination (see Figure 2). The author's calculations indicate that the elimination of all tariffs by California's trading partners would increase California's manufacturing exports by 24 percent, or $27 billion. About three-quarters of this increase would occur in Southeast Asia and the South Pacific. High-technology industries would experience the largest export gains, but food and kindred products exports would also rise 43 percent. Trade with Mexico and Canada would likely decline as the United States gives up its preferential access to these markets. The largest export increases would be with Korea, China, Taiwan, and India. Of these, only Taiwan is among California's top five trading partners.

Figure 2—Export Expansions Following Worldwide Tariff Elimination



If tariffs were eliminated worldwide, about three-quarters of California's export increases would occur in Southeast Asia and the South Pacific.

Haveman maintains that of the specific trade liberalization efforts currently proposed or under way, the Asia-Pacific Economic Cooperation Forum (APEC) is the most significant for California exporters. Those negotiations seek full unilateral liberalization by its membership, which includes all the major nations bordering the Pacific Ocean except Colombia. If successful, this effort alone would increase California manufacturing exports by $19 billion, almost 14 percent. Included in this figure is an 8 percent reduction in exports to Canada and Mexico, with which the United States would no longer enjoy preferential trade status. The countries absorbing the most new California exports would be Korea, China, Taiwan, Japan, and Peru. The sectors experiencing the largest increases would be electronic and other electric equipment ($6.8 billion), industrial machinery and equipment ($6.4 billion), instruments and related products ($2.2 billion), food and kindred products ($1.7 billion), and chemicals and allied products ($1 billion).

Another proposed agreement, the Free Trade Area of the Americas (FTAA), would extend the NAFTA to all Western Hemisphere nations except Cuba and contribute $4.6 billion to California's export growth, a 3.3 percent increase. The main export destinations for the increase in California exports would be Brazil ($3.2 billion), Peru ($600 million), Chile and Argentina ($400 million each), and Mexico ($100 million). Compared to APEC and FTAA, the proposed bilateral trade agreements are modest. None would increase California exports by as much as even $1 billion.

How Do California's Export Interests Differ from the Rest of the Nation's?

The report also details the differences between California's trade liberalization interests and those of the rest of the nation. Compared to other U.S. firms, California businesses rely heavily on exports and therefore have more to gain from trade liberalization efforts. Exports account for 10 percent of California's output compared to 7.6 percent for the rest of the United States. California exports are also more highly concentrated in technology products.

Another key finding is that California firms export proportionately more than other U.S. firms to Asia. For this reason, California's exporters would benefit more from open markets in this region. The current liberalization agenda, however, focuses on countries in the Western Hemisphere, where the potential for California exporters is smaller. Currently, FTAA member countries receive almost half of all U.S. exports but only about 29 percent of California's exports. Excluding Mexico and Canada, FTAA countries receive 8.9 percent of exports from non-California U.S. firms but only 2.9 percent of California exports.

Although trade policies are set at the national rather than the state level, they are likely to be of greater consequence for California than for other states. For this reason, Haveman concludes that California's firms, policymakers, and congressional delegation should consider these findings when discussing liberalization efforts with U.S. trade officials.

This research brief summarizes a report by Jon D. Haveman, Foreign Tariff Reductions and California Exports *(2003, 98 pp., $10.00, ISBN 1-58213-073-6). The report may be ordered by phone at (800) 232-5343 [U.S. mainland] or (415) 291-4400 [Canada, Hawaii, overseas]. A copy of the full text is also available on the Internet (www.ppic.org). The Public Policy Institute of California is a private, nonprofit organization dedicated to independent, objective, nonpartisan research on economic, social, and political issues affecting California.*

PUBLIC POLICY INSTITUTE OF CALIFORNIA
500 Washington Street, Suite 800 • San Francisco, California 94111
Telephone: (415) 291-4400 • Fax: (415) 291-4401
info@ppic.org • www.ppic.org