

What Do Trade Negotiators Negotiate About?

And Why Does It Matter for the Doha Round?

Introduction

What do trade negotiators negotiate about?

- Observation A: The standard case for free trade is a unilateral case.
- Observation B: The GATT/WTO is driven by exporter interests, not the consumer gains from freer trade.

Answer #1: No way to make sense of negotiations.

“It was a fruitful lie, this idea that the gains from trade come mainly from the exports you sell, not the imports you buy. But it was still a lie; the textbook case for [unilateral] free trade really is correct...the whole process – the GATT, the WTO, all that stuff – was just a ruse.” Clive Crook (*The Atlantic Monthly*, October 2006).

- The ultimate success of the GATT/WTO measured by how close it gets the world to global free trade.

Answer #2: identify a well-defined problem that the GATT/WTO might solve.

- The terms-of-trade theory: facilitate escape from a terms-of-trade-driven Prisoners' Dilemma.
- The commitment theory: facilitate domestic commitments to the private sector.
- The ultimate success of the GATT/WTO measured by how well it facilitates solutions to one or both of these problems.

Most research in economics focuses on terms-of-trade theory, so I will here.

The Plan:

1. Determine “the problem” according to the terms-of-trade theory.
2. Describe some key reasons why GATT/WTO looks well-designed to help governments solve this problem.
3. Present some empirical evidence that this is indeed what GATT/WTO negotiations are used for.
4. Discuss implications of this view for the Doha Round.

Implications for the Doha Round

Don't expect too much

If the GATT/WTO solves a large country problem, and if most developing country members are *small*,

-- then most developing country members can expect little from the WTO.

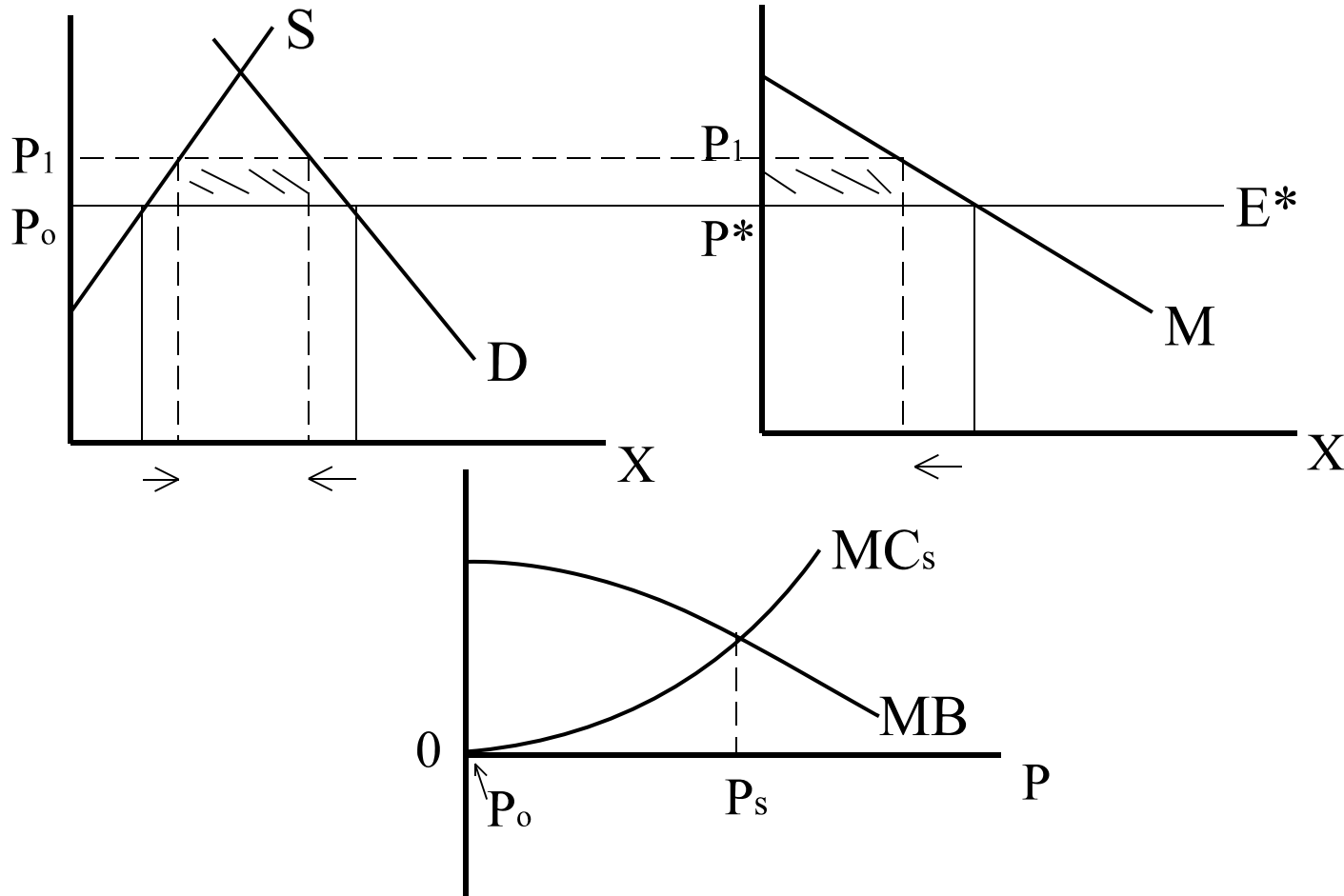
In this case, the role of small developing countries as WTO members is to

-- prevent discrimination from the larger countries as they use the WTO to solve their problems.

Most developing countries should not be asked to make concessions (as under GATT).

The Problem

A small country's unilateral tariff choice:



Internationally efficient, given national government objectives.

The Problem: No “problem” for GATT/WTO to fix!

Developed countries could grant unilateral access to developing countries as an act of altruism: But difficult to count on, and not what GATT success was based on.

Still, can seek “Rules-Based Outcomes”: Political Optimum (PO);
Figure 6.

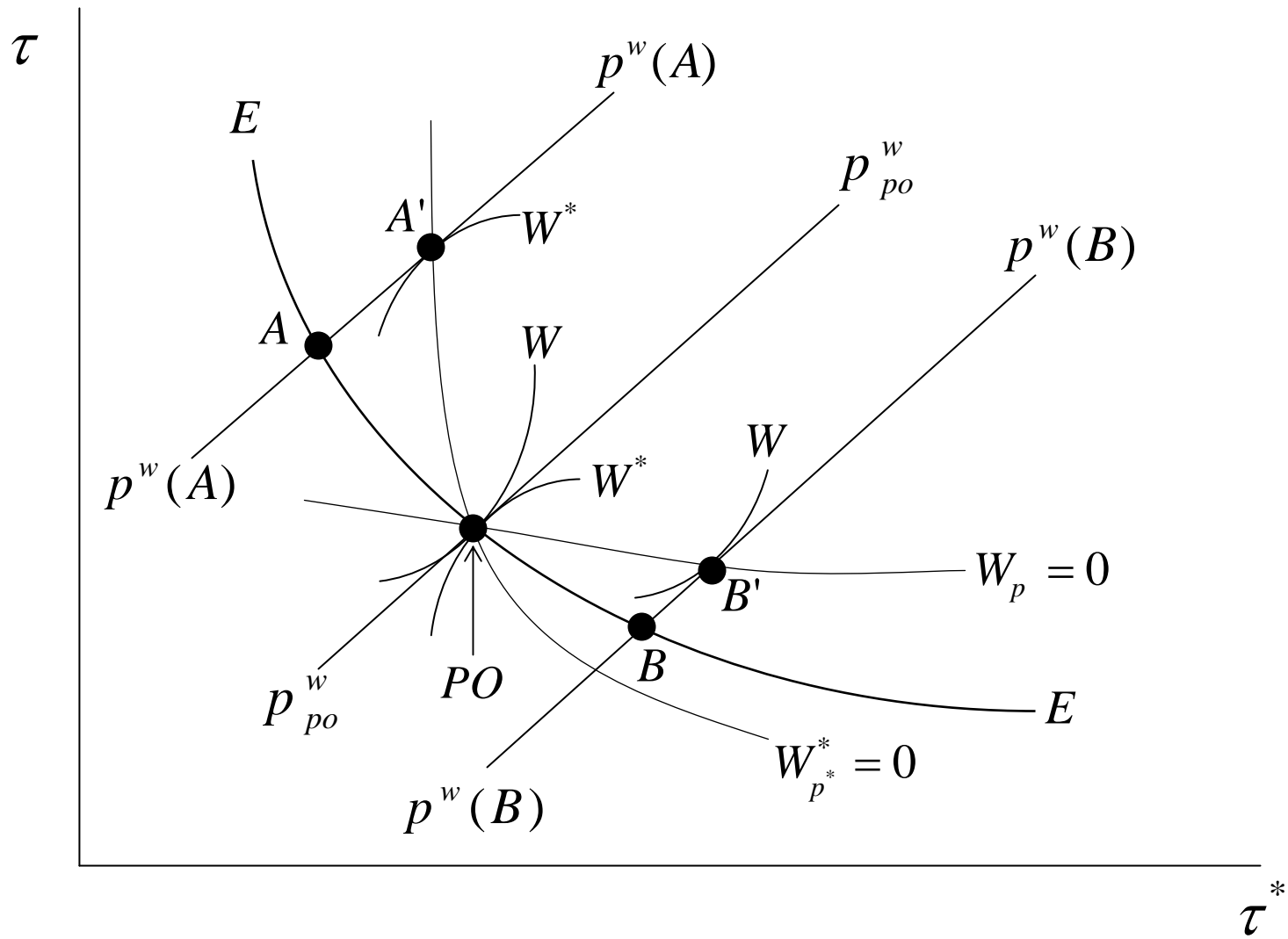


Figure 6

How to achieve PO?

SDT for tariff bindings: consistent with PO (Figure 3).

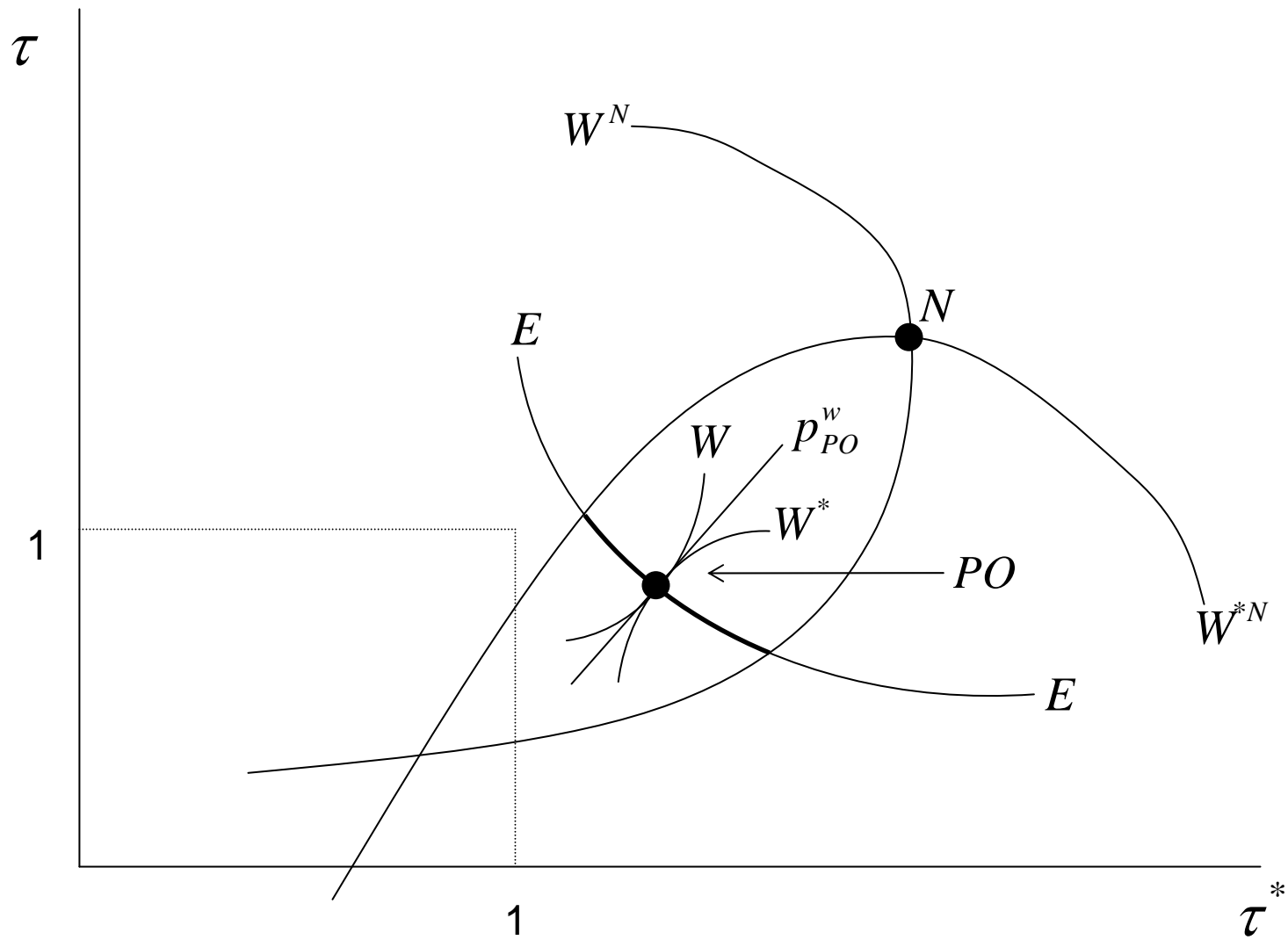


Figure 3

SDT for domestic policies (“policy space”): consistent with PO (Figures 3 and 4).

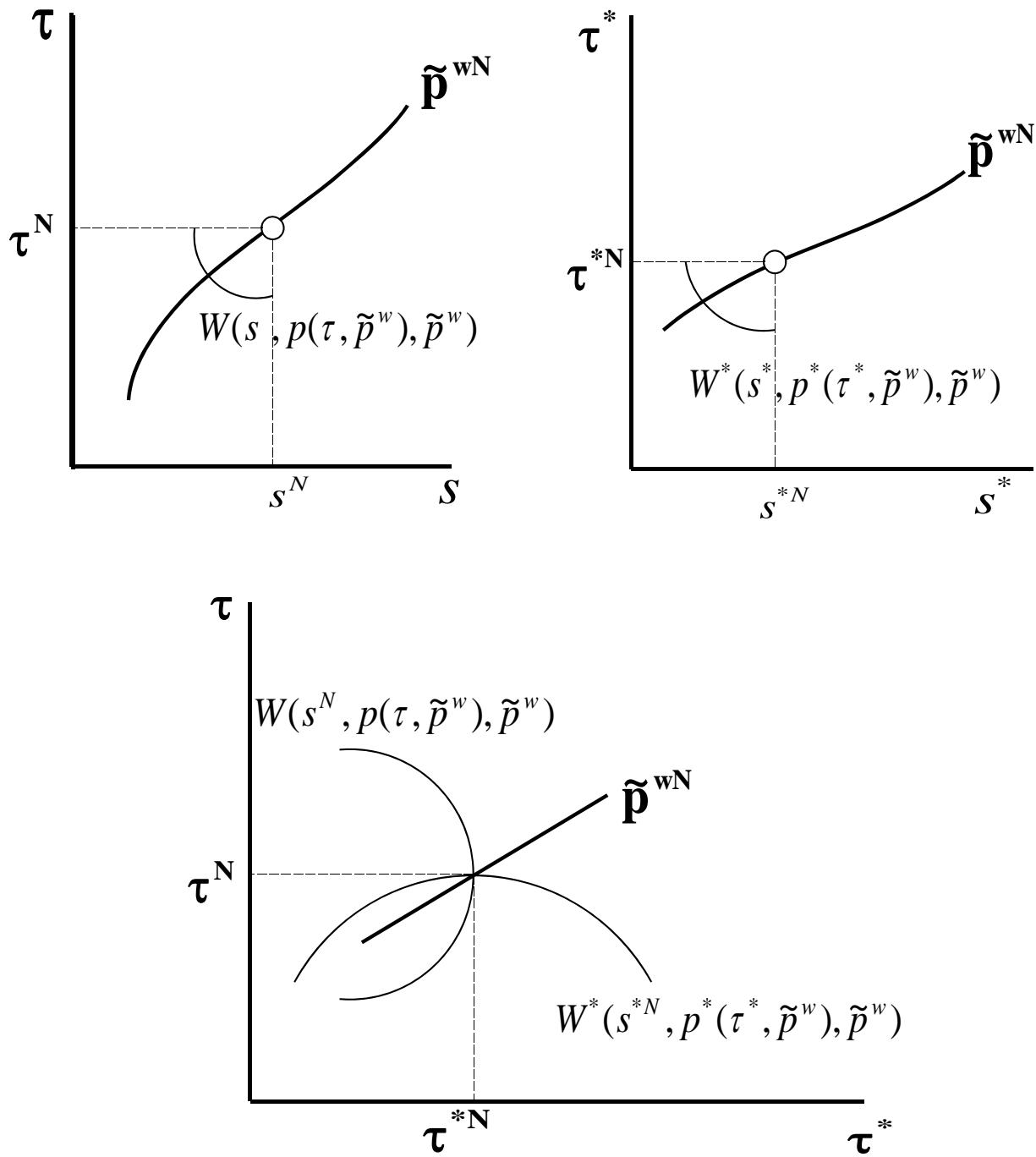


Figure 3: Nash Policy Choices.

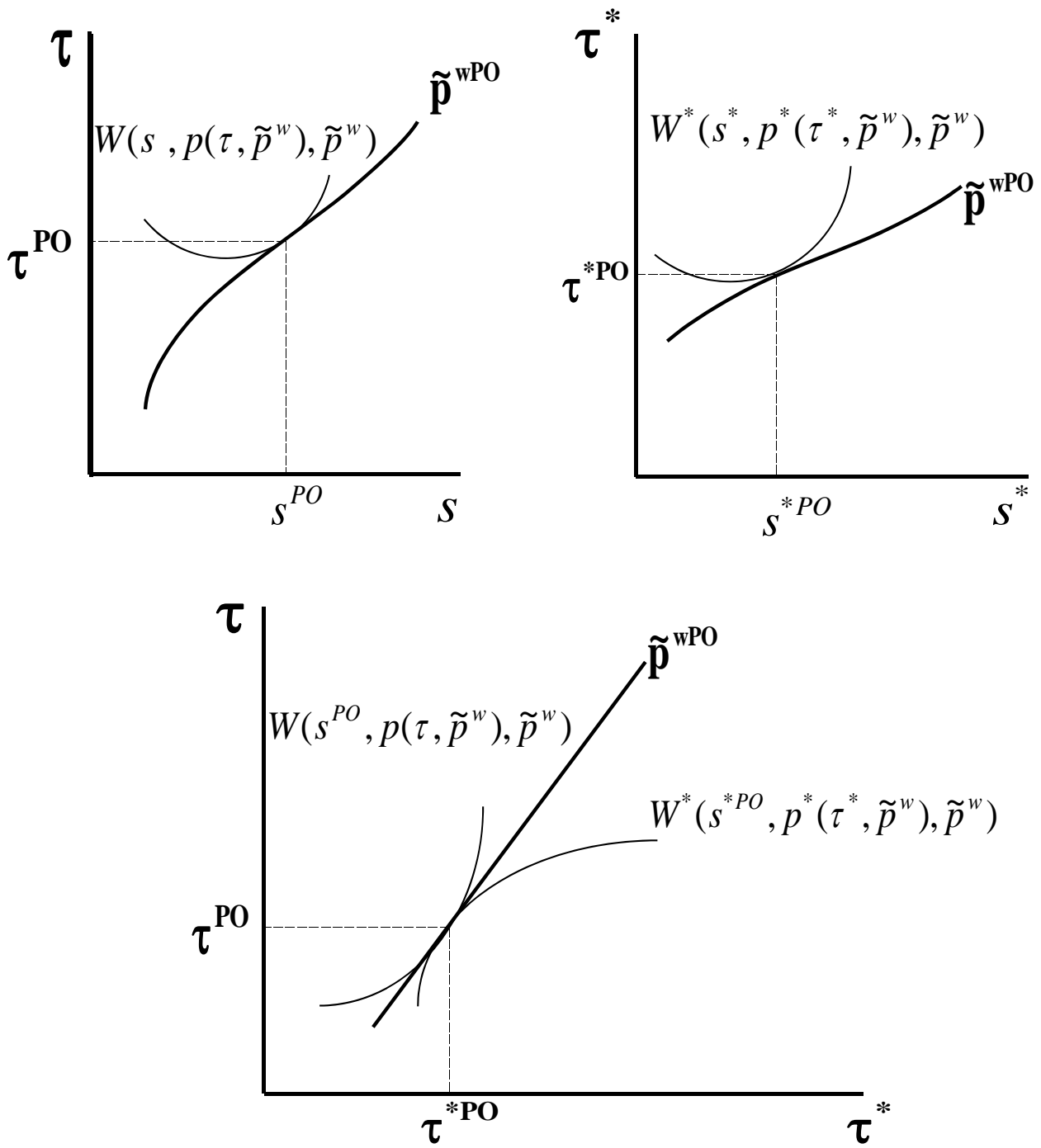


Figure 4: Politically Optimal Policy Choices.

Prevent discrimination: consistent with PO (Figure 7).

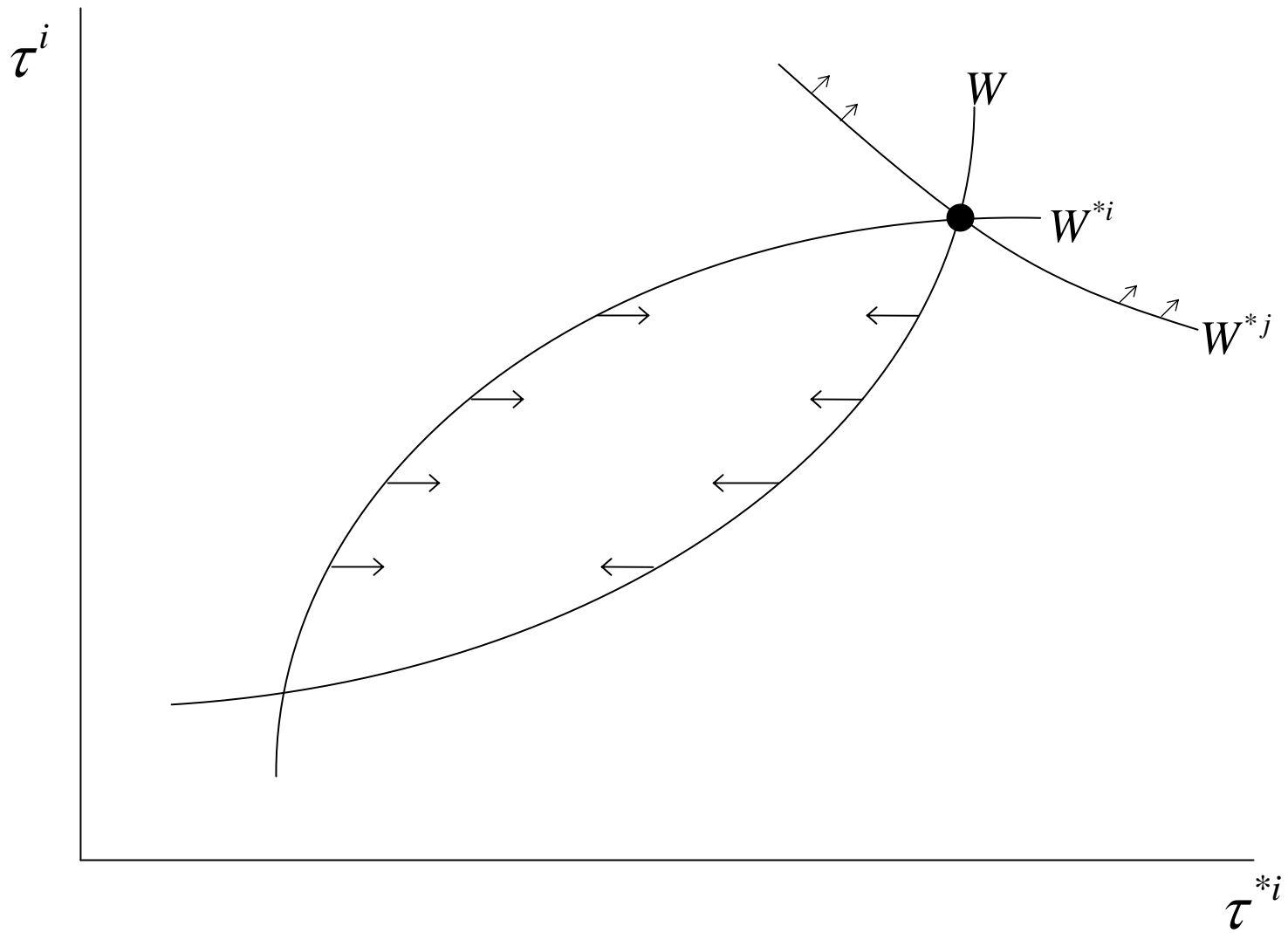


Figure 7

How to defend against discrimination? Mexican Proposal?

A potentially important qualification to all of this: Domestic Commitment problems.

Don't expect too little

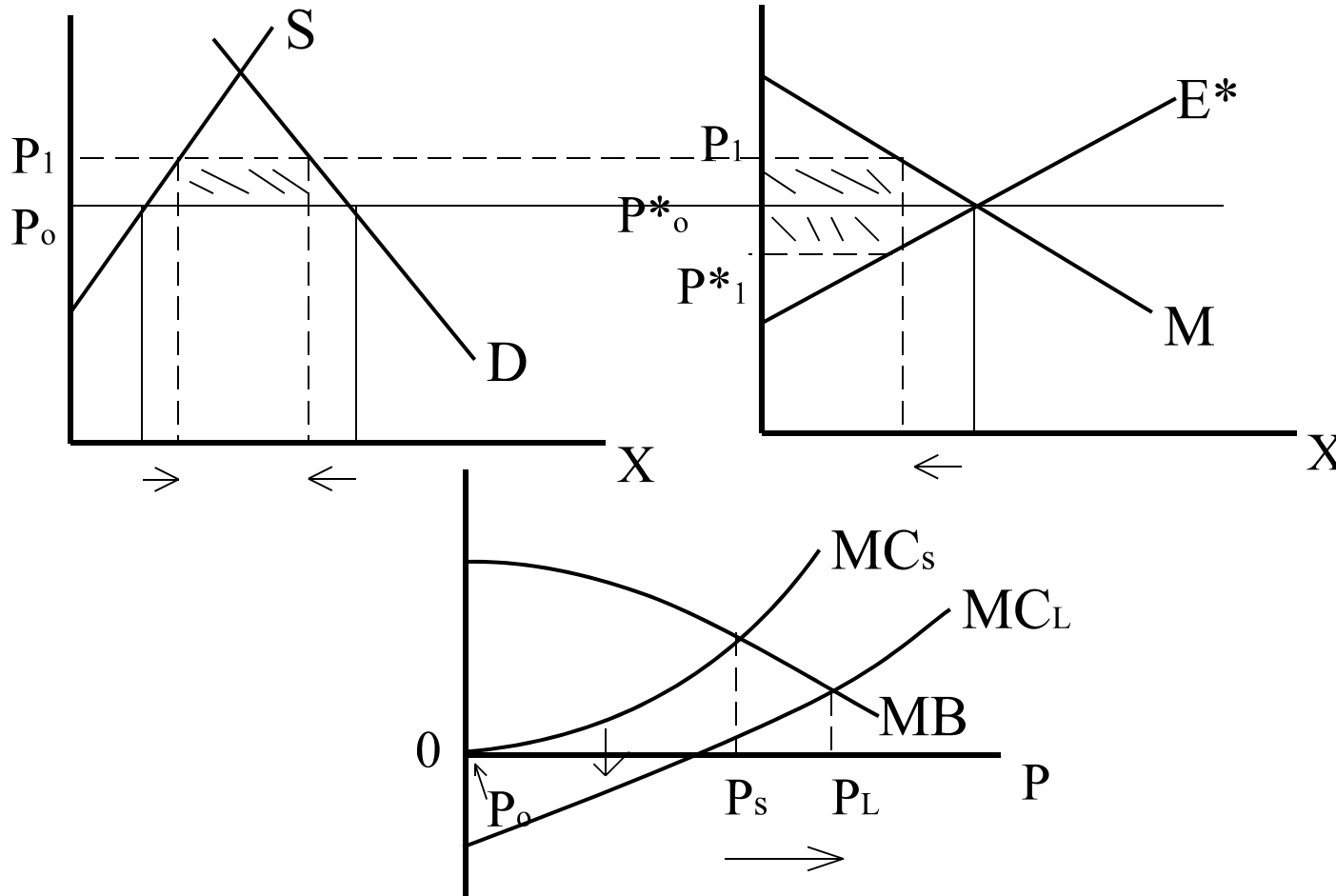
If the GATT/WTO solves a large country problem, and if most developing country members are *large* in the relevant international (or regional) markets,

-- then developing countries can achieve gains in the same way as developed countries.

Most developing countries should actively engage in the granting of reciprocal policy concessions.

The Problem

A large country's unilateral tariff choice:



Internationally inefficient, given national government objectives.

The problem to fix: *international cost-shifting*.

- “terms-of-trade” (foreign exporter price) manipulation.
- “too little trade” in the Nash (non-cooperative) equilibrium.
- each government desires more trade volume at fixed terms of trade.

Large developing countries can gain from GATT/WTO just as large developed countries do: reciprocal MFN negotiations that reduce trade distortions in their own economies; limits on domestic “policy space.”

Recall, Subramanian and Wei (forthcoming).

- Trade effects of GATT/WTO membership large for trade between developed-country members (who reciprocally liberalized) and non-existent for developing-country members (who did not).

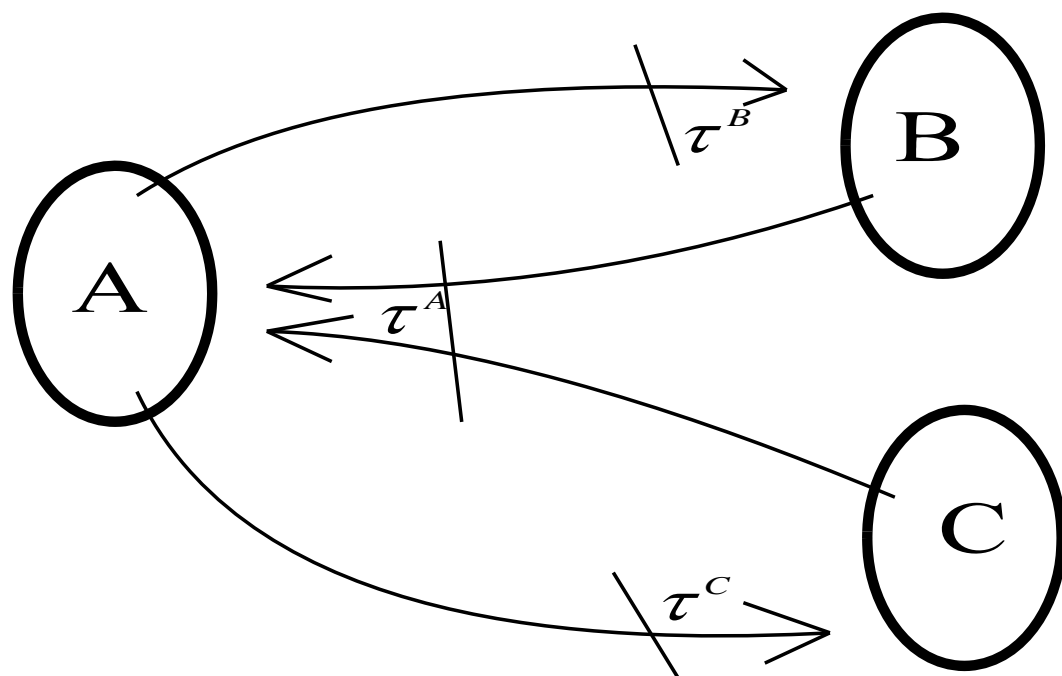


Table 2. Export-tax equivalents of tariff distortions in selected developing countries for 2001

Export-tax equivalents of tariff barriers (rates in percent)		
Country	Real income constant	Export volume constant
Tunisia	33.6	26.6
India	31.0	28.5
Morocco	26.7	25.6
Egypt	26.2	15.8
Romania	18.4	10.1
Bangladesh	18.2	16.3
Thailand	16.5	11.5
Tanzania	14.1	13.2
Vietnam 1/	12.7	12.6
China	12.1	12.0
Peru	10.9	10.4
Mozambique	10.8	9.6
Sri Lanka	10.4	8.1
Malawi	9.8	9.8
Philippines	9.7	5.4
Albania	9.4	9.3
Columbia	9.3	9.1
Zambia	8.6	8.4
Brazil	8.1	7.9
Argentina	8.0	8.0
South Africa	6.2	6.1
Uruguay	5.5	5.3
Malaysia	5.0	4.4
Botswana	3.7	3.3
Madagascar	3.6	3.6
Singapore	0.0	0.0

Note: 1 Not a member of the WTO.

Source: Author's calculations.

It is important to emphasize that the ranking of countries in Table 2 are based on the magnitudes of the welfare-based export-tax equivalents. The country rankings would be slightly different if the rankings were based on the export-volume export-tax equivalents. For example, Romania has the fifth highest export-tax equivalent calculated holding welfare constant, but the eleventh highest export-tax equivalent calculated holding export volume constant.

The two most important factors determining how a country's tariff structure affects export incentives are the size of the tariff distortion and the responsiveness of both consumption and production to changes in the prices of goods. It is not sufficient that the tariff rate itself be large for it to discourage exports, because a high tariff could be applied to a good for which consumers and producers are

Table 7. Effects of tariff elimination by both rich and developing countries on developing-country exports

	Percentage change in the value of developing-country exports	Percentage change in the volume of developing-country exports
<i>Rich-country liberalization</i>		
Eliminate tariffs against exports from developing countries	4.0	2.6
Eliminate tariffs against exports from both rich and developing countries	2.0	2.6
<i>Developing-country liberalization</i>		
Eliminate tariffs against exports from rich countries	9.9	12.9
Eliminate tariffs against exports from developing countries	14.1	12.9
Eliminate tariffs against exports from both rich and developing countries	20.1	22.4

Source: Author's calculations using the GTAP model and database, Version 6.

Developing-country exports would expand proportionately more if they were to eliminate their own tariffs compared with tariff elimination by rich countries. As shown in Table 7, elimination of all tariffs by developing countries would increase the value of their exports by about 20% and about 70% of this increase would come from eliminating tariffs against exports from other developing countries. Exports from developing countries would increase by only 4% if they were to forego liberalization themselves and rely exclusively on tariff reductions by rich countries. From a policy point of view, developing countries could expand their exports by a much larger percentage by eliminating their own tariff barriers, rather than waiting for tariff reductions by rich countries.

6. Conclusions

A central message of this paper is that a consequence of import protection is to create disincentives that diminish a country's ability to export. The anti-export bias from tariffs arises because they: (1) lower the domestic relative price of exports; (2) alter wages and rental rates which must be absorbed by the export sector; and (3) raise the cost of imported intermediate inputs used by export sectors. Also, tariffs can raise the price and output of nontraded goods, which draw resources away from exports. The simulations reported in this paper demonstrate that the export-tax equivalents of import tariffs, measured by holding

intermediate inputs. The increase in the quantity of imported intermediate inputs used outweighs the reduction in the price of imported inputs, so total costs rise in this case.

Again, can seek “Rules-Based Outcomes”: Political Optimum (PO);
Figure 6.

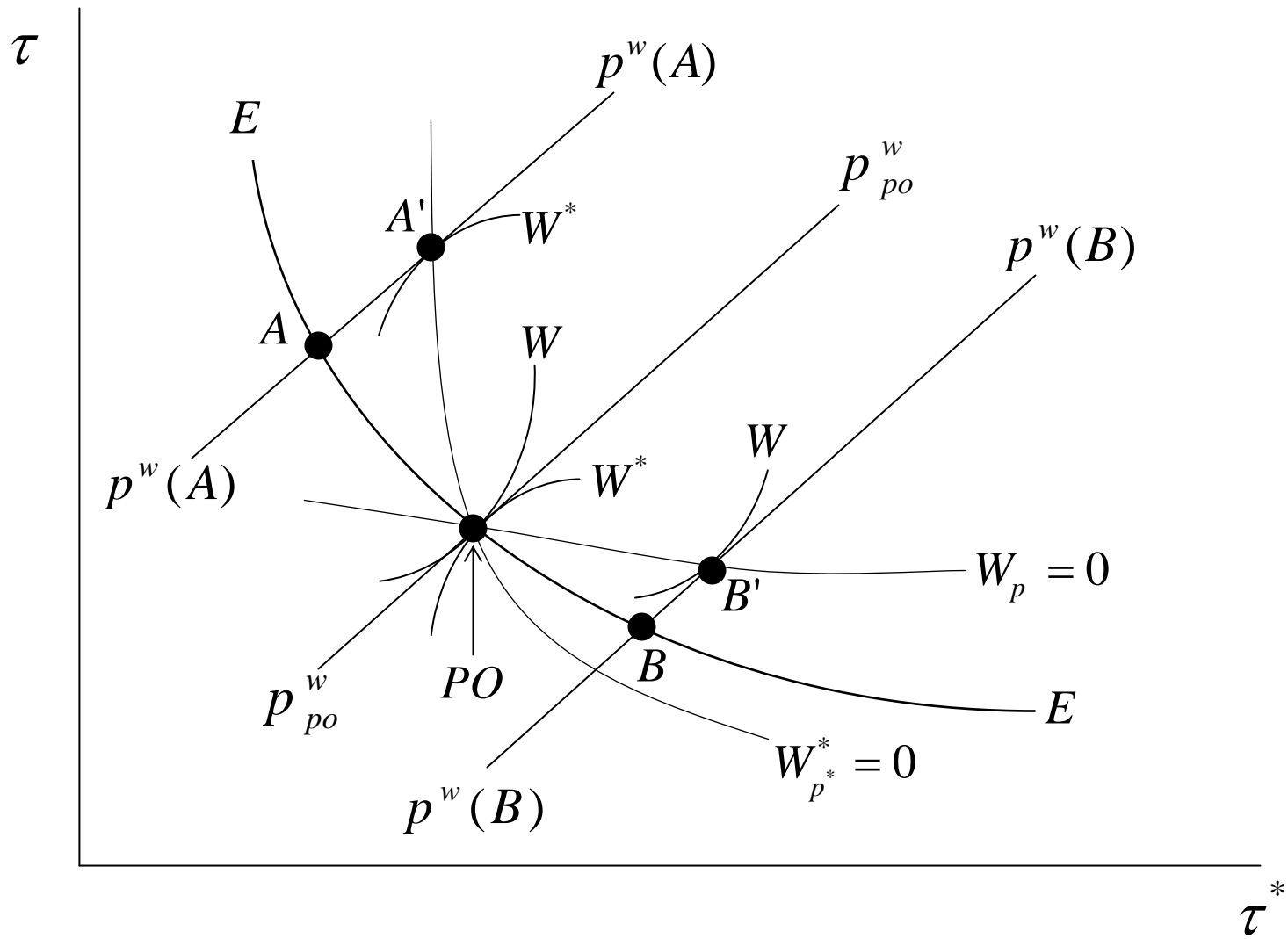


Figure 6

Either way, emphasis on Agricultural subsidies is misguided

When international negotiations are fundamentally about world prices, they are fundamentally about redistributing surplus from one side of the market to the other.

GATT/WTO market access negotiations abiding by reciprocity and MFN are not about world prices, but rather about local prices in each negotiating country.

WTO negotiations on agricultural export subsidies appear to be about exporters wishing to raise world prices by restricting trade.

Not good for food-importing countries (many of the poorest LDCs).
Caveat: “Policy coherence” with IMF.

Not good for world-wide efficiency.

Table 6
**Importance of Tariff and Subsidy Removal
 for Developing Countries**
(change in real income, in billions of U.S. dollars)

<i>Liberalization by high-income countries:</i>	<i>Impact on real income of developing countries</i>
<i>Tariff removal</i>	
Hertel and Keeney ^a	11.9
Tokarick ^b	12.5
<i>Removal of all subsidies</i>	
Hertel and Keeney ^a	-1.2
Tokarick ^b	-4.5
<i>Removal of export subsidies only</i>	
Hertel and Keeney ^a	-1.5

Sources: Hertel and Kenney (2006), and Tokarick (2005).

^a Relative to base year of 2001.

^b Relative to base year of 1997.

real income of developing countries will depend on whether they are net-importers or exporters of the previously protected products: the net-exporting countries will benefit, since their terms of trade improve, while the net-importers will lose since their terms of trade deteriorate. In my simulations in Tokarick (2005), for example, a grouping of countries in the Middle East and North Africa—Morocco and Tunisia, in particular—would probably be hurt by liberalization by high-income countries alone because they are significant net importers of products subsidized by rich countries, such as wheat, meat, and dairy products.

Studies show that some liberalization by high-income countries, without any liberalization by developing countries, could harm developing countries. In Table 5, Hertel and Keeney estimate that liberalization by high-income countries, without any reform by developing countries, would raise real income for developing countries by \$10.8 billion. Table 6 shows the components of this amount: tariff elimination by high-income countries alone would raise real income in developing countries by \$11.9 billion, but removal of all subsidies would *reduce* the real income of developing countries by \$1.2 billion, resulting in a net gain for developing countries of \$10.8 billion. Developing countries would benefit from tariff reductions in rich countries as a result of improved market access, but would be harmed by subsidy removal because they are net-importers of products subsidized in rich countries. Similarly, in Tokarick (2005), I estimate that liberalization by high-income countries alone would increase real income in developing countries by \$8 billion (Table 5), and this comes about from a gain of \$12.5 billion from tariff elimination and a loss of \$4.5 from subsidy elimination (Table 6). Cernat, Laird, and Turrini (2003) and Diao, Somwaru, and Roe (2001) reach similar conclusions. Thus, it would be incorrect to assert that agricultural trade liberalization benefits *all*

A Simple Rule.

As long as bilateral negotiations abide by MFN and satisfy reciprocity, they can be presumed to produce Pareto improvements across governments.

But if either MFN or reciprocity is violated, then this presumption may not be warranted.

- Non-MFN Example: FTAs and CUs.

$$\tilde{p}^{wAB}(\tau^{AB}, \tau^{AC}, \tau^B, \tau^C); \tilde{p}^{wAC}(\tau^{AB}, \tau^{AC}, \tau^B, \tau^C).$$

- Non-Reciprocity Example: Agreements to limit Export Subsidies.

$$\text{Unilateral tariff choices} \Rightarrow W_{p^B}^B > 0; W_{p^C}^C > 0.$$

What about TRIPS?

Addressing an international externality, but externality does not travel through exporter prices.

- Not solving a Terms-of-Trade-driven Prisoners' Dilemma.
- Not clear why TRIPS should be in the WTO: Institutional 'Targeting Principle.'

Impacts on Developing Countries:

- A substantial transfer from Developing (and Canada!) to Developed Countries (McCalman, 2001, Table 4).
- Some weak evidence for "orphaned drug" effect (Lanjouw and Cockburn, 2001, Figure 1).

Table 4
Transfers associated with TRIPs

	TRIPs net transfer ^a (in \$US millions)	S.E. ^b	Net transfer as % of GDP	TRIPs gross transfer ^c (in \$US millions)	% of Gross transfer from broader coverage ^d
US	4553	(874)	0.09	73	0.00
Germany	788	(280)	0.07	384	0.00
France	568	(117)	0.06	0	0.00
Italy	231	(47)	0.03	0	0.00
Sweden	71	(39)	0.04	104	0.00
Switzerland	22	(79)	0.01	288	0.60
Panama	0.3	(0)	0.01	0	0.00
Australia	-22	(13)	0.01	166	0.00
Ireland	-48	(7)	0.14	58	0.00
New Zealand	-54	(4)	0.12	60	0.27
Israel	-66	(10)	0.14	89	0.32
Columbia	-77	(9)	0.20	78	0.37
Portugal	-87	(7)	0.18	87	0.34
Netherlands	-96	(67)	0.04	313	1.00
South Africa	-113	(12)	0.13	123	0.40
Greece	-118	(13)	0.22	119	0.35
Denmark	-174	(28)	0.16	227	0.68
Austria	-176	(32)	0.14	229	0.64
Finland	-198	(27)	0.19	238	0.73
Norway	-206	(24)	0.23	226	0.71
Belgium	-224	(40)	0.15	293	0.64
Korea	-326	(31)	0.18	328	0.92
Spain	-345	(98)	0.10	367	0.45
Japan	-439	(204)	0.02	896	0.00
Mexico	-444	(60)	0.26	445	0.29
India	-526	(51)	0.19	526	0.34
UK	-541	(191)	0.06	1044	0.00
Brazil	-926	(95)	0.28	930	0.11
Canada	-1023	(166)	0.21	1107	0.41

^a The difference between the increase in the value of patent rights held by residents of a country and the increased value of rights granted by that country. Both quantities increase due to the higher patent standards required by the TRIPs agreement.

^b Derived using the delta method.

^c The increase in the expected present value of patent rights granted by a country to residents of the other 28 countries.

^d The share of the gross transfer attributable to the increase in industry coverage of patent protection and abolition of working requirements.

Canada ranks only fifth in terms of destination for US owned patents. In addition, in 1988 US inventors sought only 14 687 patents in Canada while seeking over 75 000 domestically. In contrast, Canada seeks more patents in the US than any other country (including Canada itself). Consequently, the harmonizing of patent standards at a high level of protection provides ample incentive and opportunity

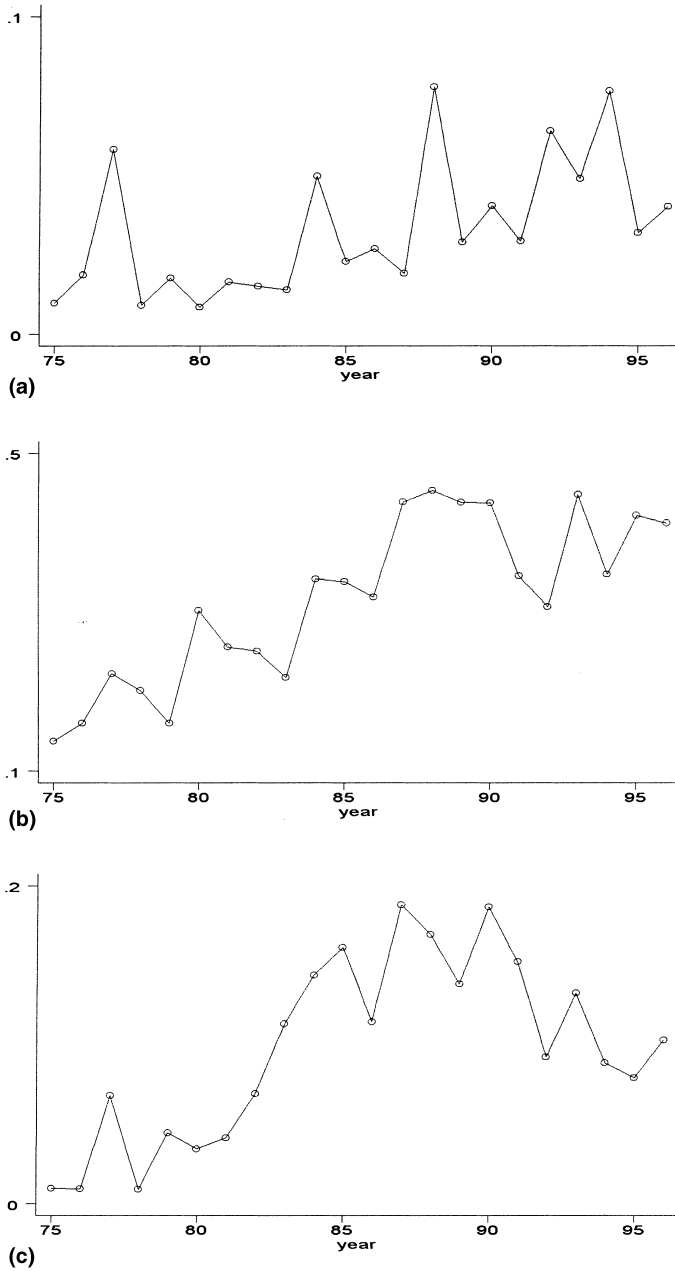


Figure 1. Patents related to tropical diseases as a percentage of all pharmaceuticals: (a) diseases with treatments; (b) diseases needing treatments; of which: (c) malaria; (d) leishmaniasis; (e) chagas; (f) leprosy.

rienced a marked surge in patenting, but somewhat earlier—beginning in the early 1980s. Further, patenting actually fell off substantially in the 1990s. Patenting related to

leishmaniasis and Chagas' disease followed more or less the pattern described for the group, but that related to leprosy was flat, and low, over the entire period.