

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.

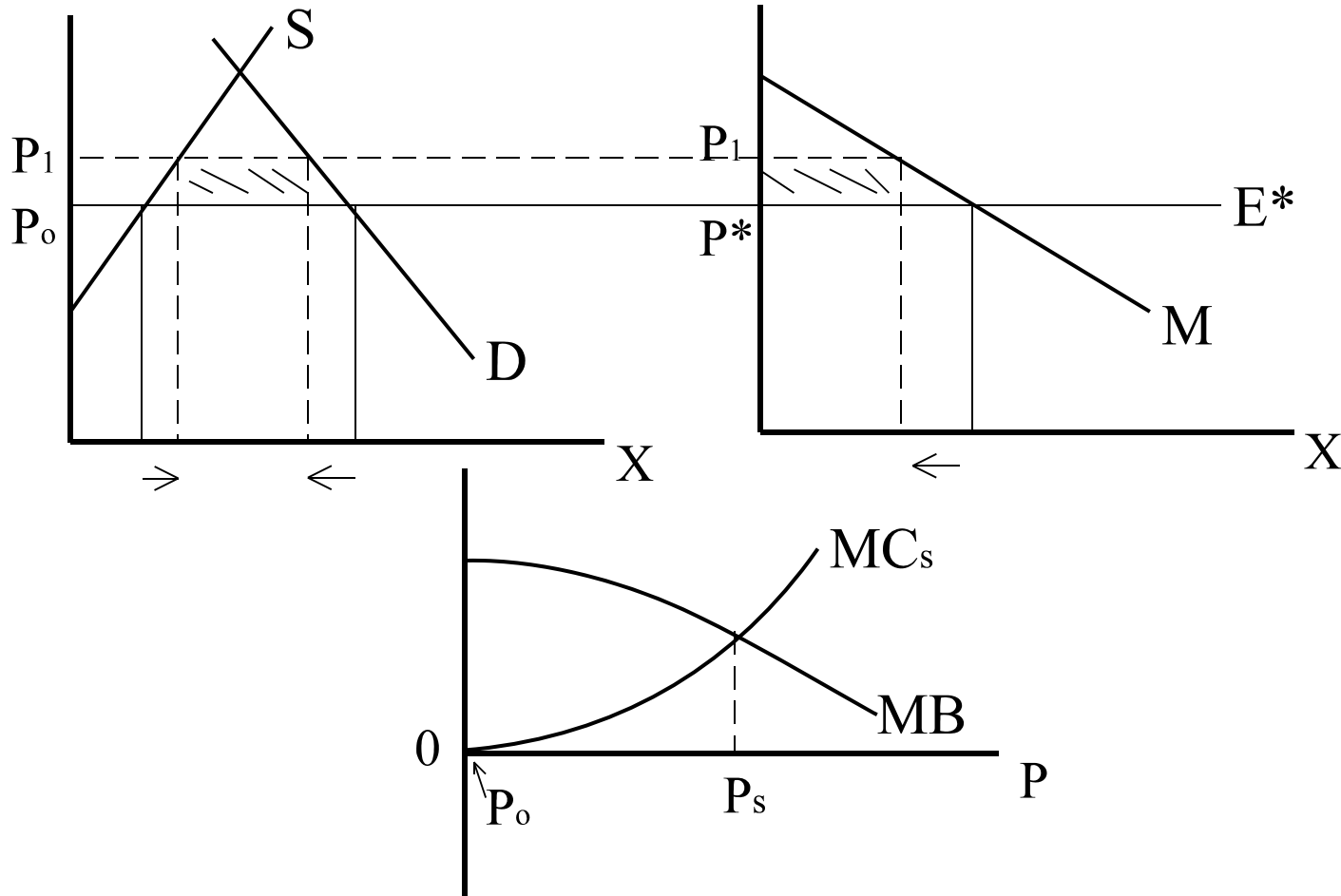
Most research in economics focuses on terms-of-trade theory, so I will here.

## 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.

# 1. The problem

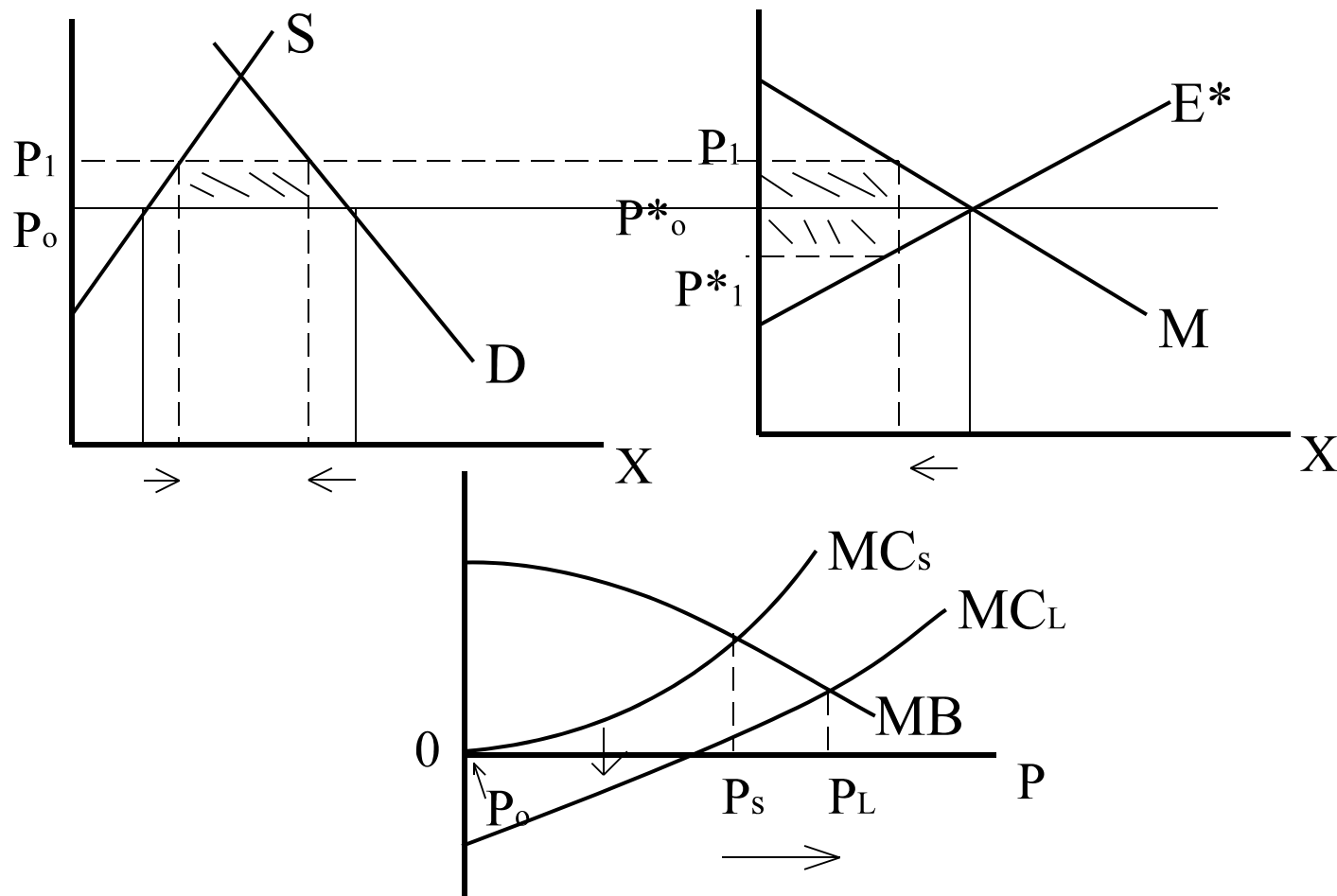
*A small country's unilateral tariff choice:*



*Internationally efficient, given national government objectives.*

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

*A large country's unilateral tariff choice:*



*Internationally inefficient, given national government objectives.*

Houston, we have a problem: *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.

## **2. The GATT/WTO as a Negotiating Forum.**

Observation: Among multilateral institutions, the GATT/WTO has adopted a distinctive approach to serving as a forum for international negotiation.

- Voluntary reciprocal market access negotiations between pairs/small numbers of countries, “multilateralized” according to MFN.
- Reciprocity and MFN are the two pillars of the GATT/WTO negotiating forum.

These features not accidental: Built on success of 1934 RTA, which in turn was influenced by:

- failed multilateral tariff bargaining approaches of inter-war years;
- failed European attempts at bilateral tariff bargaining without MFN.

From the perspective of the terms-of-trade theory, Why would the principle of *reciprocity* have appealing features?

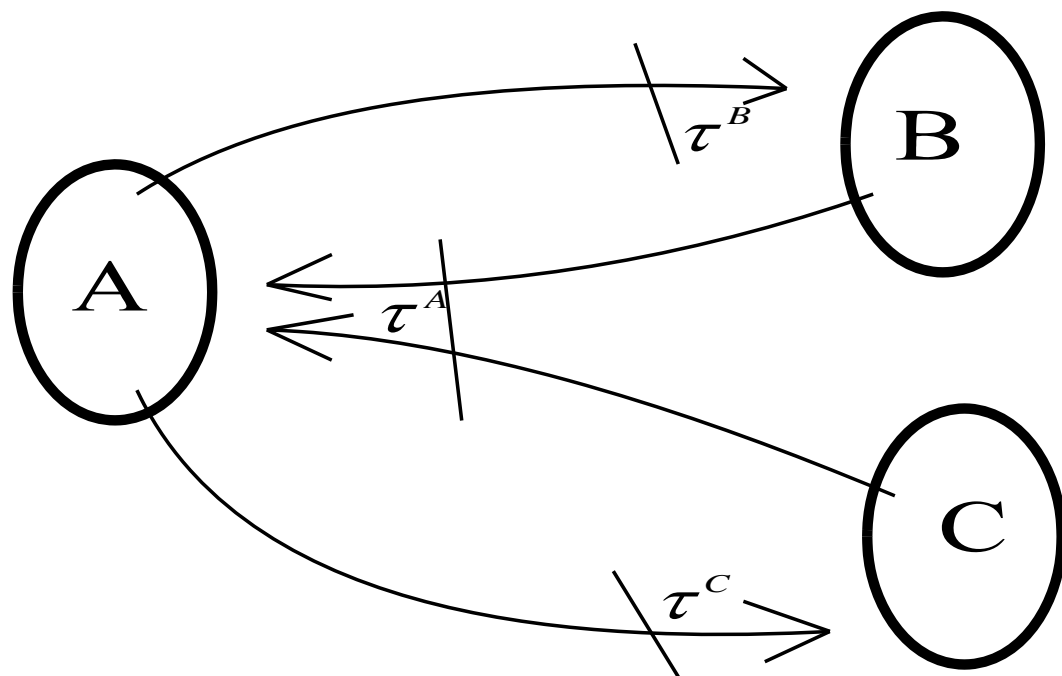
Reciprocity: the ideal of mutual changes in trade policy that trigger changes in the volume of each country's imports that are of equal value to changes in the volume of its exports.

- Describes a *fixed terms-of-trade rule* to which mutual tariff changes must conform;
- useful in an environment where terms-of-trade manipulation is *the* problem to be fixed.

Intuition: Beginning from Nash, each government desires more trade volume at fixed terms of trade.

- Reciprocity harnesses this desire, and so activates efficiency-enhancing tariff-liberalizing forces.

From the perspective of the terms-of-trade theory, Why would the *MFN* principle have appealing features?



MFN: With multiple foreign exporters (B and C) of good x, MFN requires of A a common import tariff regardless of foreign source.

Note: A and B can still negotiate reciprocal tariff reductions and benefit from more trade volume at a fixed terms of trade.

- Strikingly, as long as A and B abide by reciprocity, no third-party effects on country C.
- A and C can engage in bilateral reciprocal negotiations that have the same property.

Implication: the MFN rule permits the liberalizing force of reciprocity to be harnessed in an essentially *bilateral* manner even in a multilateral world.

*Interpretation:*

The GATT/WTO pillars of reciprocity and MFN can be understood to underpin the architecture of an international negotiating forum:

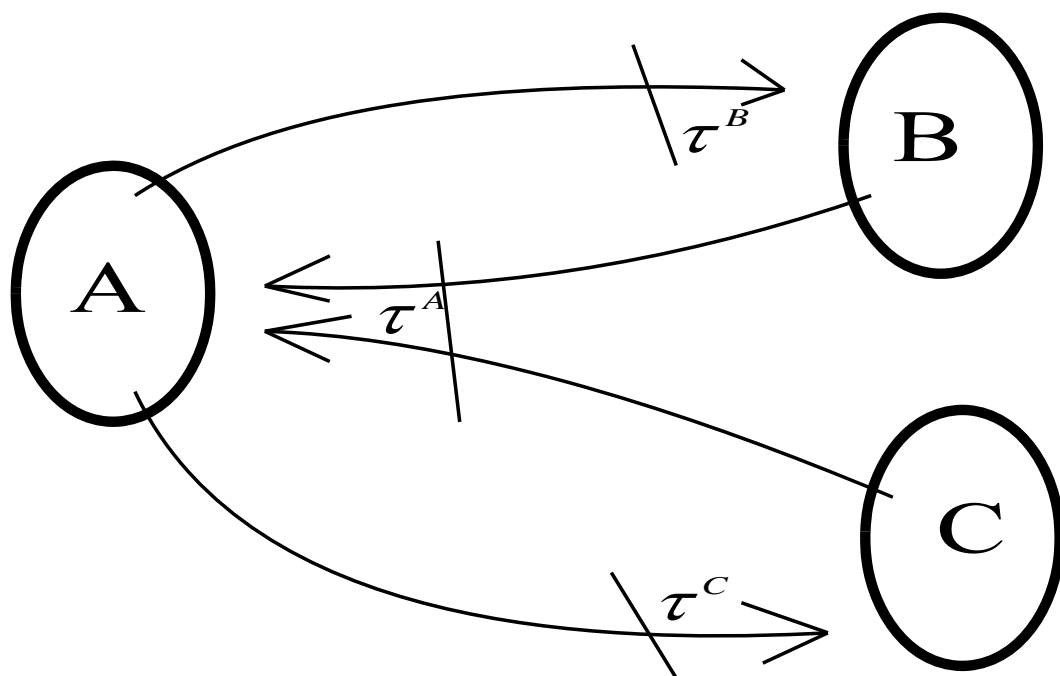
- in which the liberalizing force of reciprocity can be harnessed in bilateral negotiations with an assurance of minimal third-party spillovers;
- thereby permitting each member-government – through bilateral/small-numbers negotiations – to engineer its escape from a terms-of-trade driven Prisoners' Dilemma.

### **3. Empirical Evidence**

Three kinds of empirical evidence suggest that this is the primary purpose of GATT/WTO negotiations.

First, 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).

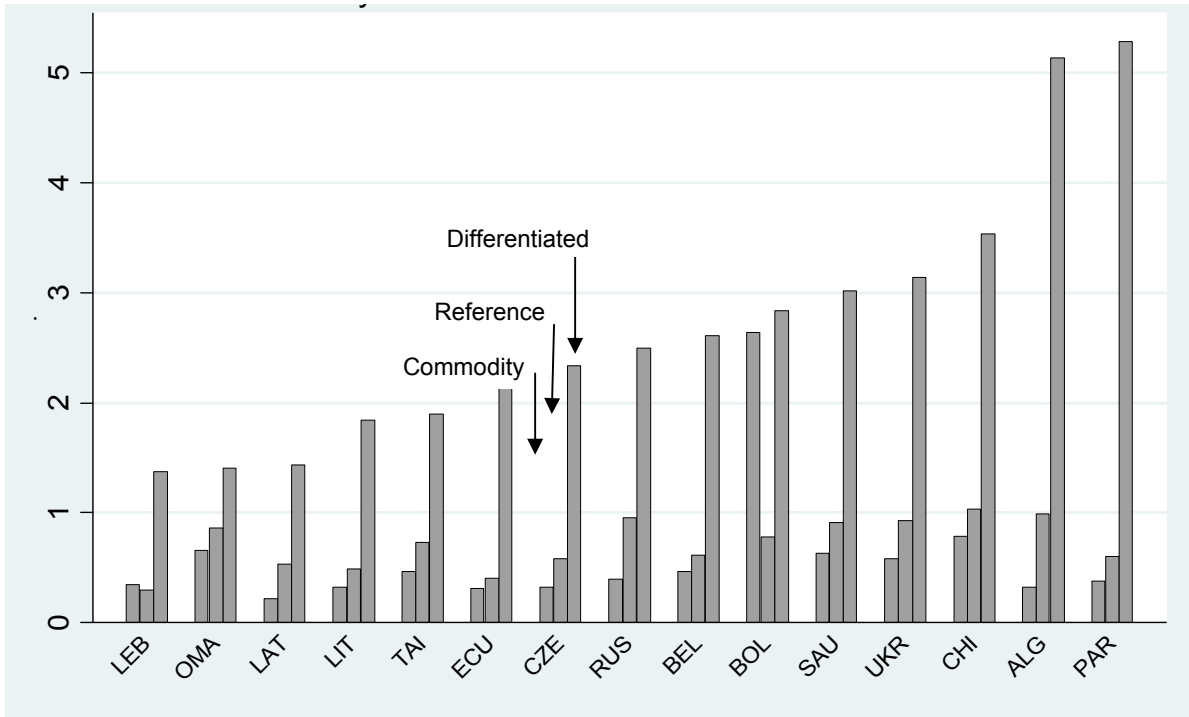


Second, Broda, Limao and Weinstein (2006).

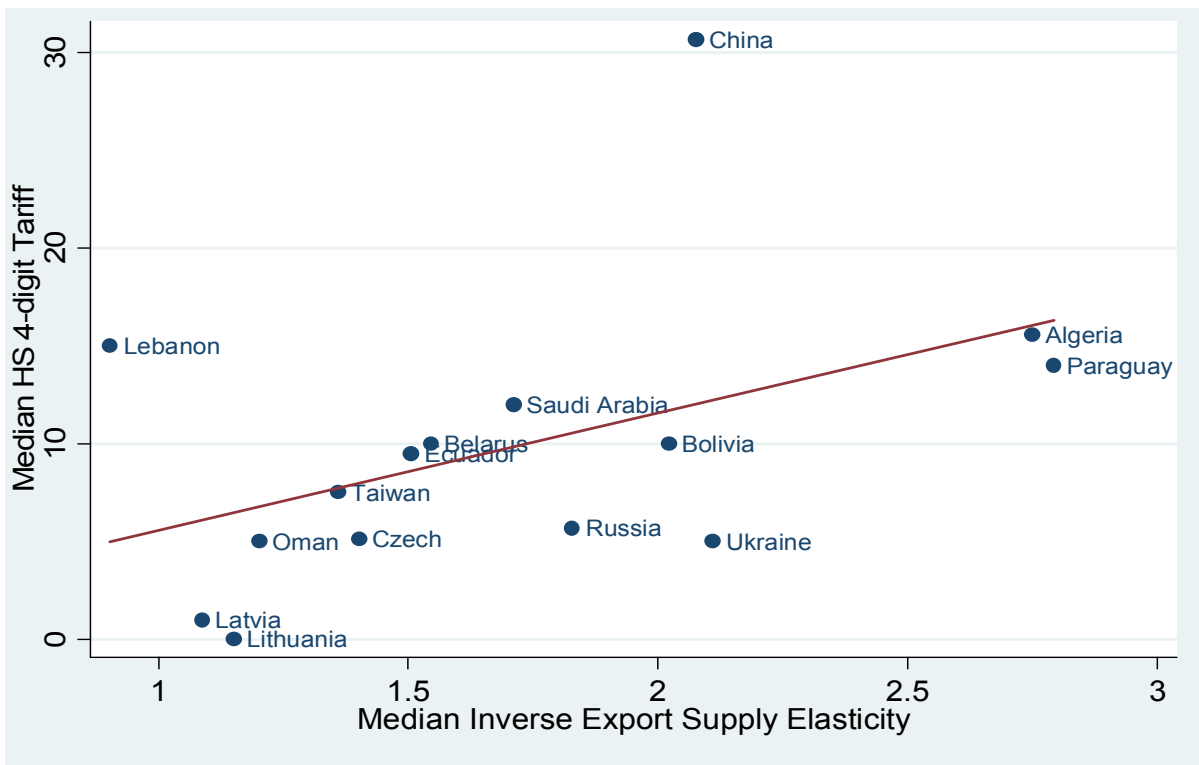
-- Evidence of “optimal tariffs.”

-- The optimal tariff exploits a country’s monopoly/monopsony power in trade, and is proportional to the inverse of the foreign export supply elasticity.

**Figure 2: Median Inverse Elasticities by Product Type**  
(Commodity; Reference Priced and Differentiated Products)



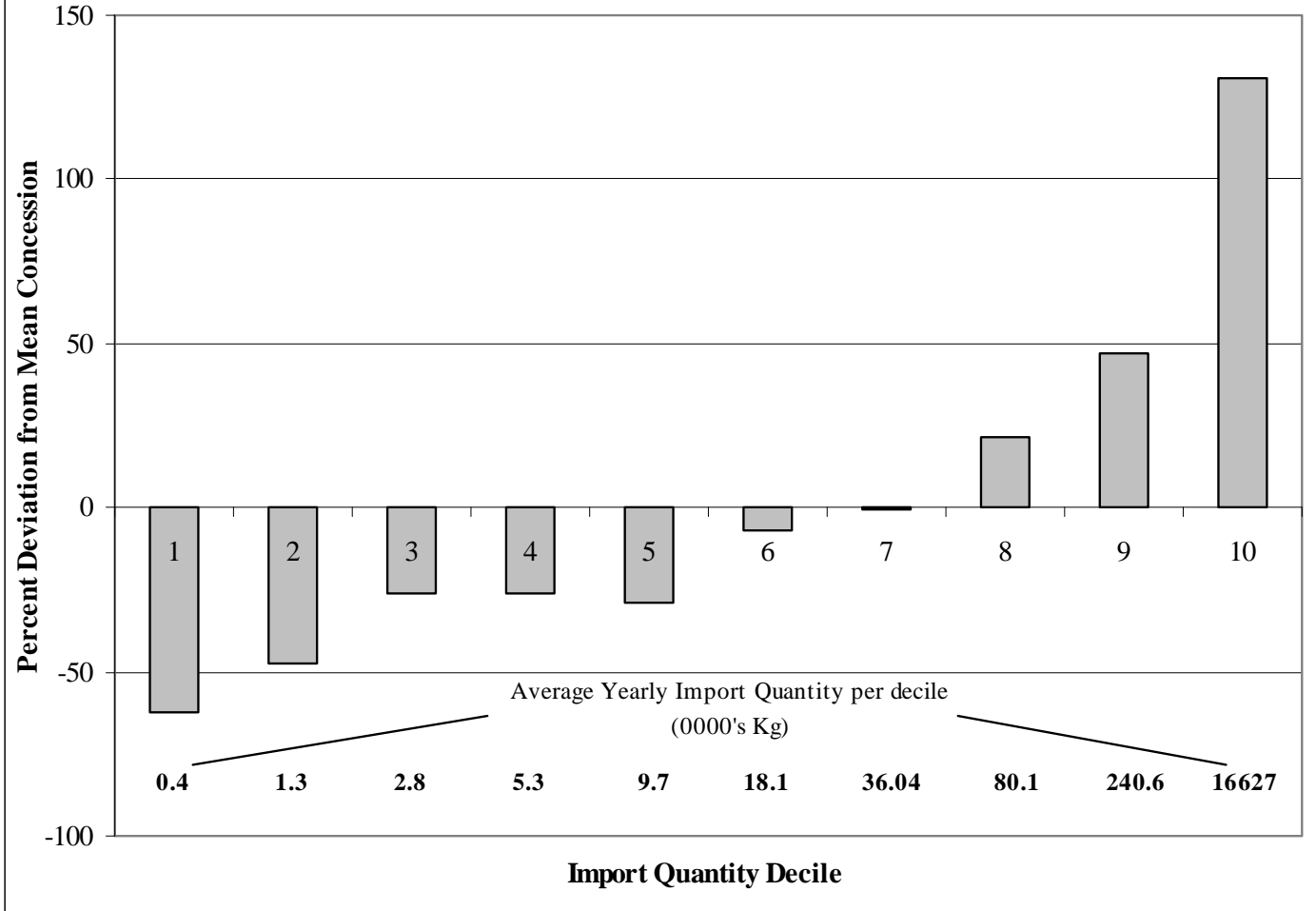
**Figure 3: Median Tariffs and Market Power Across Countries**



Third, Bagwell and Staiger (2006).

- International cost-shifting a bigger component of Nash tariffs the bigger is Nash import volume.
- Accordingly, the bigger is the Nash import volume, the bigger should be the negotiated tariff cut.

**Figure 1b: Percent Deviation from Mean Concession by Import Quantity Decile**



Notes: Percent deviation from mean concession for import decile  $k$  calculated as:

$$\left[ \frac{\frac{1}{binsize} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) - \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i})}{\left| \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) \right|} \right],$$

where  $binsize = 4201$  is the number of observations within each decile.

See Table 1 for the sample periods of Import and Tariff Data

## 4. 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).

## 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.

Either way, emphasis on Agricultural subsidies is misguided

That's another talk!