

Report on the International Trade Regime for the International Task Force on Global Public Goods

Robert W. Staiger*

The University of Wisconsin and NBER.

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Summary

The GATT and now the WTO has in effect served as the constitution of the post-war international trade regime. In this report I focus on the GATT/WTO as the centerpiece of the post-war international trade regime, and I explore a number of themes. First, what purpose is served by the WTO and the international trade agreements that it administers? Second, in what sense is the WTO a global public good? Third, I discuss two interpretations of the developing country experience in the GATT/WTO. Fourth, I identify two potential threats to the WTO and the international trade regime that is built upon it. And finally, I consider and evaluate a number of possible reforms of the WTO.

I suggest both general and specific conclusions. At a general level, I indicate the importance for the work of the Task Force with regard to the international trade regime of identifying the central inefficiencies that the WTO is being asked to address: I observe that there are two distinct inefficiencies that might reasonably be addressed through international trade agreements; and I suggest that providing its member governments with an avenue of escape from the inefficiencies that arise with a terms-of-trade driven Prisoners' Dilemma is the central task that the WTO is well-designed to handle. Also at a general level, I argue that the global public good features of the WTO are associated primarily with its design features – that is, with the creation of the WTO and with its maintenance as a negotiating forum – rather than with the end uses to which the WTO is put by its member governments. At a more specific level, I use these general conclusions to offer two interpretations of the disappointing developing-country experience within the GATT/WTO, and to suggest that the international trade regime may be threatened by the increasing numbers of preferential trade agreements and the widening scope of non-trade issues covered by the WTO. And finally, using these general and specific conclusions, I examine a number of possible WTO reform proposals. In particular, I suggest that some of the reforms proposed for initial consideration by the Task Force are quite promising, and I attempt to point out directions in which these promising reform proposals might be further developed.

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I. Introduction

An international trade regime can be largely non-cooperative, or it can be characterized by significant efforts at international cooperation. International cooperation in trade matters can be implicit, or it can take the form of explicit international trade agreements. In the post-World-War-II era, the international trade regime has been characterized by significant and sustained attempts to cooperate over trade matters at a multilateral level through voluntary but explicit international trade agreements. The GATT and now the WTO has in effect served as the constitution of the post-war international trade regime. In this report I focus on the GATT/WTO as the centerpiece of the post-war international trade regime, and I explore the following themes. First, what purpose is served by the WTO and the international trade agreements that it administers? Second, in what sense is the WTO a global public good? Third, I discuss two interpretations of the developing country experience in the GATT/WTO. Fourth, I identify two potential threats to the WTO and the international trade regime that is built upon it. And finally, I evaluate a number of possible reforms of the WTO.

II. What Purpose is Served by the WTO?

Since international trade agreements are entered into by governments voluntarily, they must offer the possibility of providing mutual gains for all participants. In a multilateral forum where all governments can participate, this possibility can only arise if there are inefficiencies absent the international agreement (i.e., if everyone is to get a bigger piece of the “pie,” then the size of the pie must be increased, which is only possible if there is an inefficiency to begin with).¹ The role of the agreement is then to reduce or eliminate the inefficiencies and distribute the gains from this accomplishment across participants. Hence, to identify the purpose served by international trade agreements, the key step is to identify the inefficiencies that such agreements can address. In this section I provide a brief description of the two central inefficiencies that international trade agreements can address.

II.1 The first role: escaping from a terms-of-trade driven Prisoners’ Dilemma

The most direct role for an international trade agreement is to eliminate an “international” inefficiency that would arise in the absence of an agreement, i.e., an inefficiency whose source can be traced to the economic interdependence among nations. What, then, is the source of the international inefficiency that provides a reason for an international trade agreement to exist? A natural possibility is the “terms-of-trade driven Prisoners’ Dilemma” that governments may confront in the absence of a trade agreement.² Providing governments with an avenue of escape from a terms-of-trade driven Prisoners’ Dilemma offers a first possible role that international trade agreements can play.

The essence of this first role may be understood as follows. When the U.S. government raises barriers against exports from the EU, it imposes a cost on EU exporters, if these exporters must ultimately accept lower prices for their products as a result of the diminished access to the U.S. market. In the absence of some compelling reason to take this cost into account, the U.S. government will naturally “under-value” the global costs of its decision to raise barriers against EU exports, i.e., it ignores the cost it imposes on EU exporters. As the EU is in a similar

¹If participation is limited to a subset of countries, then it is possible for participants in the trade agreement to gain at the expense of non-participants even when there is no inefficiency absent the agreement. I will return to this point in section V.

²The terms-of-trade driven Prisoners’ Dilemma was first formalized by Johnson (1953-54). Its history and extensions into modern political-economy theories of trade agreements are discussed in Bagwell and Staiger (2002, Ch. 2).

situation with regard to barriers against exports from the United States, the EU government will naturally undervalue the global costs of its decision to raise barriers against U.S. exports. The upshot, then, is that unless governments are given a compelling reason to take account of the costs that they impose on foreign exporters when they erect trade barriers, there will be a “problem” that translates into an international inefficiency. In particular, from a global standpoint there will be “too much” trade protection – and therefore “too little” market access – provided by governments in the following sense: if each government were given a “voice” in the market access choices made by those governments in the countries to which its exporters sell, it would be willing to pay those governments to provide greater market access to its exporters, and all governments could potentially gain from this transaction.

What I have just described is the international inefficiency that arises when governments find themselves caught in a “terms-of-trade driven Prisoners’ Dilemma.”³ As described, this international inefficiency arises naturally whenever governments lack a compelling reason to take account of the costs that they impose on foreign exporters when they erect trade barriers. And as explained, the international inefficiency takes the form of too little market access in the world.

Given this problem, the purpose of the WTO can then be seen as providing a “solution,” i.e., providing governments with an avenue of escape from the terms-of-trade driven Prisoners’ Dilemma in which they are mutually caught. As I will describe more fully below, the particular approach adopted by the WTO (and the GATT before it) to solve this problem is to provide a “market” for the exchange of market access commitments among governments. That is, the WTO is set up as a negotiating forum for governments, and its rules and norms are structured so that a government that wants access for its exporters to the markets of another country can engage in negotiations with the government of that country and offer access to its own markets in exchange.⁴ In this way, each government is given a voice – through WTO negotiations – in the market access choices made by those governments in the countries to which its exporters sell. And in this way, each government is given a compelling reason – through WTO negotiations – to take account of the costs it imposes on foreign exporters with its trade barriers (whether erecting new trade barriers or maintaining existing ones), because when it restricts access to its markets for foreign exporters it must now consider the foregone access to foreign markets for its own exporters that it could have acquired by an exchange of market access commitments with its trading partners through WTO negotiations (the recent unilateral imposition of steel tariffs by the U.S. government, and its subsequent decision to withdraw these tariffs in the face of threatened WTO-approved countermeasures against U.S. exporters by the EU, is a good illustration of this last point). It is in this way that WTO market access negotiations can “internalize” the terms-of-trade “externalities” that governments impose on each other with their unilateral trade policy choices, and thereby allow governments to achieve more efficient and mutually preferred

³The Prisoners’ Dilemma structure refers to a situation in which both governments could do better if each would cooperate with the other than if both act non-cooperatively, but each government does better yet if it alone acts non-cooperatively, and so non-cooperative behavior from both governments can be expected unless the governments can reach some enforceable agreement to cooperate. The costs imposed on exporters amount to terms-of-trade movements, which is why it can be said that the Prisoners’ Dilemma described in the text is terms-of-trade driven. The Prisoners’ Dilemma name itself refers to the original setting in which this structure was analyzed: two prisoners, accused of being partners in crime, are kept in separate rooms and must individually decide whether or not to confess (whether or not to act non-cooperatively toward the partner).

⁴Hoekman and Kosteki (1995, pp. 60-61) provide a lucid description of the GATT/WTO in these terms.

outcomes.

If the purpose of the WTO is to provide governments with an avenue of escape from a terms-of-trade driven Prisoners' Dilemma, then, WTO negotiations should be concerned fundamentally with expanding market access to globally efficient levels, and each government should be guided in these negotiations by the interests of its exporters. Three important observations follow.⁵

First, this interpretation of the purpose of the WTO explains why governments are driven by exporter interests in WTO negotiations – rather than the gains that come to consumers with freer trade – without resorting to the view that governments adopt irrational Mercantilist motives. Hence, under this interpretation, it becomes possible to view the WTO as an international institution within which the behavior of governments can be understood with basic economic reasoning.

Second, this interpretation of the purpose of the WTO indicates that governments will utilize WTO negotiations to reduce trade barriers and expand market access, regardless of their underlying ideologies or political preferences: under this interpretation, what motivates governments to negotiate trade-liberalizing agreements in the WTO is not necessarily a belief in free-trade principles, but rather the essential point that, whatever the underlying policy motivations of governments, there is simply too little market access in the world absent the WTO (or absent something else that serves the same purpose). Under this interpretation, then, arguments in support of the WTO are far more general than arguments in support of free trade. For instance, arguments in support of free trade require the absence of market imperfections (or the availability of non-trade policy instruments to address these market imperfections), and require as well the ability of governments to achieve distributional objectives through non-trade policies. Arguments in support of the WTO under this interpretation do not require that either of these conditions is met. Observe also that this interpretation of the purpose of the WTO can explain why WTO officials do not make pronouncements concerning what constitutes “good policies” (e.g., free trade) for WTO-member governments – as long as the policies of member-governments stay within the basic WTO rules (e.g., non-discrimination, transparency) – a fact that distinguishes the WTO markedly from other international economic institutions, such as the IMF, whose purposes are presumably quite different. This is a very important point for the work of the Task Force, and I will return to it below in section III.

And third, this interpretation of the purpose of the WTO carries with it a succinct mission for the WTO as an international institution. Specifically, the WTO should work to facilitate the expansion of market access commitments by its member governments; nothing more and nothing less.

II.2 The second role: making policy commitments to the private sector

An alternative role for an international trade agreement is to eliminate a “national” inefficiency that would arise in the absence of an agreement, i.e., an inefficiency whose source can be traced to a distortion in the national economy. In this case, an obvious question is, Why does a government need an agreement with other nations to help it address its national problem? A possible answer to this question is that, in the absence of a trade agreement, a government may be trapped in a sub-optimal “time-consistent equilibrium” in its policy interactions with its own private sector. Helping governments escape from time-consistent equilibria then offers a second

⁵These observations are described in detail in Bagwell and Staiger (2002, Ch. 2).

possible role that international trade agreements can play.

While the first role of international trade agreements described above focuses on the inefficiencies that arise as a result of the policy interactions among national governments, this second potential role can be seen by focusing on the inefficiencies that arise as a result of the interactions between each national government and its own private sector. Specifically, by “tying the hands” of a government, an international trade agreement may serve as an external constraint that can help the government make policy commitments (e.g., non-intervention) to the private sector that it would not be able to maintain “on its own,” i.e., without its hands tied by some external constraint. Unlike in the first role for trade agreements described above, under this second role for trade agreements other governments are not really part of the “problem,” but they can nevertheless become part of the “solution” by agreeing to punish a government if it reneges on its policy commitments. In this way, a government can potentially use a trade agreement to achieve policy goals that it would find infeasible to achieve on its own.

An example can illustrate the idea. Suppose that the government of Mexico wishes to undertake a substantial liberalization of its trade regime, because it sees the economic costs to Mexico of maintaining import protection – in terms of both the inefficiently large import-competing industries that have survived behind Mexican trade barriers and the inefficiently high prices that Mexican consumers must pay for imported and import-competing products – as outweighing the redistributive benefits that import-competing workers in Mexico enjoy as a consequence of these trade barriers. Suppose further that the government of Mexico announces a future date (e.g., one year from now) at which all remaining Mexican import barriers will be removed. Suppose finally that workers in the import-competing industries of Mexico must by that date make a largely irreversible decision of whether to relocate from the import-competing industries or stay. Plausibly, many of these workers will be better off relocating if the government of Mexico follows through with its announced trade liberalization on the announced date. But some workers may be better off staying in the import-competing industry even under liberalization, despite the precipitous drop in wages that they may experience, because their ability to relocate is sufficiently constrained. A potential credibility problem will arise for the Mexican government if there are significant numbers of Mexican workers who would choose to stay under liberalization, because in this case it would be tempting for the government to renege on its announced intentions after those workers who could leave the import-competing industries had done so, and to offer some import protection to the “un-relocatable” workers that remain in the import-competing industries at that time. The real difficulty for the government is that workers who would have relocated if they expected the government to actually follow through on its announced liberalization will choose not to leave if they understand how the government’s incentives will change with time (i.e., after the date of its announced trade liberalization has come and gone), and in the presence of this credibility problem the government may find itself trapped in a sub-optimal situation in which it cannot credibly liberalize its import barriers, and from which it cannot escape.

What I have just described is a national inefficiency that arises when a government finds itself caught in a “time-consistent equilibrium.”⁶ As described, this national inefficiency arises whenever a government faces a policy

⁶The phrase “time-consistency” is roughly analogous to “credibility”: that is, in a time-consistent equilibrium, the government is constrained to announce “credible” policies at one point in time that it would actually follow through on at a later point in time (hence “time-consistent”) if the private sector believed these announcements and acted upon them.

credibility problem with regard to the expectations of its private sector.⁷ Given this problem, the purpose of the WTO can then be seen as providing a “solution,” i.e., providing governments with an avenue of escape from the time-consistent equilibria in which each is caught with its private sector. As mentioned above, the role of the WTO in this case is to facilitate agreements that permit governments to “tie their own hands” against pressures that they face from their own private sectors to renege on announced policy goals, and thereby enhance the national credibility of trade reforms. Of course, there is no “world jail” into which a government can be thrown if it does “untie its hands” and renege on liberalization commitments made in the context of WTO negotiations. But broken WTO commitments can lead to retaliatory responses from important trading partners, a possibility that introduces additional “external” costs for a government that reneges on its policy commitments, and this possibility can potentially serve as an external commitment device that can help a government make policy commitments to its private sector that it would not be able to maintain on its own.⁸

If the purpose of the WTO is to provide governments with a means of escape from a time-consistent equilibrium, then the focus on market access commitments that characterized the mission of the WTO in the first role described above no longer applies. Instead, under this second role, it is not levels of market access per se to which governments need help committing, but rather any of a whole host of border and non-border policy instruments at their disposal. This point is very important for the work of the Task Force with regard to the international trade regime, because it indicates that some of the key design features of the WTO – such as whether agreements should seek to commit governments primarily to market access levels, leaving each government largely free to determine for itself the exact mix of border and non-border measures with which it will honor its market access commitments, or rather commit governments to specific levels of both border and non-border policy measures – will depend on which of these two roles the WTO is to play. Of course, the WTO could play both roles, and as I will observe in the next subsection probably does to some extent. But due to the distinct nature of the two problems that are being solved under these two different roles, it is likely that the WTO cannot serve both purposes well. Hence, identifying the central problem that the WTO is attempting to solve is a critical step in ensuring the coherence of the international trade regime built upon WTO principles, and it is a critical step as well for the work of the Task Force with respect to the international trade regime.

II.3 The literature, the evidence, and the design features of the GATT/WTO

The existing economics literature on trade agreements highlights one or the other of these two roles.⁹ In fact, it is accurate to say that the main branch of the economics literature adopts the view that trade agreements serve the

⁷The policy credibility problem, in turn, can be interpreted as arising whenever governments lack first-best policy instruments for their purposes. As trade intervention is almost always a second-best or worse form of policy intervention (see Bhagwati, Ramaswami and Srinivasan, 1969), it may be expected that credibility problems in trade policy will be wide-spread. The role of trade agreements in allowing governments to escape from sub-optimal time-consistent equilibria is discussed in Bagwell and Staiger (2002, Ch. 2).

⁸Ultimately, the external costs that are associated with retaliatory responses by important trading partners take the form of lower exporter prices, and so a “terms-of-trade” channel is lurking in the background of this second purpose of trade agreements as well. The threat of retaliatory responses from important trading partners is critical as well in enabling the WTO to serve the first purpose described above, a point to which I will return in section IV. On the central role played by retaliation in the WTO, see Bagwell and Staiger (2002, Ch. 6) and Lawrence (2003).

⁹Bagwell and Staiger (2002, Ch. 2) describes how the various papers that comprise the existing economics literature can be seen as reflecting either one or the other of these two roles.

first role, namely, that they allow governments to escape from a terms-of-trade driven Prisoners' Dilemma.¹⁰ Studies exist which emphasize the possible commitment role played by trade agreements as well, but this branch of the literature has not to date been developed very far.¹¹

Empirically, there are a large number of studies that provide indirect support for the terms-of-trade interpretation of the role of the WTO, though there are as yet no studies that provide direct empirical evidence that the WTO serves this role.¹² Moreover, a number of the most central design features of the WTO – such as its reciprocity norm, its non-discrimination principle, and its enforcement provisions, as well as its traditional focus on market access – can be interpreted as making the WTO well-suited to help governments in their attempt to escape from a terms-of-trade driven Prisoners' Dilemma.¹³ This evidence suggests that, at its core, the WTO is a well-designed institution *if* its purpose is to help governments escape from a terms-of-trade driven Prisoners' Dilemma.

With regard to evidence concerning the possible commitment role played by the WTO, there is one study that provides direct empirical evidence of a commitment role played by GATT (prior to its rebirth as the WTO).¹⁴ On the other hand, there are no studies that have been able to offer a commitment interpretation of the central design features of the WTO, and there is reason to believe that at least one prominent feature of the WTO – the built-in policy flexibility that governments can exercise through various WTO safeguard provisions and escape clauses – works against the role of the WTO in serving as a commitment mechanism to constrain the actions of governments against their private sectors. This evidence suggests that, while the WTO may play some commitment role for its member governments, this is not its central purpose.

So, I now return to the question with which I began this section: What purpose is served by the WTO? On the basis of this discussion, a defensible answer to this question would run as follows. The WTO (and GATT before it) owes its reputation as one of the world's most successful international institutions to the fact that it has served primarily as an effective means by which its member governments have been able to escape from a terms-of-trade driven Prisoners' Dilemma. This escape has translated into an expansion of market access through GATT/WTO negotiations to more-nearly internationally efficient levels, and mutual gains for the participating governments

¹⁰This is not to say that this view is universally accepted by economists. In fact, when stated in this way, this view is almost universally rejected by economists. Nevertheless, it is accurate to say that this is the role played by trade agreements in the main branch of the economics literature, and many economists are more comfortable with this view when it is expressed in the equivalent but WTO-compatible language of "market access" as I have expressed it in the text. The formal link between the terms-of-trade and market-access descriptions is contained in Bagwell and Staiger (2002, Ch. 2).

¹¹A possible commitment role for trade agreements was suggested in Staiger and Tabellini (1987).

¹²Empirical studies that provide indirect support for the terms-of-trade interpretation of the role of the WTO are surveyed in Bagwell and Staiger (2002, Ch. 11). More recent studies include Bown (2004a, 2004b, 2004c), Limao (2003) and Shirono (2003).

¹³The WTO's reciprocity norm, non-discrimination principle and enforcement provisions are described in Bagwell and Staiger (2002, Ch. 3), and given terms-of-trade interpretations in Bagwell and Staiger (2002, Ch. 4, 5 and 6, respectively). Briefly, reciprocity within the GATT/WTO has come to mean mutual changes in trade policy which bring about changes in the volume of each country's imports that are of equal value to changes in the volume of its exports. Non-discrimination, as embodied in the GATT/WTO's most-favored-nation (MFN) principle when applied to tariffs, means that a country cannot impose different tariff levels on the same good originating from different exporting countries.

¹⁴This is the study by Staiger and Tabellini (1999).

have been created as a result. GATT/WTO commitments can also enhance the national credibility of trade reforms and thereby help governments escape from sub-optimal time-consistent equilibria, but this role has probably been secondary in accounting for the gains that are associated with GATT/WTO membership. A key remaining question is how these gains have been distributed across the member governments. In section IV I will address this question. But before doing so, I first consider the sense in which the WTO might be thought of as a global public good. This is taken up in the next section.

III. Is the WTO a Global Public Good?

I now develop the rationale for treating the international trade regime, as embodied in the WTO, as a global (“international”) public good. I argue that the creation and maintenance of the WTO has important global-public-good features, but that its utilization by member governments need not exhibit the features of a global public good, and that this distinction between creation/maintenance and utilization can provide important guidance for the Task Force in suggesting useful reforms of the WTO.

An institution such as the WTO can be viewed as an international public good, in the sense that governments have a shared interest in its creation and maintenance, much as the inhabitants of an off-shore island have a shared interest in the creation and maintenance of a causeway for purposes of escaping to the mainland in times of an approaching hurricane. The causeway analogy is useful, because it helps to highlight a subtle but important point about the WTO. Specifically, once built (and maintained), the utilization of the causeway may be largely a private good (subject to possible congestion, a point to which I return in section VI below): individual families may escape an oncoming hurricane in their own vehicles, and the utilization of the causeway by one family may therefore entail very little “spillover” to other island inhabitants. That is, the main “collective action” problem associated with the causeway is associated with its construction and maintenance, not with its use. By analogy, the creation and maintenance of the WTO can be seen as an act of providing an international public good, but the utilization of the WTO by its member governments (e.g., the market access negotiations between two or a small number of governments) can be seen largely as an international private good.¹⁵ Returning to an observation made above in section II, this point is consistent with the fact that WTO officials do not make pronouncements on specific ways in which member-governments should utilize the WTO (e.g., free trade in services by 2015). The specific goals which the GATT/WTO is utilized by its member governments to achieve have traditionally been left up to the interests of the member governments themselves, reflecting perhaps the absence of an important collective action problem associated with WTO utilization. Rather, the main collective action problem lies in setting up and maintaining this institution as an effective negotiating forum for member governments: the uses to which the negotiating forum is put by member governments is then largely an international private good.

To see that utilization of the WTO by its member governments is largely an international private good, it is important to understand that in many ways the WTO is set up so that member governments can use it to solve either of the two problems identified in the previous section with negotiations among a small number of trading partners, and can ensure that those negotiations entail minimal spillovers to other (even WTO-member) governments. Indeed, this feature may in large part explain the success of the GATT/WTO as an international

¹⁵It is sometimes argued that the use of the WTO dispute procedures can generate public goods, by establishing precedence and clarifying for other member governments what the legal rules are as regards some new dispute area. For the purposes of my discussion here, I will view the creation of legal precedence associated with the use of WTO dispute procedures as part of the “creation and maintenance” of the WTO broadly defined.

institution: under its rules and procedures, governments have been successfully motivated to engage in trade-liberalizing negotiations, because they are the primary beneficiaries of their own negotiations (i.e., spillovers to third countries are minimized).

Consider, then, what I concluded in section II to be the central problem that the WTO is well-designed to solve, namely, providing governments with an avenue of escape from a terms-of-trade driven Prisoners' Dilemma. It can be argued that market access negotiations among a small number of governments can allow these governments to "solve their problem" and expand their market access to internationally efficient levels with minimal or even no spillovers to other countries – so that these governments can capture most or all of the benefits of their negotiations for themselves – provided that their negotiations abide by the WTO non-discrimination rule and conform to the WTO principle of reciprocity (see note 13). Intuitively, when two governments negotiate non-discriminatory trade liberalization on a reciprocal basis, each government is really accomplishing two things: it is expanding the demand for imports in its country on a non-discriminatory basis, which could potentially be satisfied by increased exports from any country in the world; and it is stimulating its own export supply with the resources released from use in its import-competing industries, giving its exporters an extra competitive advantage over exporters from other countries in serving the new import demands of its negotiating partner. In this way, WTO negotiating partners who exchange non-discriminatory market access concessions on a reciprocal basis can in effect ensure that most or even all of the expanded trade volume that derives from these negotiations goes to their own exporters.¹⁶

The implication, then, is that governments can largely "internalize" for themselves the benefits from utilizing the WTO to solve their problems. This point, in turn, has important implications for how the WTO works, because it suggests that the WTO works best to solve the problems that governments would face in its absence if governments are left largely to follow their own self interests within the international trade regime created by the WTO.

Returning to the causeway analogy, the central public-good features of the causeway are associated with its creation and maintenance, not with its use. Likewise, the central public-good features of the WTO are associated with its creation and maintenance, not with its utilization by member governments. This distinction can serve as an important guideline for the work of the Task Force with regard to the international trade regime: the focus of the Task Force should be aimed at enhancing the design features of the WTO (which are largely of an international-public-good nature) – so that member governments may more effectively utilize these features to solve either or both of the problems identified above – rather than aimed at attempting to dictate the end uses to which the WTO system is put by its member governments (which are largely of an international-private-good nature).

IV. Two Interpretations of Developing-Country Experience in the GATT/WTO

In this section, I briefly consider the evidence concerning the unevenly distributed benefits of trade expansion (skewed largely toward big developed countries) afforded by GATT/WTO membership over the past decades, and utilize the discussion of the previous sections to draw several observations.

¹⁶This point is discussed in Bagwell and Staiger (2002, Ch. 5).

There is much anecdotal evidence and recently some more systematic evidence that the main trade-expanding impacts of the GATT/WTO have been confined to developed-country members, with developing-country members experiencing little expansion in trade volumes as a result of the 50-plus year history of GATT/WTO market access negotiations. In fact, a recent study finds that GATT/WTO negotiations have had essentially no measurable impact on the trade of developing countries, but that the aggregate volume of trade for developed countries is currently about 65% greater than it would be in the absence of the market access commitments negotiated within the GATT/WTO.¹⁷ These findings support the view that the main beneficiaries of the international trade regime built upon the GATT/WTO are the developed countries. But how is this fact to be interpreted? I now make two observations, based on the arguments contained in sections II and III above.

A first observation is that the uneven distribution of benefits across countries may reflect two underlying features: (i) the uneven distribution across countries of the central problem that the GATT/WTO can reasonably be expected to solve (i.e., the terms-of-trade driven Prisoners' Dilemma as described in section II above); and (ii) the ability of governments to largely internalize for themselves the benefits of solving their problems within the GATT/WTO, as indicated in section III above. More specifically, I now observe that the terms-of-trade driven Prisoners' Dilemma problem is likely to be most prominent in large developed-country markets. This is because, for a government to create an international inefficiency with its market access choices, those choices must have a significant effect on exporter prices in other countries, and this in turn requires that the government must be a "big player" in world trade (i.e., the degree of openness of its borders to trade must have significant impacts on world markets), a feature that is shared most prominently by governments in large developed countries. Hence, the terms-of-trade driven Prisoners' Dilemma problem is likely to be found primarily among the large developed countries. In light of the observations made in sections II and III above – that the terms-of-trade driven Prisoners' Dilemma is the central problem that the WTO is well designed to solve, and that governments can largely internalize for themselves the benefits from solving this problem through GATT/WTO negotiations – it then follows that the large developed countries will naturally experience the largest beneficial expansions of trade as a result of solving this problem through market access negotiations within the GATT/WTO. In this way, it can be argued that one interpretation of the uneven distribution of the benefits of trade expansion skewed largely toward the big developed countries is relatively sanguine: this simply reflects the GATT/WTO "doing its job, and doing it well."

A second observation is that an alternative interpretation is also possible, however. Under this alternative interpretation, developing countries do suffer from significant problems that can in principle be addressed through a trade agreement (i.e., either or both of the two problems identified above), but developing countries are unable to adequately and effectively address these problems within the GATT/WTO system. The possible reasons why developing countries might have difficulty utilizing the WTO are many and varied, and to the extent that this second interpretation is correct, then addressing the most pressing of these reasons should be a priority of the proposed reforms of the WTO. For instance, as I observed in section II above, providing governments with an effective escape from a terms-of-trade driven Prisoners' Dilemma requires that negotiated market access commitments are enforceable, and in the WTO this is accomplished with the threat of retaliatory actions: it has been observed that an inability to credibly threaten retaliatory actions therefore puts small developing countries

¹⁷The most recent and comprehensive systematic evidence on the distinct trade-enhancing experiences of developed and developing country GATT/WTO members is contained in Subramanian and Wei (2003).

at a disadvantage when attempting to utilize the GATT/WTO system.¹⁸ Under this second interpretation, these and other possible impediments to the effective utilization of the WTO by developing countries are surely worthy targets of reform proposals.

Indeed, this second interpretation seems consistent with the Ministerial Declaration of November 14 2001 that launched the Doha Round of WTO Negotiations, which stated in part:

“International trade can play a major role in the promotion of economic development and the alleviation of poverty. We recognize the need for all our peoples to benefit from the increased opportunities and welfare gains that the multilateral trading system generates. The majority of WTO members are developing countries. We seek to place their needs and interests at the heart of the Work Programme adopted in this Declaration. Recalling the Preamble to the Marrakesh Agreement, we shall continue to make positive efforts designed to ensure that developing countries, and especially the least-developed among them, secure a share in the growth of world trade commensurate with the needs of their economic development. In this context, enhanced market access, balanced rules, and well targeted, sustainably financed technical assistance and capacity-building programmes have important roles to play.

“We recognize the particular vulnerability of the least-developed countries and the special structural difficulties they face in the global economy. We are committed to addressing the marginalization of least-developed countries in international trade and to improving their effective participation in the multilateral trading system. We recall the commitments made by ministers at our meetings in Marrakesh, Singapore and Geneva, and by the international community at the Third UN Conference on Least-Developed Countries in Brussels, to help least-developed countries secure beneficial and meaningful integration into the multilateral trading system and the global economy. We are determined that the WTO will play its part in building effectively on these commitments under the Work Programme we are establishing.”

This declaration is a clear statement of intent to harness the WTO to better serve its developing country member governments. But especially in light of the sweeping goals of the Doha Round in this regard, it deserves emphasis that there is at least the possibility that the many problems faced by developing country governments are not the problems that the WTO is well-equipped to solve, in which case placing reforms of the WTO at the heart of efforts to help developing countries may be ill-advised.

The upshot, then, is that what – if anything – should be done about the unevenly distributed benefits of trade expansion afforded by GATT/WTO membership over the past decades hinges largely on which of the two interpretations offered above is correct, and currently there is very little evidence one way or the other with which to weigh the validity of these alternative interpretations. In this light, and until more evidence is available on this critical question, a sensible position might proceed cautiously, by seeking to identify the most obvious impediments that developing countries face in making use of WTO procedures, and then advocating reforms of the WTO aimed at dismantling these impediments in the hope of enhancing the effectiveness with which developing countries can put the WTO to use in solving either or both of the problems identified in section II.

V. Potential Threats to the International Trade Regime

I now briefly discuss how the effectiveness of the international trade regime may be threatened by two trends. The first trend is the increasing numbers of bilateral and regional preferential trade agreements. The second trend is the widening scope of non-trade issues covered by the WTO.

In effect, these two trends may be seen to pose the clearest threat to the effectiveness of the WTO if the WTO’s central purpose is seen as helping governments escape from a terms-of-trade driven Prisoners’ Dilemma, as I argued was the case in section II. In this case, the escape can be engineered with traditional market access

¹⁸This observation was made recently in the proposal for reform of the WTO Dispute Settlement Procedures put forward by Mexico: see WTO (2002).

agreements that focus primarily on border measures and trade issues, but only provided that border measures are primarily maintained on a non-discriminatory basis. Intuitively, under the non-discrimination principle of the WTO, tariffs must be applied on a most-favored-nation (MFN) basis (see note 13). When all tariffs conform to MFN, the international externalities that governments impose on each other with their unilateral tariff choices take on a very simple form, because no government has any particular reason to care about the source of its imports (i.e., the particular exporter country from which these imports originate). And in light of the simple nature of the international externalities in an MFN environment, it can be argued that a negotiating forum structured by the other central features of the WTO (such as its reciprocity norm) is likely to be especially effective in allowing governments to solve their terms-of-trade driven Prisoners' Dilemma problem through market access negotiations.¹⁹ In contrast, a government that imposes discriminatory tariffs on its trading partners now has a reason to care about the source of its imports, and this introduces a more complex pattern of international externalities that the negotiating forum structured by WTO rules is not as well-equipped to handle. For example, the ability of negotiating governments (as described in section III) to use reciprocal exchanges of market access commitments to capture for themselves most or even all of the benefits that derive from their negotiations is altered when tariff discrimination is prevalent. In fact, once the WTO norm of non-discriminatory and reciprocal exchanges of market access commitments is widely compromised, a new threat to the international trade regime arises: rather than utilizing international trade agreements to solve inefficiencies so that all countries can potentially gain (or at least some can gain and none need lose) as I described in section II, governments may see discriminatory preferential agreements as a way for the participants in those agreements to gain at the expense of non-participants.

The upshot, then, is that the more prevalent and important are preferential trade agreements, the less effective is the negotiating forum defined by WTO rules and norms likely to be for solving the terms-of-trade driven Prisoners' Dilemma problem. And once the basic reason for the effectiveness of reciprocal market access negotiations as a solution to this problem is compromised, as I have argued will be the case in the more complicated discriminatory environment that preferential agreements create, negotiations over other non-border measures and non-market-access issues may be deemed necessary to achieve internationally efficient outcomes. In addition to posing the threat of "mission creep" for the WTO, this movement toward negotiating over non-border measures and non-market-access issues may make agreements that are struck within the WTO increasingly at odds with traditional notions of national sovereignty.²⁰

As a consequence of these arguments, it is possible to see the erosion of the non-discrimination principle that has accompanied the increasing numbers of bilateral and regional preferential trade agreements as complicating the task before the WTO – to the extent that this task amounts to helping governments escape from a terms-of-trade driven Prisoners' Dilemma – and inducing it to confront a widening scope of non-trade issues in an attempt to serve this purpose, thereby diluting its central mission and threatening the sovereignty of its member governments.

VI. Reforms of the WTO

In this section I consider and briefly evaluate a number of possible concrete reforms that might be proposed to

¹⁹This point is discussed in Bagwell and Staiger (2002, Ch. 5).

²⁰See Bagwell and Staiger (2003) for an analysis along these lines concerning the WTO, market access and national sovereignty.

enhance the efficiency and the effectiveness of the international trade regime. These reform proposals are drawn from the list of reforms proposed for initial consideration by the Task Force, and I have suggested a number of specific directions in which the reform proposals might be developed. Throughout, my criterion for identifying a promising reform proposal for the Task Force to consider is that the proposal is directed toward the global public good features of the WTO.

VI.1 Proposal 1

Proposal: Strengthen WTO instruments such as transparency, trade policy reviews, and dispute settlement procedures.

Evaluation: I advise that the Task Force pursue this proposal. This proposal is directed toward making the design features of the WTO more effective for use by member governments, and as such it is directed at the global public good features of the WTO, as discussed in sections II and III above.

In light of the discussion in section IV above, one specific focus of this proposal might be to consider ways to enhance the effectiveness with which developing countries can use the WTO Dispute Settlement Procedures (DSP). In this regard, Mexico (WTO, 2002) has proposed a number of reforms of the DSP, and some of these might form the basis for specific reform proposals from the Task Force. For instance, Mexico's proposal to make WTO retaliation rights tradeable among WTO member governments has some appealing features from an economic perspective, and it might warrant further investigation and possible support by the Task Force. In effect, if implemented through auctions, the idea of tradeable retaliation rights represents a market-based approach to introducing multilateral elements into retaliation threats within the WTO – thereby possibly giving small/developing countries more of a “voice” in their bilateral disputes with large/developed trading partners – and at the same time raises the possibility that small/developing countries may achieve some restitution (in the form of auction revenue) even if they are unable to bring about change in the offending policies of their large/developed trading partners.²¹

A second specific focus of this proposal – which could potentially have cross-cutting effects on the issues of transparency, trade policy reviews, and dispute settlement procedures as they relate to government responses to “unfair trade practices” – might be to consider the possibility of providing governments whose exporters face countervailing or antidumping duties with some form of reciprocal rights of compensation/retaliation against the countries that impose these duties on their firms. A proposal that adopted this second specific focus would build from the observation that a major accomplishment of the GATT/WTO relative to the pre-GATT era has been to harness retaliation and convert it into a tool of international order, and that retaliation in the GATT/WTO serves two roles: a first role is to provide the retaliating government with some restitution when it is harmed by the unilateral policy action of a trading partner; but a second role is to confront the government that takes the unilateral policy action more completely with the full costs of its decision in the international arena, and thereby fend off the re-emergence of a terms-of-trade driven Prisoners' Dilemma akin to that described in section II.1 above. According to this second role, retaliation/compensation provisions in the GATT/WTO can be important in ensuring that governments face the “correct” incentives when making their policy decisions. From this

²¹The case for auctioning countermeasures in the WTO is considered from a formal economic perspective in Bagwell, Mavroidis and Staiger (2003), and is described in non-technical terms in Bagwell, Mavroidis and Staiger (2004).

perspective, the idea of extending the existing rights of retaliation/compensation in the WTO – which currently apply in areas such as GATT Article XIX Safeguard actions and GATT Article XXVIII Renegotiations – to apply as well to GATT Article VI actions (antidumping and countervailing duties) has some appealing features, and it might warrant further investigation and possible support by the Task Force. For instance, it can be argued that introducing into the WTO a set of new provisions that would give governments the right of retaliation/compensation in response to the imposition of antidumping/countervailing duties on their exporting firms could diminish the temptation to “over-utilize” antidumping/countervailing duties, at the same time that it could diminish the need for transparency of the process that leads to the imposition of such duties and reduce the extent to which disputes over antidumping/countervailing actions clog the WTO dispute settlement procedures.²²

VI.2 Proposal 2

Proposal: Disentangling trade from other issues to better assign issues to institutions.

Evaluation: I advise that the Task Force pursue this proposal. This proposal seeks to improve and sharpen the basic architecture of the WTO, and as such is directed toward the global public good features of the WTO as discussed in sections II and III above. Moreover, this proposal responds to a potential threat to the international trade regime as indicated in section V above.

This proposal, of course, takes on an extremely complex problem, but it is possible to argue that a coherent assignment of issues to international institutions can be established if the WTO acts as an effective mechanism for securing market access property rights.²³ As indicated in the discussion in section V above, it may be increasingly difficult for the WTO to perform this role in the presence of widespread discriminatory trade practices, and so this proposal may need to confront the challenge to the international trade regime posed by increasing numbers of bilateral and regional preferential trade agreements, among other challenges. But a specific proposal that the WTO’s agenda remain focused (or return to its original focus) on market access issues – and that its attention be restricted with regard to other issues (such as the environment, labor standards, etc.) to the market access implications of those issues – could achieve two things: it could strengthen the ability of the WTO to serve as an effective mechanism for securing market access property rights;²⁴ and it could help to ensure that the WTO is not asked to solve “problems” that might be better solved in other international institutions.

Even this specific proposal is of course very broad, and making it more concrete is not an easy task. But perhaps a concrete proposal might suggest that the WTO undertake a “self-evaluation” of each of the existing issue-areas that it is currently involved in and also each of the “new” issue areas that it has begun to take under consideration, with an eye toward ensuring two things: first, that there is a significant market access concern associated with the issue area; and second, that the approach taken by the WTO to deal with this issue area handles the market access

²²For a more extensive development of this argument, see Janow and Staiger (2003).

²³Bagwell and Staiger (2001) provide a non-technical discussion which interprets the role of the WTO in these terms, while Staiger (2003) provides a non-technical description of how this assignment can be established for the particular issue of labor standards.

²⁴A proposal to return to a focus on market access could have implications beyond the WTO’s approach to labor and environmental standards. For example, it can be argued that the WTO’s current approach to subsidies has “lost touch” with the market-access concerns that guided the approach to this issue within GATT (see Bagwell and Staiger, 2004).

concerns with a minimum of intrusion into the policy choices of its member governments.

VI.3 Proposal 3

Proposal: Provide more resources for monitoring implementation of WTO agreements.

Evaluation: I advise that the Task Force pursue this proposal. This proposal is directed toward making the design features of the WTO more effective for use by member governments, and as such it is directed at the global public good features of the WTO, as discussed in sections II and III above.

More specifically, as discussed in section II above, providing governments with an effective escape from a terms-of-trade driven Prisoners' Dilemma requires that negotiated market access commitments are enforceable, and in the WTO this is accomplished with the threat of retaliatory actions. To be effective, such threats require reliable monitoring of WTO agreements, as well as effective and timely legal and information-gathering procedures in case of disputes. As indicated by the discussion in section II, many issues within the WTO hinge on appropriate monitoring of market access commitments, and on the market access implications of various border and non-border policy measures. Measuring these concepts is often accomplished in very rudimentary ways, and with appropriate resources to collect the required data and perform the required statistical analysis the monitoring of WTO implementation could be greatly improved. Moreover, as indicated in section III, "congestion" can introduce global-public-good features into the utilization of the WTO, and this congestion is most likely to arise in the utilization of the WTO's procedures for monitoring and ensuring the implementation of its agreements. Providing more resources for monitoring implementation of WTO agreements can in both these dimensions enhance the effectiveness of the operations of the WTO.

A specific proposal for resources might focus on developing in-house (i.e., within WTO) expertise in measuring and quantifying the links between market access levels and national policy choices. Better understanding of these links is crucial for an international institution whose member governments rely on this institution to deliver secure property rights over negotiated market access levels but at the same time wish to maintain a high degree of sovereignty over their national policy choices.

VII. Conclusion

The GATT and now the WTO has in effect served as the constitution of the post-war international trade regime. In this report I have focused on the GATT/WTO as the centerpiece of the post-war international trade regime, and I have explored a number of themes. First, what purpose is served by the WTO and the international trade agreements that it administers? Second, in what sense is the WTO a global public good? Third, I have discussed two interpretations of the developing country experience in the GATT/WTO. Fourth, I have identified two potential threats to the WTO and the international trade regime that is built upon it. And finally, I have considered and evaluated a number of possible reforms of the WTO.

I have suggested both general and specific conclusions. At a general level, I have indicated the importance for the work of the Task Force with regard to the international trade regime of identifying the central inefficiencies that the WTO is being asked to address: I have observed that there are two distinct inefficiencies that might reasonably be addressed through international trade agreements; and I have suggested that providing its member governments with an avenue of escape from the inefficiencies that arise with a terms-of-trade driven Prisoners'

Dilemma is the central task that the WTO is well-designed to handle. Also at a general level, I have argued that the global public good features of the WTO are associated primarily with its design features – that is, with the creation of the WTO and with its maintenance as a negotiating forum – rather than with the end uses to which the WTO is put by its member governments. At a more specific level, I have used these general conclusions to offer two interpretations of the disappointing developing-country experience within the GATT/WTO, and to suggest that the international trade regime may be threatened by the increasing numbers of preferential trade agreements and the widening scope of non-trade issues covered by the WTO. And finally, using these general and specific conclusions, I have examined a number of possible WTO reform proposals. In particular, I have suggested that some of the reforms proposed for initial consideration by the Task Force are quite promising, and I have attempted to point out directions in which these promising reform proposals might be further developed.

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