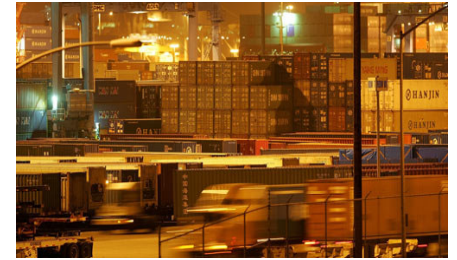


Multilateral vs. Regional Free Trade?



In the twilight of Doha?



- ❖ **WTO trade talks collapsed in July 2006**
- ❖ **The Doha Round is “...definitely between intensive care and the crematorium...”
(Kamal Nath, India’s Trade Minister)**
- ❖ **Many believe US and other developed countries will turn from multilateralism in the WTO to regionalism**
- ❖ **Is this good or bad for trade liberalization?**

Ways to freeing trade



David Ricardo

◆ Unilateral reduction of tariffs:

- cheaper imports raises domestic productivity and consumer purchasing power
- an article of faith among economists since Ricardo
- does not pass the political “laugh test”



“...try telling that to a member of Congress, who imagines defending a trade deal in the home district, saying, ‘We gave x, y and z, and they didn’t give up a thing’...” (Ford Runge, University of Minnesota, 2006)

Ways to freeing trade

WORLD TRADE
ORGANIZATION



◇ **Multilateral trade liberalization:**

- within GATT/WTO, each member country makes tariff concessions on a *quid pro quo* basis (reciprocity)

- any concession made to one member is automatically extended to all other members (non-discrimination)

- it works politically:

“...multilateral trade liberalization is a sort of jujitsu that uses exporters’ determination to get into foreign markets to overwhelm domestic lobbies that would sooner keep home markets closed...”
(The Economist, July 27, 2006)

Ways to freeing trade

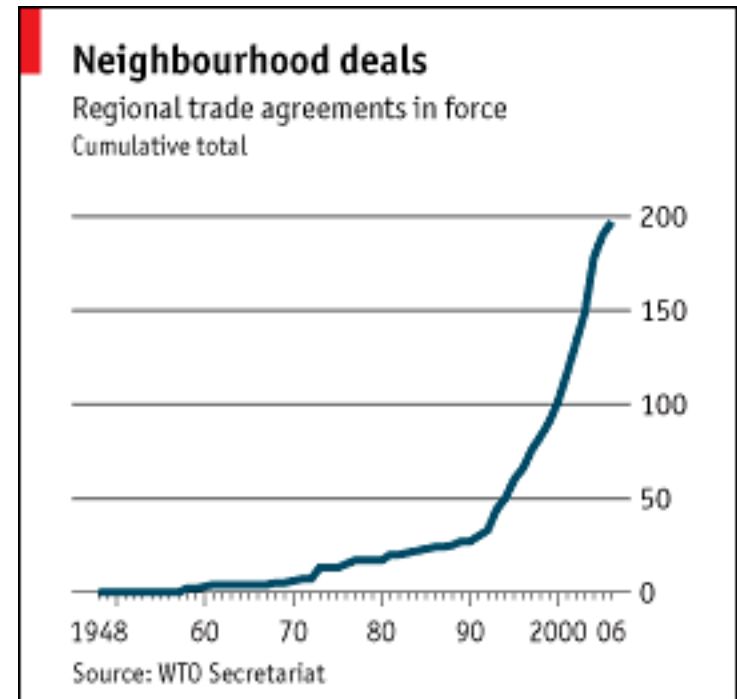


◆ Regional/bilateral trade agreements:

- trade liberalization on a discriminatory basis, i.e., concessions only made between parties to agreement
- free trade areas (NAFTA) or customs unions (EU)
- in conflict with principle of non-discrimination in GATT/WTO Article 1, but allowed under Article 24 if tariffs are reduced for “substantially all trade” between parties

Regionalism is growing

- ◆ **Regional and bilateral trade deals have mushroomed since 1990**
- ◆ **Bush Administration has signed 14, negotiating another 11**
- ◆ **East Asia will have 70 by end of 2006**
- ◆ **EU will negotiate more if Doha fails**
- ◆ **GATT/WTO probably never envisioned this many**



Is more regionalism good?



Significant debate among economists:



- Jagdish Bhagwati (Columbia) – “...do trade blocs serve as ‘building blocks’ or ‘stumbling blocks’ for worldwide freeing of trade?”



- Larry Summers (Harvard) – “...I like all the ‘isms’, unilateralism, regionalism and multilateralism...”

- In assessing regionalism, Bhagwati sees discrimination, Summers sees liberalization – smacks of the blind men and the elephant!

Why might regionalism be bad?

◇ Economic benefits, *trade creation*, may be outweighed by costs, *trade diversion*

- trade creation occurs due to removal of tariffs between members of a regional agreement

- trade diversion occurs because non-members face discriminatory tariffs on their goods

◇ As a result, it really matters where a good comes from - the *rules of origin*

Example: Mexico can export overcoats to the US tariff-free, but if the yarn/fabric used to make them is imported from outside NAFTA, the overcoat is no longer Mexican and is subject to a tariff

Alphabeti spaghetti



- ◆ **Multiple agreements, and different rules of origin cause production inefficiency**
- ◆ **Half-finished goods go around agreement networks based on differential tariffs in an attempt to deliver final good at lowest price – a “spaghetti bowl” effect (Bhagwati, 1995)**
- ◆ **If all WTO members signed a bilateral agreement with every other member, there would be 11,026 strands of spaghetti**

Are all 'isms' good?

- ◆ **Uruguay Round not undermined by 1980s and 1990s regionalism, e.g., EC expansion, formation of CUSTA**
- ◆ **Key multilateralist countries have also been regionalists, e.g., US and members of the EU**
- ◆ **Multilateralism often a response to regionalism, e.g., the Kennedy Round of GATT in 1960s after formation of EEC**
- ◆ **Implies trade liberalization is dynamic**

Dominos and juggernauts



- ◆ **Domino theory of regionalism: formation of regional bloc eventually triggers membership requests, e.g, EEC6 in 1950s, entry of UK, Ireland, Denmark.....**
- ◆ **Juggernaut theory of multilateralism: once liberalization ball starts rolling it's difficult to stop, i.e., successive rounds of GATT/WTO**
- ◆ **Dominos can start juggernauts: regional blocs may be building blocks to freer trade, e.g., enlargement of EU has resulted in reform of the CAP**

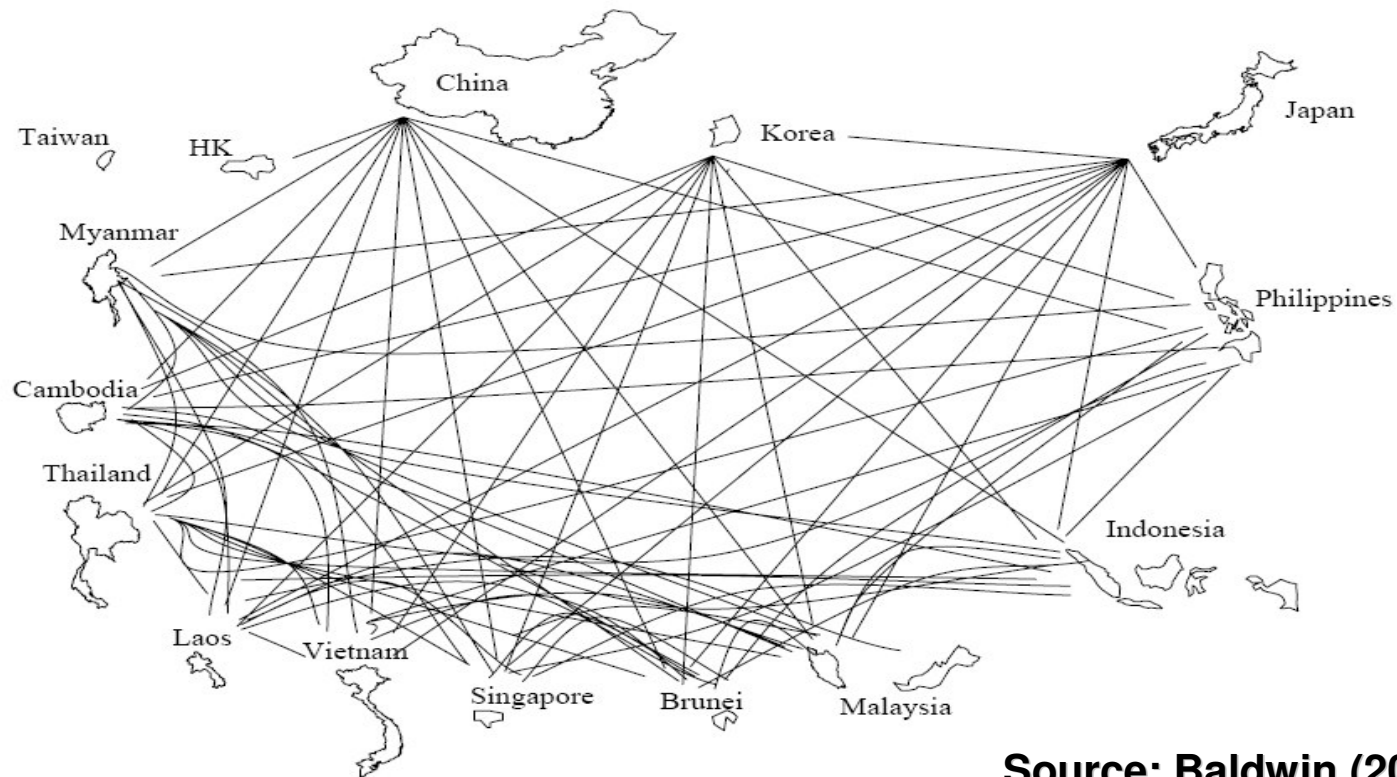
Asia: a case of unilateralism to regionalism

- ◆ **Until 1980s, tariff-cutting in Asia limited to Japan**
- ◆ **In mid-1980s, “factory Asia” led to “race to the bottom” unilateralism**
- ◆ **China’s entry to WTO sparked a domino effect with signing of multiple regional/bilateral agreements**
- ◆ **Created Asian “noodle bowl”**

Asian noodle bowl

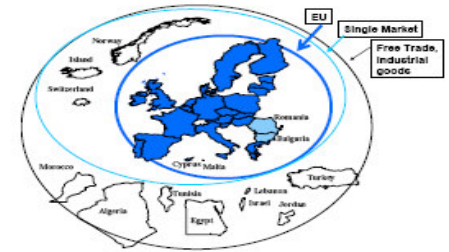


Reality: Noodle Bowl Syndrome



Source: Baldwin (2006)

Multilateralizing regionalism: how the EU spaghetti bowl was tamed



- ◆ **In early-1990s, EU signed many bilateral agreements with Central and Eastern European countries, followed by bilateral agreements with Mediterranean countries**
- ◆ **Resulted in emergence of European spaghetti bowl with complex rules of origin**
- ◆ **This became unsustainable for many EU-based firms as they began to offshore production of inputs**
- ◆ **EU introduced Pan-European Cumulation System (PECS) in 1997 – a coat that was 50% Hungarian, 30% Turkish, and 20% Polish is now 100% European, i.e., de facto multilateral freeing of trade**

Will the juggernaut re-start?



- ◆ **History suggests idiosyncratic shocks are required for trade liberalization to occur**
- ◆ **At present, political unwillingness to liberalize agricultural trade is holding up continued multilateralism in WTO**
- ◆ **Future role of WTO may be to promote multilateralism through taming tangle of regional/bilateral agreements**
- ◆ **Alternatively, “...leaders need to ‘stew in their own juices’ until they realize a Doha deal is worth doing...”**

The Economist, July 27, 2006