

# **Multilateral vs. Regional Free Trade?**

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# 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

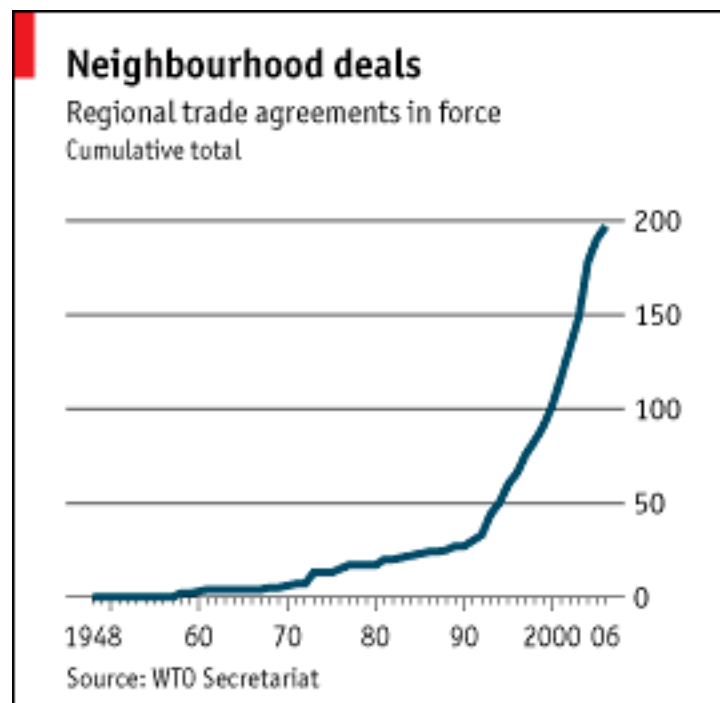


## ◇ Regional/bilateral trade agreements:

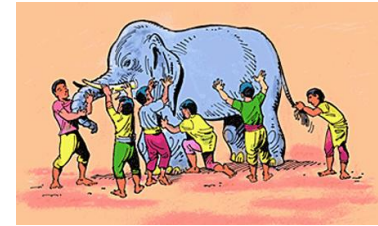
- trade liberalization on a discriminatory basis, i.e., concessions only made between parties to agreement
- free trade areas (NAFTA) or customs unions (EU)
- in conflict with principle of non-discrimination in GATT/WTO Article 1, but allowed under Article 24 if tariffs are reduced for “substantially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

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- ◇ 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?

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- ◆ **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**

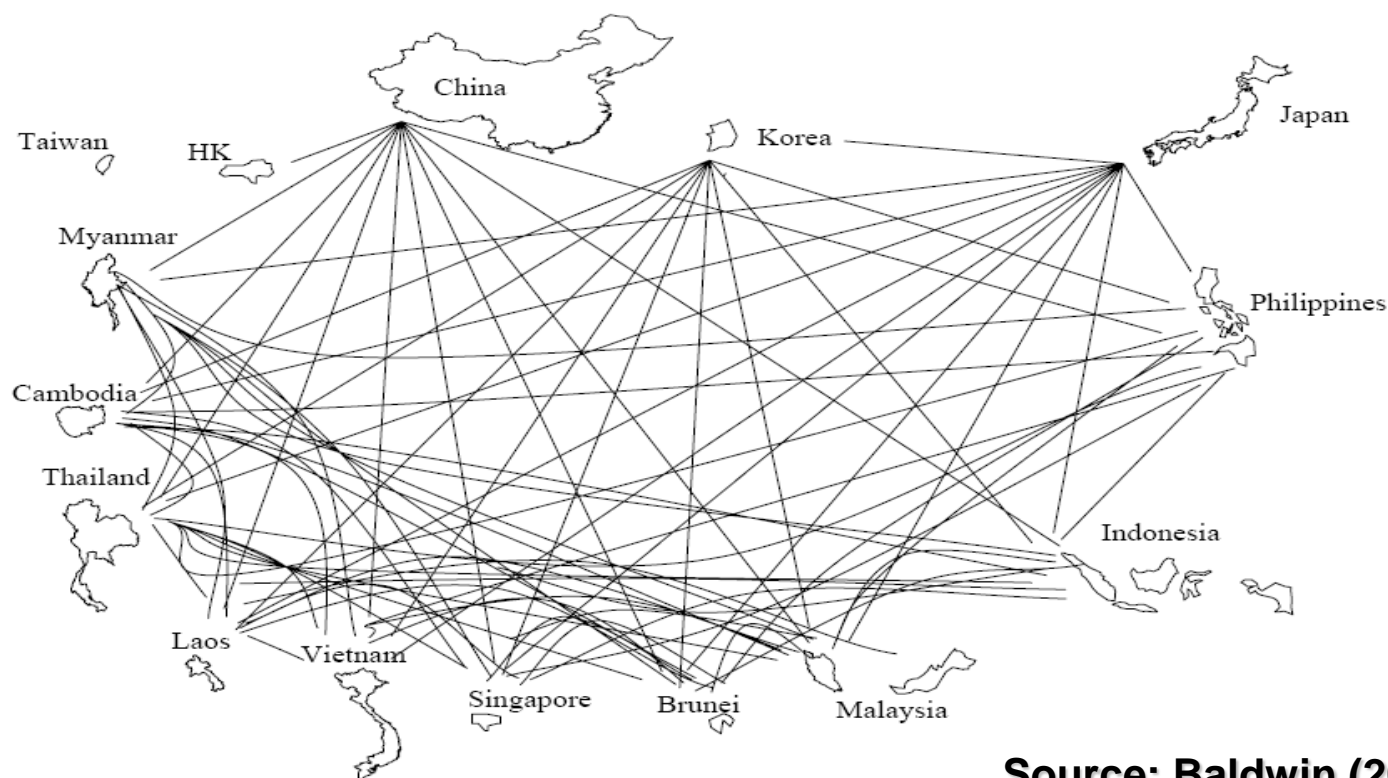
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- ◆ **Until 1980s, tariff-cutting in Asia limited to Japan**
- ◆ **In mid-1980s, “factory Asia” led to “race to the bottom” unilateralism**
- ◆ **China’s entry to WTO sparked a domino effect with signing of multiple regional/bilateral agreements**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

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