“Trade Liberalization and Institutional Constraints on Moves to Protectionism: Multilateralism vs. Regionalism”

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Motivation

- By simple metrics, GATT/WTO successful:
  - Increase in membership - 23 (1947) to 164 (2018)
  - Average industrial tariffs reduced to less than 4%
  - Rules-based system and dispute settlement accepted and respected by members

- Significant impact on trade volumes in manufacturing and agricultural sectors (Subramanian and Wei, 2007; Grant and Boys, 2012)

- Growing emphasis on “deep” integration through regional trade agreements (RTAs) (Baldwin, 2016)

- If Pareto-improving – why leave/undermine cooperative agreement(s)?
Economic Logic of GATT/WTO

- Seminal approach to modelling GATT/WTO due Bagwell and Staiger (1999)

- If countries are able to influence their terms-of-trade, unilateral incentive to raise tariffs beyond what is “politically-optimal”

- Nash equilibrium tariffs inefficient as countries would like to lower tariffs in order to reduce domestic distortion and generate more trade

- GATT/WTO is cooperative solution to cost-shifting externality, i.e., countries offer reciprocal tariff concessions without changing world relative prices

- Practical implication: negotiations are about reciprocal exchange of market access
Economic Logic of GATT/WTO

- Reciprocity also helps explain idea behind “withdrawal of equivalent concessions” as part of dispute settlement.

- Credible punishment for deviation from low-tariff equilibrium is reversion to Nash - in practice, rules of GATT/WTO seek to maintain balance of concessions and avoid punitive action (Zissimos, 2007).

- Objective is to ensure retaliation is proportional, minimizing chances of trade war.

- Tariff concessions also applied on MFN basis - in combination with reciprocity, minimizes risks of third-country spillovers and prevents preference erosion (Bagwell and Staiger, 2010).
Can US Trade Policy be Rationalized?

- If on efficiency frontier, and policies have been politically-optimal, it *cannot* be Pareto-optimal to raise tariffs
- US may be on efficiency frontier, but political preferences have changed enough in favor of *renegotiation* – why the change in preferences?
  - More weight attached to import-competing sectors and/or world price has fallen below *reference* price
  - US seeks “more reciprocal” tariffs with countries where it has a trade deficit
  - US does not appreciate “latecomers” problem
- US approach is unilateral based on notion that trade agreements are a zero-sum game
Economic Logic of GATT/WTO

Tariff equilibrium
US Trade Policy and Regionalism

- US appears interested in regionalism rather than multilateralism, e.g., NAFTA renegotiations
- Decision puzzling in context of NAFTA renegotiating objectives (deep integration) and pulling out of TPP
- Current US brand of regionalism is probably better described as bilateralism though – echoing view of multilateralism as a zero-sum game
- Reflected in US position on Chapter 19 of NAFTA, and its application of countervailing duties in aircraft sector
- Objectives of NAFTA renegotiations suggests progress could be made in lowering trade barriers, but its actual approach may ultimately be self-defeating
WTO Dispute Settlement and Protection

- US political preferences may have changed, but institutional features of WTO have not

- System likely cannot be used effectively to counter current US policies:
  - Injury must have occurred before any relief is possible
  - If injury is proven, aggrieved member can seek compensation, but US may refuse to provide it
  - WTO can authorize retaliation – but US may simply refuse to comply and live with it, and even impose counter-retaliation measures

- Consequently, there may be little WTO can do to deter US economic nationalism
Takeaways

- Underlying economic logic of GATT/WTO is still relevant
- Enforcement of cooperative agreement will be placed under significant strain with threat of increased US trade protection, and even potential trade war
- Multilateralism is also under threat from US approach to regionalism, i.e., bilateralism based on idea that all trade agreements are a zero-sum game
- WTO has well-defined enforcement/legal mechanisms in place to handle disputes, but they probably cannot contain an all-out trade war
- RTA dispute settlement mechanisms are also weak at best