

# **How to Free Trade: Multilateralism and the WTO**



**AED/IS 4540  
International Commerce  
And the World Economy**

**Professor Sheldon  
sheldon.1@osu.edu**

# Ways to freeing trade



*David Ricardo*

## ◆ Unilateral reduction of tariffs:

- cheaper imports raises domestic efficiency 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

---

WORLD TRADE  
ORGANIZATION



- ❖ **Why then in trade negotiations does a government “...require a ‘concession’ from its trading partner(s) in order to do what is in any event best for its country”?**
- ❖ **Observation that governments seek reciprocity in trade agreements often interpreted to mean trade negotiators are adopting a *mercantilist* perspective inconsistent with economic logic**
- ❖ **Paul Krugman observes there are three simple rules (GATT-think) about objectives of negotiating countries:**
  - **exports are good**
  - **imports are bad**
  - **an equal increase in imports and exports is good**

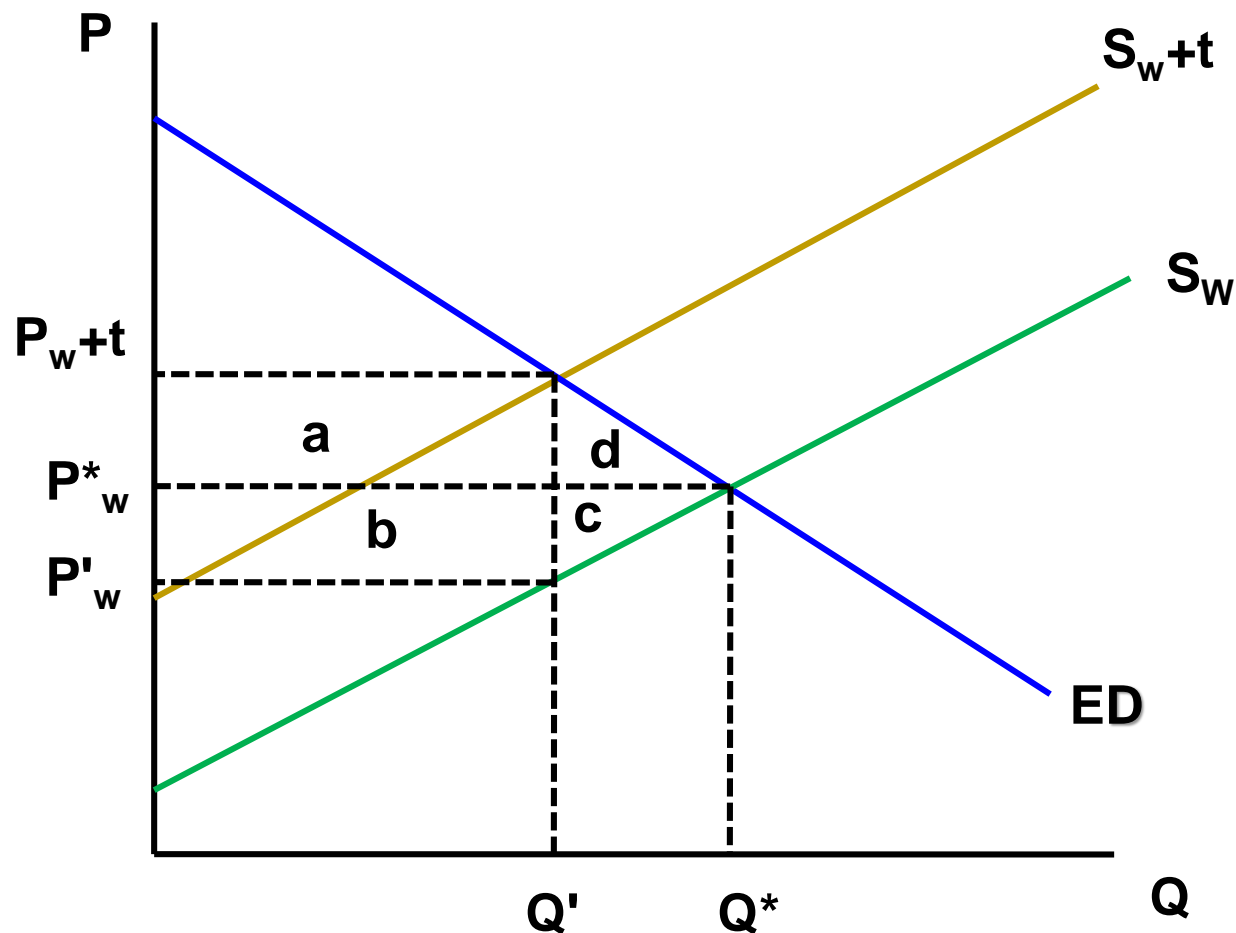
# Ways to freeing trade

WORLD TRADE  
ORGANIZATION



- ❖ **“GATT-think” is “enlightened mercantilism”, i.e., it is *mercantilist* in presuming countries unilaterally like to tax imports, and *enlightened* in recognizing this could be destructive**
- ❖ **“GATT-think” then sees the trade policy problem as a Prisoners’ Dilemma – individually, countries have an incentive to be protectionist, yet collectively they gain from free trade**
- ❖ **Think again about case where an importing country can influence its terms of trade by imposing an import tariff**

# Terms of trade effects of tariffs



# Terms of trade effects of tariffs

---

- ◇ Home importing country faces an upward-sloping supply curve,  $S_w$
- ◇ With a tariff  $t$ , domestic deadweight loss is  $d$ , foreign deadweight loss is  $c$ , and tariff revenue is made up of  $(a + b)$ , where  $b$  is a terms of trade benefit due to world price being driven down to  $P'_w$
- ◇ While there are net domestic costs,  $d$ , due to the tariff, an “externality” is also imposed on the foreign country,  $(b + c)$
- ◇ The foreign country would have a similar incentive to impose a tariff on its imports from the home country

# Trade policy Prisoners' Dilemma

---

		Home country	
		No Tariff	Tariff
Foreign country	No Tariff	0,0	100,-150
	Tariff	-150, 100	-50,-50



# Ways to freeing trade

WORLD TRADE  
ORGANIZATION



◆ **How is it that “GATT-think” has turned out mostly right? What is its hidden logic?**

**(i) Government policy does not necessarily represent public interest, but rather well-organized groups such as exporters and import-competing producers – explains first two principles of “GATT-think”**

**(ii) In setting exporter interests as a counter-weight to import-competing interests, and by bargaining for access to each others’ markets, trade negotiators do move system closer to free trade**

**(iii) Strong empirical evidence for cost-shifting effect of tariffs (Bagwell and Staiger, 2010)**

# The GATT/WTO

WORLD TRADE  
ORGANIZATION



- ◆ **Origins of GATT can be traced to trade policy choices in 1920s and 1930s – notably US Smoot-Hawley Tariff Act**
- ◆ **General Agreement on Tariffs and Trade (GATT) signed in 1947, the emphasis being on reciprocity and non-discrimination – as opposed to free trade**
- ◆ **Since 1947, through 8 rounds of GATT, average *ad valorem* tariffs have fallen from over 40 percent to less than 4 percent, and membership of GATT/WTO has gone from 23 to 164 countries**
- ◆ **Uruguay Round of GATT, lasted from 1986 to 1994, ending in formation of World Trade Organization (WTO) in 1995 – adopted rules of GATT, and unified dispute-settlement mechanism**

# Tariff reductions under GATT/WTO

---

## GATT/WTO – 60 years of tariff reductions

(MFN tariff reduction of industrial countries for industrial products (excl. petroleum))

Implementation Period	Round covered	Weighted tariff reduction
1948	Geneva (1947)	-26
1950	Annecy (1949)	-3
1952	Torquay (1950-51)	-4
1956-58	Geneva (1955-56)	-3
1962-64	Dillon Round (1961-62)	-4
1968-72	Kennedy Round (1964-67)	-38
1980-87	Tokyo Round (1973-79)	-33
1995-99	Uruguay Round (1986-94)	-38

Source: WTO World Trade Report (2007)