Is Multilateralism Dead?

Trade in the era of Trump

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Introduction

- Individuals are the ultimate drivers of globalization, but governments set the rules of the game
  - the rules can be very important to the outcome

- The WTO (and GATT before it) is a place where governments come to agree on the rules of globalization
  - the multilateral rules that apply to all 164 member countries and their preferential trade agreements (PTAs)

- The rules solve problems that would arise under “law of the jungle”
  - these rules define the constitution of the Global Trade Order
The GATT/WTO

- The GATT/WTO is “member-driven,” and has traditionally been about “shallow integration”
  - seeking mutually advantageous trade liberalization as judged by the member governments
  - a focus on tariffs and other trade impediments imposed at the border
The ground is shifting

- But the WTO’s Doha Round, begun in 2001, has disappointed

- Meanwhile, with the most recent wave of globalization...
The rise of large emerging economies

IMF DataMapper

GDP based on PPP, share of world (Percent of World)

Emerging market and developing economies
Advanced economies

The rise of offshoring and global supply chains
...the ground under the WTO is shifting, the WTO seems to be stumbling

...we are witnessing a clear evolution from shallow to deep integration
  - The Transatlantic Trade and Investment Partnership (TTIP)
  - The Comprehensive Economic and Trade Agreement (CETA)
  - The Trans Pacific Partnership (TPP)
  - To some extent in the WTO

...and a strong backlash against at least some dimensions of globalization
  - from those who have not shared in the gains
  - from those who feel sovereignty of their governments has been eroded
What can we expect from trade in the Trump era?
When a country (USA) is losing many billions of dollars on trade with virtually every country it does business with, trade wars are good, and easy to win. Example, when we are down $100 billion with a certain country and they get cute, don’t trade anymore—we win big. It’s easy!

3/2/18, 5:50 AM

5,189 Retweets 20.1K Likes

IR.net @IRdotnet · 1h
Replying to @realDonaldTrump
But this affects American businesses moron.
This is about something much bigger than Trump
The prognosis for Multilateralism

- Is Multilateralism dead?
  - not dead, but may be entering a period of hibernation

- Do we need a new global trade order?
  - hard to say
We need a diagnosis

- Now more than ever, globalization’s challenges demand a nuanced response based on a solid understanding of the problems.

- Important to understand:
  - why GATT worked
  - the economic environment it is best suited for
  - whether changes in the economic environment imply the need for changes in design of trade agreements.
The stakes are high

- What’s at stake?
  - the future path of globalization
  - which international institutions will set the rules of globalization
  - what trade-offs we will face in our globalized world
A key starting point

- The WTO’s legitimacy is not built on the case for free trade
  - rather, it’s built on the case for internalizing negative externalities
Explaining this is going to be a little tedious...
A closed economy

- A closed economy

![Graph of a closed economy](image-url)
A closed economy

- A closed economy

![Graph showing consumer surplus](image-url)
A closed economy

- A closed economy

![Diagram of a closed economy]

- Consumer surplus
- Producer surplus

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A small open economy

- A small open economy

![Graph showing demand and supply curves in a small open economy.](image)
A small open economy

- A small open economy

[Diagram of supply and demand curves with consumer surplus highlighted]
A small open economy

- A small open economy

[Diagram showing supply (S^a) and demand (D^a) curves with producer surplus labeled.]
A small open economy

- A small open economy

\[ p^a \]

\[ d^a \]

\[ q^a \]

\[ q_s \]

\[ q_d \]

\[ S^a \text{ gains from trade} \]

\[ p^a_{FT} \]

\[ p^a_1 \]

\[ E^a \]

\[ M^a \]
The purpose of Trade Agreements

- A *small country’s* unilateral tariff choice

Diagram showing supply (S^a), demand (D^a), and tariff (t^a) curves with price (p^a) and quantity (Q^a).
The purpose of Trade Agreements

- A small country’s unilateral tariff choice

![Diagram showing the loss of consumer surplus]

Loss of consumer surplus
The purpose of Trade Agreements

- A small country’s unilateral tariff choice

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The purpose of Trade Agreements

- A *small country’s* unilateral tariff choice

\[ Q_s \rightarrow Q_d \]

**gov’s valuation of shifting surplus from consumers to producers**
The purpose of Trade Agreements

- A small country’s unilateral tariff choice

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The purpose of Trade Agreements

- A small country’s unilateral tariff choice

A small country’s policy choices impose no externalities on the world. Policy choices are internationally efficient in a world of small countries, given national government objectives.

Nothing for a trade agreement to do!

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The purpose of Trade Agreements

- A *small country*’s unilateral tariff choice

![Diagram showing the effects of unilateral tariffs on domestic and foreign markets.](image)
The purpose of Trade Agreements

- A *small country’s* unilateral tariff choice
The purpose of Trade Agreements

- A small country’s unilateral tariff choice

- A small country’s policy choices impose no externalities on the world
- Policy choices are internationally efficient in a world of small countries, given national government objectives
- No international inefficiency, nothing for a trade agreement to do!
The purpose of Trade Agreements

- A large country’s unilateral tariff choice (recall small country)

A large country's tariffs impose negative externalities on the world. Tariff choices are internationally inefficient (too high) in a world with large countries, given national government objectives. A mutually beneficial member-driven trade agreement is possible!
The purpose of Trade Agreements

- A *large country’s* unilateral tariff choice

![Diagram showing the effects of unilateral tariffs on a large country.](image)
The purpose of Trade Agreements

- A large country’s unilateral tariff choice

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The purpose of Trade Agreements

- A large country’s unilateral tariff choice

A large country’s tariffs impose negative externalities on the world

⇒ Tariff choices are internationally inefficient (too high) in a world with large countries, given national government objectives

- Address the inefficiency, and a mutually beneficial agreement possible!
If this is correct, the tariffs of non-WTO members should reflect their market power (monopsony power to depress foreign exporter prices)

**Figure 3. Median Tariffs and Market Power across Countries**
A key starting point

- The WTO’s legitimacy is not built on the case for free trade
  - rather, it’s built on the case for internalizing negative externalities
Generally, designing an effective institution to address an international externality is challenging (think climate change) for a member-driven institution, what is important is not so much what policy is chosen as how it is chosen.

Two pillars of the GATT/WTO architecture:
- Non-discrimination (MFN)
- Reciprocity

MFN:
- In a multi-country world, MFN keeps the trade policy externality as simple as in a 2-country world.

Reciprocity:
- Defines a measured, proportionate response to a country’s trade policy changes by its trading partners that keeps it acting like a small country.
Reciprocity

- Recall a large country’s unilateral MFN tariff choice
Unilateral MFN tariff choice in the presence of reciprocity

- A measured, *proportionate response* by its trading partners

- The large country faces the trade-offs of a small country

- \( \Rightarrow \) Legitimacy: A multilateral trade institution built on the pillars of MFN and reciprocity should work well to help governments solve the fundamental trade agreement problem
If this is correct, the tariff cuts negotiated by WTO members should reflect their market power.

**Figure 2. Percent Deviation from Mean Concession by $\eta^{RR}$ Decile**
Reciprocity in action

NYTimes March 2 2018

Trump’s Tariffs Prompt Global Threats of Retaliation

... The European Union detailed a three-step plan to penalize $3.5 billion of American trade — the same amount of European steel and aluminum the bloc estimates would be harmed by the planned tariffs. It proposed taxing American exports including bourbon, bluejeans, orange juice, cranberries, rice and motorcycles. The European Union could then ... bring a case against the United States at the World Trade Organization.

A European Union official said that the bloc had been preparing for the announcement for months and that everything was in place for a swift, proportionate response. ...
Unilateral MFN tariff choice in the presence of reciprocity

- A proportionate response by its trading partners

- The large country faces the trade-offs of a small country

- \( \Rightarrow \) Like a small country, it cannot reduce the costs to its citizens of its tariff choice by shifting some of those costs onto foreign companies.

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Reciprocity in action

- These WTO-legal threats of reciprocal retaliation are converting an attempted unilateral tariff action into a linked reciprocal tariff action.

- They are having the intended effect.

NYTimes March 6 2018
News Analysis

WASHINGTON — ... In a sharply worded letter on Tuesday to Mr. Trump, Mr. Hatch said that the proposed tariffs would be paid by American manufacturers and consumers, not foreign companies, ...
Escalating Trade Fight, Trump Threatens Higher Taxes on European Cars

By EMILY COCHRANE New York Times MARCH 3, 2018

WASHINGTON — President Trump warned on Saturday that he would apply higher taxes on imported European cars if the European Union carried through on its threat to retaliate against his proposed stiff new tariffs on steel and aluminum.

“If the E.U. wants to further increase their already massive tariffs and barriers on U.S. companies doing business there, we will simply apply a Tax on their Cars which freely pour into the U.S.,” Mr. Trump wrote on Twitter from Florida, where he was spending part of the weekend. “They make it impossible for our cars (and more) to sell there. Big trade imbalance!”
### Shallow versus Deep integration

- Externalities lead to inefficient choices, and cross-border policy externalities lead to internationally inefficient policies
  - GATT’s original purpose: to *reduce* tariffs and expand market access to levels that internalized the negative externalities that large countries imposed on one another under their law-of-the-jungle trade policies

- But economics ⇒ a crucial point: under the law of the jungle, only trade policies, *not domestic policies*, would have been set inefficiently

- If
  - market access can be expanded to efficient levels through negotiated tariff reductions
  - and accompanying rules prevent countries from distorting domestic policies for protective purposes once their tariffs are constrained
  - then international efficiency is achieved

- That is the logic of GATT/WTO shallow integration
What is the Trump Administration’s vision for the Global Trade Order?

Wilbur Ross, US Secretary of Commerce:

"An ideal global trading system would facilitate adoption of the lowest possible level of tariffs. In this ideal system, countries with the lowest tariffs would apply reciprocal tariffs to those with the highest and then automatically lower that reciprocal tariff as the other country lowers theirs. This leveling technique could be applied product by product or across the board on an aggregated basis. Such a modification would motivate high-tariff countries to reduce their tariffs on imports."

Purpose:

→ Achieve reciprocal Free Trade (or at least a "level playing field")

Means:

→ Abandon MFN
→ Reciprocity in tariff levels
In case you doubt this...

Donald J. Trump
@realDonaldTrump

When a country Taxes our products coming in at, say, 50%, and we Tax the same product coming into our country at ZERO, not fair or smart. We will soon be starting RECIPROCAL TAXES so that we will charge the same thing as they charge us. $800 Billion Trade Deficit-have no choice!

8:57 AM - Mar 2, 2018

❤️ 27.5K  🗓️ 14.3K people are talking …
The Trump Administration’s Vision

- The Trump Administration’s vision for the Global Trade Order appears to be “Repeal and Replace”

- An existential challenge to the pillars of the GATT/WTO architecture
  - Abandons MFN
  - Emphasizes a form of reciprocity that is not found in GATT/WTO

- Appears unhappy with the GATT/WTO shallow integration approach
  - Wilbur Ross: “…The second thing is the WTO doesn’t really deal very much with non-tariff trade barriers…”

  - → Perhaps support for “deep integration” together with assertion of US bargaining power
Whose interests does the WTO serve?

- Under MFN and reciprocity, the WTO is a rules-based multilateral system that serves the interests of the member governments.
- These rules blunt the power of large dominant countries.
  - Why would powerful countries submit to these rules?
- If a country is sufficiently dominant, other countries may not participate in trade negotiations with it absent such rules of behavior.
  - Judge Bowker’s argument against Canada’s participation in the US-Canada FTA negotiations.
  - \( \Rightarrow \) it is then in the country’s interest to commit to these rules.
- But if a country’s dominance wanes, its support for the WTO rules-based multilateral system could rationally erode.
  - \( \Rightarrow \) it may be in the country’s interest to depart from these rules (this is accelerating with Trump, but didn’t start with him).
- The WTO may need a “hegemon” to support it.
Could Multilateralism be going into hibernation, awaiting the rise of the next hegemon?

IMF DataMapper

GDP based on PPP, share of world (Percent of World)

Emerging market and developing economies  Advanced economies
If so, then this is about something *much bigger than Trump*
The value of preserving the Global Trade Order

- So is Multilateralism dead?
The value of preserving the Global Trade Order

- If the diagnosis is one of declining hegemonic support
  - then the rules-based multilateral system may be entering a period of decline until the needed support arises from other quarters
  - but it is not dead, and it is worth trying to save

- The shallow-integration approach of the WTO is well-designed to solve the fundamental trade agreement problem
  - a trade-off between sovereignty and globalization may be avoidable, but only if the WTO is supported and its approach strengthened

- Could China be the next hegemon that the WTO is looking for?
  - currently seems unlikely, but as its dominance grows, China may see it in its interest to more fully commit to these rules
  - and until that time, the WTO deserves broad support as the legitimate constitution of the global trade order

- But the rise of offshoring provides an alternative, more dire, diagnosis
Why offshoring may have changed everything

- Offshoring may be changing nature of international policy externalities
  - Recall: for 20\textsuperscript{th}-century-style globalization, economics $\Rightarrow$ under the law of the jungle, only trade policies, not domestic policies, would be set inefficiently
  - But with offshoring, economics $\Rightarrow$ under law of the jungle, all policies, trade and domestic, may be set inefficiently
  - depends on how offshoring has changed nature of international price determination (think of the Boeing Dreamliner)
Why offshoring may have changed everything

- The rise of offshoring may have altered (deepened) the kinds of rules needed to avoid “the law of the jungle”
  - the shallow-integration approach of the WTO is no longer well-designed to solve the fundamental trade agreement problem
  - a trade-off between sovereignty and globalization now unavoidable
If this is correct, WTO members should be less successful in negotiating deep tariff cuts for customized inputs.

Figure 1. Percent Deviation from Mean Concession by Tercile of Input Customization Measure
Bottom Line

- It is possible that rise of offshoring has *not* fundamentally changed the nature of international policy externalities...
  - depends on subtle features of offshoring

- or has changed the nature of the policy externalities only temporarily...
  - offshoring itself may be a transitory phenomenon

- If so, the WTO has a strong claim of legitimacy in serving as the constitution for the global trade order

- And if offshoring *has* fundamentally changed the nature of international policy externalities, building on the WTO foundation to address these 21st century problems seems sensible

- Either way, “Repeal and Replace” seems like the wrong strategy
  - and by undercutting the WTO this strategy may undermine our best hope for balance between globalization and national sovereignty
Further thoughts on what’s at stake

- There would also be broader implications of the demise of the WTO that are more difficult to assess but could be important.

- The loss of an international institution that has built-in procedures for rethinking levels of market access commitments.
  - GATT/WTO market access commitments are structured as “liability rules”.

- The loss of an international institution that places multilateral restraints on the structure and negotiation of PTAs.
  - Imagine what it would be like to renegotiate the terms of NAFTA with the US if the US did not feel constrained by its WTO commitments.
Oh, wait

... *if* the US did not feel constrained by its WTO commitments?

To borrow from Paul Samuelson’s remark about Milton Friedman

- If Donald Trump did not exist it would be necessary to invent him
Further thoughts on what’s at stake

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- Collateral damage: the loss of the possibility of linkage between the WTO and International Environmental Agreements:
  - participation linkage; negotiation linkage; enforcement linkage
Advice for Canada (and all of us)