

IS MULTILATERALISM DEAD?

TRADE IN THE ERA OF TRUMP

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Dartmouth College

March 9 2018

Introduction

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 - the multilateral rules that apply to all 164 member countries *and* their preferential trade agreements (PTAs)

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 - 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 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

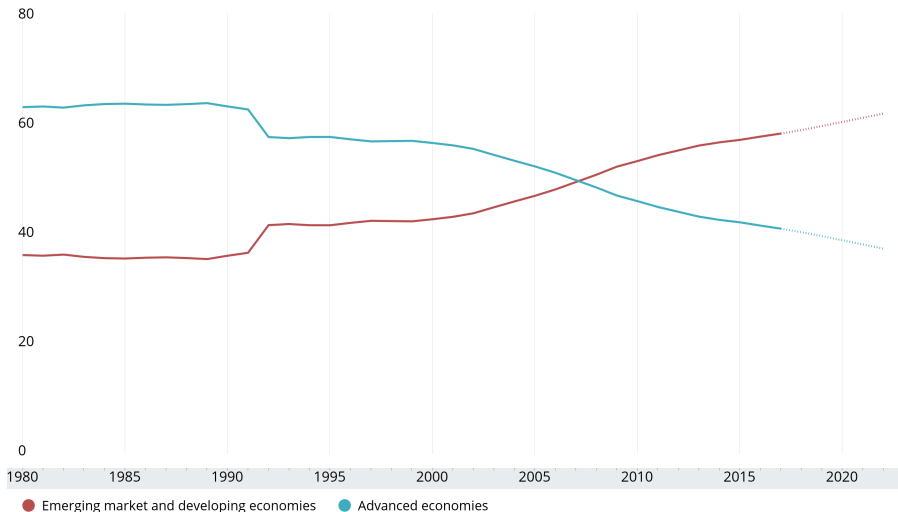
The ground is shifting

- 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

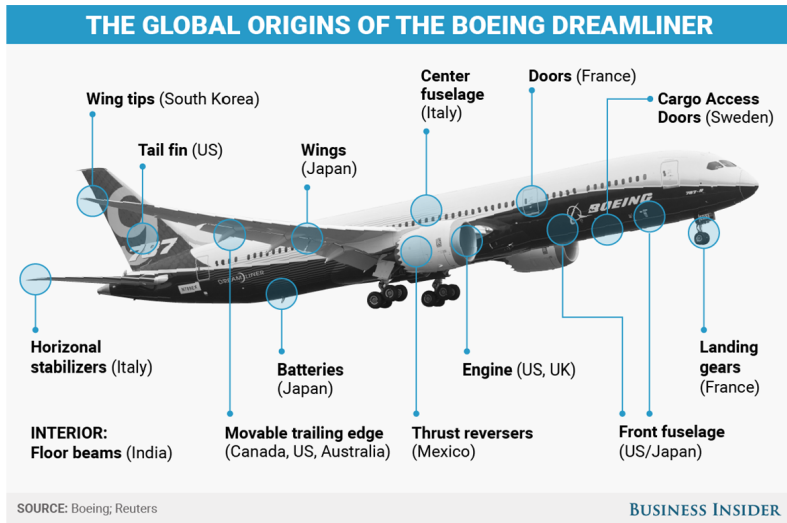
IMF DataMapper

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



©IMF, 2017, Source: World Economic Outlook (October 2017)

- The rise of offshoring and global supply chains



Multilateralism is stumbling

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- ...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

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- ...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?

Trump Trade Tweets

Verizon 7:36 AM 100%

< Tweet +

 **Donald J. Trump** @realDonaldTrump

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.

Tweet your reply

- 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

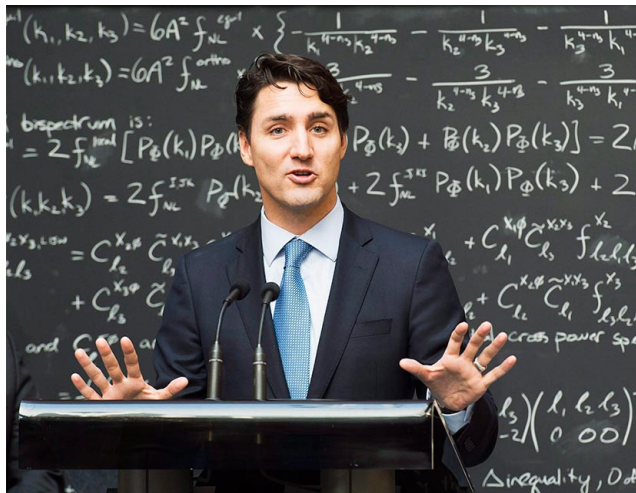
The stakes are high

- 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

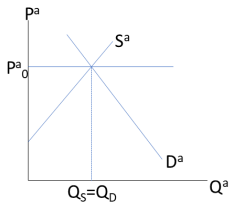
- The WTO's legitimacy is not built on the case for free trade
 - rather, it's built on the case for internalizing negative externalities

- Explaining this is going to be a little tedious...



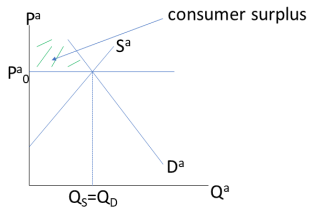
A closed economy

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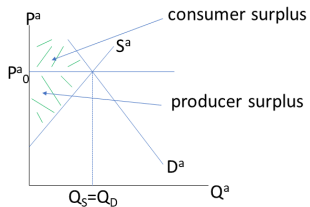
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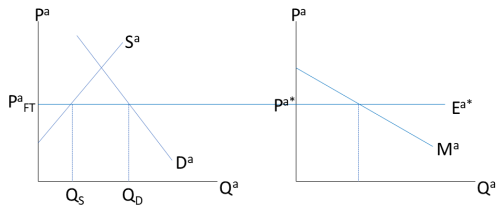
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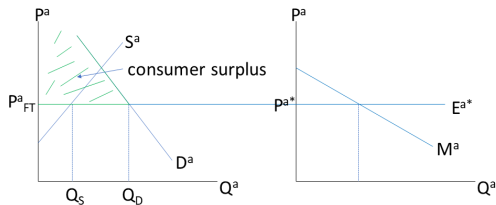
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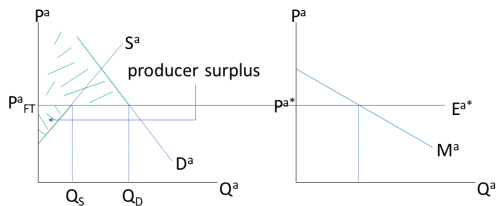
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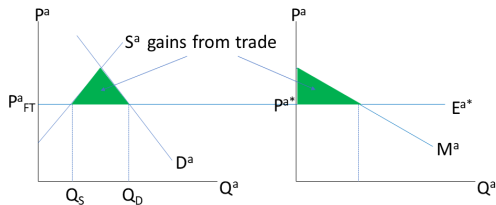
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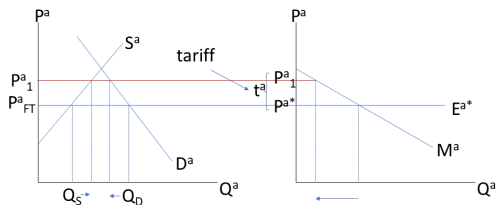
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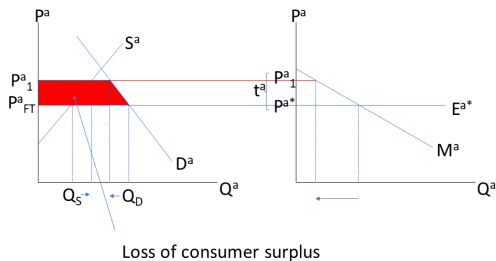
The purpose of Trade Agreements

- A *small country's* unilateral tariff choice



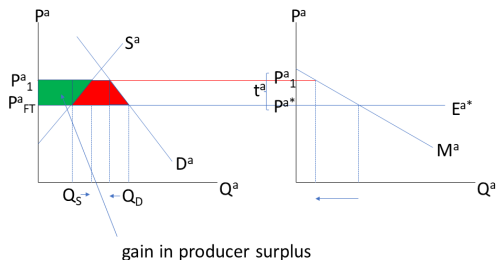
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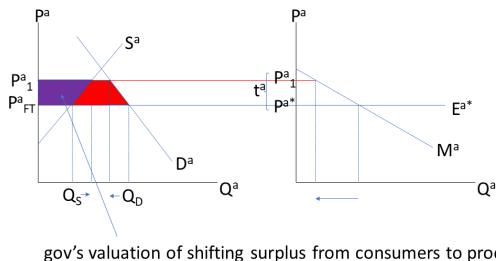
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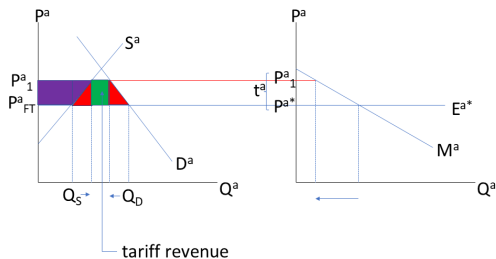
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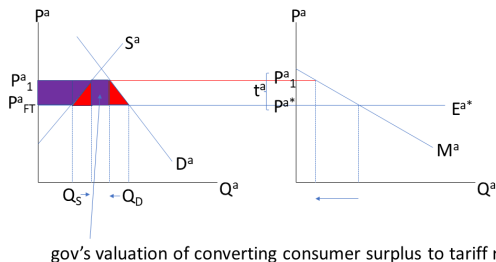
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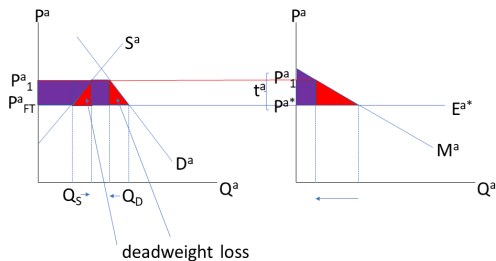
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gov's valuation of converting consumer surplus to tariff revenue

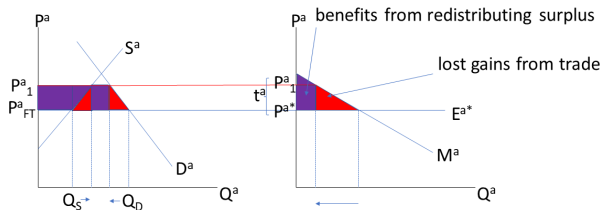
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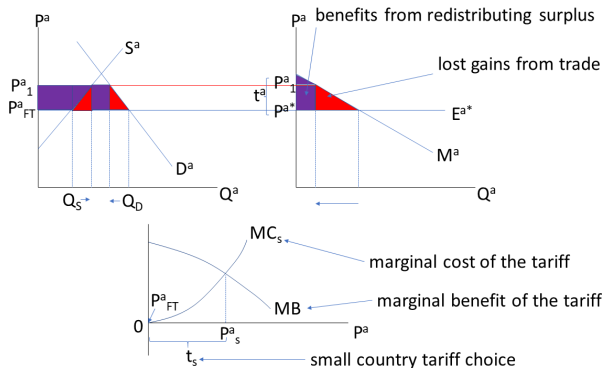
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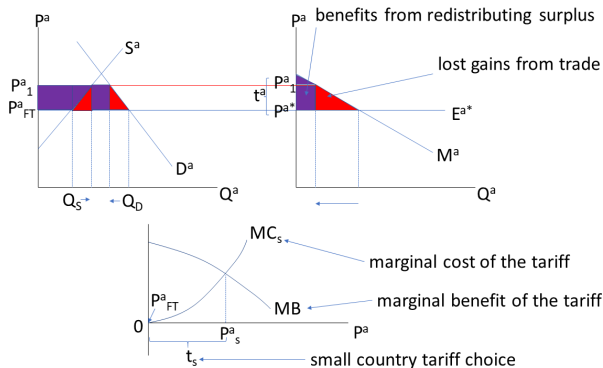
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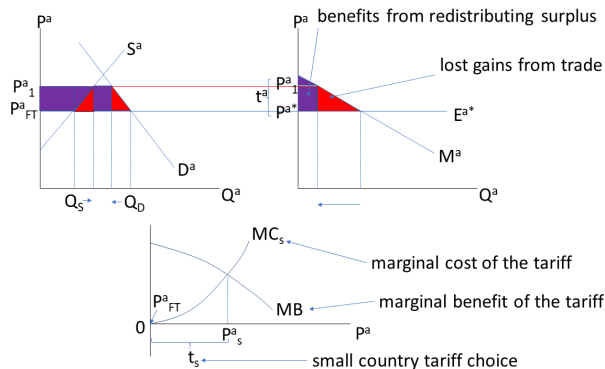
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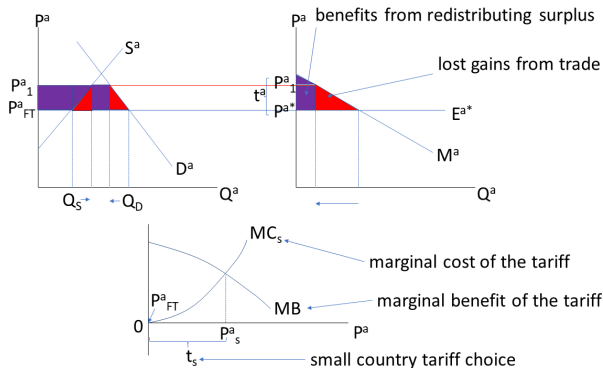
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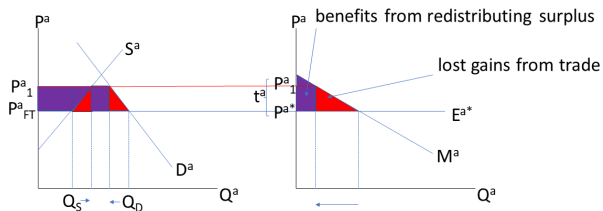
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- No international inefficiency, nothing for a trade agreement to do!

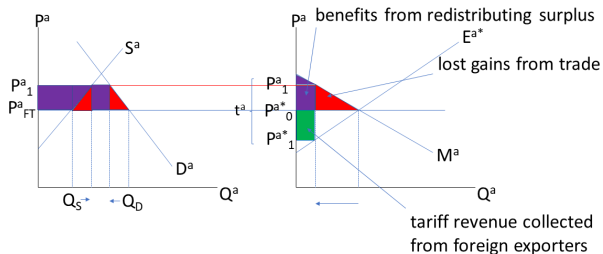
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- A *large country's* unilateral tariff choice (recall small country)



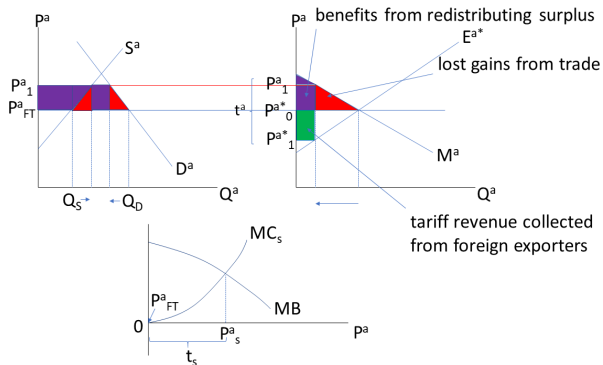
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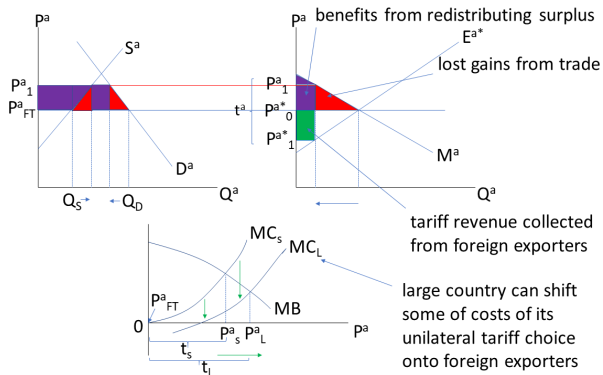
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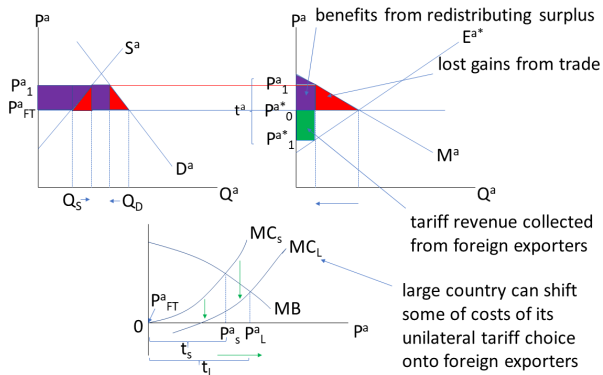
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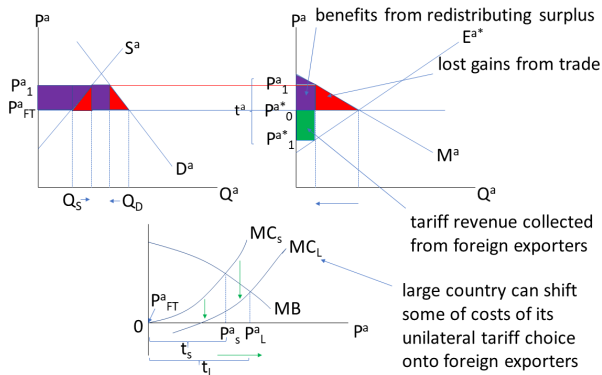
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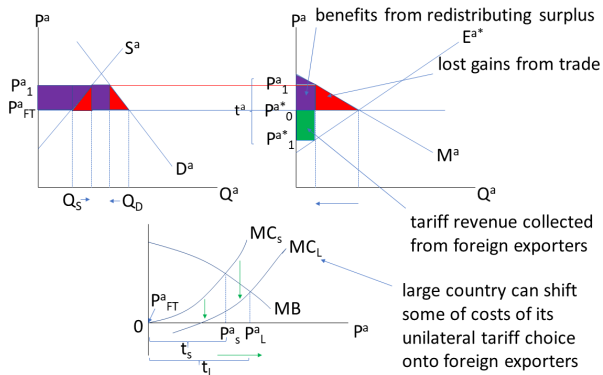
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- A large country's tariffs impose negative externalities on the world
- \Rightarrow Tariff choices are *internationally inefficient* (too high) in a world with large countries, given national government objectives
- Address the inefficiency, and a 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)

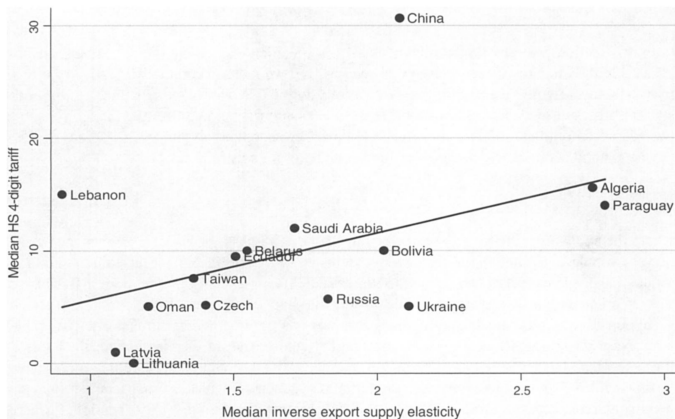


FIGURE 3. MEDIAN TARIFFS AND MARKET POWER ACROSS COUNTRIES

A key starting point

- The WTO's legitimacy is not built on the case for free trade
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Is the WTO well-designed to serve this purpose?

- 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

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 - Non-discrimination (MFN)
 - Reciprocity

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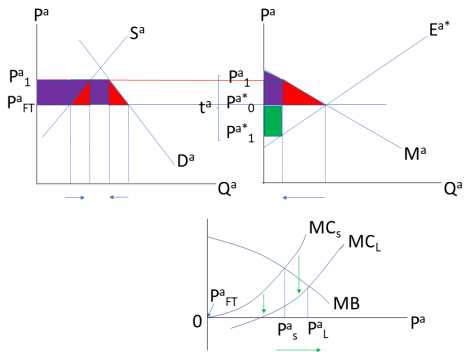
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- MFN
 - in a multi-country world, MFN keeps the trade policy externality as simple as in a 2-country world
- Reciprocity
 - defines a measured, *proportionate response* to a country's trade policy changes by its trading partners that *keeps it acting like a small country*

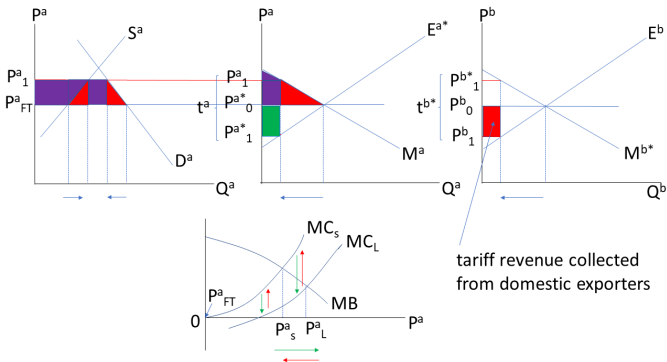
Reciprocity

- Recall a large country's unilateral MFN tariff choice



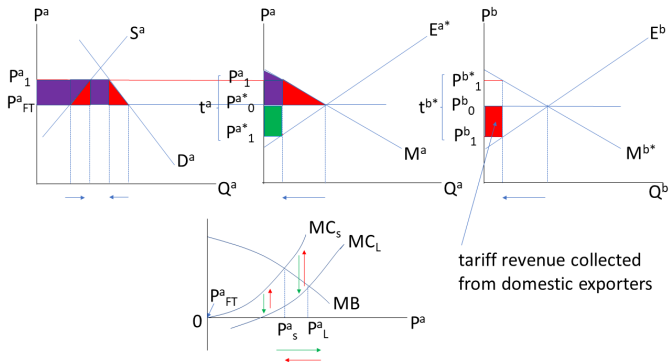
Unilateral MFN tariff choice in the presence of reciprocity

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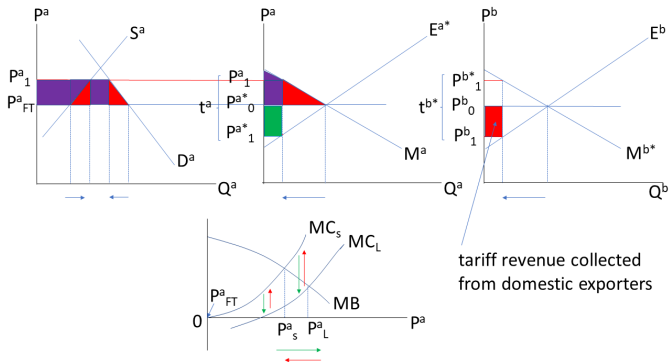
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Unilateral MFN tariff choice in the presence of reciprocity

- 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

VOL. 101 NO. 4 BAGWELL AND STAIGER: EVIDENCE FROM THE WORLD TRADE ORGANIZATION 1247

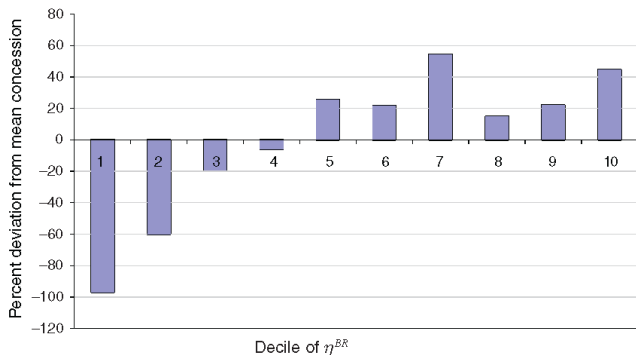


FIGURE 2. PERCENT DEVIATION FROM MEAN CONCESSION BY η^{BR} DECILE

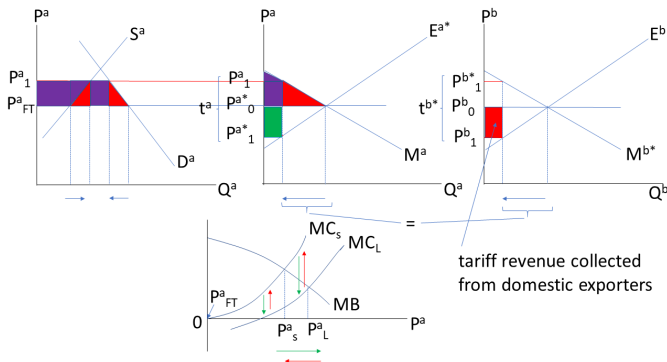
NYTimes March 2 2018 ***Trump's Tariffs Prompt Global Threats of Retaliation***

... 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

- 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, ...

- This is not (yet) a trade war, it is the way the system is meant to work

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

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 - 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

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- That is the logic of GATT/WTO shallow integration

The Trump Administration's ideal Global Trade Order

- 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.”

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- Purpose:
 - \implies Achieve reciprocal Free Trade (or at least a “level playing field”)
- Means:
 - \implies Abandon MFN
 - \implies 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 ... ⓘ

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 - \implies Perhaps support for "deep integration" together with assertion of US bargaining power

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 - Judge Bowker's argument against Canada's participation in the US-Canada FTA negotiations
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- 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)

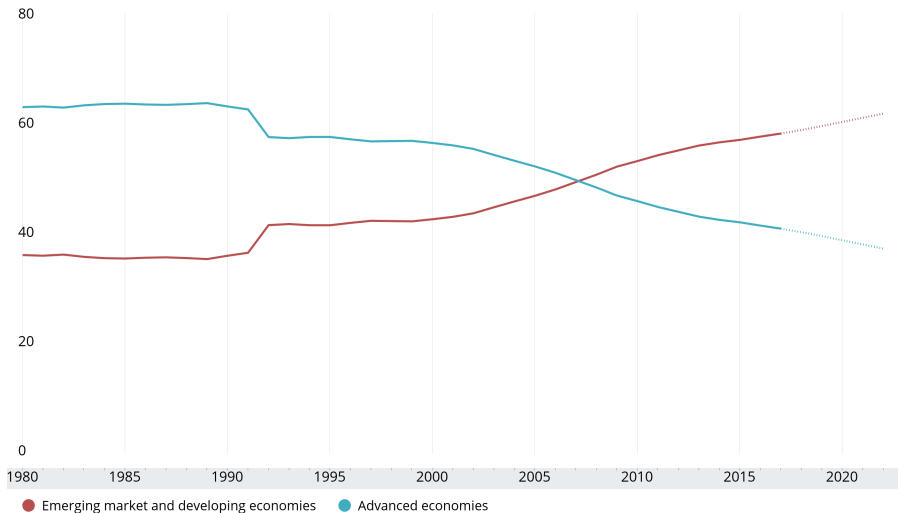
Whose interests does the WTO serve?

- 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
 - ⇒ 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
 - ⇒ 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)



- 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

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- 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 20th-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

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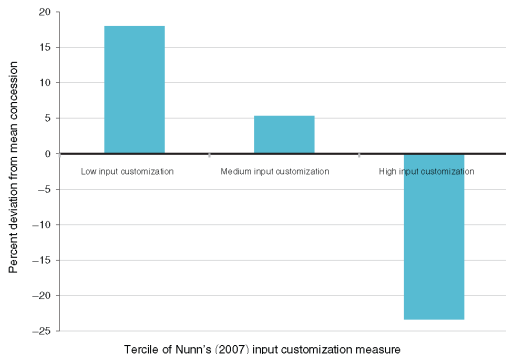


FIGURE 1. PERCENT DEVIATION FROM MEAN CONCESSION BY TERCILE OF INPUT CUSTOMIZATION MEASURE

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- 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

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



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- To borrow from Paul Samuelson's remark about Milton Friedman
 - If Donald Trump did not exist it would be necessary to invent him

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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

