

# What can Developing Countries Achieve in the WTO? A View from Economics

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- In the opening paragraph of *Behind the Scenes at the WTO: the real world of international trade negotiations*, the authors Fatoumata Jawara and Aileen Kwa offer a very telling account of what is to come:

“The remainder of this book recounts what happened before, during and after the Fourth WTO Ministerial Conference in Doha, Qatar, in November 2001. It tells how developing countries were bullied and coerced into acquiescing with an ‘agreement’ with which most of them profoundly disagreed. The process culminated in a Ministerial Conference which continued through the night and after its scheduled end (and the departure of some developing country delegations) until the developing countries were finally beaten into submission and the major powers got their way.” (P. xv).

# Introduction (cont'd)

- The central message of the book: “Developed countries are benefitting from the WTO, as are a handful of (mostly upper) middle-income countries. The rest, including the great majority of developing countries, are not. It is as simple as that.” (P. 269).
- The authors attach to this message a significance for the WTO which is very pessimistic:
- “This prompts the question of whether the world needs a World Trade Organization, and if it does, what it should look like. The WTO’s supporters regularly respond to its critics that such an organization is needed, because the institutional framework provided by a ‘rules-based’ international institution at least puts the developing countries in a stronger position to challenge the developed countries than the anarchy of a ruleless system.

- “In theory, this is plausible. The existence of the WTO should put some constraint on the ruthless pursuit of self-interest by the most powerful countries in the field of trade. In practice, however, the defence mechanisms that exist are largely inaccessible to, and ineffective in the hands of, most developing countries; and many aspects of the WTO merely provide the developed countries with new instruments to put pressure on developing countries in pursuit of their own commercial agendas.

- ... “In short, appealing as the idea of some kind of multilateral trade system might be in principle, it seems clear that the WTO as it currently operates does not constitute such a system. Far from setting fair trade rules to protect the interests of the weak, the WTO has been complicit in reinforcing the interests of the strong: Anarchy – the threat (real or supposed) used to justify the WTO – may be bad for the weak, but the tyranny of the strong may be worse.” (Pp. 302-304).

- Evidently, the authors' stated position derives from the following observations:
- (A) the WTO's reason for existence is (or should be) to provide the world with a rules-based institutional framework that protects the interests of the weak within the context of trade bargaining;
- (B) the WTO does not appear to have been successful in delivering significant benefits of trade bargaining to the majority of developing countries, and so the WTO has failed to provide an effective rules-based institutional framework;
- (C) therefore, the world does not need the WTO (at least in anything like its current form).

# Introduction (cont'd)

- The authors find substantial support for – and indeed arrive at – their position through interviews with numerous (mostly developing country) member-government WTO delegates as well as with WTO Secretariat staff members.
- Hence, the authors' position or something approaching it is evidently embraced by important players in the WTO system, and on that basis alone deserves serious consideration from economists.
- At the same time, this position illustrates well why it is important for economists to offer a theoretically coherent and empirically grounded answer to the question “...of whether the world needs a World Trade Organization, and if it does, what it should look like.”

# Introduction (cont'd)

- In what follows, I will provide a brief sketch of an answer to this question as viewed from Economics.
- To preview, my answer is that the world does need a WTO and that it should look a lot like it does (though maybe more like the way it used to as GATT), but that the problems it is best equipped to solve may not be the problems of small developing countries.



# What do Trade Negotiators Negotiate About?

- Does the world need a WTO?
- One way to rephrase the question: What are trade negotiators negotiating about?
- Observation A: The standard case for free trade is a unilateral case.
- Observation B: The GATT/WTO is driven by exporter interests, not the consumer gains from freer trade.
- Answer #1: No way to make sense of negotiations.

# What do Trade Negotiators Negotiate About? (cont'd)

- “It was a fruitful lie, this idea that the gains from trade come mainly from the exports you sell, not the imports you buy. But it was still a lie; the textbook case for [unilateral] free trade really is correct...the whole process – the GATT, the WTO, all that stuff – was just a ruse.” Clive Crook (The Atlantic Monthly, October 2006).
- The ultimate success of the GATT/WTO measured by how close it gets the world to global free trade.

# What do Trade Negotiators Negotiate About? (cont'd)

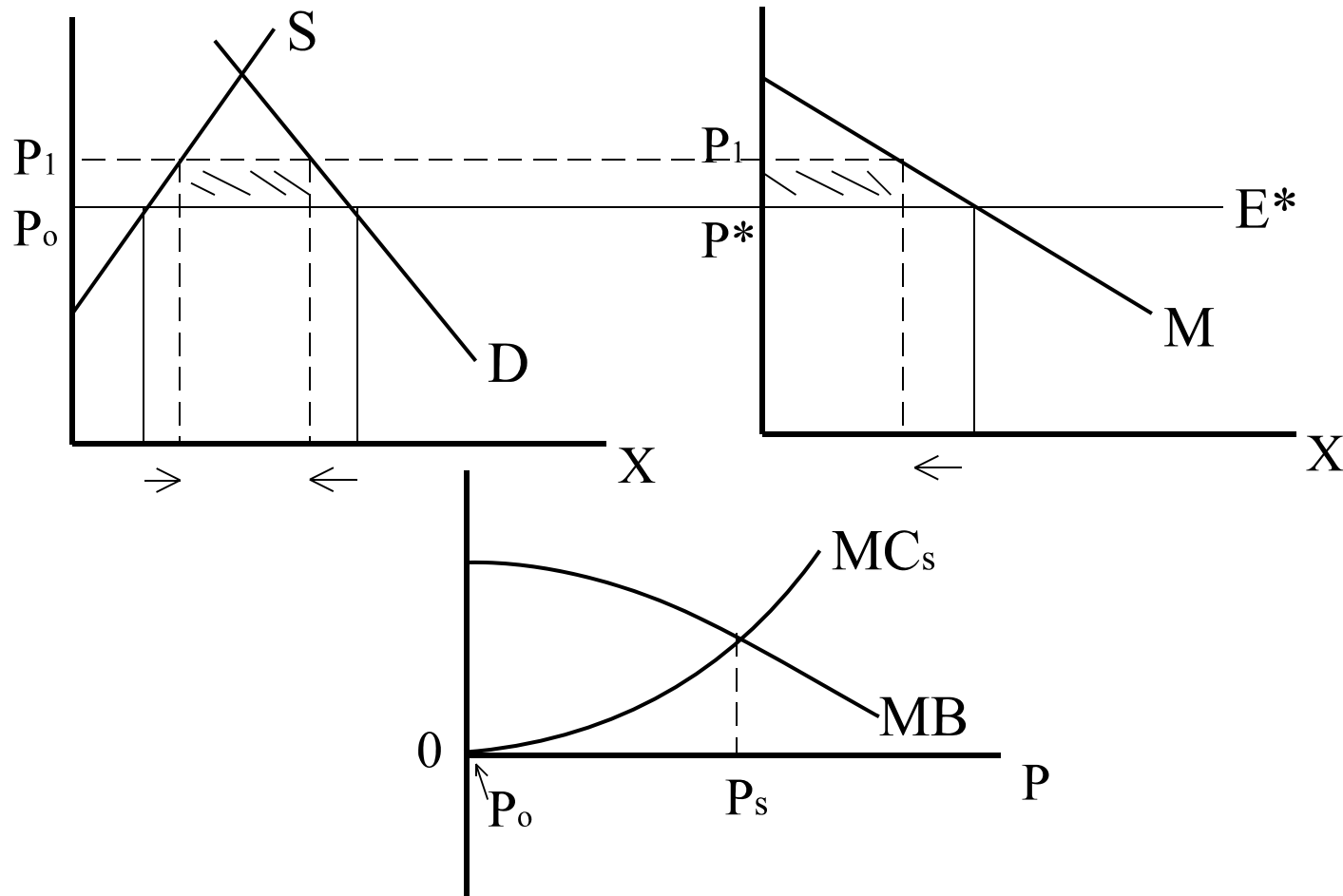
- Answer #2: identify a well-defined problem that the GATT/WTO might solve.
- –The terms-of-trade theory: facilitate escape from a terms-of-trade-driven Prisoners' Dilemma.
- –The commitment theory: facilitate domestic commitments to the private sector.
- The ultimate success of the GATT/WTO measured by how well it facilitates solutions to one or both of these problems.
- Most research in economics focuses on terms-of-trade theory, so I will here.

# What do Trade Negotiators Negotiate About? (cont'd)

- The Plan:
  1. Determine “the problem” according to the terms-of-trade theory.
  2. Describe some key reasons why GATT/WTO looks well-designed to help governments solve this problem.
  3. Present some empirical evidence that this is indeed what GATT/WTO negotiations are used for.
  4. Discuss implications of this view for the Doha Round.

# 1. The problem

*A small country's unilateral tariff choice:*

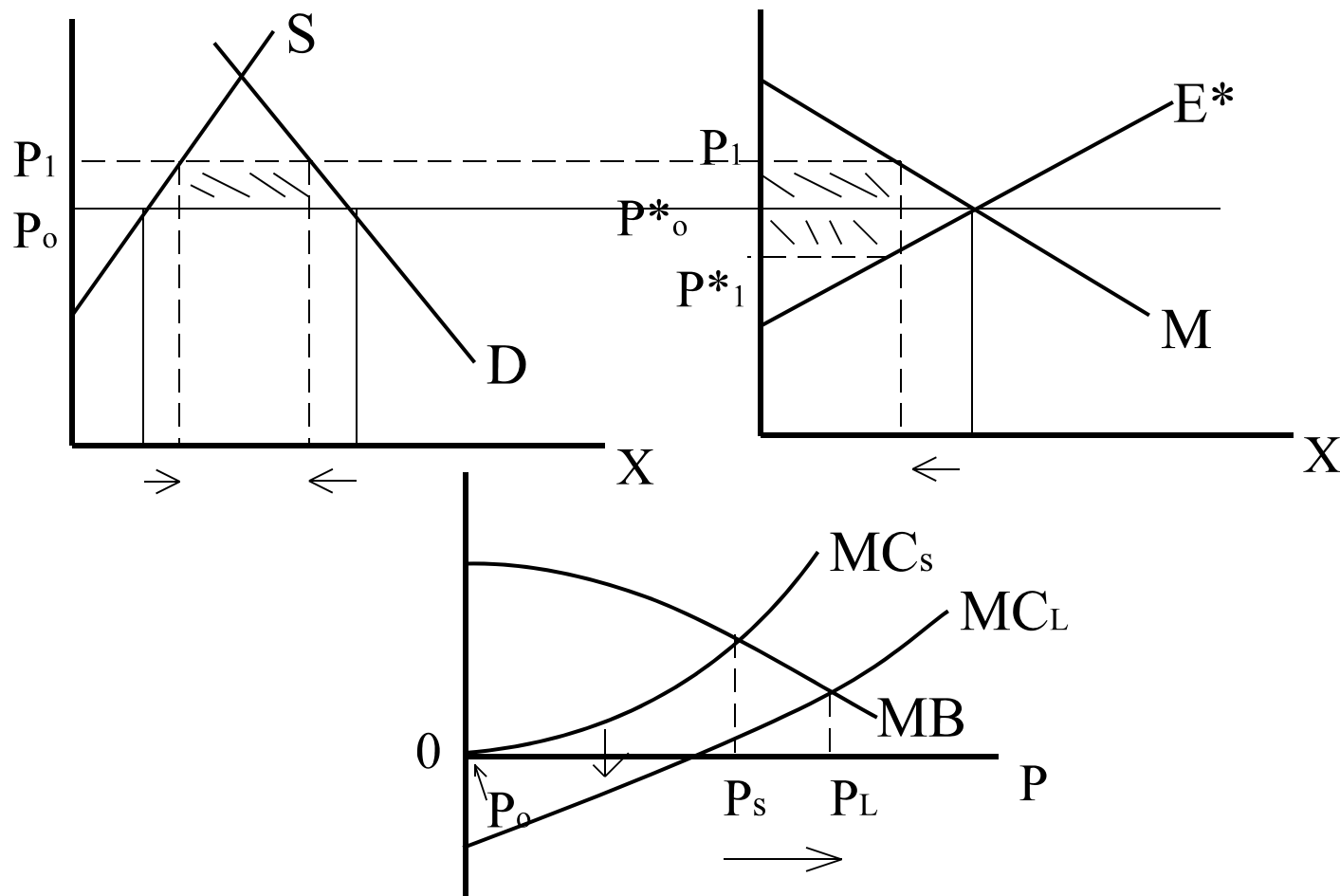


*Internationally efficient, given national government objectives.*

# The Problem

- A small country's unilateral tariff choice:
- Internationally efficient, given national government objectives.
- The Problem: No “problem” for GATT/WTO to fix!

*A large country's unilateral tariff choice:*



*Internationally inefficient, given national government objectives.*

# The Problem (cont'd)

- A large country's unilateral tariff choice:
- Internationally inefficient, given national government objectives.
- Houston, we have a problem: international cost-shifting.
- –"Terms-of-trade" (foreign exporter price) manipulation.
- –"Too little trade" in the Nash (non-cooperative) equilibrium.
- –Each government desires more trade volume at fixed terms of trade.



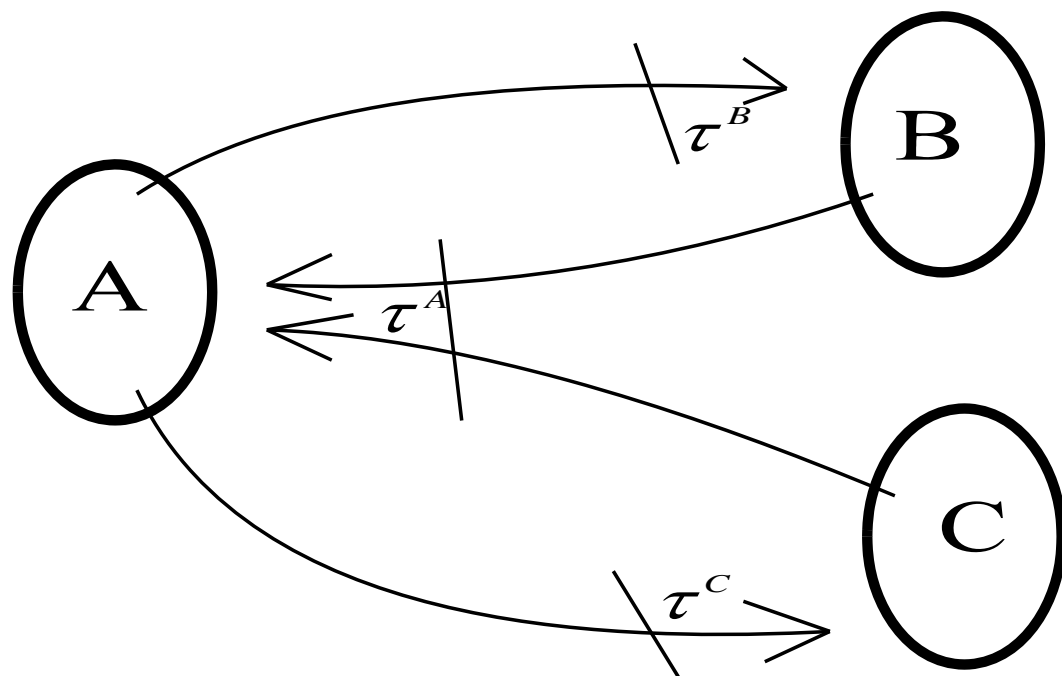
# The GATT/WTO as a Negotiating Forum

- Observation: Among multilateral institutions, the GATT/WTO has adopted a distinctive approach to serving as a forum for international negotiation.
- –Voluntary reciprocal market access negotiations between pairs/small numbers of countries, “multilateralized” according to MFN.
- –Reciprocity and MFN are the two pillars of the GATT/WTO negotiating forum.
- These features not accidental: Built on success of 1934 RTA, which in turn was influenced by:
  - –failed multilateral tariff bargaining approaches of inter-war years;
  - –failed European attempts at bilateral tariff bargaining without MFN.

# The GATT/WTO as a Negotiating Forum (cont'd)

- From the perspective of the terms-of-trade theory, Why would the principle of reciprocity have appealing features?
- Reciprocity: the ideal of mutual changes in trade policy that trigger changes in the volume of each country's imports that are of equal value to changes in the volume of its exports.
- –Describes a fixed terms-of-trade rule to which mutual tariff changes must conform;
- –useful in an environment where terms-of-trade manipulation is the problem to be fixed.
- Intuition: Beginning from Nash, each government desires more trade volume at fixed terms of trade.
- –Reciprocity harnesses this desire, and so activates efficiency-enhancing tariff-liberalizing forces.

From the perspective of the terms-of-trade theory, Why would the *MFN* principle have appealing features?



MFN: With multiple foreign exporters (B and C) of good x, MFN requires of A a common import tariff regardless of foreign source.

# The GATT/WTO as a Negotiating Forum (cont'd)

- From the perspective of the terms-of-trade theory, Why would the MFN principle have appealing features?
- MFN: With multiple foreign exporters (B and C) of good x, MFN requires of A a common import tariff regardless of foreign source.
- Note: A and B can still negotiate reciprocal tariff reductions and benefit from more trade volume at a fixed terms of trade.
- –Strikingly, as long as A and B abide by reciprocity, no third-party effects on country C.
- –A and C can engage in bilateral reciprocal negotiations that have the same property.
- Implication: the MFN rule permits the liberalizing force of reciprocity to be harnessed in an essentially bilateral manner even in a multilateral world.

# The GATT/WTO as a Negotiating Forum (cont'd)

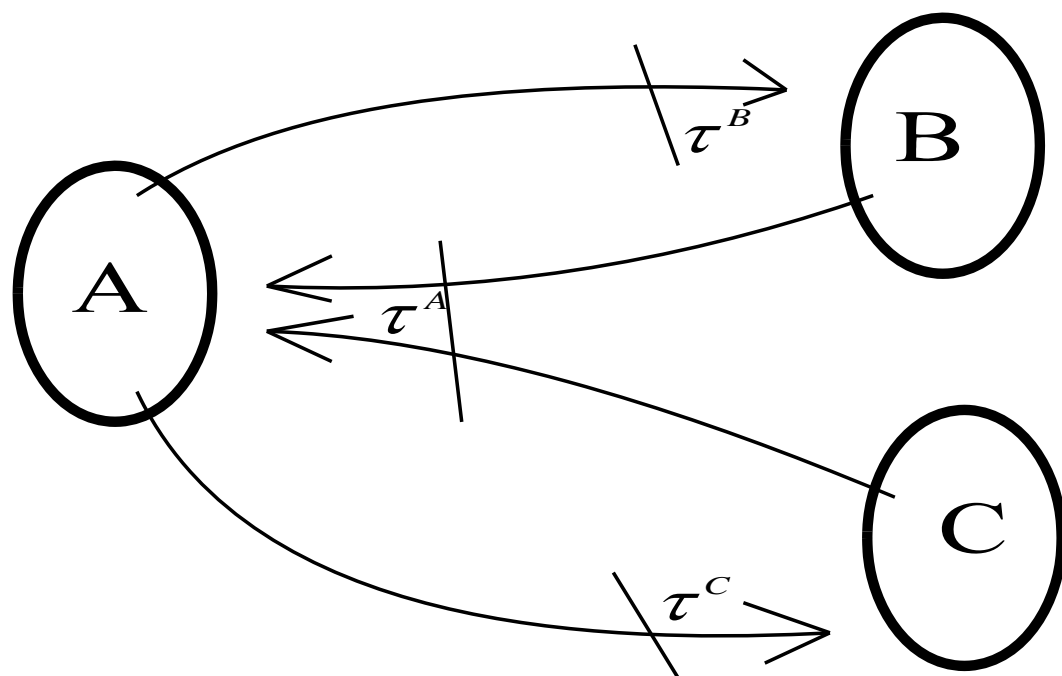
- Interpretation:
- The GATT/WTO pillars of reciprocity and MFN can be understood to underpin the architecture of an international negotiating forum:
- –in which the liberalizing force of reciprocity can be harnessed in bilateral negotiations with an assurance of minimal third-party spillovers;
- –thereby permitting each member-government – through bilateral/small-numbers negotiations – to engineer its escape from a terms-of-trade driven Prisoners' Dilemma.

# Empirical Evidence

- Three kinds of empirical evidence suggest that this is the primary purpose of GATT/WTO negotiations.
- First, Subramanian and Wei (2007).
- –Trade effects of GATT/WTO membership large for trade between developed-country members (who reciprocally liberalized) and non-existent for developing-country members (who did not).

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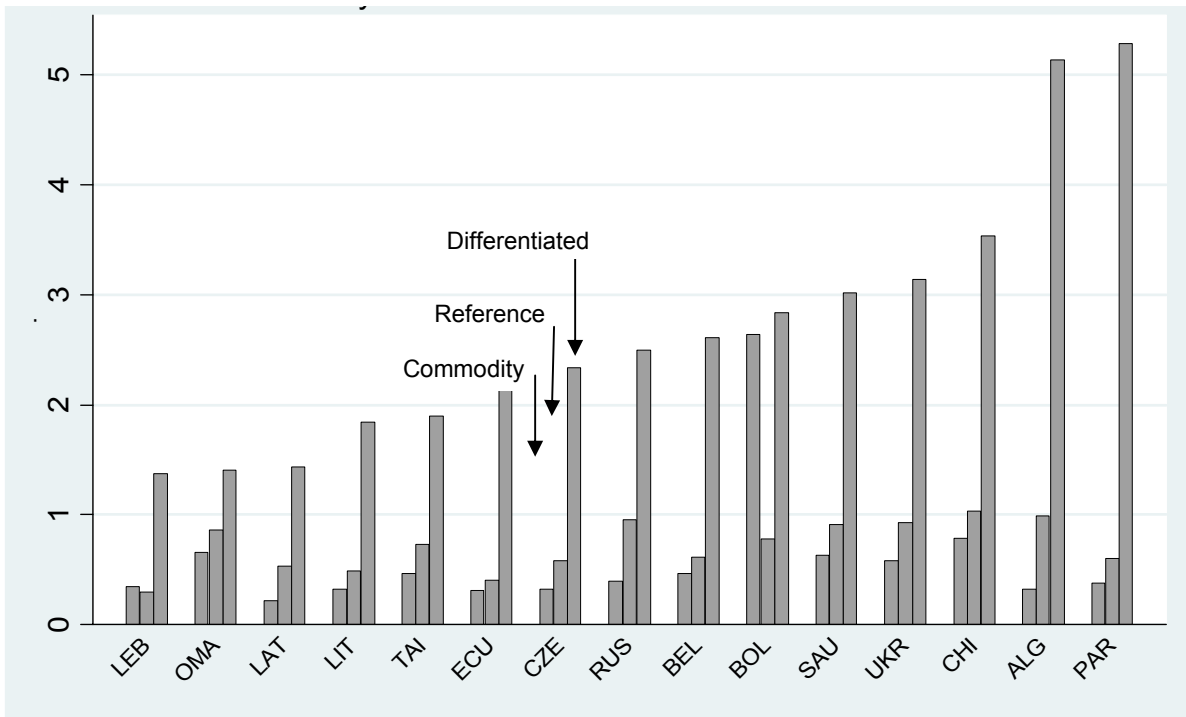


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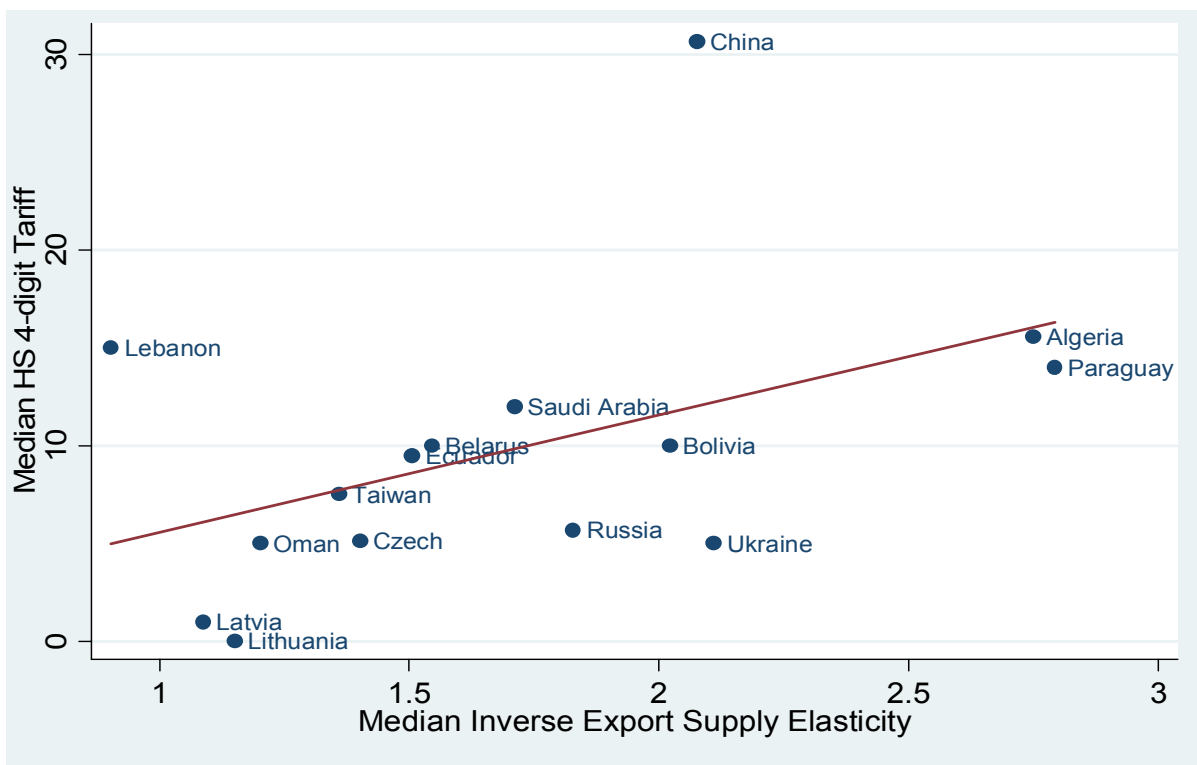
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- Second, Broda, Limao and Weinstein (2008).
  - –Evidence of “optimal tariffs.”
  - –The optimal tariff exploits a country’s monopoly/monopsony power in trade, and is proportional to the inverse of the foreign export supply elasticity.



**Figure 2: Median Inverse Elasticities by Product Type**  
(Commodity;Reference Priced and Differentiated Products)



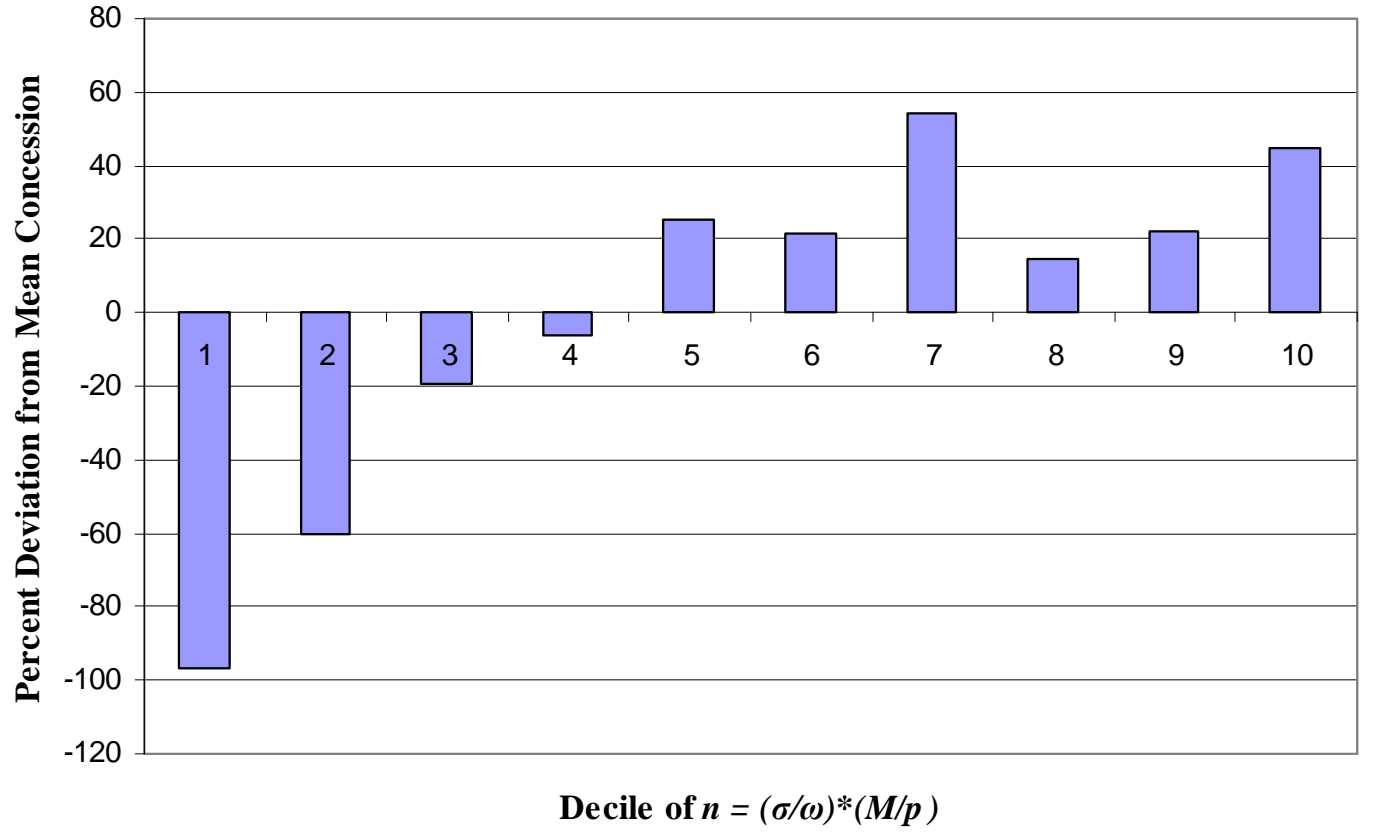
**Figure 3: Median Tariffs and Market Power Across Countries**



# Empirical Evidence (cont'd)

- Third, Bagwell and Staiger (2009).
- International cost-shifting a bigger component of Nash tariffs:
  - – the bigger the elast. of import demand  $\sigma^{BR}$  (b/c a given tariff increase generates a larger fall in import demand);
  - – the lower the elast. of foreign export supply  $\omega^{*BR}$  (b/c a given fall in import demand generates larger fall in foreign exporter price); and
  - – the larger the import volume  $M^{BR}$  (b/c a given fall in foreign exporter price generates a larger income effect).
- $\implies$  negotiated tariff cut  $(\tau^{BR} - \tau^{PO})$  increasing in  $\frac{\sigma^{BR}}{\omega^{*BR}} \frac{M^{BR}}{p^{BR}}$ .
- In linear model, international cost-shifting a bigger component of Nash tariffs the bigger is Nash import volume.
- $\implies \tau^{BR} - \tau^{PO}$  increasing in  $\frac{M^{BR}}{\bar{p}^{wBR}}$ .
- Finally, absent political economy,  $\tau^{BR} - \tau^{PO} = \frac{1}{\omega^{*BR}}$ .

**Figure 2: Percent Deviation from Mean Concession by "n" Decile**

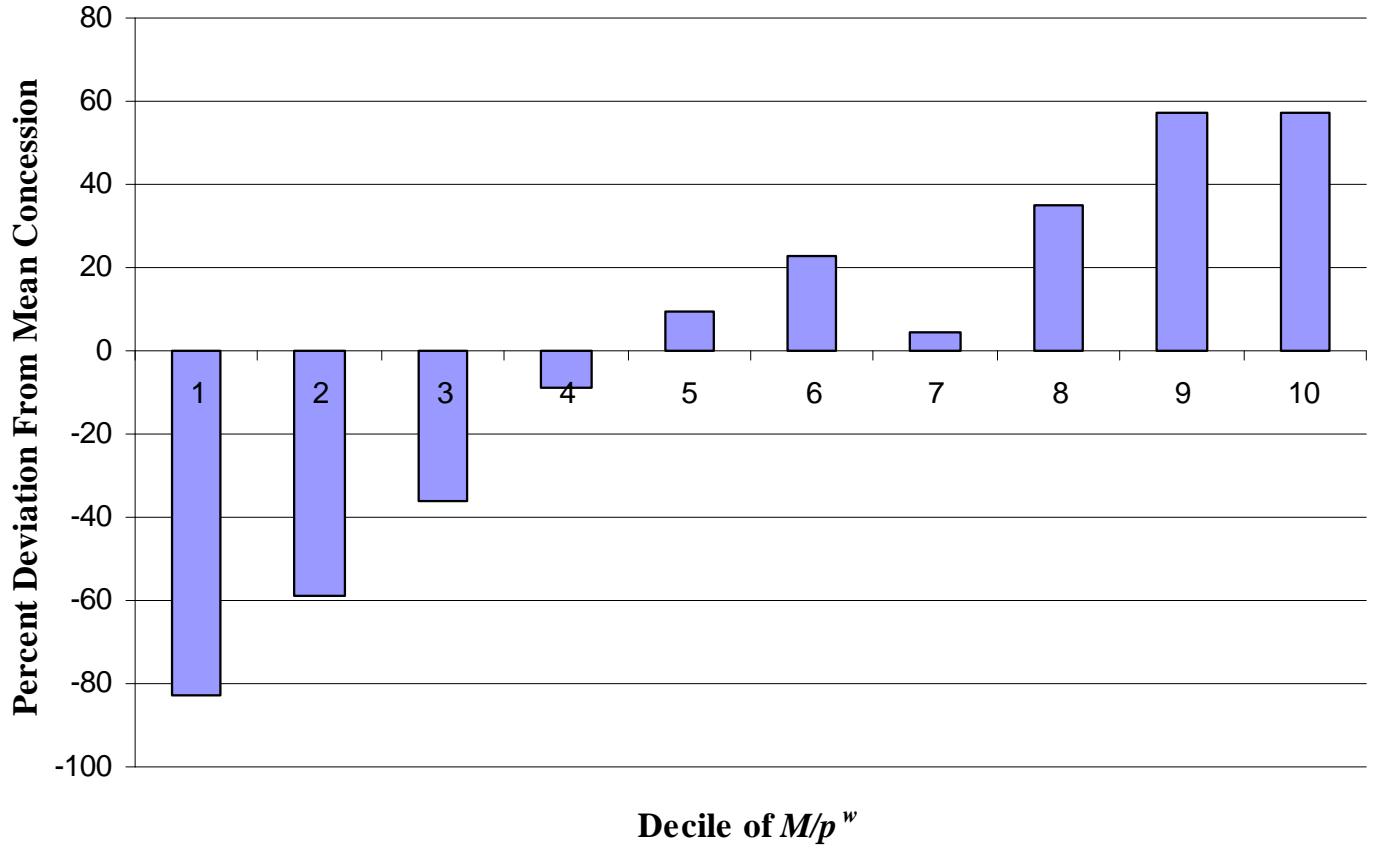


Notes: Percent deviation from mean concession for import decile  $k$  calculated as:

$$\left[ \frac{\frac{1}{binsize} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) - \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i})}{\left| \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) \right|} \right],$$

See Table 1 for the sample periods of Import and Tariff Data

**Figure 1: Percent Deviation from Mean Concession by  $M/P^w$  Decile**

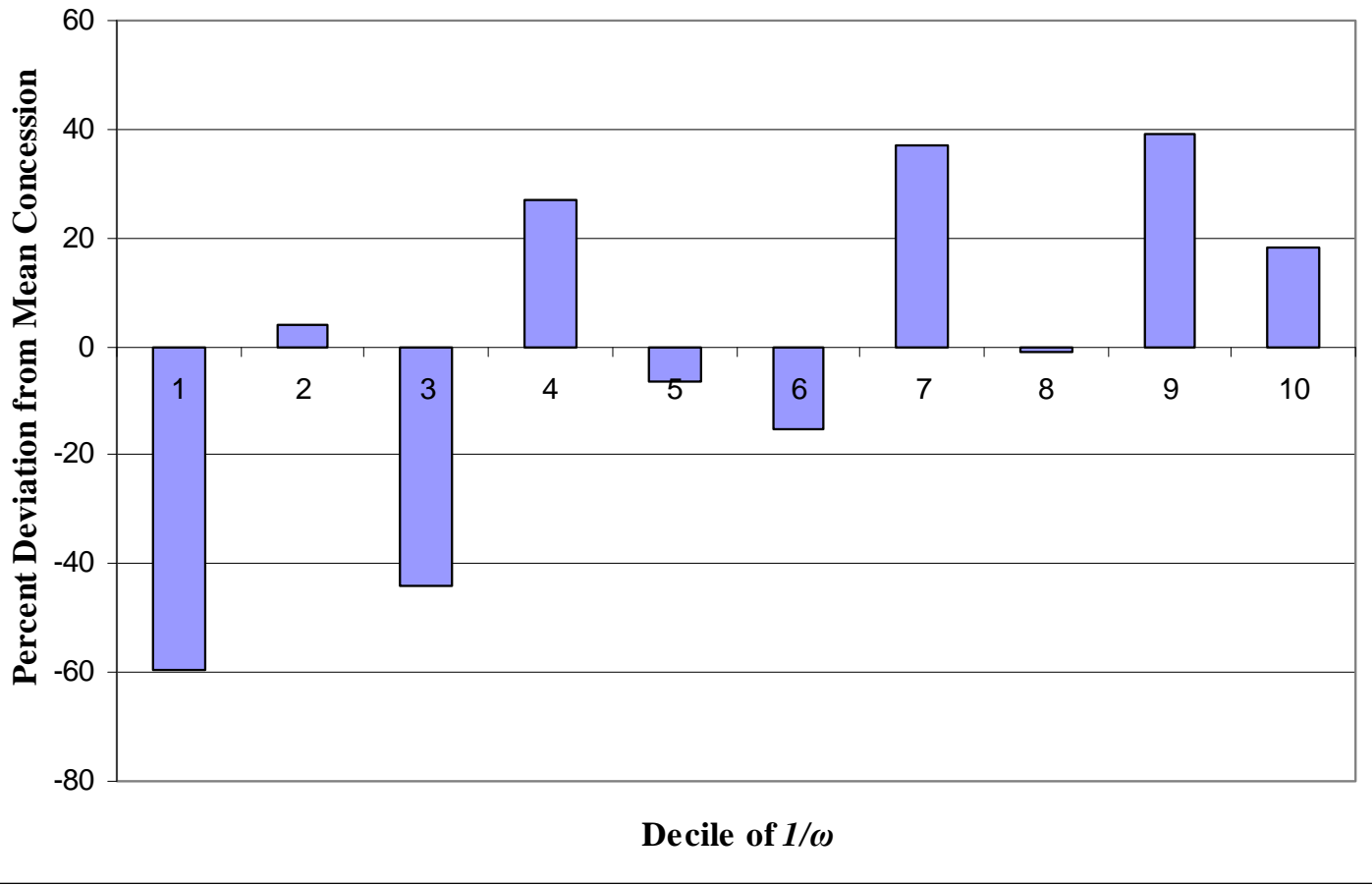


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**Figure 3: Percent Deviation from Mean Concession by  $1/\omega$  Decile**



Notes: Percent deviation from mean concession for import decile  $k$  calculated as:

$$\left[ \frac{\frac{1}{binsize} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) - \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i})}{\left| \frac{1}{10 * binsize} \sum_{k \in 10} \sum_{i \in k} (t_{prewto,i} - t_{wto,i}) \right|} \right],$$

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# Implications for the Doha Round

- Don't expect too much
- If the GATT/WTO solves a large country problem, and if most developing country members are small,
  - –then most developing country members can expect little from the WTO.
- In this case, the role of small developing countries as WTO members is to
  - –prevent discrimination from the larger countries as the larger countries use the WTO to solve their problems.
- Most developing countries should not be asked to make concessions (as under GATT).

# Implications for the Doha Round (cont'd)

- Don't expect too little
- If the GATT/WTO solves a large country problem, and if most developing country members are large in the relevant international (or regional) markets,
- –then developing countries can achieve gains in the same way as developed countries.
- Most developing countries should actively engage in the granting of reciprocal policy concessions.