



Topic 13 – The World Trading System

Prof. Ralph Ossa



Introduction

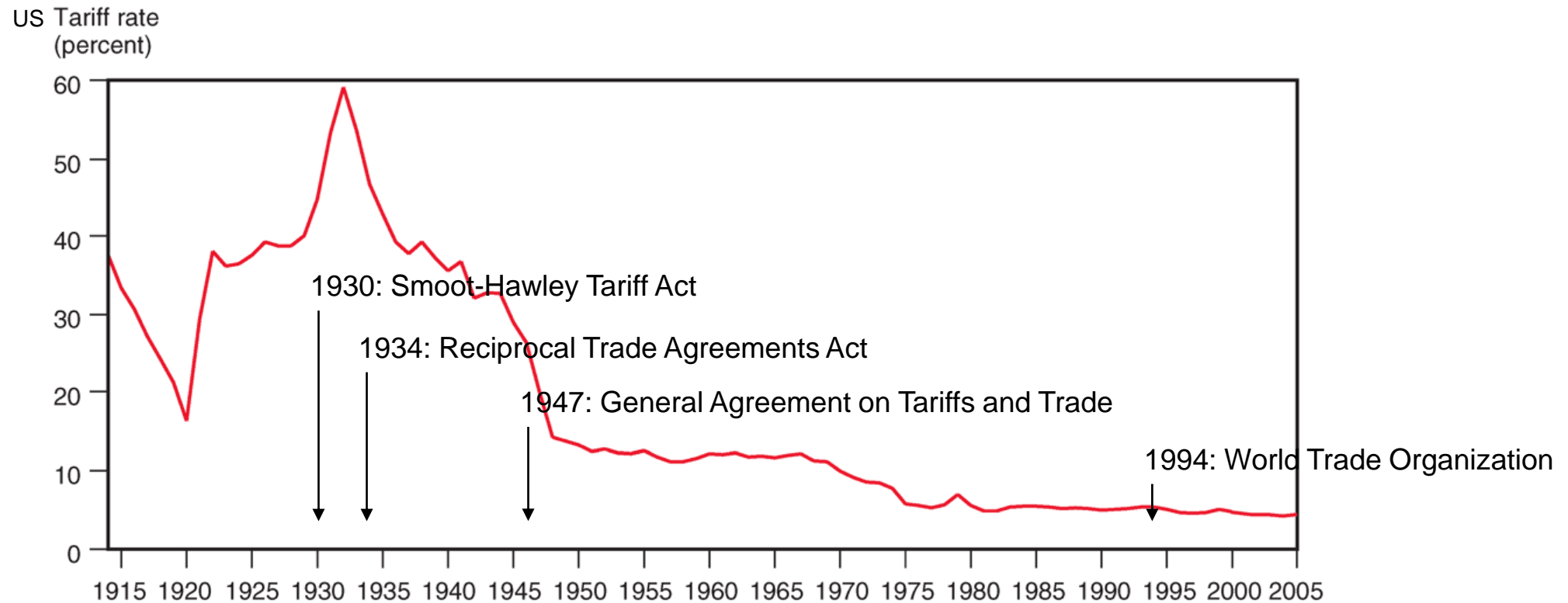
- In this topic, we introduce the world trading system, that is the institutions governing international trade and trade policy
- We begin by discussing the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) which provide the multilateral framework for trade policy
- We then turn to regional trade agreements (RTAs) such as the proposed Transatlantic Trade and Investment Partnership (TTIP) and Trans-Pacific Partnership (TPP)



Overview

- Multilateral trading system
- Regional trade agreements

Multilateral trading system - Basic history



Source: KMO textbook



Multilateral trading system – Basic history (contd.)

1930: US Smoot-Hawley Tariff Act

- Raised US tariffs to extreme levels in response to the Great Depression and triggered a worldwide trade war

1934: US Reciprocal Trade Agreements Act (RTAA)

- Marked the beginning of a more cooperative US trade policy based on the principles of reciprocity and nondiscrimination

1947: General Agreement on Tariffs and Trade (GATT)

- Was modeled after the RTAA and became the central agreement governing multilateral trade negotiations after the US Congress failed to ratify the International Trade Organization

Multilateral trading system – Basic history (contd.)

Year	Name	Countries	Key achievements
1947	Founding Round	23	GATT established (details below) tariffs reduced by around 20 percent
1949	Annecy Round	13	tariffs reduced by around 2 percent
1951	Torquay Round	38	tariffs reduced by around 3 percent
1956	Geneva Round	26	tariffs reduced by around 2.5 percent
1960-61	Dillon Round	26	tariffs reduced by around 4 percent
1964-67	Kennedy Round	62	tariffs reduced by around 35 percent
1973-79	Tokyo Round	102	tariffs reduced by around 33 percent
1986-94	Uruguay Round	123	WTO established (details below) tariffs reduced by around 38 percent
2001-	Doha Round	141	currently suspended (details below)



The GATT

The GATT regulates trade negotiations through a number of specific articles. These articles essentially require countries to:

1. Concentrate national protective measures into the form of tariffs (**principle of tariffication**)
2. Apply these tariffs according to the **principle of nondiscrimination**
3. Change these tariffs according to **the principle of reciprocity**



The GATT – Tariffication – Elimination of quantitative restrictions

- Article XI requires the elimination of quantitative restrictions:
- *“No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party.”*
- However, this requirement does not extend to agricultural products



The GATT – Tariffication – Prohibition of export subsidies

- Article XVI prohibits export subsidies:
- *“Further, [...] contracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product [...] which [...] results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.”*
- Again, this prohibition does not extend to agricultural products



The GATT – Nondiscrimination – MFN

- Article I requires general **most-favored nation (MFN) treatment**:
- *“With respect to customs duties and charges of any kind [...], any advantage, favor, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”*



The GATT – Nondiscrimination – National treatment

- Article III further calls for **national treatment**:
- *“The products of the territory of any contracting party [...] shall not be subject [...] to internal taxes or other internal charges of any kind in excess of those applied [...] to like domestic products.”*
- A similar statement can be found regarding *“all laws, regulations, and other requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use.”*



The GATT – Nondiscrimination – CUs and FTAs

- However, article XXIV allows the formation of **customs unions** and **free-trade areas**:
- *“Accordingly, the provisions of this Agreement shall not prevent [...] the formation of a customs union or of a free-trade area [...].”*
- Customs unions such as the EU have common external tariffs. Free-trade areas such as NAFTA maintain differential external tariffs through complex **rules of origin**



The GATT – Reciprocity

- The principle of reciprocity appears in two specific applications
- First, governments tend to seek a “balance of concessions” during rounds of trade liberalization in the sense that they cut tariffs reciprocally
- Second, governments are entitled to “withdraw substantially equivalent concessions” if a contracting partner increases previously bound tariffs in the sense that they increase tariffs reciprocally



The GATT – Reciprocity – First application

- In the preamble, the contracting parties commit to enter *“into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other trade barriers to trade.”*
- This is echoed in article XXVIII bis, which stresses that *“negotiations on a reciprocal and mutually advantageous basis, directed to the substantial reduction of the general level of tariffs [...] are of great importance to the expansion of international trade.”*



The GATT – Reciprocity – Second application

- Article XXVIII specifies that *“a contracting party may, by negotiation and agreement [...], modify or withdraw a concession [...].”*
- Moreover, *“if agreement between the contracting parties [...] cannot be reached [...], the contracting party which proposes to modify or withdraw the concession shall, nevertheless, be free to do so”*. However, any affected contracting party is then free to withdraw *“substantially equivalent concessions initially negotiated with the applicant contracting party.”*



The GATT – Reciprocity – Second application (contd.)

- Article XIX further allows “*emergency action on imports of particular products*”: “*If, as a result of unforeseen developments and of the effect of the obligations incurred by a contracting party [...], any product is being imported [...] in such increased quantities [...] as to cause or threaten serious injury to domestic producers [...], the contracting party shall be free [...] to suspend the obligation in whole or in part [...].*”
- If no agreement is reached, any affected contracting party can then again “*withdraw substantially equivalent concessions.*”



The GATT – Reciprocity – Precise definition

- Nowhere in the GATT is the term “reciprocity” precisely defined. According to Bagwell and Staiger (2002), it “refers broadly to the ideal of mutual changes in trade policy which bring about changes in the volume of each country’s imports that are of equal value to changes in the volume of its exports.”
- This definition can be understood as an ideal guiding GATT negotiations, which governments seek to approximate by using simple rules of thumb



The GATT – More general exceptions – Antidumping and countervailing duties

- Article VI allows countries to impose **anti-dumping duties** or **countervailing duties**
- Anti-dumping duties are allowed in response to “dumping”
- Countervailing duties are allowed in response to export subsidies



The GATT – More general exceptions – Developing countries

- Developing countries are granted **special and differential** treatment
- Article XVIII states that the *“contracting parties recognize further that it may be necessary for [developing countries], in order to implement programs and policies of economic development designed to raise the general standard of living of their people, to take protective or other measures affecting imports [...].”*
- Moreover, the so-called **enabling clause** adopted in 1979 ensures that: *“Notwithstanding the provisions of Article I of the General Agreement, contracting parties may accord differential and more favorable treatment to developing countries, without according such treatment to other contracting parties.”*
- Among other things, this clause allows developing countries to sign preferential trade agreements. Unlike customs unions or free-trade areas, preferential trade agreements may not involve internal free trade



The GATT – More general exceptions – Protection of human, animal, or plant life or health

- Also, article XX requires that:
- *“Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary [...] discrimination between countries where the same conditions prevail [...] nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures [...] necessary to protect human, animal or plant life or health.”*



The GATT – More general exceptions – Multi-fiber agreement

- Finally, trade in textile and clothing was not governed by the GATT but instead by the **Multi Fiber Agreement (MFA)**
- The MFA regulated textile and clothing exports from developing countries into developed countries through a complex system of quantitative restrictions.

The GATT – Main principles and exceptions

MAIN GATT PRINCIPLES

Tariffication	Nondiscrimination	Reciprocity
No quant. restrictions (Art. XI)	MFN treatment (Art. I)	1 st application (Art. XXVIII bis)
No exp. subsidies (Art. XVI)	National treatment (Art. III)	2 nd application (Art. XXVIII & XIX)

MAIN EXCEPTIONS TO THESE PRINCIPLES

Agriculture (Art. XI & XVI)	CUs & FTAs (Art. XXIV)	
	Antidumping and countervailing duties (Art. VI)	
Developing countries (Art. XVIII & enabling clause)		
Protection of human, animal or plant life or health (Art. XX)		
Trade in textiles and clothing (MFA)		



The GATT – Dispute settlement

GATT's dispute settlement mechanism was based on article XXIII and usually involved three steps:

- (i) consultation
- (ii) investigation, ruling, and recommendation by a GATT panel
- (iii) authorization of retaliation



The GATT – Dispute settlement (contd.)

- The main weakness of the GATT's dispute settlement mechanism was that it was fully consensus based
- In particular, all countries had to authorize the establishment of a GATT panel and endorse its ruling before retaliation could be allowed
- For that reason, contracting parties could always block negative rulings against themselves. As a consequence, the main focus was usually on consultation



The WTO – Overview

The Uruguay Round ended with the foundation of the WTO. While the WTO entails the GATT, it goes beyond it in various dimensions:

- (i) Tariffication of agricultural trade policy
- (ii) Termination of MFA
- (iii) Strengthening of dispute settlement mechanism
- (iv) General Agreement on Trade in Services (GATS)
- (v) Trade-Related Investment Measures (TRIMs)
- (vi) Trade-Related Intellectual Property (TRIPs)



The WTO – Tariffication of agricultural trade policy

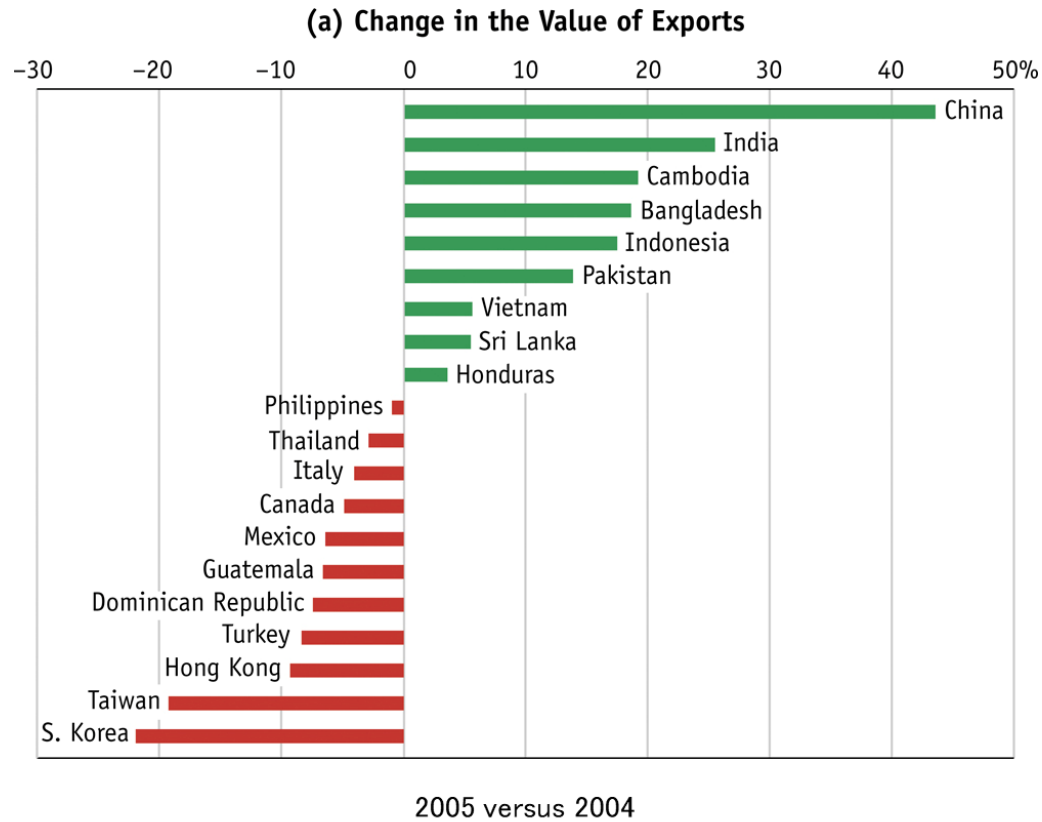
- Recall that the principle of tariffication did not apply to agricultural products under the GATT
- In contrast, the Uruguay Round agreement urged countries to convert all quantitative restrictions into import tariffs for agricultural products. It also limited the use of export subsidies for agricultural products
- As a consequence, quantitative restrictions and export subsidies for agricultural products were reduced but not eliminated



The WTO – Termination of MFA

- Recall that trade in textiles and clothing was not governed by the GATT but instead by the MFA
- The Uruguay Round agreement terminated the MFA. Its quantitative restrictions were phased out over ten years ending on 1 January 2005
- Since the phase-out was heavily back-loaded, textile and clothing exports into the US and the EU surged dramatically in 2005, especially from China

The WTO – Termination of MFA (contd.)



Source: KMO textbook



The WTO – Termination of MFA (contd.)

- As a consequence, the US and the EU threatened to impose new import quotas leading China to adopt Voluntary Export Restraints (VERs) to limit the growth of its textile and clothing exports
- While such quantitative restrictions were generally prohibited after the Uruguay Round, an exception had been granted in the context of China's WTO accession agreement in 2001



The WTO – Strengthening of the dispute settlement mechanism

- Recall that countries could block the establishment or ruling of a panel in order to escape authorized retaliation under the GATT
- In contrast, the creation of a panel and the adoption of its report go forward unless there is a consensus in opposition under the WTO
- Nevertheless, retaliation still occurs infrequently since most disputes continue to be settled through negotiation



The WTO – GATS

- The GATS is an agreement regulating trade negotiations in the domain of service trade broadly defined (i.e. involving cross-border supply, consumption abroad, commercial presence, and presence of natural persons)
- More details can be found on the WTO website:

http://www.wto.org/english/tratop_e/serv_e/gatsqa_e.htm



The WTO – TRIMS

- Despite its name, the TRIMs agreement is not regulating FDI or FDI policy
- Instead, it provides an interpretation and clarification of the GATT provisions on national treatment (Art. III) and quantitative restrictions (Art. XI). For example, it specifies that local content requirements are inconsistent with national treatment
- More details can again be found on the WTO website:

http://www.wto.org/english/tratop_e/invest_e/invest_info_e.htm



The WTO – TRIPS

- The TRIPs agreement defines minimum requirements for various forms of intellectual property regulation and provides for their enforcement within the WTO by permitting **cross-retaliation**
- It is one of the most controversial outcomes of the Uruguay Round since it (i) links a non-trade issue to the WTO, and (ii) is often perceived to be mainly to the advantage of multinational corporations in developed countries
- More details can again be found on the WTO website:

http://www.wto.org/english/tratop_E/trips_e/intel2_e.htm



The WTO – The Doha Round

The Doha Round was launched in 2001 with the following goals:

- (i) liberalization of trade in agricultural products
- (ii) liberalization of trade in manufacturing products
- (iii) liberalization of trade in services (GATS)
- (iv) expansion of intellectual property regulation (TRIPs)



The WTO – The Doha Round (contd.)

- After unsuccessful talks in Doha (2001), Cancun (2003), Geneva (2004), Paris (2005), Hong Kong (2005), Geneva (2006), Potsdam (2007), and Geneva (2008) the Doha Round was suspended by the WTO's Director-General Pascal Lamy
- In Geneva (2008), countries managed to reach “convergence” on 18 of 20 contentious topics but stumbled over the 19th topic:
- Special safeguard duties for agricultural products, which countries were allowed to impose in the event of import surges. These duties had been introduced only in the Uruguay Round to persuade countries to accept tariffication

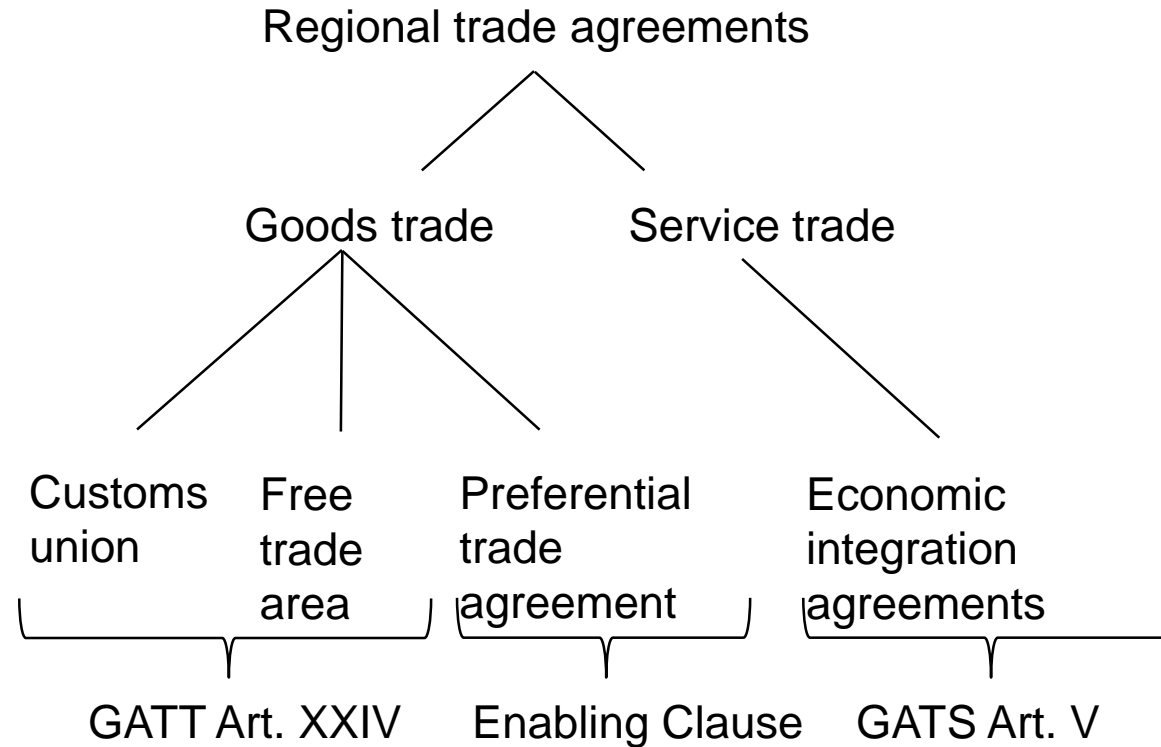


The WTO – The Doha Round (contd.)

- Specifically, China, India, and the US could not agree on the import threshold that would allow these duties to be used
- But as the Economist noted, “the shadow of the Uruguay Round arguably extended beyond this nettlesome detail. Many developing countries believe that the earlier round was lopsided, doing little to constrain the farm policies of the rich world even as it placed heavy obligations on the poor in areas such as intellectual property. In the Doha Round they wanted to get their own back, by asking more of the rich world than they offered in return.”

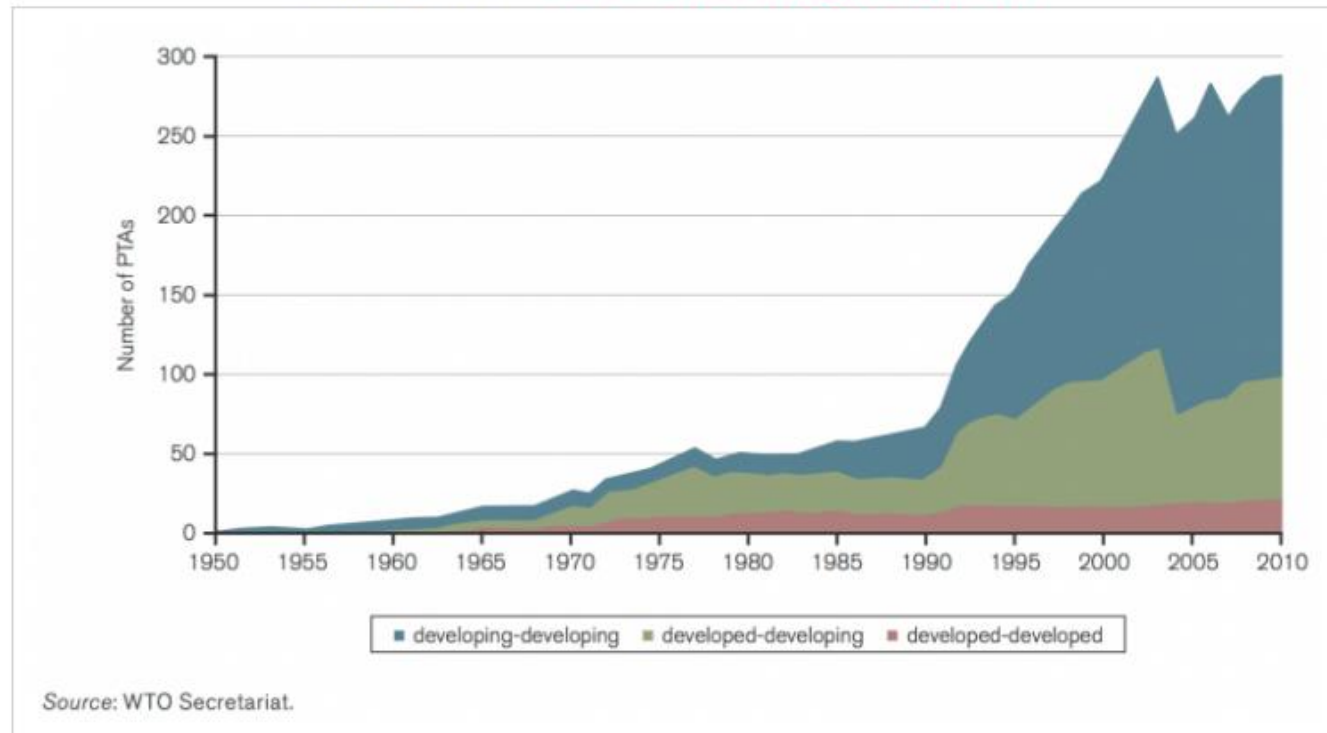


Regional trade agreements - Overview



Regional trade agreements - Proliferation

Number of preferential trade agreements in force by country group, 1950-2010 –
Figure B1 in **WTO Trade Report (2011)** 



Source: <https://ourworldindata.org/international-trade>



Regional trade agreements – Main concern

- While RTAs have been the main driver of trade liberalization since the early 1990s, many economists would have preferred progress in the WTO
- The main concern with RTAs is that they are inherently discriminatory and therefore undermine one of the central pillars of the WTO
- This matters because the WTO principles of reciprocity and non-discrimination appear to be well-suited to internalize trade policy externalities
- This was first shown by Bagwell and Staiger (1999) in the context of the canonical terms-of-trade theory discussed in Topic 12



Regional trade agreements – Other criticisms

In addition, it has been argued that:

- RTAs can make member countries worse off if they divert trade from a low-cost supplier to a high-cost supplier
- A “spaghetti bowl” of RTAs is much more costly to navigate for businesses than a coherent set of WTO rules
- RTAs might be “stumbling blocks” instead of “building blocks” on the way to global free trade for a number of reasons



Regional trade agreements – Mega RTAs

- Recently, countries have attempted to negotiate so-called mega-RTAs which involve many countries and cover a substantial fraction of world trade
- One prominent example is the Transatlantic Trade and Investment Partnership (TTIP) between the EU and the US
- Another prominent example is the Trans-Pacific Partnership (TPP) between 12 Pacific rim countries including the US and Japan (but not China)
- After the election of Donald Trump, TPP negotiations were continued without the US (the US withdrew) and TTIP negotiations were put on hold



Regional trade agreements – Mega RTAs (contd.)

- TTIP and TPP are so-called “deep” integration agreements in the sense that they go beyond simply tariff cuts
- For example, they include provisions on investor rights, intellectual property protection, and standards and regulations
- Unfortunately, we will not have time to discuss all these provisions in detail (I offer a course on trade policy in our Master program if you want to learn more)
- The bottom line is that there is still little academic research on these topics that could reliably guide us to endorse or condone them in their current form



Conclusion

- Multilateral trading system
- Regional trade agreements



References

- *K. Bagwell and R. Staiger. 1999. "An Economic Theory of GATT". American Economic Review*
- *K. Bagwell and R. Staiger. 2002. "The Economics of the World Trading System". MIT Press*