

IS MULTILATERALISM DEAD?

TRADE IN THE ERA OF TRUMP

Luca d'Agliano Lecture in Development Economics

Robert W. Staiger

Dartmouth College

October 19 2018

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

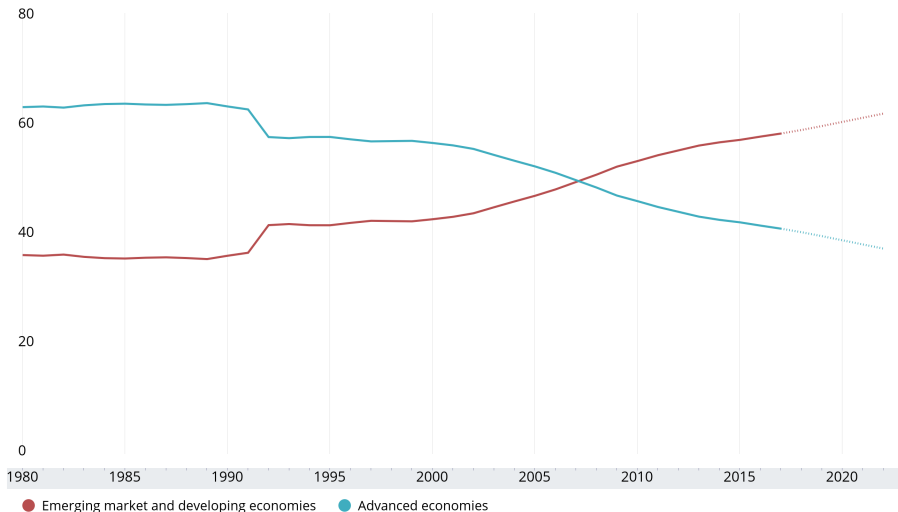
The ground is shifting

- But the WTO's Doha Round, begun in 2001, has disappointed
- Meanwhile, with the most recent wave of globalization, characterized by ...

• The rise of large emerging economies

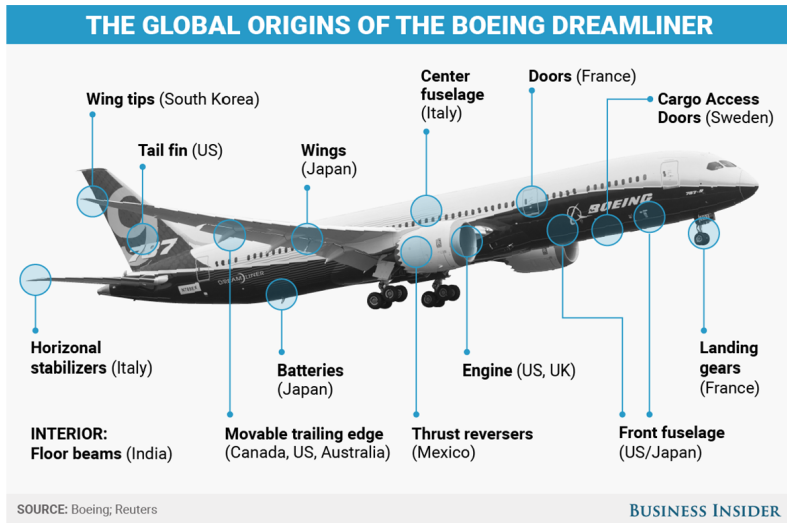
IMF DataMapper

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

- ...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

Trade in the Trump era

- 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

- But this is about something much more subtle

- But this is about something much more subtle
 - and bigger



- But this is about something much more subtle
 - and 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

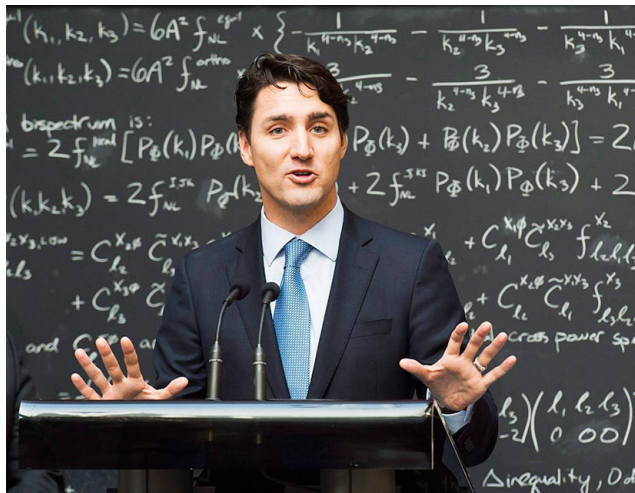
The stakes are high

- 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

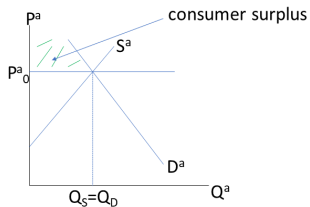
- The WTO's legitimacy is not built on the case for free trade
 - rather, it's built on the case for internalizing negative externalities

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



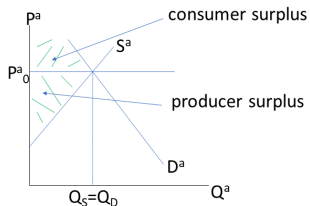
A closed economy

- A closed economy



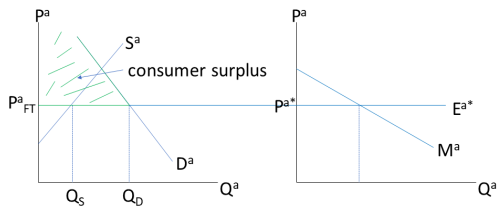
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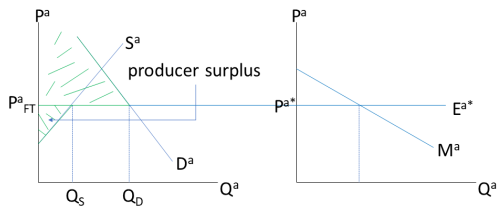
A small open economy

- A small open economy



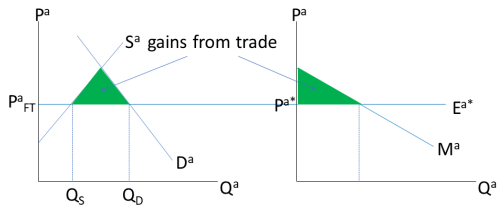
A small open economy

- A small open economy



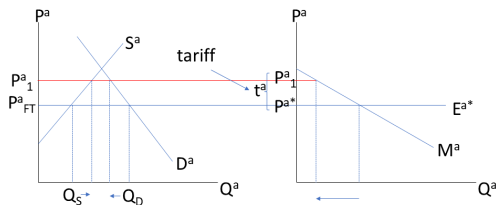
A small open economy

- A small open economy



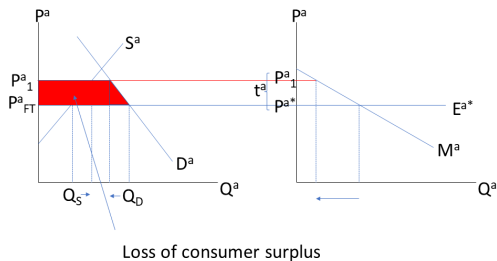
The purpose of Trade Agreements

- A *small country's* unilateral tariff choice



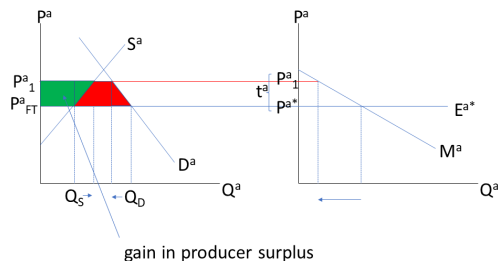
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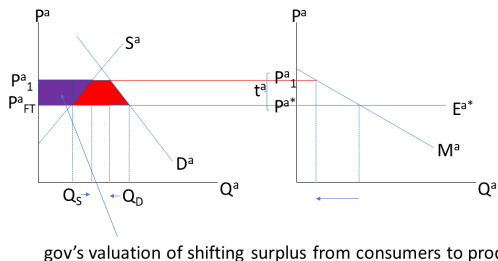
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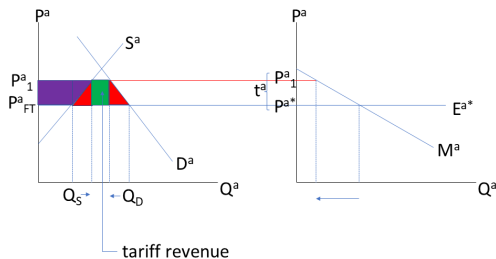
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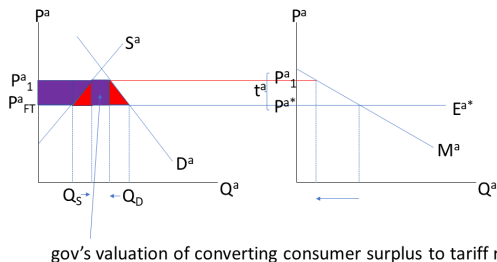
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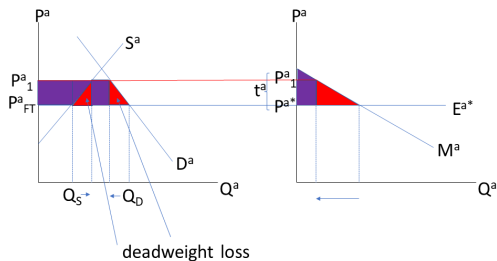
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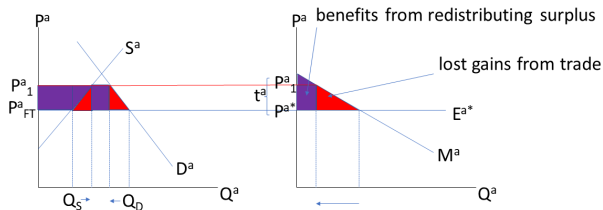
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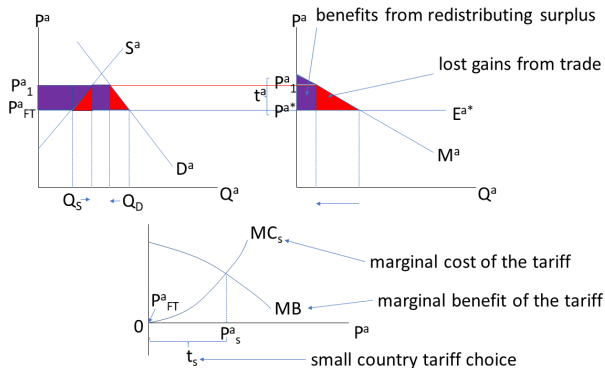
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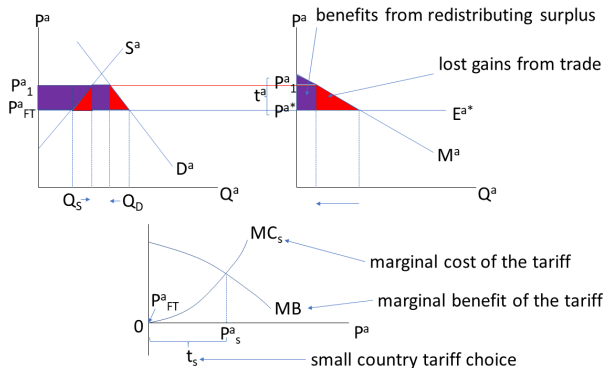
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The purpose of Trade Agreements

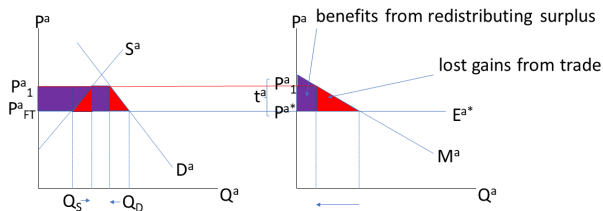
- A *small country's* unilateral tariff choice



- A *small country's* policy choices impose no externalities on the world
- \Rightarrow 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!

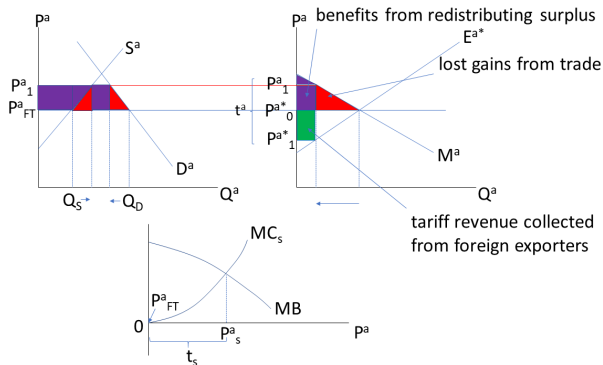
The purpose of Trade Agreements

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



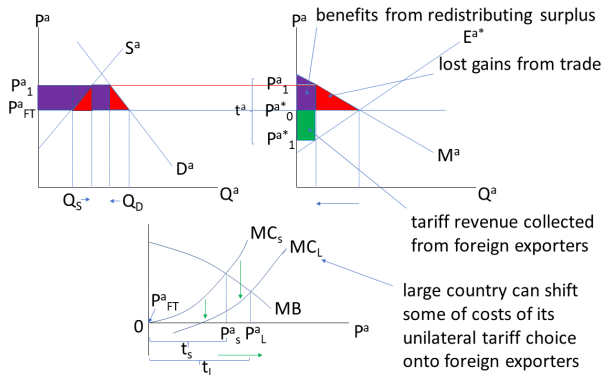
The purpose of Trade Agreements

- A *large country's* unilateral tariff choice



The purpose of Trade Agreements

- A *large country's* unilateral tariff choice



- 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)

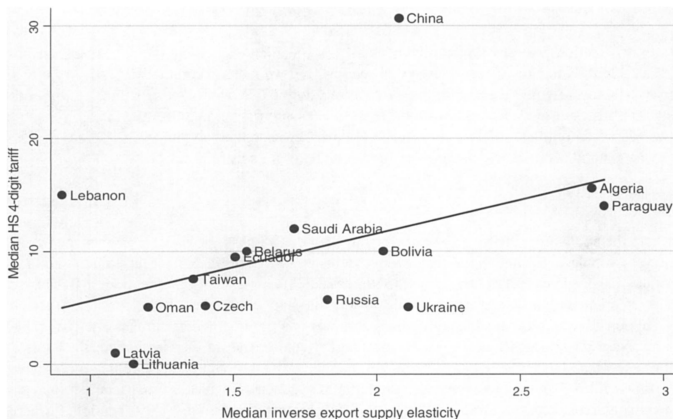


FIGURE 3. MEDIAN TARIFFS AND MARKET POWER ACROSS COUNTRIES

A key starting point

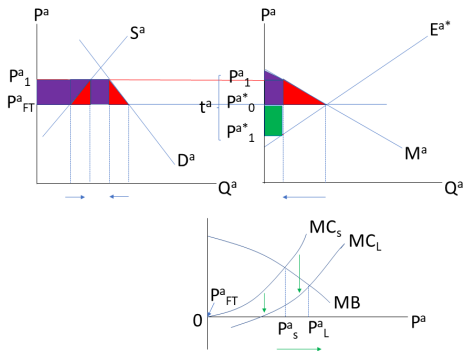
- The WTO's legitimacy is not built on the case for free trade
 - rather, it's built on the case for internalizing negative externalities

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
- 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*

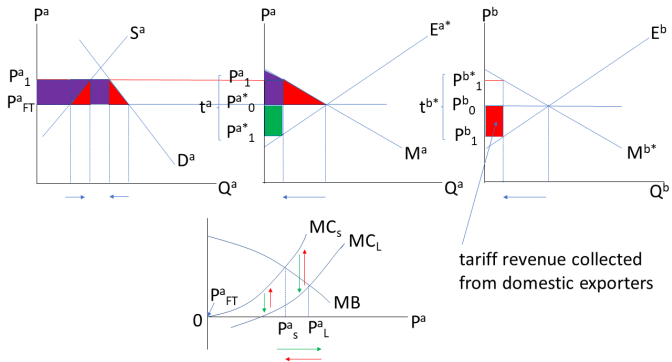
Reciprocity

- Recall a large country's unilateral MFN tariff choice



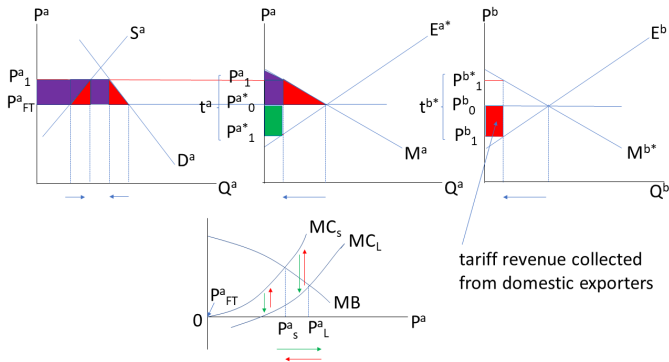
Unilateral MFN tariff choice in the presence of reciprocity

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



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

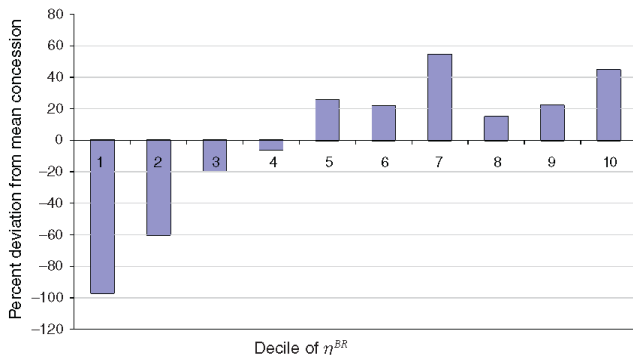


FIGURE 2. PERCENT DEVIATION FROM MEAN CONCESSION BY η^{BR} DECILE

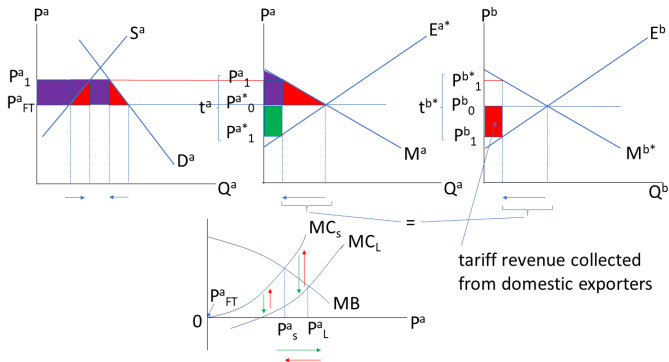
NYTimes March 2 2018 ***Trump's Tariffs Prompt Global Threats of Retaliation***

... 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. ...

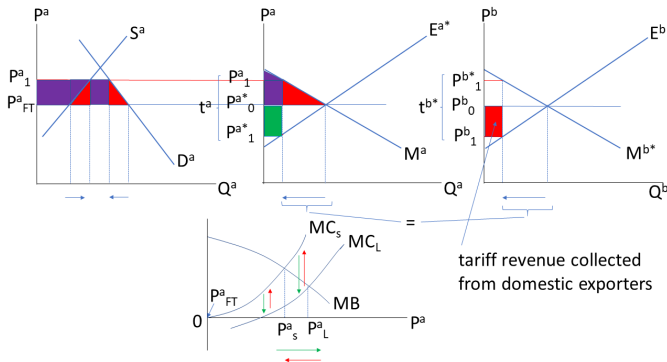
Unilateral tariff choice in the presence of reciprocity

- A *proportionate response* by its trading partners



Unilateral 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
 - nothing left for a trade agreement to do!

This is not a trade war

- This is how the GATT/WTO system works to *avoid* a trade war

The Organization's control over countermeasures of this kind enables it to keep such measures within reasonable limits: to allow countermeasures commensurate with the action which occasions them; and to hold in check emotional reactions which might result in punitive measures by countries injured against the country responsible for the injury. The control over countermeasures is a check on the development of trade wars. (US Council of the ICC, 1955)

- What keeps countries operating within this rules-based system?
 - the off-equilibrium threat of an all-out trade war
- What might the beginning of a trade war look like?

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 \Rightarrow 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

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.”
- 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, Trump tweeted it...



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 ... ⓘ

And he appears to be following through...



TRADE & INVESTMENT POLICY WATCH

Trump's Trade War Timeline: An Up-to-Date Guide

Chad P. Bown (PIIE) and Melina Kolb (PIIE)
September 24, 2018 12:00 PM
Photo Credit: PIIE/Daniel Housch



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

What difference do these rules make?

- Under MFN and reciprocity, the WTO is a rules-based multilateral system
 - seems well-designed to help governments solve the fundamental trade agreement problem
- But what difference do these rules make?
- Why not just engage in “power-based” tariff bargaining without reference to any previously agreed-upon rules?
- One reason: MFN and reciprocity can convert a complex multi-country bargaining problem
 - into a web of simpler bilateral bargaining problems
 - and help move countries to the efficiency frontier

What difference do these rules make?

- MFN
 - in a multi-country world, MFN keeps the trade policy externality as simple as in a 2-country world
 - \Rightarrow in the trade-agreements context, unlike e.g. climate accords, institutional design can actually shape the externality itself
- Reciprocity
 - defines a measured, proportionate response to a country's trade policy changes by its trading partners
 - \Rightarrow keeps countries with market power acting like small countries

What difference do these rules make?

- More specifically, reciprocity shapes GATT/WTO tariff negotiations in two ways
 - a norm of negotiation when a tariff is to be bound at a lower level
 - a rule of *renegotiation* when a previously bound tariff is to be raised
- If countries rigidly abide by these norms and rules, reciprocity in combination with MFN affords a dramatic simplification of the tariff bargaining problem
 - through the norm of negotiation: *terms of exchange of market access* are fixed one for one (the terms of the deal are fixed)
 - through the rule of renegotiation: *extent of exchange of market access* is determined by the country wanting the smallest deal at these fixed terms (the size of the deal is determined by “voluntary exchange”)
 - nothing left to bargain over!
- ⇒ Can turn a potential haggling situation into a “retail store for market access”

A reduction in strategic behavior

- A striking lack of strategic behavior noted by GATT practitioners
 - *“... Their requests cannot be higher than their offers and negotiations start from this maximum position: if all requests are granted all the offers will be fulfilled. ... As some of the requests are rejected, some of the offers are withdrawn. This procedure has been raised to a Gatt principle and is not laid down by any rule. It is a convention but one which creates a much better negotiating climate than the opposite trend which was a feature of the classical bilateral negotiations. Then, everyone put forward very low offers with the intention of increasing gradually if the bargaining proved profitable. A country never knew, however, when it had reached the maximum its partner was willing to concede.”* (Curzon, 1966)
- Evidence from early GATT negotiating records also supports this lack of strategic behavior in tariff bargaining (Bagwell, Staiger and Yurukoglu, 2017)

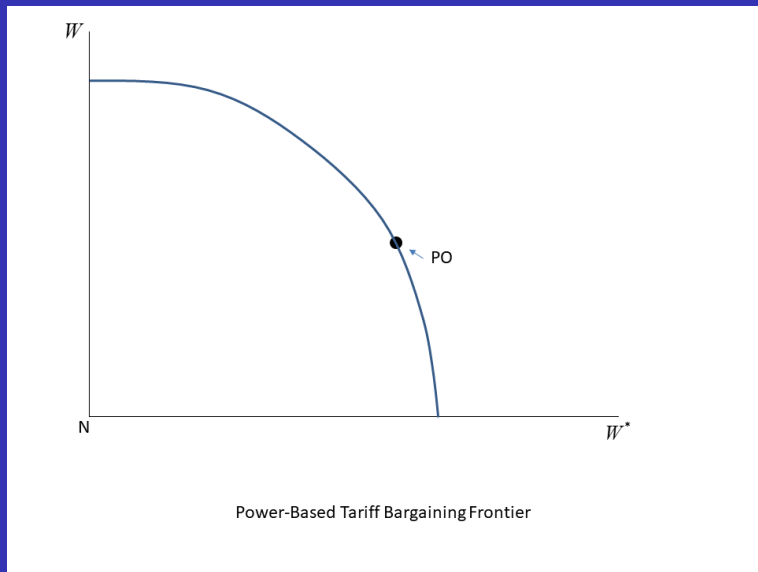
Whose interests does the WTO serve?

- But these rules also blunt the power of large dominant countries
- Obviously so if countries rigidly abide by these rules and norms
 - if the rules and norms leave nothing left to bargain over, then no room for exercise of power in tariff negotiations
- More generally, reciprocity in renegotiations is a rule
 - seems to hold pretty well, e.g., this is what we have seen play out recently in the tit-for-tat “trade wars” between WTO members
- But reciprocity in negotiations is just a norm
 - powerful countries may seek to get better terms of trade with their weaker bargaining partners – America First!
- ⇒ If a powerful country pushes for better than reciprocal terms along the efficiency frontier
 - its trading partner can subsequently renegotiate subject to reciprocity, either explicitly or in effect
 - and at least achieve the size of the deal it desires at these terms

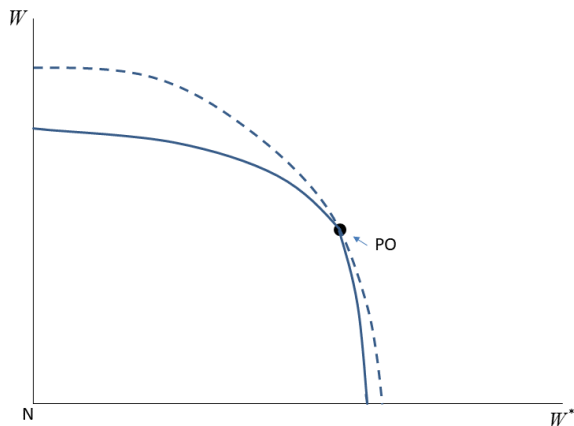
Reciprocity blunts the power of large dominant countries

- The implication is that the bargaining outcomes implementable under reciprocity are described by a bargaining frontier
 - that lies inside the power-based frontier
 - except at the point PO on the efficiency frontier where neither partner would wish to renegotiate subject to reciprocity

Reciprocity blunts the power of large dominant countries



Reciprocity blunts the power of large dominant countries

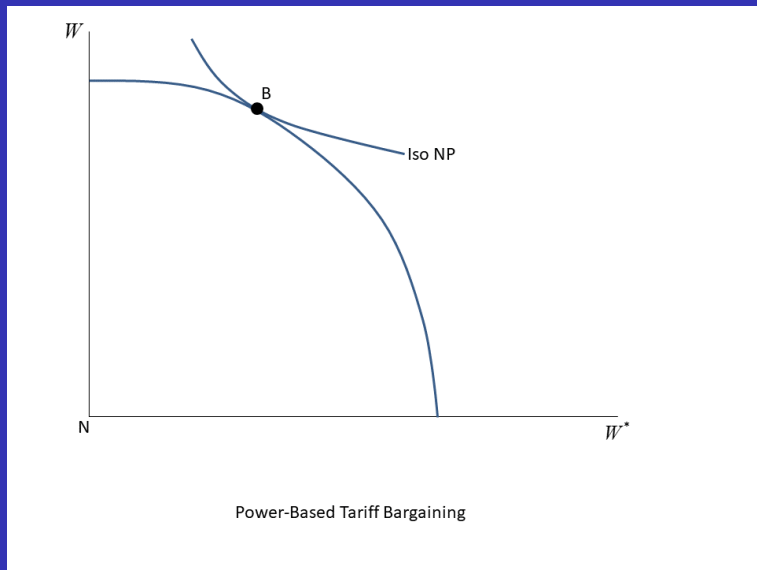


Rules-Based Tariff Bargaining Frontier Under Reciprocity

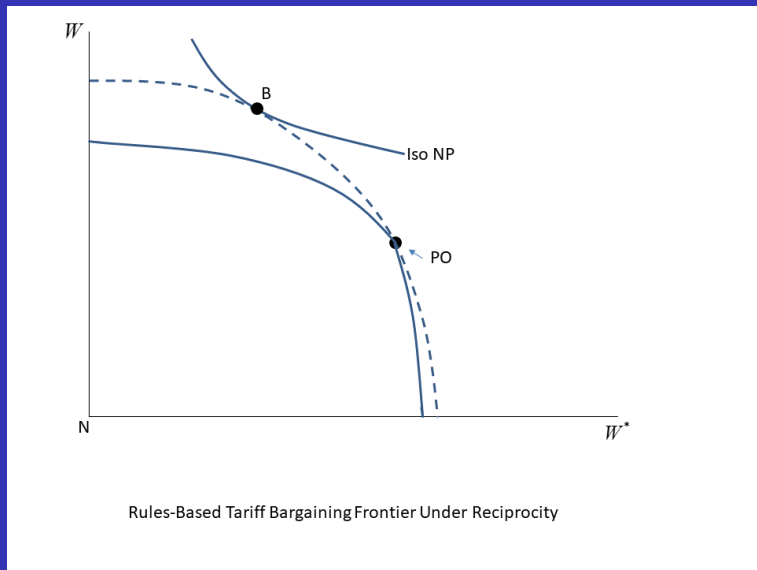
Reciprocity blunts the power of large dominant countries

- The implication is that the bargaining outcomes implementable under reciprocity are described by a bargaining frontier
 - that lies inside the power-based frontier
 - except at the point PO on the efficiency frontier where neither partner would wish to renegotiate subject to reciprocity
- But what are the properties of this point PO?
 - recall: expectation of reciprocal retaliation from trading partners eliminates the exercise of market power (monopsony power to depress foreign exporter prices) from tariff choices
 - so PO is a “rules-based” point, defined without reference to (market) power, where countries implement the tariffs they would desire if they had no market power
- ⇒ Reciprocity blunts the power of large countries and steers the negotiation toward the rules-based outcome

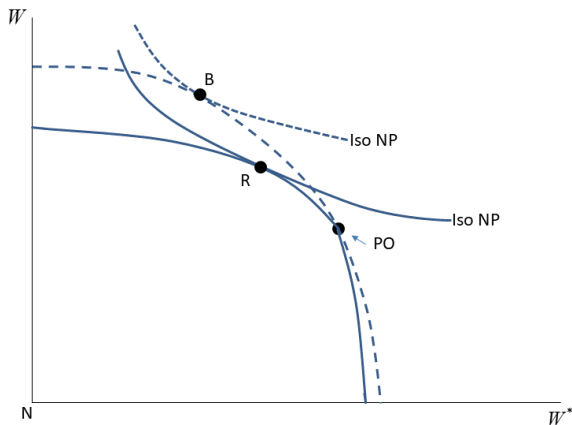
Reciprocity blunts the power of large dominant countries



Reciprocity blunts the power of large dominant countries



Reciprocity blunts the power of large dominant countries



Rules-Based Tariff Bargaining Under Reciprocity

MFN blunts the power of large dominant countries

- Tariff bargaining in the absence of MFN
- A country that succeeds in winning large discriminatory tariff cuts in a bilateral bargain extracts surplus from 3rd parties with its efforts
 - *power enhanced* through negative bargaining externalities
 - Table 8 of Bagwell, Staiger and Yurukoglu (2018)

Table 8: Spillover Benefits to Third Parties (Discriminatory Negotiations)

Country 1	Country 2	Reducing Country	Tariff Reduction from Agreement			Tariff Reduction from Binding		
			Δ Welfare Country 1	Δ Welfare Country 2	Δ Welfare 3rd Parties	Δ Welfare Country 1	Δ Welfare Country 2	Δ Welfare 3rd Parties
			(1)	(2)	(3)	(4)	(5)	(6)
US	Aus	US	-1.000	2.138	-0.270	-1.000	11.018	-1.598
US	Aus	Aus	0.201	-1.000	-0.004	0.312	-1.000	0.011
US	EU	US	-1.000	1.450	-0.538	-1.000	4.588	-1.136
US	EU	EU	0.521	-1.000	-0.060	1.717	-1.000	-0.180
US	Japan	US	-1.000	1.397	-0.197	-1.000	3.619	-0.633
US	Japan	Japan	0.608	-1.000	-0.120	1.004	-1.000	-0.066
Aus	Korea	Aus	-1.000	0.729	-0.720	1.000	1.672	-1.060
Aus	Korea	Korea	1.805	-1.000	-0.345	8.255	-1.000	-1.635
EU	Japan	EU	-1.000	0.941	-0.016	-1.000	4.635	-0.327
EU	Japan	Japan	0.944	-1.000	-0.267	1.596	-1.000	-0.079
EU	Korea	EU	-1.000	0.716	-0.294	-1.000	2.873	0.436
EU	Korea	Korea	1.026	-1.000	-0.985	20.792	-1.000	-2.628
Japan	Korea	Japan	-1.000	1.101	-0.712	-1.000	9.263	-3.009
Japan	Korea	Korea	0.936	-1.000	-0.374	89.785	1.000	-8.289

MFN blunts the power of large dominant countries

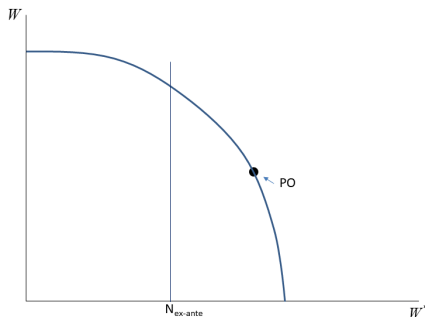
- MFN tariff bargaining
- A country that succeeds in winning large MFN tariff cuts in a bilateral bargain spreads benefits to 3rd parties with its efforts
 - *power dissipated* through positive bargaining externalities
 - Table 6 of Bagwell, Staiger and Yurukoglu (2018)

Table 6: Spillover Benefits to Third Parties (MFN Negotiations)

Country 1	Country 2	Reducing Country	Tariff Reduction from Agreement			Tariff Reduction from Binding		
			Δ Welfare Country 1 (1)	Δ Welfare Country 2 (2)	Δ Welfare 3rd Parties (3)	Δ Welfare Country 1 (4)	Δ Welfare Country 2 (5)	Δ Welfare 3rd Parties (6)
US	Aus	US	-1.000	2.677	3.594	-1.000	3.285	4.520
US	Aus	Aus	0.083	-1.000	0.384	0.090	-1.000	0.398
US	EU	US	-1.000	1.557	1.231	-1.000	2.516	2.144
US	EU	EU	0.335	-1.000	1.410	0.405	-1.000	1.728
US	Japan	US	-1.000	1.166	0.712	-1.000	2.240	1.347
US	Japan	Japan	0.501	-1.000	0.460	0.576	-1.000	0.564
Aus	Korea	Aus	-1.000	0.731	3.909	1.000	0.048	0.240
Aus	Korea	Korea	0.786	-1.000	1.015	0.725	-1.000	1.134
EU	Japan	EU	-1.000	0.609	0.677	-1.000	15.438	19.550
EU	Japan	Japan	0.739	-1.000	0.573	1.495	-1.000	1.382
EU	Korea	EU	-1.000	0.513	4.766	1.000	0.160	1.361
EU	Korea	Korea	0.783	-1.000	1.972	0.928	-1.000	2.658
Japan	Korea	Japan	-1.000	0.826	1.555	1.000	0.629	1.103
Japan	Korea	Korea	0.991	-1.000	1.275	5.723	1.000	8.413

Why would powerful countries submit to these rules?

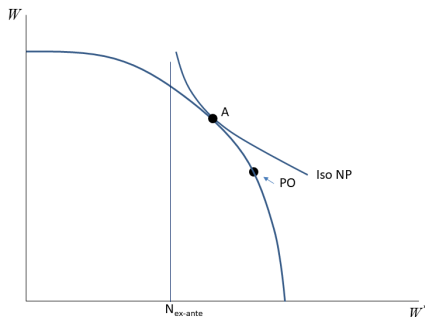
- Why would powerful countries submit to these rules?
- If a country is sufficiently dominant, other countries may not participate in trade negotiations with it absent such rules of behavior
 - Judge Bowker's argument against Canada's participation in the US-Canada FTA negotiations (McLaren, 1997)



Holdup Under Power-Based Tariff Bargaining

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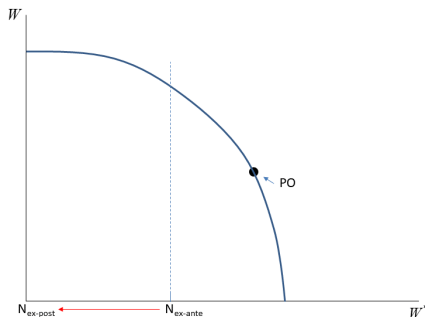
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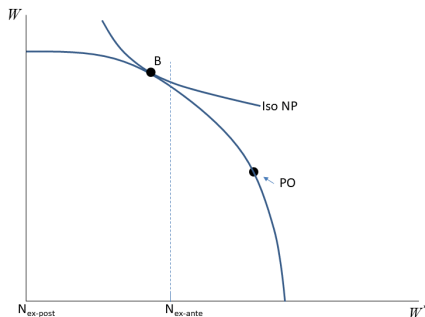
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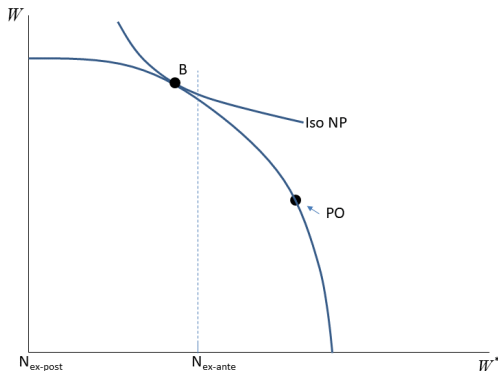
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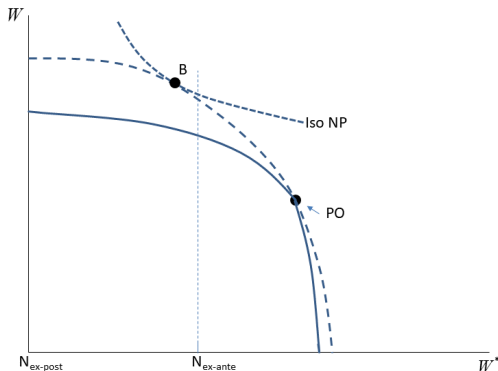
Enlightened Self-Interest and Reciprocity

- A rules-based multilateral system can help secure the participation of weaker countries
- Reciprocity
 - Figure 5B of Bagwell and Staiger (1999)



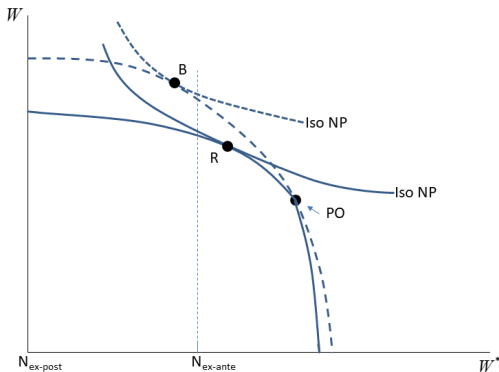
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Enlightened Self-Interest and MFN

- A rules-based multilateral system can help secure the participation of weaker countries
- MFN
 - Absent MFN, weaker countries could lose from a multilateral round of tariff negotiations due to the negative bargaining externalities exerted by the stronger countries
 - Table 7 of Bagwell, Staiger and Yurukoglu (2018)

Table 7: Estimated Uruguay Round and Counterfactual Outcomes

	MFN		No MFN	
	Tariffs			
Average Tariffs	-46.95%		-47.43%	
Weighted Average Tariffs	-54.50%		-48.96%	
	Country Welfare			
	with transfers		with transfers	
United States	0.00%	0.04%	0.03%	0.09%
EU	0.04%	0.02%	-0.03%	-0.05%
Austria	0.07%	0.05%	-0.02%	-0.04%
Belgium	0.01%	0.00%	0.00%	-0.01%
Denmark	0.02%	0.00%	-0.04%	-0.05%
France	0.03%	0.00%	0.05%	0.03%
Germany	0.00%	-0.01%	-0.09%	-0.10%
Italy	0.02%	-0.02%	0.01%	-0.02%
Netherlands	0.05%	0.03%	0.02%	0.01%
Spain	0.07%	0.02%	-0.07%	-0.10%
Sweden	0.06%	0.04%	0.02%	0.00%
United Kingdom	0.14%	0.12%	-0.03%	-0.04%
Argentina	0.05%	0.05%	-0.02%	-0.02%
Australia	0.08%	0.04%	0.22%	-0.03%
Brazil	0.05%	0.05%	-0.02%	-0.02%
Canada	0.00%	0.00%	-0.10%	-0.10%
China	0.35%	0.35%	-0.10%	-0.10%
India	0.31%	0.31%	-0.06%	-0.06%
Indonesia	0.14%	0.14%	-0.05%	-0.05%
Japan	0.21%	0.20%	0.29%	0.28%
Mexico	0.00%	0.00%	-0.04%	-0.04%
Russia	0.07%	0.07%	-0.04%	-0.04%
South Korea	0.47%	0.43%	-1.86%	-2.02%
Switzerland	-0.04%	-0.04%	-0.07%	-0.07%
Thailand	0.42%	0.42%	-0.07%	-0.07%
Turkey	-0.08%	-0.08%	-0.06%	-0.06%
America NES	0.11%	0.11%	0.02%	0.02%
Asia/Oceania NES	0.36%	0.36%	-0.16%	-0.16%
MENA NES	0.06%	0.06%	-0.08%	-0.08%
Africa NES	0.05%	0.05%	-0.02%	-0.02%
Europe NES	0.40%	0.40%	-0.12%	-0.12%
Total Welfare	0.12%	0.11%	0.00%	-0.01%

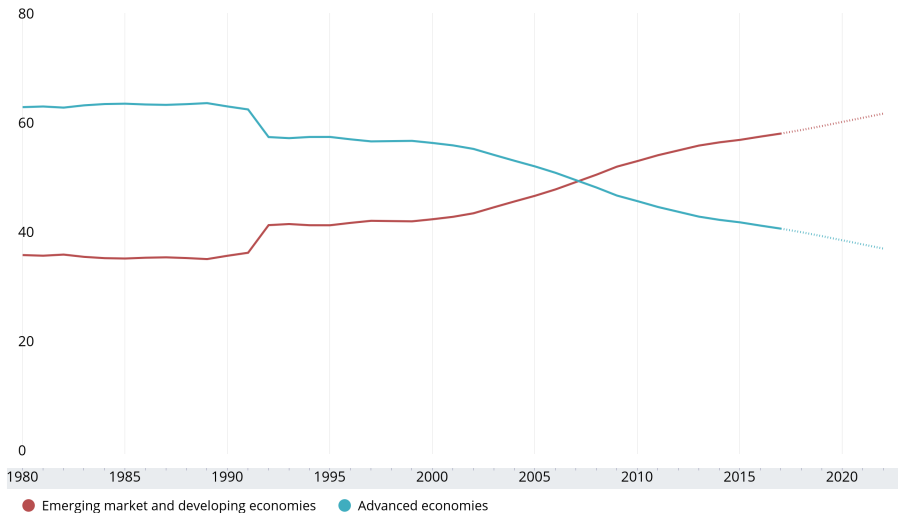
A Declining Hegemon

- 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)
- In the broader context of security and trade
 - historian/commentator Robert Kagan sees the rules-based international order as “a historical anomaly” made possible by U.S. leadership,
 - which is now collapsing, “returning the world to its natural state — a dark jungle of competing interests, clashing nationalism, tribalism and self-interest.” (*NYTimes*, September 22, 2018)
- The WTO may need a new “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

- 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 may seem 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 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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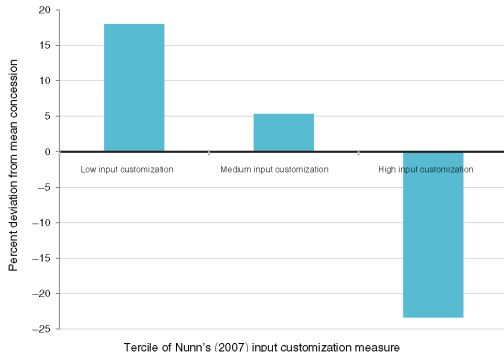


FIGURE 1. PERCENT DEVIATION FROM MEAN CONCESSION BY TERCILE OF INPUT CUSTOMIZATION MEASURE

- 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 as the constitution for the global trade order, strengthened with some key reforms
 - e.g., subsidies: Bagwell&Staiger, 2012, Venables, 1985; Bagwell&Lee, 2018, Melitz&Ottaviano, 2008
- 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?



- 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

Advice for Italy (and all of us)

