

# Check In

Grab an index card, write your name, and name the relevant theory:

- ① Explains that Americans are divided over trade along industry/sector lines
- ② Explains why free trade is welfare enhancing
- ③ Explains why small, unequal and incentivized groups are more likely to organize
- ④ Explains why countries have a comparative advantage in the products they do
- ⑤ Explains that Americans are divided over trade along class/factor lines
- ⑥ Explains the rules and strategies that actors use to pursue their policy objectives

WORLD TRADE  
ORGANIZATION



Can we govern trade? Successfully?

How do governments decide which interests to listen to? ✓

- Collective Action Theory
- Domestic institutions

How are interests aggregated up to the international level?

- The Prisoner's Dilemma
- International Institutions: The WTO?

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# Anarchy

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- Anarchy: a state of chaos or disorder because there is no ultimate authority
- No international government to aggregate up human interests
- No legal rules or structure to guide trade bargaining
- No authority to enforce agreements

# A Dilemma

If there are no rules to structure trade bargaining in an anarchic world, how do governments ensure that their partners don't renege on their commitments?

This creates a dilemma!

# The Prisoner's Dilemma

The ability of governments to conclude trade agreements is hindered by **the enforcement problem**.

- If governments can't be sure their partners will comply with agreement, they won't enter them. Even if they would be better off!
- **The Prisoner's Dilemma:** A situation in which rational, self interested decision making makes everyone worse off

# The Prisoner's Dilemma



# The Prisoner's Dilemma



VS.



# The Prisoner's Dilemma



VS.



# The Prisoner's Dilemma

		United States	
		Liberalize	Protect
EU	Liberalize		
	Protect		

# The Prisoner's Dilemma

		United States	
		Liberalize	Protect
EU	Liberalize	100, 100	
	Protect		50, 50

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EU	Liberalize	100, 100	10, 120
	Protect	120, 10	50, 50

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A 2x2 payoff matrix for the Prisoner's Dilemma between the EU and the United States. The EU's strategies are Liberalize and Protect, and the US's strategies are Liberalize and Protect. Payoffs are listed as (EU, US). The bottom row (EU Protect) is highlighted with a blue border.

# The Prisoner's Dilemma

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# The Prisoner's Dilemma

No matter what the other country does, I'm always better off choosing **protection**.

But that makes both countries **worse off**.

## Another example

Would you **split** or **steal**?

Does the idea of rational self-interested decisions leading to socially sub-optimal outcomes sound familiar?

Does the idea of rational self-interested decisions leading to socially sub-optimal outcomes sound familiar?

- The **collective action problem** is a form of the prisoner's dilemma
- The decision not to contribute is rational given large groups and low stakes
- If everyone chooses not to contribute, we are worse off and public goods are underprovided

## Remember Smoot-Hawley?

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- Great Depression of 1929 struck
- 1930 Smoot-Hawley raised tariffs on 20,000 goods (even higher tariffs than Fordner-McCumber)
  - Also led to retaliation by other countries

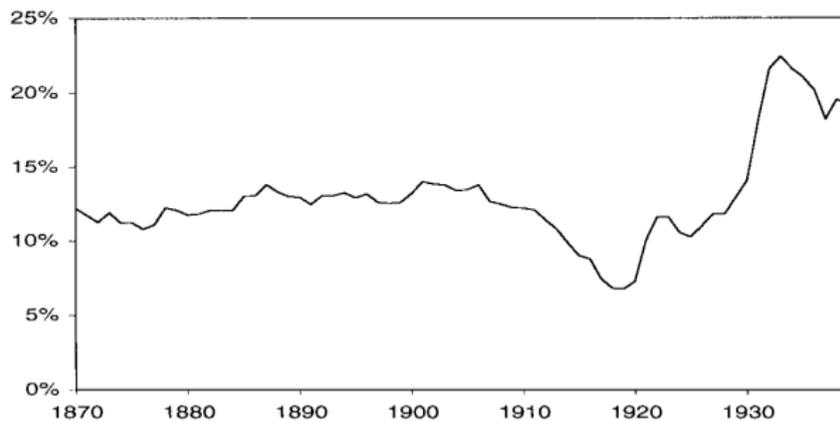
# Retaliation

In reaction to Smoot-Hawley, Canada responded with retaliatory tariffs on US goods.

“How many thousands of American workmen are living on Canadian money today? They’ve got the jobs and we’ve got the soup kitchens. I will not beg of any country to buy our goods. **I will make [tariffs] fight for you. I will use them to blast a way into markets that have been closed.**” (Canadian Prime Minister Richard Bedford Bennett)

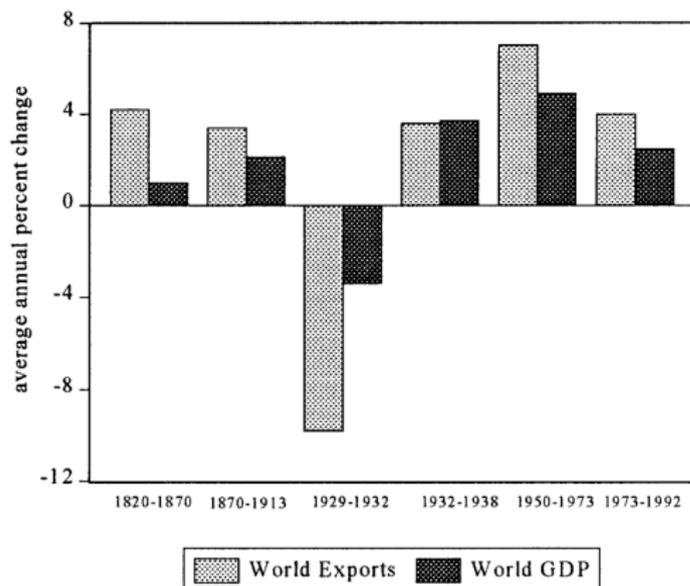
# Retaliation

## World Average Tariff Levels



Source: Estevadeoral et al (2002)

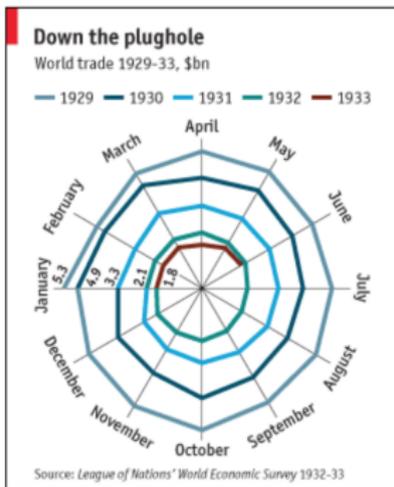
## World Exports and GDP



Source: Maddison (1995).

Source: Irwin (2002)

# Beggar thy neighbor



World trade collapses as countries chose the **protect/protect** option of the prisoner's dilemma. This is called **beggar thy neighbor**. As each country tries to increase demand for domestic industries by raising tariffs on imports, tariffs become gradually higher and world trade shrinks.

# How do we get out of the prisoner's dilemma?

		United States	
		Liberalize	Protect
EU	Liberalize	100, 100	10, 120
	Protect	120, 10	50, 50

# How do we get out of the prisoner's dilemma?

Cooperation can emerge if three conditions are met:

- ① Repeated play by the same governments (iteration)
- ② Enforcement (via tit-for-tat strategies)
- ③ Countries care sufficiently about the future

# The Role of Institutions

These three conditions can be met with institutions:

- Domestic institutions
  - RTAA moved Congressmen out of protect/protect vote trading (logrolling)
- International institutions
  - The GATT/WTO

# The GATT/WTO

- Initial attempts to form an International Trade Organization after WWII failed
- In 1947, the General Agreement on Tariffs and Trade (GATT) was founded
  - Based in Geneva, Switzerland
  - Started with 24 members
- In 1994, the GATT became the World Trade Organization (WTO)
  - 164 members in 2016
  - Accounts for 97% of world trade
  - Key innovation is the dispute settlement mechanism

## Functions of the GATT/WTO:

- ① Forum for negotiating trade reductions
  - Creates repeated interactions
  - Increases future payoffs from cooperation
- ② Administers and monitors current trade agreements
  - Makes agreements more transparent
  - More easily identify cheaters
- ③ Provides a mechanism for dispute settlement
  - Enforcement improved in 1994 with the founding of the WTO
  - Allows for enforcement via sanctioned retaliation

# Principles

- ① Market liberalization
- ② Non-discrimination

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  - Economic rationale for the organization
  - “The system’s overriding purpose is to help trade flow as freely as possible - so long as there are no undesirable side effects - because this is important for economic development and well-being”
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# Principles of GATT

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- ② Non-discrimination
  - Reciprocity
  - Most Favored Nation

# Reciprocity

Reciprocity: One country offers to reduce a barrier to trade and a second country reciprocates by offering to reduce one of its own trade barriers

- Give and take approach
- Same principle as in the RTAA
- Remember that reciprocity makes trade agreements palatable **within** member countries as export industries have a special interest in their success

Most Favored Nation: If a member offers a tariff reduction to another GATT member, it must offer the same reduction to all GATT members

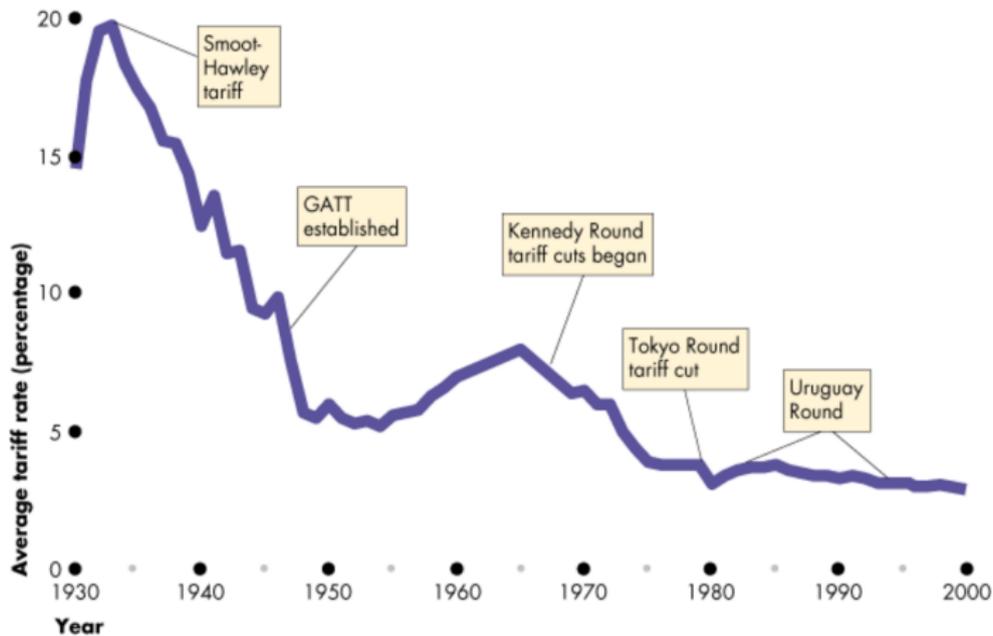
- MFN allows smaller countries to participate in the same advantages that larger countries grant each other
- Prohibits national treatment: governments can't use taxes or regulations to provide an advantage to domestic firms
- Exceptions: Generalized system of preferences (GSP, exceptions for developing countries), Free Trade areas (FTAs) and Customs Unions

# Trade Bargaining

GATT's (and the WTO's) rules are created through intergovernmental bargaining, conducted in **rounds**. Rounds are concluded when all members agree on a new set of common rules.

Year	Name	Tariff	Parties
1947	Geneva	65%	23
1949	Annecy	43%	13
1951	Torquay	31%	38
1956	Geneva	29%	26
1960/61	Dillion	23%	26
1964/67	Kennedy	12%	62
1973/79	Tokyo	8%	102
1986/94	Uruguay	5%	123

# Trade Bargaining



# Failures of the GATT

Yet...

- The dispute settlement mechanism was rudimentary and ineffective
- Trade of agricultural goods and services was exempted
- No protection for intellectual property
- States increasingly relied on non tariff barriers
  - Anti-dumping duties
  - Safeguards
  - Subsidies/Countervailing duties
  - Custom Unions/Free Trade Agreements

# The Creation of the WTO

The Uruguay Round of negotiations lasted from 1986-1994 and ultimately created the World Trade Organization.

The WTO:

- Incorporates all GATT provisions and principles
- Covers trade in services and intellectual property
- Begins to cover agriculture (very limited success)
- Most important: A new dispute settlement process

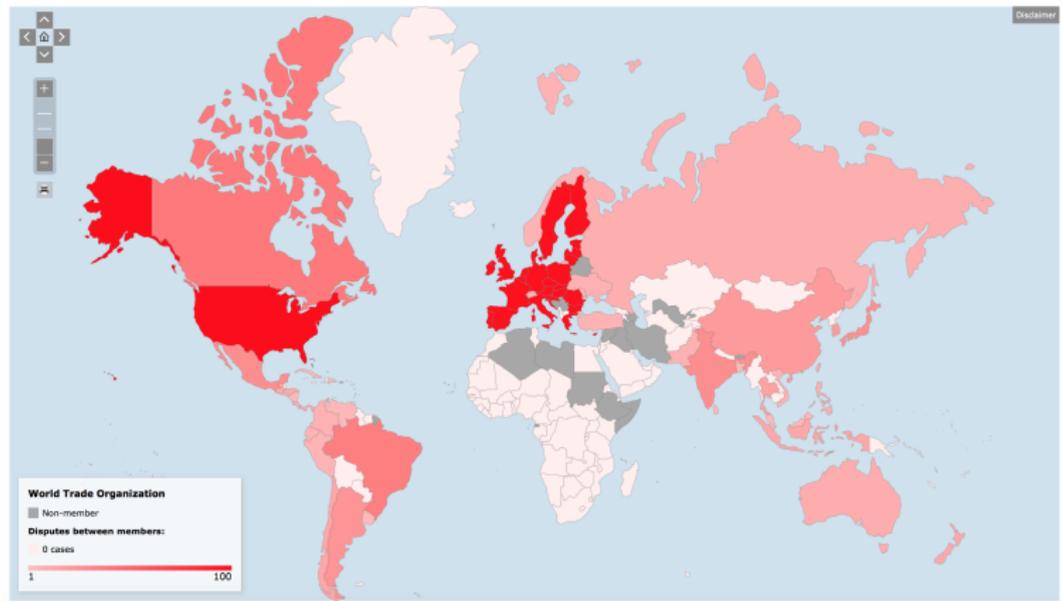
# Dispute Settlement Mechanism

The dispute settlement process (simplified):

- ① Dispute is filed.
- ② Parties try to reach a settlement before formal proceedings.
- ③ If a settlement cannot be reached, the dispute proceeds to a panel of 3 experts. The panel issues a ruling which will go into effect unless **all** WTO members vote unanimously to block it.
- ④ Both parties can appeal to an appellate body of 3-5 members. Appeal decision will go into effect unless **all** WTO members vote unanimously to block it.
- ⑤ Defendant must end the ending policy or pay compensation
- ⑥ If no agreement on compensation is reached, the injured party can impose retaliatory tariffs

# WTO Disputes

## Map of WTO Disputes



## DISPUTE SETTLEMENT

# DS267: United States — Subsidies on Upland Cotton

This summary has been prepared by the Secretariat under its own responsibility. The summary is for general information only and is not intended to affect the rights and obligations of Members.

### See also:

- ▣ **One-page summary of key findings of this dispute**
- ▣ News items about this dispute
- ▣ The basics: how disputes are settled in WTO
- ▣ Computer based training on dispute settlement

## Current status

[back to top ▲](#)

- ▣ **Mutually acceptable solution on implementation notified on 16 October 2014** ⓘ

## Key facts

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Short title:	US — Upland Cotton
Complainant:	Brazil
Respondent:	United States

# Brazilian Cotton

- Brazil filed a complaint the US in 2002 citing that US subsidies given to American cotton producers gave them an unfair advantage against foreign competitors.
- The panel ruled in favor of Brazil in 2004.
- The US immediately appealed. They lost the appeal in 2005.
- However, the US did not revise its cotton subsidies.
- The dispute went back and forth in the WTO until 2009 when the WTO decided how much retaliation Brazil could impose
- Brazilian negotiators got to choose which products to put retaliatory tariffs on. They targeted major American corporations.
- American firms persuaded the government to find a compromise that didn't involve retaliatory tariffs.

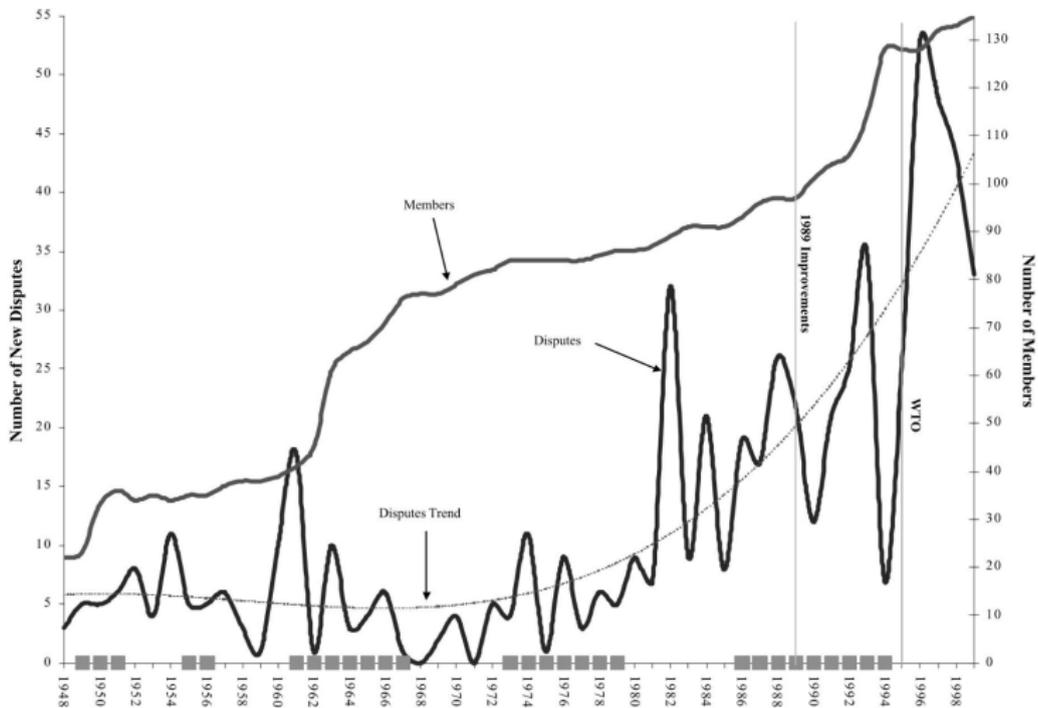
## Brazilian Cotton

- The US couldn't end subsidies right away, but in 2010 they did **compensate Brazilian cotton farmers** by making monthly payments to the Brazilian Cotton Institute.
- This settlement worked until the 2014 renewal of the US Farm Bill. The settlement had to be renegotiated.
- In October 2014, the US agreed to give Brazil \$300 in a final payment to officially conclude the dispute.

## Does the DSM work?

- The DSM is decentralized - No violation is challenged unless another member state files a formal complaint
- WTO disputes can also be end when the injured party is satisfied - regardless if justice is served
- Can powerful states get private peace at the expense of public justice?

# Are disputes escalating?



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Stage of escalation	Disputes initiated			
	1948–1999	1948–1988	1989–1994	1995–1999
Initiated	620	313	122	185
of which				
Panel established	276 (44.5%)	137 (43.8%)	59 (48.4%)	80 (43.2%)
of which				
Panel ruling issued	233 (37.6%)	120 (38.3%)	51 (41.8%)	62 (33.5%)
of which				
Appellate ruling issued	—	—	—	44 (23.8%)

Source: Busch/Reinhardt

# Are disputes escalating?

What might explain the variation across time?

- Number of members
- Issue scope (more complex issues)
- Volume of trade

# Do countries participate equally?

State classification	Member- years	Cases as complainant	Cases as defendant	Total cases
All developed	<b>1,329</b> (32.3%)	<b>457</b> (70.2%)	<b>535</b> (82.2%)	<b>992</b> (76.2%)
All less developed	<b>2,787</b> (67.7%)	<b>194</b> (29.8%)	<b>116</b> (17.8%)	<b>310</b> (23.8%)
Just least developed	830 (20.2%)	2 (0.3%)	0 (0.0%)	2 (0.2%)
Total	4,116	651	651	1,302

Source: Busch/Reinhard

# Do countries participate equally?

WTO members most involved in disputes, 1995 to 2015



# Do countries participate equally?

What might explain the variation across countries?

- Dependency on trade as national income
- Power
- Legal capacity
  - 26,000 pages of new treaty text and rapidly increasing case law
  - Increased importance of pre-arbitration settlement
  - Increase in permissible delay period

## Do countries win equally?

From 1948-2000, there were 654 disputes in the GATT/WTO

	Total	Resolved	Won	Lost
US as respondent	61	17	14	30
US as complainant	54	24	26	4

- As a **respondent**, the US lost 77% of the time (including cases resolved to the satisfaction of the complainant)
- As a **complainant**, the US won 93% of the time (including cases resolved to its satisfaction)

## But the environment?

Many environmentalists have criticized the WTO for negative environmental effects.

- Undermines national sovereignty by preventing countries from setting their own environmental policies.
- Enables imports to be made from countries with the least environmental protection.
- Places maximizing trade and GDP above health and environmental standards

The perceived culprit is the WTO's DSM, where environmental protections have been considered trade discrimination

# Shrimp-Turtles

The Endangered Species Act in the US protects sea turtles from shrimp nets by requiring turtle exclusion devices (TEDs)

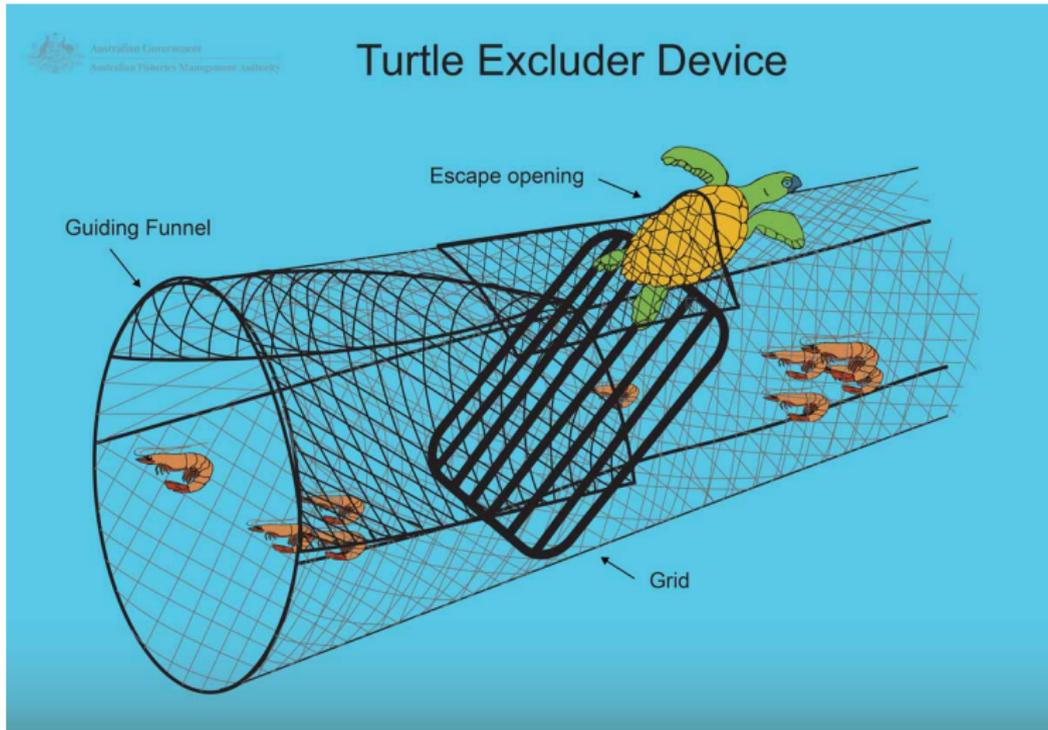
- US law prohibited shrimp imports from countries that don't use TEDs
- Foreign shrimp producers from India, Malaysia and Pakistan filed a WTO case
- The US lost the case and in 1998, had to strike down the law requiring shrimp importers to use TEDs

# Shrimp-Turtles

The US lost the case, not because it sought to protect nature, but because it **discriminated between WTO members**

- The US provided some Caribbean countries with technical and financial assistance to use TEDs
- They also gave Caribbean countries longer transition periods to start using TEDs
- Asian countries did not get special treatment
- The US discriminated in **how** it applied its environmental protection, making it against WTO rules

# Shrimp-Turtles



# Has the WTO increased trade?

GATT/WTO **theoretically increases** free trade because:

- It alleviates the prisoner's dilemma
- Insulates leaders from protectionist domestic political pressure
- Enforcement prevents backtracking

# Has the WTO increased trade?

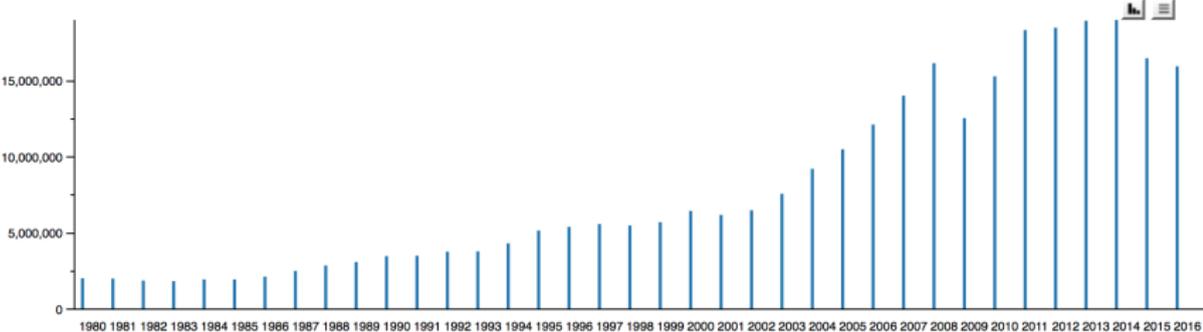
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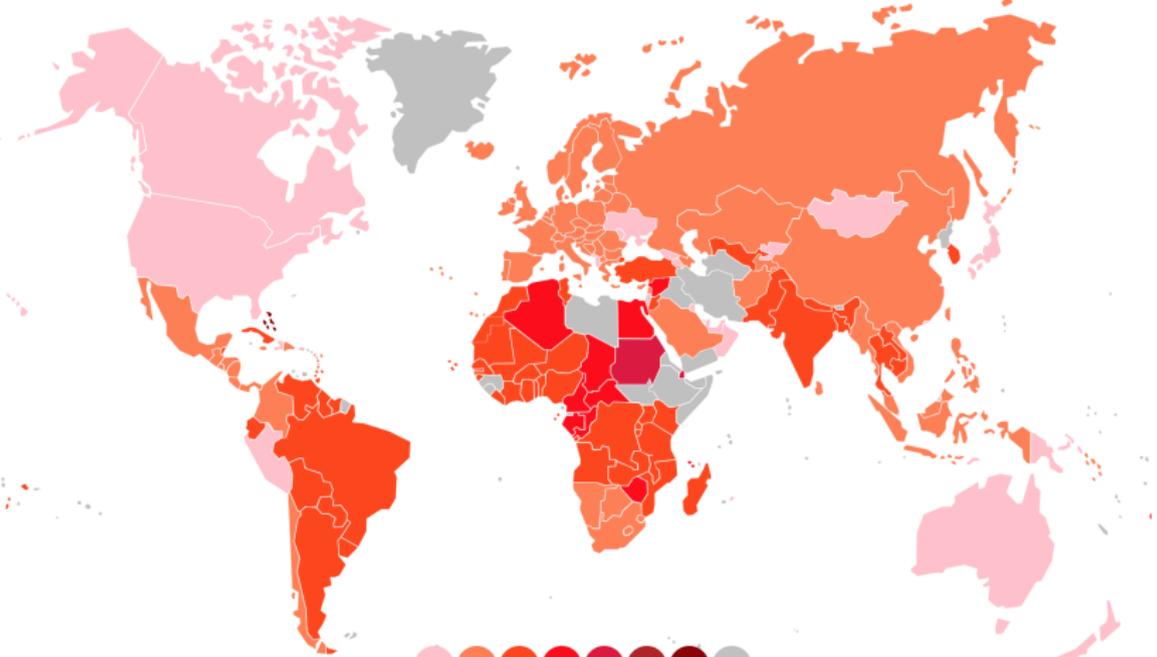
GATT/WTO may be **theoretically limited** by:

- Free Trade Agreements/Customs Unions
- Preferential Trade Agreements
- Generalized System of Preferences (developing countries)

# More Trade?



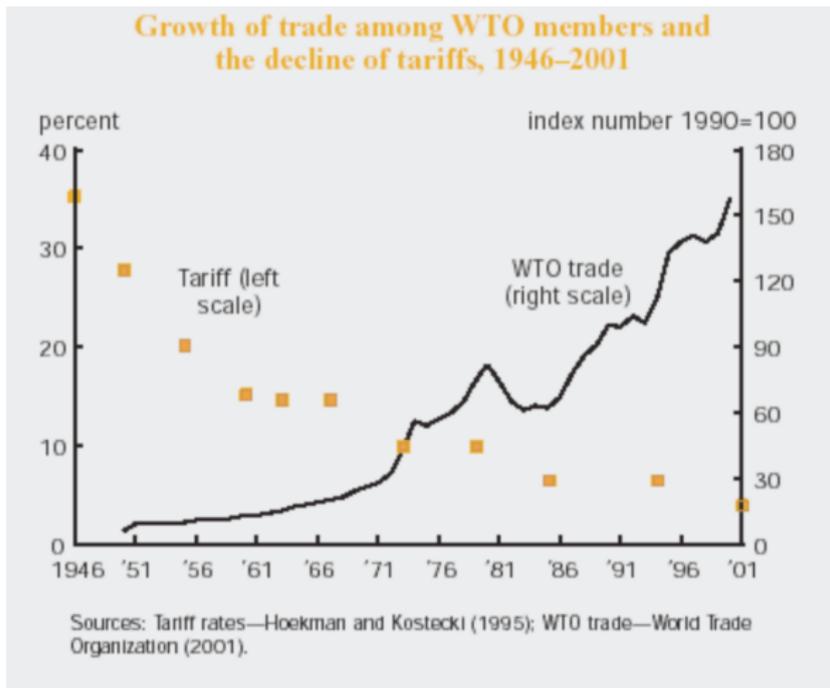
# Lower Tariffs?



Disclaimer

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# More Trade? Lower Tariffs?



What does empirical research say?

Membership in the GATT/WTO is **NOT** associated with increased trade, once the following factors are controlled for:

- Size
- Distance
- Colonialism
- Customs Union
- FTA/PTA membership
- Generalized System of Preferences

According to Goldstein et al 2007, Rose does not account for:

- Members opting out
- Nonmembers opting in

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  - Political and economic reasons for exclusion
  - More than 60 countries have used these clauses
- Nonmembers opting in

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- Nonmembers opting in
  - “Standing is the degree to which a country, territory or nongovernmental actor has rights and obligations from the institution.”
  - Nonmembers, territories, and transitioning countries have standing

Changing the sample of countries implies that the GATT/WTO has **increased trade** between members and between nonmember participants.

# Where are we now?

## The Doha Round:

- The Doha round of negotiations was launched in 2001
- The major conflicts are between developed nations (The US, Canada, The EU, and Japan) and the largest developing countries (China, India, Brazil and South Africa)
- Intent of the round is to make trade more fair for developing countries

# Where are we now?

## The Doha Round:

- Negotiations over the Doha round broke down in 2008 (over US agricultural subsidies)
- A small portion of the Doha agreement on bureaucratic reforms was reached in Bali in 2013
- However, the future of the Doha round is unclear
- The largest issues remain agriculture, special/differential treatment for developing countries, and logistical/technical support for developing countries in implementing agreements

# Summary

Can we govern trade? Successfully?

## **The Prisoner's Dilemma**

Rational, self interested decision making makes everyone worse off  
International institutions can help overcome the PD by iterating and enforcing the game

The GATT/WTO was founded on market liberalization and non discrimination

Current questions surrounding the WTO/GATT include:

- Increasing use of the DSM
- Over-participation of developed countries in the DSM
- Environmental protection
- Effectiveness (increased trade?)
- Conclusion of the Doha round