The Value of the WTO

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PRELIMINARY DRAFT, NOT FOR CITATION

Abstract

Recent developments in global trade include actions by major global traders that lie outside the norms of behaviour of the WTO over the last 20 years. Member frustrations with the slow pace of negotiations and concerns about strategies and behaviors of other members approaches to trade and economic development have created unprecedented stresses on a system of rules and commitments that have long encouraged global trade growth and increased economic integration. In this paper we explore the potential value of the multilateral trading system, particularly the WTO, and emphasize that the value goes well beyond the headline of tariff reductions, but that value is also found in increased certainty and transparency. The paper also shows that while preferential trade agreements may provide some backstop to the multilateral system their implicit costs from rules of origin may limit their ability to replace the MTS, particularly in the area of goods trade.

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INTRODUCTION

Recent trade policy developments, particularly related to tariff policies, appear to lie well outside the norms of trade policy as developed over the last 24 years since the creation of the WTO, and even, to some extent, the previous 47 years of the GATT. While other articles have summarized the details of those policy developments, and others have estimated their potential impacts, this paper aims to provide a succinct summary of the various ways the multilateral trade contributes to economic growth and development.[2]

Some have argued that the WTO is one of the most successful—and perhaps the most important—source of global economic cooperation in history. Yet since its creation there has been significant, recurrent misunderstanding about the role of the WTO and the role of trade in domestic and global economic growth. In addition, there is often significant misunderstanding on how negotiations of new trade rules have historically taken place, the WTO's role in global trade governance, and finally what WTO agreements typically do. This article provides a brief overview of history of how

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[2] For example see Bown (), X Y and Z

new rules have been negotiated in the organization (and its predecessor, the General Agreement on Tariffs and Trade), a summary of the role of trade in economic growth and development in the broader context of other forces driving growth and economic change, and then provides a summary of the ways the organization's agreements have contributed to a well-functioning global trading system. We also attempt to succinctly address some of the myths many non-experts hold about how the organization operates and what it achieves.

A Brief History of Negotiations

Launched as a limited tariff agreement among 23 members—the 1947 GATT—it has grown into a multi-issue economic agreement among 164 members—the modern WTO. It provides the key forum for negotiating multilateral liberalization agreements, the core rules governing global trade relations, and the essential mechanism for resolving trade conflicts. As the only global trade body, the WTO is—by definition—the only way that all countries, including the most powerful, can cooperate on the growing number of global trade issues that impact them collectively. Under the WTO—and its predecessor, the GATT—trade barriers have fallen to their lowest level in history, with over a third of world trade now flowing tariff free. Trade rules now cover, not just goods and raw materials, but services, investment and intellectual property. And trade conflicts have generally been resolved, not in trade wars, but in the WTO's dispute settlement system, or 'trade court'. The biggest testament to the WTO's success is that almost all countries—even the former cold war warriors—are now part of a rules-based trading system, while those still outside are queuing up to join. WTO accessions over the past 20 years have been an important source of liberalization. One common myth about the GATT and WTO is that negotiations have always been conducted the same way, like the "single undertaking" in the Uruguay Round.

The multilateral system is not alone responsible for today's open and integrated global economy. Unilateral, bilateral and regional agreements have played an increasingly key role, while underlying technological changes – from containerization to the internet – have clearly been the most fundamental drivers of greater integration through lowering trade costs. But it is inconceivable that countries—like corporations—would be actively participating in today's interdependent global economy without the underlying security and certainty that the multilateral system provides. The fact that, like gravity, the system's role often goes unnoticed makes it no less pervasive or critical.

But the success of the WTO—and its growing importance to international economic relations—has also given rise to new challenges. Multilateral rules that underpinned the expansion and dynamism of today' global economy now risk being rendered outdated or obsolete by the very industries they helped to fuel, especially in fast-growing digital economy. The last major reform or upgrade of the system's rulebook and procedures took place over two decades ago, when the internet had only just been invented, and long before the arrival of Google, Facebook or Amazon. As the number of new issues has expanded, so too has the number of new players. Fast-emerging powers, such as China and India, play a role that was unimaginable even 20 years ago, while smaller countries naturally want a say in a system in which they have a growing stake. Meanwhile, countries' growing use of the WTO's dispute settlement system – and the increasing economic and strategic importance the conflicts being address – have invariably intensified the scrutiny of the system, and fuelled debates about the outcomes.

The particular strains on the multilateral system may be new, but they are not unprecedented. In fact, the system's evolution throughout the modern era has been marked by a series of crisis or conflicts, each one at least partly the result of new economic activities, new trade participants, or new 'integrating' technologies overtaking existing rules and trade relations, and each one prompting a re-evaluation the status quo and a re-negotiating of the system's rules, procedures or even basic structures. Although this evolution has not always been smooth – often advancing in fits and starts – the long-term trend has been towards wider, deeper and more flexible cooperation - with more countries, negotiating more issues, within a more multi-speed or variable geometry framework of rules. The following article looks at these broad historical trends and asks whether the current tensions facing the multilateral system can also be seen as part and parcel this pattern of crisis, adaptation and expansion.

THE 'PLURILATERAL' GATT

To understand the multilateral trading system's achievements, it is important to remember where it started. A central goal of the international community after the Second World War was to build an open, cooperative, and rules-based world trading system—and to avoid a repeat of the 1930s when escalating protectionism and rival trade blocs contributed to the collapse of world trade and the rise of international tensions. The plan was to create a new International Trade Organization (ITO)—alongside the IMF and the World Bank—to oversee a series of multilateral negotiations

aimed at lowering tariffs and strengthening rules. These negotiations were based on three broad principles: The first was reciprocity—the idea that negotiations should involve a balanced (the not an identical) exchange of liberalization commitments. Not only did reciprocity maximize liberalization outcomes, but it helped to build domestic support for freer trade by balancing export gains against import concessions. The second principle was non-discrimination—the idea that any trade concession granted to one member should be extended to all members. In addition to mitigating against exclusionary blocs, it ensured that trade powers, in pursuing reciprocal liberalization, had an incentive to include other major players in their deals as well to avoid "free riding" – thus creating a powerful dynamic to expand freer trade. Concern for reciprocity and non-discrimination, in turn, gave rise to the need for a general code of trade rules. Unless negotiated tariff reductions were reinforced by agreed rules, commitments could be reversed and/or nullified by non-tariff measures. From the outset, however, these general rules were subject to various exceptions, safeguards, and escape clauses resulting in a system that was strong enough to encourage compliance, but flexible enough to allow accommodation. The overall approach was both old and new, deriving its inspiration and design from US bilateral trade agreements of the 1930s, as well as from the League of Nations' interwar economic conferences, but applied to the challenge of creating the first multilateral trading system after 1945.

Before the ITO charter was finalized in 1948, a "core" group of countries (15 initially which grew to 23) began negotiating a parallel tariff reduction agreement—the General Agreement on Tariff and Trade (GATT)—largely because of concerns that an ambitious liberalization deal would be difficult to reach among the 50-plus countries negotiating the ITO, negotiations which were already proving more difficult and fraught than expected now that wartime 'solidarity' was weakening and Cold War fault lines were beginning to harden. Even among this smaller group, agreement was not easy. Many in the core group wanted to reduce tariffs across-the-board, or "multilaterally", but because the United States was constrained by congressional authority to negotiate bilaterally, the first GATT round was a hybrid "multilateral/bilateral" approach; countries engaged in simultaneous bilateral, request-offer negotiations the result of which were then multilateralized through the MFN principle to everyone else.

To "bind" their tariff commitments, the GATT used the draft commercial rules section of the ITO charter with minor modifications. The United States wanted the rules to outlaw all discriminatory trade arrangements and eliminate most quantitative restrictions, but the Europeans resisted

dismantling their balance-of-payments controls and preferential colonial blocs. As a result, existing colonial preferences were grandfathered in the GATT, and Article XXIV exempted customs unions and free trade agreements from MFN treatment—guaranteeing that multilateral and regional trade arrangements would henceforth coexist. For its part, the United States wanted exceptions for its agricultural price support programmes and export subsidies—opening the way for the agricultural sector to be shielded from the liberalizing pressures of future rounds. Despite these differences—and the near collapse of talks on several occasions—the initial Geneva Round resulted in a 30 per cent reduction in average industrial tariffs and, even more important, demonstrated that multilateral trade negotiations could be highly successful. Although the GATT was intended as a temporary arrangement until it could be absorbed in the new ITO—with excluded countries given a set time-frame in which to join the pre-negotiated tariff agreement—the United States' failure to ratify the ITO several years later left the "provisional" GATT as the only multilateral instrument for managing world trade relations for the next half century.

TOWARDS 'VARIABLE GEOMETRY' RULES

The GATT's success in dramatically lowering tariff barriers and attracting new members created several new challenges by the time of the Kennedy Round (1964-67). One was the challenge of negotiating tariff reductions in a system that had already doubled in size in less than two decades. In particular, the need to integrate new developing-country members in ways that increased their export opportunities without requiring full reciprocity was a growing issue. Another challenge was trying to discipline non-tariff barriers—which were becoming more salient to trade as tariffs declined—with the existing rules of the 1947 GATT. The newly formed European Economic Community (EEC) posed perhaps the biggest challenge, for the first time creating a negotiating counterweight to US preponderance in the system and raising the risk of widening transatlantic trade friction at a time when Cold War tensions demanded western solidarity. All of these factors served to increase the scope of the Kennedy Round—which became the first multilateral negotiation since GATT's creation to attempt rules reform, as well as tariff reductions.[3]

The results were mixed. In terms of liberalization, the round was highly successful—thanks in part to the adoption of a formula approach to tariff negotiations—with industrial tariffs reduced by an

[3] The formation of the EEC—and subsequent expansion—provided a major impetus to liberalization in GATT round as outsiders looked to reduce the trade diversionary impact of intra-Europe free trade by further lowering barriers multilaterally.

average of 38 per cent. One major disappointment was agriculture which, despite initial plans to begin grappling with the issue, was left largely untouched because of members' unbridgeable differences. Regarding rules reforms, the results also fell short of ambitions, in no small part because of the perennial challenge of getting members—especially the transatlantic giants—to agree on even modest changes to the rules. Although the round resulted in new agreements to allow preferential, non-reciprocal access for developing-country exports—Part IV of the GATT—and to discipline anti-dumping procedures—the Anti-Dumping Code—efforts to update the rules and tackle non-tariff barriers more generally failed to advance. By the end of the Kennedy Round—which had lasted three years instead of the planned six months—some were already asking whether multilateralism in trade had run its course.

This unfinished reform agenda from the Kennedy Round, the expansion of the EEC, the growing export strength of Japan and other newly industrializing countries already provided ample sources of tension in the system and a rationale for new multilateral negotiations. But the biggest 'shock' to the system — and the main impetus for the launch of the Tokyo Round (1973-79) – was clearly the US unilateral decision to close the gold window, impose a 10% surcharge, and force a devaluation of the dollar, leading to the collapse of the Bretton Woods fixed exchange rate system and a period of turbulence in the global economy. Its broad agenda, combined with the fact that there were now 102 GATT members, ensured that the Tokyo Round would be the most comprehensive and wide-ranging multilateral trade negotiation so far, as well as the most protracted and contentious. Once again, transatlantic tensions—especially over agriculture—were a main source of negotiating friction, although for the first time major differences between developing and developed members also complicated the search for agreement. In terms of liberalization, the round achieved a 35 per cent reduction in average industrial tariffs, equivalent to the Kennedy Round—although agriculture was again largely side-stepped.

To solve the challenge of reaching unanimous agreement on rules reform, negotiators sought to clarify and strengthen GATT rules in key areas, such as subsidies, anti-dumping, technical standards, import licensing, customs valuation, and government procurement, by creating six new side agreements or codes (modelled on the existing Anti-Dumping Code) which members were free to either join or opt out of. As well as being less than universal, most of these codes were in principle subject to the same MFN treatment as other GATT rules, meaning that members who opted out could benefit from the commitments of members who opted in. While the Tokyo Round

achieved the most far-reaching reform of the system's rules since the ITO charter, the codes' limited coverage, ambiguous application, and perceived fragmentation of the system, proved a source of dissatisfaction with the round's results, the resolution of which provided an important motive for launching of the Uruguay Round seven years later.

SINGLE UNDERTAKING-PLUS

By the time of the Uruguay Round (1986-94), the GATT system had expanded to 123 members and the constellation of major trade powers included, not only the United States and the EEC, but also a fast-rising Japan, and increasingly engaged developing countries members, such as India and Brazil. Although not foreseen at the launch of round in Punta del Esta in 1986, this most ambitious and far-reaching reform of the system would also take place against the backdrop of the end of the Cold War, and the shift of many centrally planned economies towards open markets and global integration. This epochal event alone made the Uruguay Round *sui generis.* Still, the challenge of reaching agreement among an expanded membership was reflected in the fact that the round took four years to launch and required another eight to complete—double the expected duration. In addition to reducing tariffs and addressing new subjects such as agriculture, textiles, services and intellectual property, the round's goal was to expand the system's rules to all members and to clarify ambiguity around their application.[4] The big innovation - marking an important departure from previous rounds - was the “single undertaking”, the idea that all WTO members were now committed, not just to negotiating a single package of trade reforms, but to adhering to all aspects of it as well. This model not only replaced the Tokyo Round’s ‘opt in, opt out’ approach to new agreements, but seemed to run against the previous trends towards greater variable geometry in the system.

However, even this far-reaching notion of a single undertaking included important exceptions. For example, because of the controversy surrounding the proposal to launch services talks—and because of concerns, especially among developing countries, that progress in goods liberalization would be made conditional on progress in services—a formula was worked out that services would be included in the round only if the negotiation proceeded on a separate track and only if a resulting agreement was kept outside the GATT architecture: hence the creation of the General Agreement on Trade in Services, or GATS, at the end of the Round. The content and objectives of

[4] While code members were concerned about non-members "free riding" on their commitments, non-members were concerned about ambiguity surrounding the code's non-discriminatory application.

the negotiation also evolved over the course of eight years, most notably with the decision to create a new trade organization, the WTO, towards the end of the round.

The fact that the Uruguay Round delivered the most far-reaching package of trade reforms in GATT history—cutting industrial tariffs by over 30 per cent, addressing agriculture, textiles, services and intellectual property rights for the first time, strengthening the dispute settlement mechanism, and leading to the creation of the WTO—was seen by many as a testament to the success of the "round" approach to negotiations and the value of the single undertaking model. They argued that "bigger was better" not just because larger trade-offs met the needs of an ever-expanding membership—and gave them a larger stake in a successful outcome—but because high-profile packages generated the needed political support to bring the negotiations to a conclusion. They also argued that only an ambitious round—where all issues where linked and all members were equally committed to negotiated outcomes—would encourage progress on the most difficult issues and avoid some members attempting to 'cherry pick' the negotiating subjects that mattered most to them, inevitably leaving the toughest ones behind.

However, others drew the opposite conclusion. The sheer length of the Uruguay Round and the many moments of near-failure, they argued, raised questions about the continuing value of ever bigger negotiations that tried to tackle all issues simultaneously, and underlined the need for faster and more flexible ways to negotiate trade deals. They also pointed to the fact that while the Uruguay Round may have been successfully concluded it was not "finished", in the sense that substantive commitments on the two most difficult subjects, agriculture and services, were to a large extent deferred to future negotiations as part of the Uruguay Round's "built-in-agenda". Instead of grand, "all or nothing" rounds, they argued that the new WTO—with its stronger institutional foundations and greater technical expertise—should focus on continuous sector-by-sector and/or multispeed negotiations reflecting the more varied interests and capacities of its rapidly expanding membership.

Over the next five years, the WTO pursued this sector-by-sector approach with mixed results. On the one hand, it delivered early stand-alone agreements on financial services and telecommunications—as well as on trade in information technology products—which suggested that more focused negotiating approaches could work for certain subjects. On the other hand, the WTO failed to conclude a maritime services agreement—or to significantly advance other proposed

sectoral initiatives—which seemed to point to the need for trade-offs with other issues for some subjects to advance. As members approached the built-in-agenda's 2000 deadline for launching negotiations on agriculture and services a growing number were persuaded that meaningful progress could only take place within a larger package of negotiations that included more scope for trade-offs. A main impetus for launching the DDA in 2001 was therefore the mounting pressure to tackle agriculture in particular—an issue which had been sidestepped for most of the GATT's history and was only partially addressed in the Uruguay Round—and to make progress on other market access issues more generally where developing countries felt that the Uruguay Round results had fallen short, leaving the system unbalanced.

In hindsight, it is not surprising that the DDA encountered even more difficulties than previous rounds. It tackled the toughest issues left over from previous negotiations—agricultural subsidies, services liberalization, tariff peaks and escalation, preference erosion, non-tariff barriers, etc. It also included the largest number of actors and covered the biggest share of the world economy. With China, Russia, and 32 other new members at the negotiating table—a fifth of the WTO's membership—the DDA represented the first truly global trade negotiation in history. At the same time, it adopted an even stricter single-undertaking approach than the Uruguay Round, arguably leaving negotiators with less flexibility to decide which issues were ‘ripe’ for progress, which members were able to advance, and where the negotiating agenda might need to evolve. The fact that was no Cold War 'glue' to bind free world allies together – nor a falling Berlin Wall to generate a new globalist, end-of-history solidarity – meant that the foreign policy imperatives that lay behind all previous rounds was also absent. Progress in the Doha Round has been disappointing, to say the least, to the point where many countries have concluded that the round should be abandoned.

THE FUTURE OF MULTILATERAL TRADE NEGOTIATIONS: MORE OPPORTUNITIES, MORE CHALLENGES

It is clear from recent events that pressures to revaluate the global trade status quo and to return to the multilateral negotiating table are building once again. The US in particular has served notice that it will seek a redress of what it sees as unacceptable trade imbalances, insufficient market access reciprocity, and inadequate or out-of-date WTO rules in the system, cooperatively if possible, unilaterally if necessary. Recently there are also clear signs that the system is beginning

to respond and to adapt. The first major breakthrough was the 2013 “Bali package” of trade reforms which, in addition to measures aimed at addressing important agricultural issues and improving trade opportunities for least developed countries, delivered the Trade Facilitation Agreement – the first new multilateral agreement under the WTO. Two years later, ministers concluded a “Nairobi package” of trade reforms at their 10th ministerial conference which included a breakthrough agreement to eliminate farm export subsidies—the WTO’s first major agricultural advance in twenty years – and an expansion of the Information Technology Agreement. The most significant breakthrough so far came at the WTO's 11th Ministerial Conference in Buenos Aires last December where groups of 70 to 80 Members – representing three quarters of world trade – launched 'open plurilateral' discussions on e-commerce, investment facilitation, services regulation, and MSMEs. Since linkages will almost certainly need to be made among these new issues – as well as with outstanding DDA ones – if common ground is to be found and agreements are to be struck, the question arises as to whether we are witnessing the brick-by-brick construction of a new multilateral negotiation.

Beyond demonstrating that WTO negotiations can deliver results, the Bali, Nairobi and Buenos Aires successes highlight new approaches to negotiating, structuring, and implementing multilateral trade agreements that warrant further reflection. Key questions include: Could more progress be made in more focused, continuous negotiations than in large multi-issue rounds? Should certain new agreements be optional—allowing some members to go further and faster than others—rather than universal? Is there scope for negotiating "soft" rules—backed up by best endeavour commitments and monitoring mechanisms—as well as "hard" rules—enforceable through binding dispute settlement? Four observations are relevant to these debates.

First, the WTO is already a highly flexible and adaptable system—combining multi-issue with single-issue negotiations; universal with variable geometry rules; hard law with soft law.[5] Successive multilateral negotiations have been open to all members, but not all members have had the same ambitions or undertaken the same commitments—especially as the system has grown more diverse. Every round has been multi-speed—with some members going further and

[5] In the GATT, members schedule country-specific commitments for tariffs on goods (agricultural and non-agricultural) as well as in other quantifiable areas such as agricultural subsidies. In the GATS, there are even more detailed means of scheduling country-specific commitments (including the extent to which members are prepared to offer national treatment in specific services sectors). In addition, there are the special and differential treatment provisions for developing and least-developed countries across the GATT, GATS and TRIPS agreements. Finally, there are voluntary agreements—such as the Code of Good Practice for the Preparation, Adoption and Application of Standards (annexed to the Agreement on Technical Barriers to Trade)—and plurilateral agreements—such as the Government Procurement and Civil Aviation agreements.

faster than others—and the resulting agreements have been variable geometry—with members choosing their own levels of obligations on everything from tariff schedules to services commitments, notwithstanding the common set of principles and general rules. It is this mix of approaches which has made far-ranging trade integration possible among an increasingly broad and diverse membership. A good example of the system's flexibility and adaptability is the more 'individualized' design of the new Trade Facilitation Agreement. The future expansion of the system will like require even more – and more innovative – flexible approaches.

Second, no single negotiating approach will be appropriate for all issues. Some subjects—such as trade facilitation—can be solved in single-issue negotiations whereas others—such as agriculture—are more likely to advance when combined with other issues in a more negotiation. On certain issues—such as government procurement—only a sub-set of members may choose to negotiate, whereas on other issues—such as subsidies—universal engagement is needed. Small groups may make agreement easier but the results are narrower; single-issue negotiations will address some members' concerns but not necessarily others. Every negotiating approach involves trade-offs.

Third, each negotiating round was conceived as an indivisible package—where "nothing was agreed until everything was agreed"—but in practice most were concluded with key issues, often the most contentious, left unresolved. These left-over issues typically provided the impetus for the next round of negotiations. Successive multilateral rounds were not so much isolated events—with clear beginnings and ends—as stages in a continuous negotiating process—interrupted by the periodic harvesting of results—constantly adapting to changing global economic and political conditions.

Fourth – and most important - multilateral negotiations advance when members agree, and stall—or fragment into regional efforts—when members disagree. The biggest challenge is not the structure of negotiations, but the issues being negotiated—and members' willingness to find common ground. For any negotiation to succeed, members need to want something from one another, to engage in mutually beneficial exchanges, and to find a win-win outcome for all parties. When these conditions are met, an appropriate architecture can be found within the WTO.

The Bali, Nairobi and now Buenos Aires successes have demonstrated that progress in multilateral negotiations is possible when members find common ground—and when innovation and flexibility is embraced. Ultimately, the choice facing members is between finding ways to negotiate on trade issues inside the WTO—with its shared rules, transparency mechanisms, and dispute settlement procedures—or outside it through less inclusive and more fragmented regional approaches.

ROLE OF TRADE IN ECONOMIC GROWTH AND DEVELOPMENT - WHAT HAS BEEN ACCOMPLISHED?

Summary

What does trade do? Canonical economic theory models identify the following mechanisms ways trade works through an economy based on the evolution of theory and empirical facts.

- **Exploiting Ricardian productivity differences in each country while using trade to use existing resources more efficiently – everyone gains. In the long run comparative advantage can change and can have some important implications as illustrated by Samuelson (2004). Gains from terms of trade changes (prices of exported goods up and imported goods down.) Explains final goods trade between countries with different technologies.**

- **Exploiting factor endowment differences (H-O). Illustrates that there can be winners and losers. Gains from terms of trade changes (as above). Explains trade between countries with different endowments.**

- **Specific factors model. Short run fixity in factor market demonstrates winners and losers. Gains from terms of trade changes (as above).**

- **Economies of scale models (Krugman and Helpman). Hard to pin down exact sector/firm/country winners and losers, but consumers gain as prices of exported goods fall in both countries (falling average costs of production as market size expands.) Helps explain final and intermediate goods trade between countries with similar levels of economic development, technology and endowments.**

- **Love of variety models (Krugman). Consumers gain from increased number of varieties as a result of trade. As above.**

- **Firm productivity models (Melitz). Most productive firms in each country gain (can more easily overcome trade costs) while relatively inefficient firms lose, reallocating their resources to most productive firms. Gain to economy from increased productivity in resource use. Explains interfirm trade and fact that much trade is done by very few, usually large companies.**

Most of these models emphasize specific mechanisms that create (net) gains from trade, as well as potential winners and losers from trade in "comparative static" sense. They are not focused on either transition paths in the adjustment, or the longer-term dynamic effects of trade from technological change, knowledge transfer, foreign direct investment, etc. These other effects can be very important, particularly.

Transition effects as economies adjust to increased trade openness (and many other forces!) is a major economic and political issue in some countries and regions, but it appears that there are relatively few agreed upon principles for adjustment programs (see IMF, WB, WTO (2017), Huffbauer and Lu (2017), Lawrence and Moran (2016)). Most analysis for countries like the US suggests the gains from trade (which tend to be distributed widely) significantly exceed the adjustment costs, but the adjustment costs are often concentrated causing significant economic pain in those sectors and regions for firms, workers and households and that adjustment programs are not sufficient to offset those concentrated losses (see Autor, Dorn and Hanson (2014) and related literature.) It is useful to keep in mind that technological change (not just automation) and changing consumer preferences bring about major adjustment costs also. WTO research suggests that 20 to 25 percent of manufacturing job losses in developed economies in recent years may be due to trade while the other 75 to 80 percent are due to these other forces (WTO 2016).

The dynamic effects of trade are more difficult to isolate from other factors, but appear to be large. The dynamic effects tend to work through forces that enhance productivity, particularly through investment, and are those forces typically identified in traditional growth and innovation theories (see for instance instance Helpman, 2004, but also Frankel and Romer, 1999). Researchers at the WTO (Auboin and Borino 2018), and others, have found that the investment component of GDP is very trade intensive, that is, investment typically involves a lot of imported capital equipment and parts and components. The IMF (2019) found that trade played a significant role in reducing prices for capital goods, resulting in higher quality, greater variety, and lower cost access for leading edge investment goods. This in turn will likely result in higher productivity growth. The role of foreign direct investment, often spreading through development of regional and global value chains, has helped close the technology gap between developed and developing countries, often using imported technologies and foreign knowhow to improve domestic production processes in developing countries. In this case imported capital and knowhow, learning by doing, and competitive forces created by competing in foreign markets that developing and emerging economies can now access more easily due to falling tariffs and increased regulatory transparency have spurred substantial economic convergence since the mid-1980s. The trade theories described above explain some of the forces driving these gains, but not necessarily their combined dynamic effects.

Value of WTO – the WTO is a set of agreements that essentially facilitates the mechanisms identified by trade theories that contribute to improved economic welfare, as well as facilitating the more dynamic effects of trade that work through more traditional economic growth theories.

- **WTO has helped reduce trade costs and increased trade with both members and non-members.**
- **WTO bindings and transparency work contributed to the muted responses to the 2008 crisis. Without bindings 23% of global trade would have been affected by tariff increases instead of the 4% observed in the data.**
- **WTO lowers the cost of living for consumers, equivalent to almost 1% of their income.**
- **WTO creates a predictable trading environment. This increased the number of products traded and the volume of trade between 10 to 30 per cent.**
- **The success of the WTO at preventing a breakdown in global trade cooperation prevents losses as high as $1.6 trillion in GDP.**

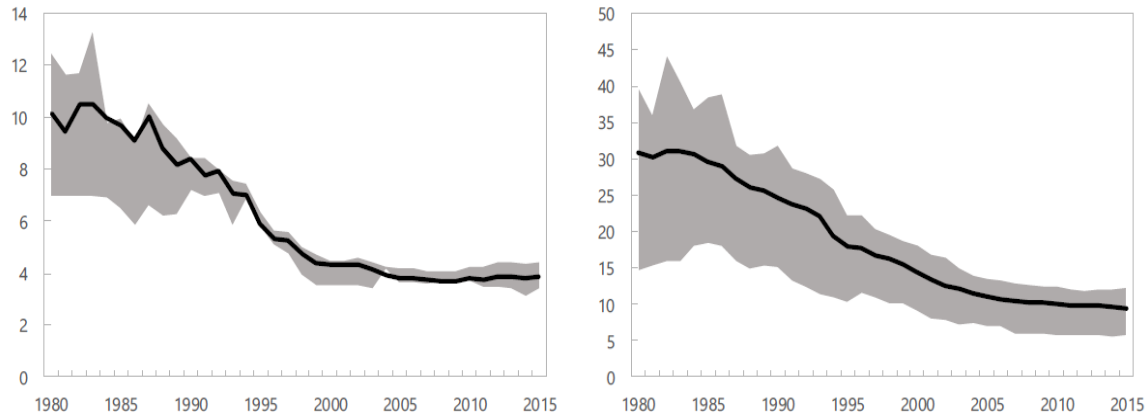
WTO has helped and can help to reduce trade costs and increase trade

International cooperation has achieved already a lot in terms of tariff liberalization. While the average tariff applied during the trade war of the 1930s was around 50% (Bagwell and Staiger 2002), the average tariff applied by WTO members today is only around 9%. The multilateral trading system embedded in the GATT/WTO has led to an increase in world trade of 120 per cent (Subramanian and Wei, 2007).

Chart 1 shows the evolution of global tariffs since 1980. There has indeed been a dramatic decline in average tariffs as well as a reduction in the dispersion of tariffs over time and across countries (IMF, WB, WTO 2017). Current global trade amounts to about $22 trillion dollars, $17 trillion in goods trade and $5 trillion in services trade. Of this trade about 85 percent is traded on WTO most favoured nation (MFN) tariffs, 50 percentage points of which is WTO MFN of zero and 35 percent is WTO MFN of greater than zero. Thus approximately 15 percent of global trade is conducted under preferential trade agreement (PTA) tariff rates - a surprisingly small amount given the proliferation of PTAs over that last few decades. One explanation for this surprising result is that PTA compliance requirements for rules of origin incur trade related costs that are equivalent to at least the WTO MFN tariff or greater and thus firms prefer to claim the WTO MFN tariff rather than meet the compliance costs.

It is important to recognize the importance of PTA tariff commitments in particular sectors, but also perhaps more importantly, in PTA commitments beyond tariffs, such as in regulatory areas (which are often non-discriminatory) in reducing trade costs and stimulating more trade. Very recent work by Larch et al (2019) also find that non-discriminatory elements of the multilateral WTO agreements in regulatory areas such as TBT and SPS commitments lower trade costs and stimulate trade between WTO members, but also trade with non-WTO members.

Chart 1. Evolution of average tariffs.



Sources: WTO Tariff Download Facility, IMF (2016a).

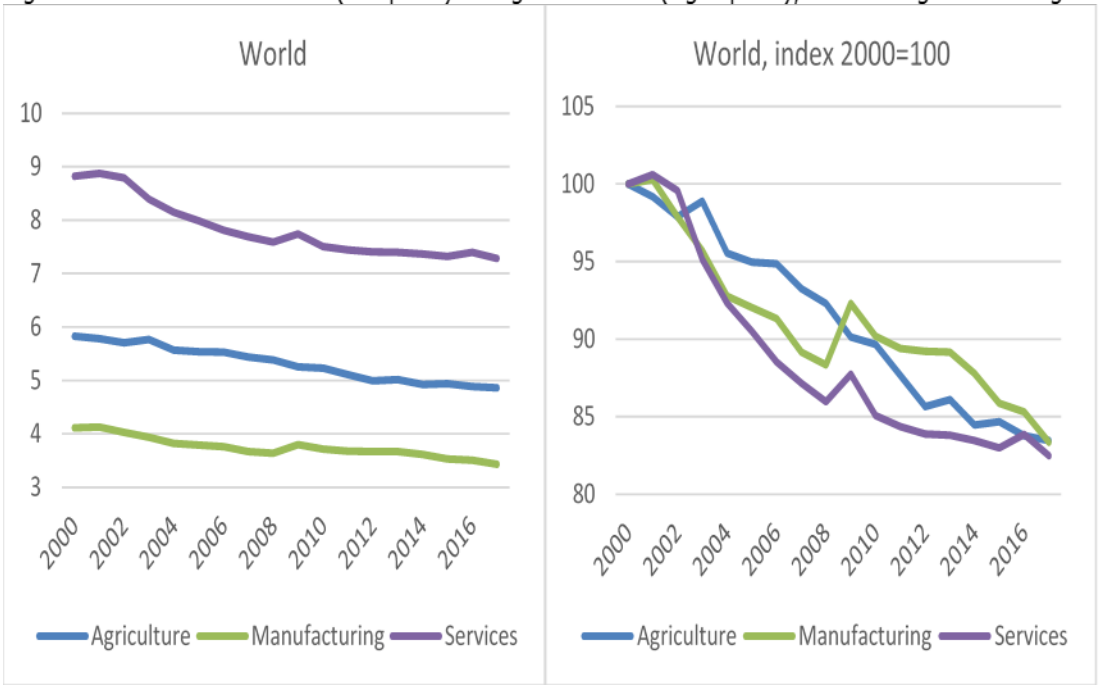
BUT TARIFFS ARE ONLY PART OF TRADE COSTS…

Tariffs, and other policy barriers, are not an insignificant part of overall trade costs, but other costs, such as transport, communications, and regulatory requirements are very significant. Anderson and van Wincoop estimated that the total cost of moving a good from the factory gate in one country to the final consumer in another country ranged from 200 percent in developed countries to over 300 percent in developing countries. They estimate that tariffs and other trade barriers accounted for only about 24 percent of those total costs. Technological change, evolving business models, and improvements in transportation have significant impacts on these trade related costs.

In Chart 2 we show the evolution of trade costs from 1996 to 2014. Trade costs on average fell by 15 percent during this period, with trade costs falling the most between developing countries.

Chart 2. The evolution of trade costs since 2000, WTO estimates.

Figure 1: Trade cost in levels (left pane) and growth rates (right pane), trade-weighted average



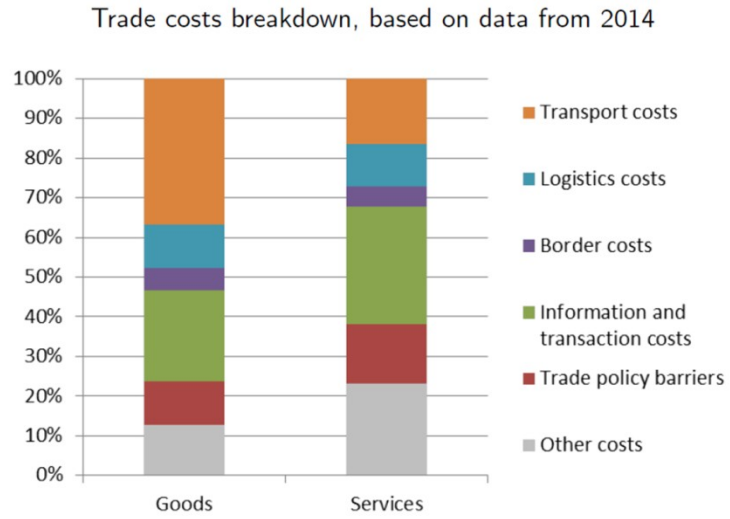
Note: The level of trade cost can be interpreted as how many times higher is international trade cost compared to domestic trade cost. Hence, trade cost in services in 2017 (7.28) corresponds to an ad valorem equivalent of 628 per cent. Trade cost in manufacturing in 2017 (3.43) corresponds to an ad valorem equivalent of 243 per cent.

Trade costs are the highest in services and the lowest in manufacturing.

In Chart 3 we break down overall trades cost components for 2014. We can see from these estimates that transport and information and transaction costs tend to make up the largest share of total trade costs, with transport accounting for a much larger share of goods trade than for services trade, which makes intuitive sense. Trade policy barriers account are the third most significant component and account for maybe 10 percent of total trade costs (and slightly greater share for services trade costs.) Changes in transport costs and information and transaction costs are likely to have important impacts on trade flows, and while economic policies can indeed influence these components technological change, such as containerization for transport and digitization for information and transaction costs are probably bigger drivers in lowering (or raising) these components. Clearly the tariff declines illustrated in chart x and other policy commitments have helped reduce trade policy barriers overtime, but the data clearly shows that other factors are very important determinants of total trade costs. Thus regardless of trade policy

changes one can see falling trade costs and increased trade flows. While this may seem painfully obvious to many trade economists a surprising number of trade economists and particularly trade policy negotiators seem ignorant of these other drivers.

Chart 3. Trade cost components in 2014 for Goods and Services.



WTO tariff bindings helps tame countries tendency respond to import shocks with protectionism

Tariff bindings reduce the likelihood to respond to import shocks by raising tariffs and increase the likelihood of contingent measures (such as anti-dumping). We show that without bindings 23% of global trade would have been affected by tariff increases instead of the 4% observed in the data. (Piermartini and Jakubick, 2019). This increase in certainty around tariffs is also likely a substantial contributor to firms' willingness to undertake investment and knowledge sharing abroad as it ensures more certainty around trade costs for both imported inputs as well as exports. As import shocks become larger, countries increase tariffs within the bound or use contingent measures depending on the level of tariff water. An important implication is that the WTO Agreement reduces trade policy uncertainty not only by setting a maximum allowed tariff, but also by reducing the probability to use tariff water by providing other flexibilities that are designed to be more predictable.

WTO lowers cost of living

Absent the WTO, prices in many countries would be higher. For the US, research has estimated that reduced prices following China's accession to WTO increased consumers' income by at least 0.8 percent, the welfare equivalent of an 8-percentage point tariff decrease. (Handley and Limão, 2017)

WTO creates a predictable trading environment resulting in the number of products traded and on the volume of trade increasing between 10 to 30 per cent.

An important component of trade costs that is often neglected is trade policy uncertainty. Exporters evaluate the risk associated with the possible increase in barriers to trade in the destination market when deciding whether to export and delay exports to risky destinations. The commitments made by WTO members on tariffs and on other trade policy instruments play a key role in reducing this uncertainty.

The mere reduction of policy uncertainty, and not tariff changes, explains 22% of Chinese export growth to the U.S. following China's entry in the WTO. In addition, reduced policy uncertainty lowered U.S. prices, thus increasing consumers' income by at least 0.8 percent, the welfare equivalent of an 8-percentage point tariff decrease (Handley and Limão, 2013)

While China got greater certainty, the US got increased market. US exports to China faced average tariffs of 16.5% in 1996 prior to China’s accession. By 2015, the average tariff this export basket faced had been reduced to 5.2%. Second, by binding its tariffs China also reduced its discretion to raise tariffs, lowering part of the uncertainty faced by US exporters. US exports to China grew more rapidly in sectors where policy uncertainty fell the most. (Piermartini and Jakubick, 2019)

Preventing trade war is the major value of WTO

Using the WTO Global Trade Model, Bekkers and Teh (2019) find that global trade conflict started in 2019 would lead to a reduction in global GDP in 2022 of about 1.96% (about $1.7 trillion less) and a reduction in global trade of about 17% (or a decline of about $3.9 trillion) compared to the baseline. For context global GDP fell about 2.1% and global trade 12.4% in the global financial crisis of 2009. Second, there are much larger, double-digit sectoral production effects in many countries, leading to a painful adjustment process. Third, the large swings in sectoral production

lead to substantial labour displacement. On average 1.15% and 1.74% of high-skilled and low-skilled workers respectively would leave their initial sector of employment.

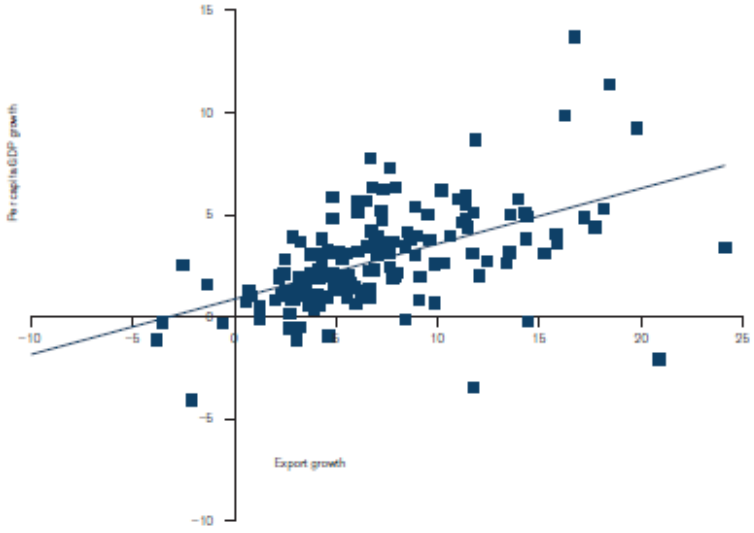
The effects of WTO on trade are larger than we thought. WTO members not only trade more with each other, but also with non-member countries

Larch et al (2019) capture the non-discriminatory nature of GATT/WTO commitments by measuring the effects of GATT/WTO membership on international trade relative to domestic sales. They find that, on average, joining GATT and/or WTO has increased trade between members by 171% and trade between member and non-member countries by about 88%. The also find that although both GATT/WTO has been effective in promoting trade between members, the WTO has been more effective in promoting trade with non-members than GATT.

Between 1980 and 2015 global trade flows have risen dramatically. Trade as a share of GDP has grown rapidly, as well as developing countries share of global trade (see WTO, 2015).

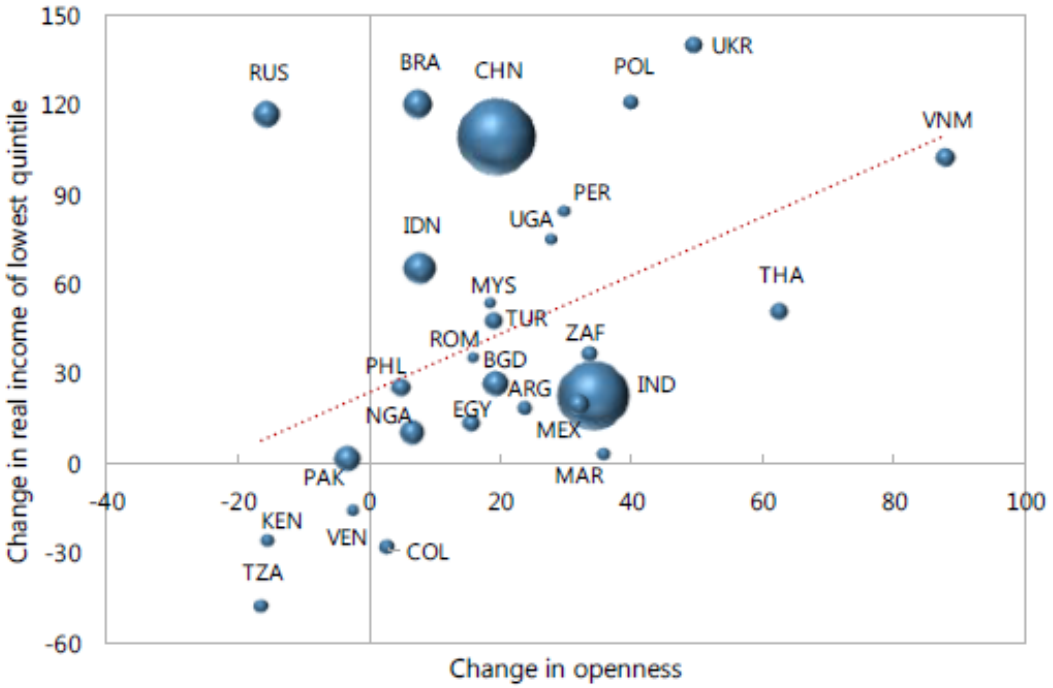
One also observes a significant correlation between increased openness on the part of countries and faster growth.

Chart 4. The relationship between openness and growth. Source WTO, 2015.



Further this increased openness is also highly correlated with faster growth in the poorest parts of income distributions in many countries.

Chart 5. Openness and income growth for poor.



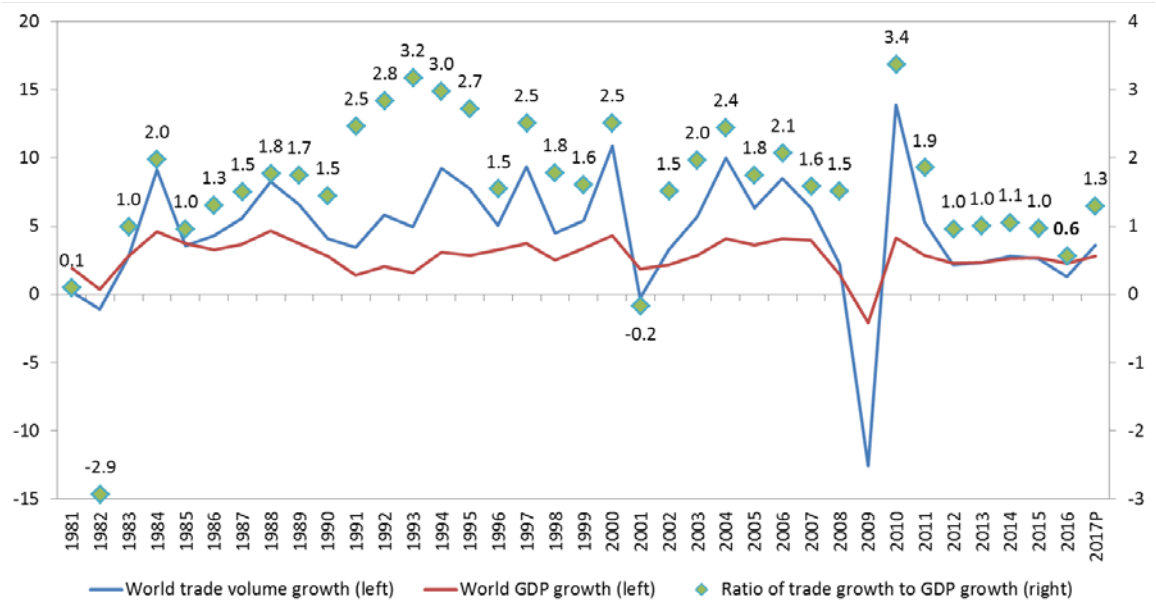
Source: IMF, WB and WTO (2017), based on Lakner-Milanovic (2013), World Panel Income Distribution dataset and World Development Indicators.

These data suggest a strong correlation between increased openness and greater certainty and faster economic growth and particularly faster income growth for the poor. But one myth that trade policymakers often subscribe to, as well as critics of more open trade, is the role of tariff cuts in driving these outcomes. IMF research has found that trade policy changes account for between 25 to 33 percent of trade growth (IMF, 2016) The fact is that there are many cost components to moving goods and services across borders (recall Anderson and Van Wincoop mentioned above). In addition to cost factors there are also demand factors. Research suggests that trade growth can be heavily influenced by the relative trade intensity of consumption, investment, government and export components of GDP. What kind of demand growth a country is experiencing can have a significant impact on how much it trades.

But supply side factors such as falling trade costs and reduced uncertainty are not the only determinant of growing trade flows. Recent work by the WTO, IMF, OECD, and World Bank also highlight the importance of demand side drivers.

A key puzzle facing trade economists in the post financial crisis period was a dramatic decline in the trade elasticity, that is the elasticity of trade growth to GDP growth. In chart zzzz below we plot the evolution of this relationship for goods trade between 1981 and 2017. Between 1987 and 2011 this elasticity rarely fell below 1.5, and often exceed 2. Between 2012 and 2016 it barely rose above 1.0. In trying to explain this dramatic change some authors pointed to rising "murky protectionism" (see for example Baldwin and Evenett, 2009 and Hoekman, 2015) and the fact that many countries were taking trade unfriendly policy actions in the aftermath of the financial crisis But average applied tariffs during this period did not increase (though they have indeed increased since 2016), and while "counts" of policy measures rise throughout the period there is no historical series to compare these numbers to from pre-crisis periods. This has change with the recent tariff increases introduced since 2016, particularly (though not exclusively) between the US and China. Recent empirical and simulation related research indicates that these increases in trade costs are affecting the volume and pattern of trade between countries, but thus far has had less impact on total trade imbalances.

Research by Auboin and Florino (2018), IMF, and OECD have found that certain components of GDP are more trade intensive than others, particularly Investment demand, and that weak investment demand and uneven demand growth in general in the post crisis economic recovery compared to the pre-crisis period seems to explain about two-thirds to three quarters of the slowdown in global trade. Another argument is the "slow down" in liberalization following the burst of unilateral opening up in the 1980s and 1990s, rapid growth in preferential trade agreements being signed, and of course the Uruguay Round multilateral agreement. IMF research suggests that trade policy contributed about 25 percent to the pre crisis rapid trade growth compared to GDP growth. This research highlights the importance of non-trade related policy changes, in particular forces that affect trade intensive demand components in GDP, such as investment demand, in explaining overall trade growth. Interest rates, fiscal deficits, demographics, changing technology have important indirect impacts on trade flows by working through domestic economic drivers.



DISPELLING THE MYTHS AND MAKING PROGRESS

The accumulated body of research suggests that while trade policy changes can explain an important part of trade growth that other factors play a potentially much larger role. Thus expecting trade liberalization, or an institution like the WTO to be the main driver of future trade growth is likely to be misplaced. Further, the gains and/or costs from trade policy changes, either in reducing poverty, increasing economic convergence, or increaseing imports and causing declines in import competing industries is often overstated. The fact is not only is the impact of increasing global trade a complex phenomena that needs a multifaceted understanding, but its role in domestic growth or adjustment is also complex and is not likely to be effectively addressed through tariffs or other border measures.

The goal of this paper was to lay out some of the arguments for the value of the WTO, but placed more broadly into the array of forces driving economic growth and adjustment. address two common myths around trade – how multilateral trade negotiations have historically occurred and the role of trade policy changes such as tariff and other trade policy barriers have in promoting trade growth in the last 30 to 40 years. For trade to continue to play an important role in stimulating economic growth and convergence it is useful for policy makers to both recognize how most multilateral negotiations have been done, and to recognize that the impacts of those

negotiations, while important contributors to trade growth, are likely not the most important factors driving such growth. With a more nuanced and informed understanding of these forces perhaps policymakers can make better informed decisions and consider how best to view the role of the WTO – which is mainly about increased certainty, more transparency, and a multifaceted approach to lower trade costs through tariff reductions and fair, more equitable application of both tariffs and regulatory procedures.

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