EC246-2-AU – Lecture 2

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GATT and the Control of World Trade: The Early Rounds

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Plan of talk

- **Introduction**

1. GATT
   1. Philosophy
   2. Principles
   3. Early Rounds

2. Effects of tariffs
   1. Small economy
   2. Large economy

3. Types of trade
   1. IntER-regional vs. IntRA-regional
   2. IntER-industry vs. IntRA-industry

- **Wrap-up**

Aim and learning outcomes

- **Aim:** summarise GATT working principles and early rounds in the context of the economic effects of tariffs and the key dimensions of real-world trade
- **Learning outcomes**
  - understand how GATT functions
  - interpret GATT principles
  - sketch conflicts and achievements in GATT early history
  - provide arguments from economic theory why imposing a tariff hurts a small country but not necessarily a big one
  - characterise major types of trade evidenced in the data

GATT (1947): philosophy

- A fundamental perception of the founders of GATT: *multilateral institutions* facilitating cooperation among countries important not only for economic reasons, but will help **reduce the risk of war**

  GATT => **trade liberalisation** and **nondiscriminatory access** => real incomes ↑ => scope for political conflicts ↓
- **Objectives** according to the *Preamble* of GATT 1947:
  - raising standards of living
  - full employment, steady growing real income and effective demand
  - full use of world's resources, expanding goods production and exchange
- **Remark**
  - *reciprocal reductions of tariffs* and other barriers to trade and *elimination of discriminatory treatment* will contribute to the realisation of GATT objectives
  - but no mention of *free trade* as an ultimate goal (the case under WTO too)!

GATT / WTO principles: (1) nondiscrimination

- **2 components/rules**
  1. **Most-Favoured Nation (MFN)**, embodied in Art. I ≡ a product made in one *member* country (or CP, initially) cannot be treated less favourably than a like product originating in *any other* country =>
     - the benchmark for MFN is thus the best treatment (e.g. 5% tariff) offered to a country (including nonmembers to GATT, as initial CPs were only 23)
     - *3 areas* of application *under WTO*: goods (GATT), services (GATS) and intellectual property (TRIPs)
  2. **National Treatment**, in Art. III ≡ having once passed the border, foreign goods cannot be treated less favourably than like or directly competitive *domestic* goods (applies to GATT only) in terms of (i) internal *(indirect) taxation* and (ii) *nontax* policies (e.g. regulations)
- MFN is a basic pillar of GATT/WTO
  - applies unconditionally, e.g. not conditional on reciprocity
  - disputes can be brought alleging both *de jure* et *de facto* violation

GATT / WTO principles: (2) reciprocity

- **No** clear **definition** ("tit for tat") in economics, but *intended*
  - to *limit* the scope for *free riding* that may arise from MFN
  - to "pay" for trade liberalisation, which occurs on a *quid pro quo* basis
- 2 **forms**
  1. *diffuse* (Keohane, 1984)
  2. *specific*: may be expressed in quantitative or qualitative terms and applied to levels or changes in protection (Winters, 1987)
- **Rationale:** from the *political economy* literature
  - costs of liberalisation *concentrated* => industries *organised*
  - benefits (although *in the aggregate* usually greater than costs) *dispersed* => *lesser incentives* for consumers to defend expected welfare gains
  - potential reciprocal sector-specific gains may thus help *sell* trade liberalisation politically
  - to negotiate, a country has to gain more than from *unilateral* liberalisation

GATT / WTO principles: (3) enforceable commitments

- Liberalisation commitments useless if not *enforceable*
- Tariff commitments are enumerated in lists termed *Schedules of Concessions* (Art. II)
  - **ceiling bindings** are established ≡ the member concerned cannot raise tariffs above bound levels
  - without negotiating **compensation** with the principal suppliers of the product concerned
- If another government actions are perceived to have the effect of nullifying or impairing committed market access => **dispute settlement** procedure
  - *panel of impartial experts* determines whether a contested measure violates GATT/WTO or not
  - since GATT/WTO is an *intergovernmental* agreement, private parties do not have legal standing before its dispute settlement body, only governments have the right to bring cases!
  - existence of dispute settlement procedure *precludes* use of unilateral retaliation
- *Small* countries have a great stake in a **rule-based international system**, as this constrains the likelihood of being confronted with *bilateral* pressure from *large* trading powers!!!

GATT / WTO principles: (4) transparency

- Access to **information** on the *trade regime* of signatories
  - *internal* transparency: requirement to publish national trade regulations
  - *external* transparency: multilateral surveillance facilitated by periodic country reports prepared by GATT/WTO Secretariat (and discussed by its Council) ⇔ so-called *Trade Policy Review (TPR) mechanism*
- **Benefits** of transparency, e.g. publishing TPRs and other reports
  - reduces pressure on the *dispute settlement* system: measures can first be discussed by the appropriate GATT/WTO body before filing an appeal
  - strengthens GATT/WTO *legitimacy* by informing civil society what is going on in multilateral trade policy and what are the key implications
  - according to studies in the 1990s, reduces trade-policy *uncertainty* resulting in low investment and growth rates and shift to nontradables => risk premia for likely trade regime/policy reversals

GATT / WTO principles: (5) safety valves

- government measures to restrict trade in *specific* circumstances => **3 types** of provisions/articles (*exceptions* in GATT/WTO)
  1. to attain **noneconomic objectives**: protect *public health*, *national security* or industries so seriously injured by import competition that *social/political problems* arise
  2. to ensure **“fair competition”**: this objective is often *in conflict* with market access as its instruments are duties
     – **countervailing duties** on imports that have been *subsidised*
     – **antidumping duties** on imports that have been *dumped*, i.e. sold at a price *below* the one charged in the *home* market
  3. to attain **economic objectives**
     – if serious *BoP difficulties*
     – or to support an *infant industry*

GATT (1947): foundation, status, role

- emerged from negotiations to create an **ITO**
- is an **international treaty** and not an organisation
- negotiated and signed in **1947**, Geneva (⇔ GATT 1947) by 23 countries, 12 developed + 11 developing, increasing afterwards
- *in effect* only **provisionally** (*Protocol for Provisional Application* actually signed in Geneva) since 1 Jan 1948, due to
  – *constitutional restrictions* in some countries for parliamentary approval
  – wish to submit GATT for ratification together with *ITO charter*
- had to fill the vacuum left by ITO failure => *role gradually changing*, as nations turned to it as the **forum** to handle *problems* in contracting parties (CPs) trading relationships

GATT (1947): working methods

- **Rounds** of *multilateral* trade negotiations
- Contracting parties (CP's) usually met *every six months* for *several weeks* at regular **sessions**
- Interim Commission for ITO **(ICITO)**, since Havana
- Later, ICITO *transformed* into GATT **Secretariat**
- Early rounds of GATT negotiations: **reciprocal tariff reductions** were of *primary* concern

Tariffs: effects for a small economy

- **Duty/Tariff** ≡ a tax (in %, if *ad valorem*) on the import/export of a good: Fig. 10.1, CFJ
  - Reduction in *consumer* surplus: area *1+2+3+4*
  - Increase in *producer* surplus: area *1*
  - *Government* revenue: area *3*
  - **Deadweight loss** ≡ the excess of what consumers lose *over and above* what producers and the government gain: area *2+4*
- **Quota** ≡ total quantity of imports/exports of a good allowed: Fig. 10.1, CFJ
  - Largely *similar effects*, but
  - Two important *differences*
    1. *Rigidity* is a shortcoming as, unlike with tariffs, when the world price ↓ *only* rents ↑
    2. *Quota rents*, area *3* (government revenue under a tariff), are windfall profits to whoever owns the *quota rights* => lobbying to obtain *licenses*

Tariffs: effects for a big economy

- If the tariff-imposing country is not small *relative to* competitive world markets, the tariff will $\downarrow$ the relative price of its *imports* or, equivalently, $\uparrow$ the relative price of its *exports* $\Leftrightarrow$ **ToT improvement:** Fig. 10.5, CFJ
- Improved ToT is a **beggar-thy-neighbour** policy
- **Retaliation** possible => “trade wars”
- Even if no retaliation, a tariff is a **second-best** instrument from a world point of view: other means of *international income redistribution* (e.g. a direct gift) may allow both countries to benefit from higher levels of real income
- **Positive** (on *prices*, *consumption*, *production* and *trade*) **vs. normative** (on *welfare*) **effects** of a tariff

GATT 3 Rounds between ITO and EEC

1. 2nd Annecy Round (1949)
2. 3rd Torquay Round (1951)
   1. Inter-sessional Committee established to organise voting by *air*mail ballot on use of trade measures to safeguard BoP
   2. (FR)Germany accedes
3. 4th Geneva Round (1954)

- 1950: China withdraws (GATT seen as "a club of the rich")
- 1955: CP's 9th regular session designed as a "review session"
  - modifies numerous provisions
  - a move to transform GATT into an Organisation for Trade Cooperation (OTC) failed to get the approval of US Congress: **OTC** also *stillborn*
  - *US* granted **waiver** for certain *agricultural* policies
  - Japan accedes

GATT 5th Dillon Round (1960-1962)

- Focus on negotiating **compensation** for traditional exporters for loss of markets due to EEC(1957) and its *common external tariff*
- The round essentially comprised **two parts**
  - *compensatory* phase (conducted under Art. XXIV:6)
  - *reciprocal* phase of tariff reductions (under Art. XXVII[bis])
- **Agricultural issues** were a particular area of conflict
  - EEC's move to a common external tariff with *variable levies* replacing import duties violated previous bindings
  - to permit CAP, US and EEC agreed to recognise "unsatisfied negotiating rights" of US embodied in "standstill agreements" for cereals and poultry
  - "chicken war" of 1962: EC levy system for imports *tripled* the level of protection to the poultry industry => US took the matter to GATT and an independent panel found that US was *entitled* to compensation of $ 26 mln => US withdrew concessions on potato starch, light trucks, brandy

GATT 6th Kennedy Round (1964-1967)

- **As with previous rounds**, benefits to agricultural trade far less significant than those to manufacturing, because of two factors
  - nontariff barriers not addressed, although a vast array of them applied
  - EEC and US reluctant to subject domestic agro-policy to GATT scrutiny
- **Conflicting interests** of the major players
  - US, world's largest exporter of agricultural products, claimed *trade liberalisation* and greater reliance on market forces
  - EEC, world's largest importer of agricultural products, favoured a system of managed markets via *international commodity agreements*
- An amendment to GATT general clauses dealing with **problems of developing countries** (trade and development) in force since 1966: although primarily expression of goals rather than concrete obligations, it has been evoked a lot in policy debates

IntER- vs. intRA-regional trade:
as % of world trade in 1994 (1979), GATT/WTO data

	NAmer	LAmer	WEur	EEFSU	Africa	MidEast	Asia
NAmer	6.1 (4.6)						
LAmer	2.3 (4.0)	0.9 (1.1)					
WEur	3.1 (6.6)	0.8 (2.6)	29.9 (28.8)				
EEFSU	0.1 (0.5)	0.0 (0.6)	1.8 (4.1)	0.5 (4.3)			
Africa	0.3 (1.9)	0.1 (0.3)	1.3 (5.0)	0.1 (0.3)	0.2 (0.3)		
MidEast	0.4 (1.9)	0.1 (0.5)	1.3 (5.7)	0.1 (0.5)	0.0 (0.2)	0.3 (0.4)	
Asia	4.2 (6.4)	0.4 (0.9)	4.2 (5.0)	0.4 (1.0)	0.3 (0.7)	1.3 (3.8)	13.1(6.3)

IntER- vs. intRA-industry trade

- IntER-industry trade ⇔ one-way trade ≡ trade in goods produced by different industries: food for cloth
  - most trade between developED and developING countries
  - theoretically originating from comparative advantage
  - ↓ as part of world trade
- IntRA-industry trade ⇔ two-way trade ≡ trade in goods produced by the same industry: French wine for Italian wine
  - most trade among developED economies
  - theoretically arising when goods are differentiated or markets are imperfectly competitive
  - ↑ as part of world trade

Concluding wrap-up

- **What have we learnt**
  - why GATT was found and how it worked
  - what are its principles and what happened in its early rounds
  - why GATT (primarily) fighted tariff barriers
  - what are the major trade patterns observed in the data
- **Where we go next**: further on into the more recent history of GATT, related in particular to
  - the demands of the *developing countries* for a new international economic order, and
  - the establishment of *UNCTAD*