

***Multilateralising regionalism:
Spaghetti bowls as building blocs on
the path to global free trade***

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Introduction & Plan

- Two Topics
 - 1) Final steps to global free trade
 - 2) Multilateralising regionalism
- Outline
 1. Punchline
 2. Political economy logic
 3. Structured historical narrative & Staging post 2010
 4. Leap of faith: SBBB
 5. WTO's job (Multilateralising regionalism)

Global trade liberalisation: 6 facts

1. The GATT process started when tariffs were very high worldwide;
2. Rich nations liberalised much more than poor nations, in both the GATT process (i.e. bound rates) and RTAs;
3. The liberalisation focused on industrial goods in which two-way trade in similar goods is prevalent;
4. The process took 40 years;
5. Some sectors were excluded entirely and others experienced much less tariff cutting;
6. Regional tariff cutting went hand-in-hand with multilateral liberalisation.
7. Unilateralism is now rampant.

Political Economy

- Status quo tariff: Tariff balances supply & demand for protection.
 - Supply = marginal cost curve (marginal welfare damage).
 - Demand = marginal utility curve (marginal benefit to special interests).

Juggernaut: demi-cycle 1

- Political equilibrium tariff balances Supply & Demand for protection.
- Reciprocal trade talks re-align political economy forces inside each participating nation.
- MTN makes exporters into anti-protectionists.
- One-off tariff cut.
 - Govt find it politically optimal to remove a tariff they previous found politically optimal to impose.

Juggernaut: demi-cycle 2

- Size of import competing sectors depend upon tariff, ditto export sector.
- One-off tariff cut alters the economic landscape.
 - Anti-trade forces ↓, pro-trade forces ↑
- Next MTN, all nations find it politically optimal to cut tariffs some more.

Domino effect

- Demi-cycle I: Idiosyncratic formation or deepening of a trade bloc re-aligns the political economy forces inside non-member nations.
- Pro-membership political economy forces:
 - Non-member exporters: Trade diversion (fresh loses) & Trade Creation (lost opportunity).
- Anti-membership political economy forces:
 - If deeper, may resist more.
- If export sectors are politically larger than import competing sectors.
- Demi-cycle II: if a new member joins, “forces for inclusion” get stronger in non-member nations.

RTB unilateralism

- Competition for out-sourcing jobs and investment drive nations to unilaterally cut tariffs.
- Re-aligns political economy forces in DCs.
- Unbundling of manufacturing process (i.e. fragmentation, vertical differentiation, slicing up value added chain) is key.
 - Destroys import substitution (scale, competition)
 - Makes export-led industrialisation more successful (foreign technology from MNC/buyers, ready market).
- Finer division of labour may mean no import competing industry.
- MNC role may imply imports mostly re-exported.
 - Importers are also exporters => no political economy conflict.

Ancillary effects

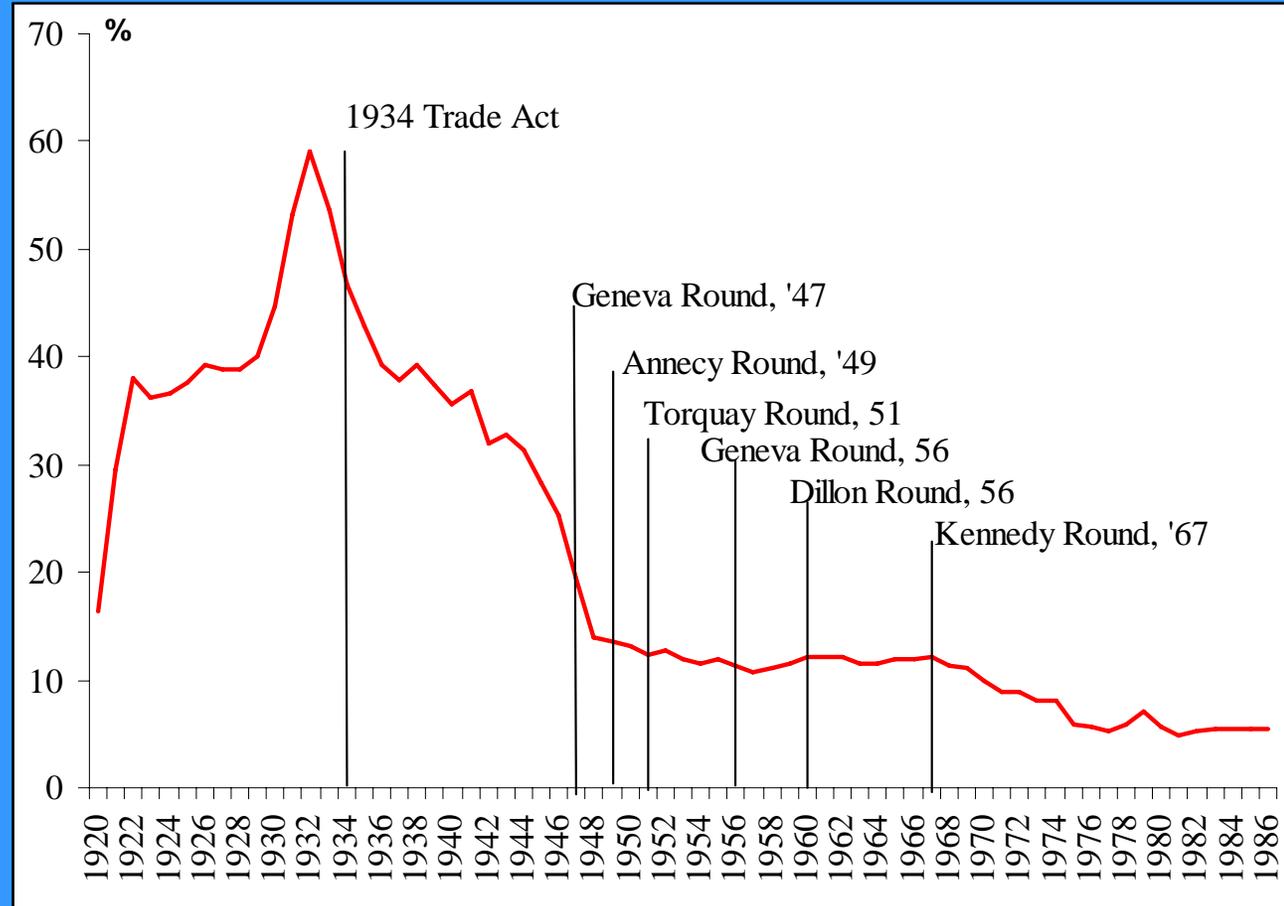
- Intra-sectoral special interest politics.
 - Melitz model & reciprocal liberalisation: big firms win, small firms lose.
 - Add Mancur Olsen's *Asymmetry* on political organisation & juggernaut effect works well on intra-industry trade.
- Losers lobby harder.
- Home market magnification effect.
 - Industry becomes more footloose, not less, as trade barriers fall.
 - Competition for industry becomes more fierce as tariffs fall globally. (Small preference margins can matter a lot).

Historical Narrative

- 3 key effects: Juggernaut (MTNs), Domino (RTAs), RTB (unilateralism).
- “Empirical evidence” intended to “demonstrate” usefulness of the 3 key effects.
- Line sketch.
- Can’t pretend to explain everything.

Historical Narrative

- 1947-1958.
 - GATT starts.
 - Juggernaut works but stops in 1950s.



Dominos trigger juggernauts

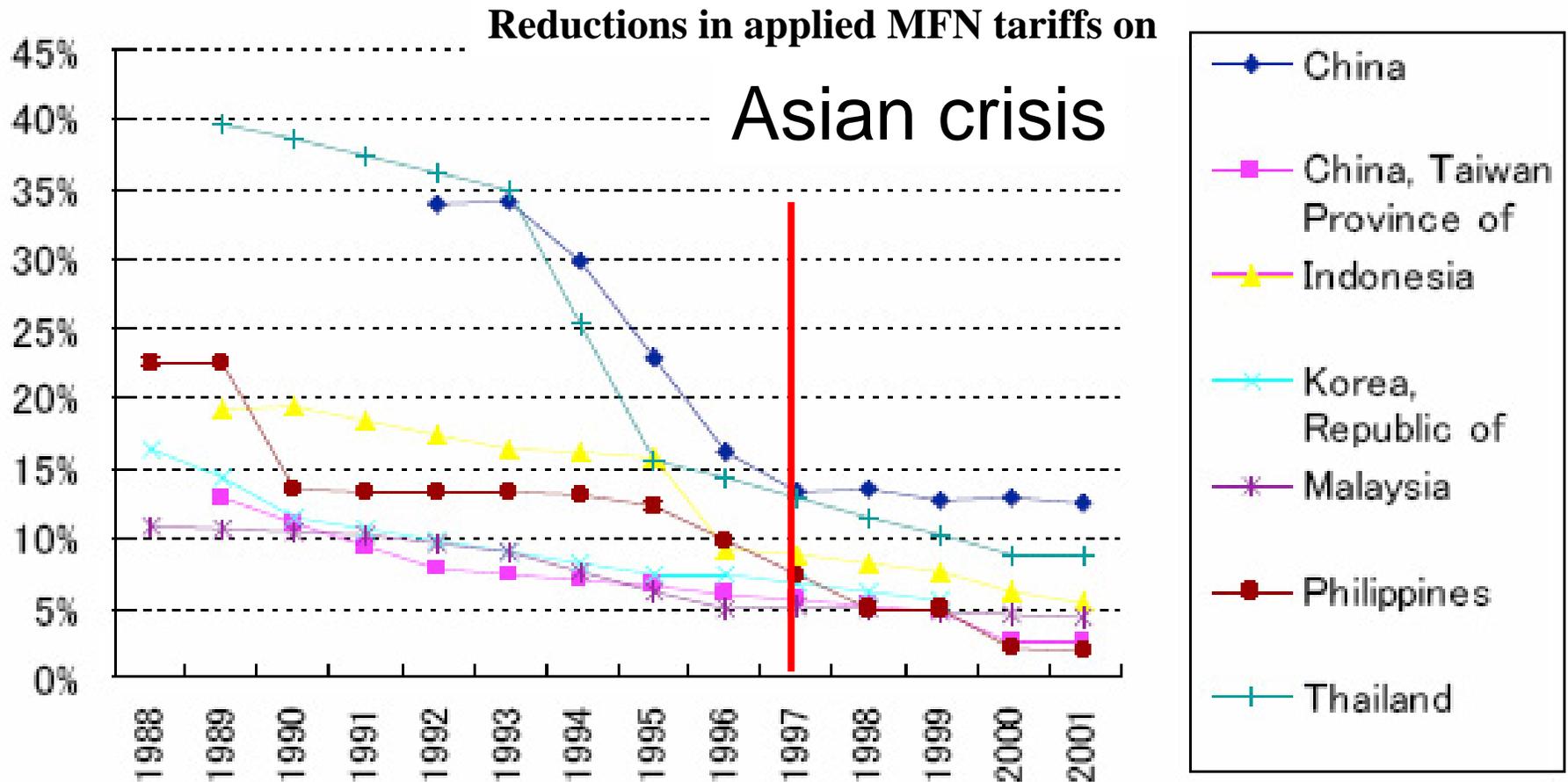
- 1958-1972.
 - EEC formation:
 - Europe domino effect phase I.
 - Kennedy Round.
- RTAs: US Auto Pact & EEC, EF12TA.
- MTNs, RTAs & unilateralism proceed in tandem.
- Liberalisation begets liberalisation.

1990-1994

- European spaghetti bowl forms.
- North American spaghetti bowls forms.
 - US-Mexico FTA triggers massive domino effect.
 - NAFTA, Mercosur, dozens of spoke-spoke FTAs, long queue for US bilaterals.
- Aside: NAFTA crushes Mexican anti-trade forces.
 - Mexico ‘sells’ its politically optimal tariff cuts in over 40 bilaterals.
 - Cross bloc canals (Japan, EU & US).

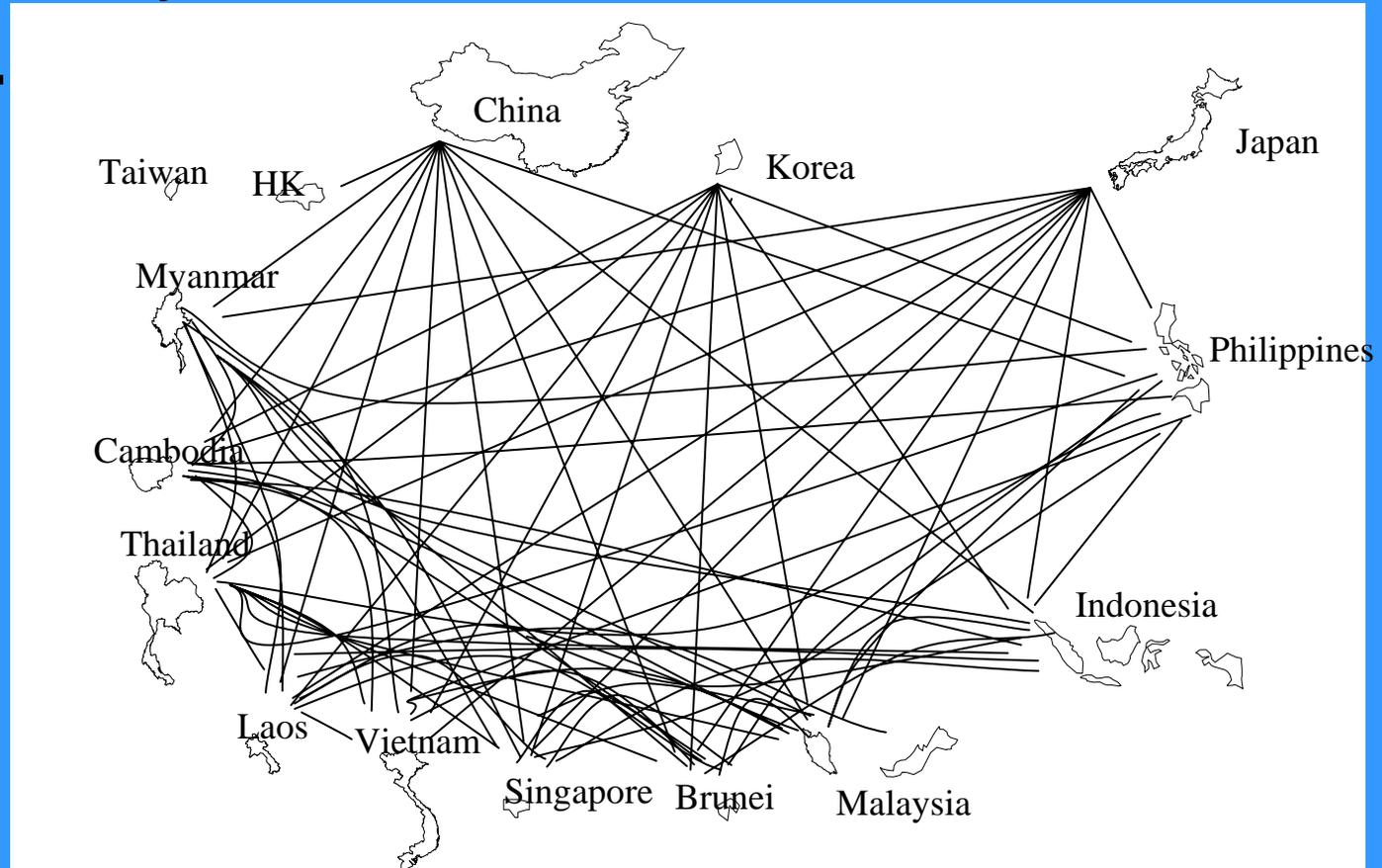
1986-2000

- RTB unilateralism in East Asia (circa 1985).



2000-2006

- East Asian domino effect
- Noodle bowl syndrome; all have 2010 deadlines.



Staging Post 2010

- Europe, North America and East Asia: ‘fuzzy’, ‘leaky’ trade blocs.
 - North America & Europe (near-duty-free status on major flows).
 - Rest due to domino and RTB unilateralism.
- Prediction: Applied tariffs will be near zero for world’s major trade flows around 2010.

Fractals

- Definition: “A rough or fragmented geometric shape that can be subdivided in parts, each of which is (at least approximately) a reduced/size copy of the whole.”
- World trade system made of 3 fuzzy, leaky trade blocs each of which is made up of fuzzy leaky sub-blocs.
- The point:
- Solution to one is the solution to all (roughly).

PECS

- How PECS fixed the European spaghetti bowl and why.
- Spaghetti bowl problems:
 - Multi ROOs (hard to do biz in spokes)
 - Bilateral cumulation (hinders efficient sourcing in spokes)
- 1997, EU set up PECS:
 - imposed common set of ROOs on EU, EFTA & CEECs.
 - Imposed diagonal cumulation.

PECS

- Spaghetti bowl is not by accident.
 - Pair-specific political economy forces => pair-specific policy; especially hub & spoke.
- Unbundling & off-shoring
 - Former beneficiaries of complexity downsized and off-shored from EU.
 - Some EU firms set up in spokes and are now harmed by the complexity (“us” becomes “them”).
 - EU firms push EU to tame the tangle of FTAs.
- “Spaghetti bowl as building blocs”
- Complexity & unbundling create new politically economy force
 - Push system the short distance from near-free trade with matrix of bilaterals to free trade ‘lake.’
 - Multilateralise the FTAs.
- Domino effect in ROOs/Cumulation.

2 final steps

- Penultimate:
- Multilateralise the spaghetti bowl FTAs in North America (when US firms become victims of the complexity).
 - NAFTA ROOs already popular.
 - Diagonal cumulation is next.
- East Asia, much more difficult.
 - Might be RTB unilateralism makes ROOs/Cumulation irrelevant.
 - ASEAN ROOs already popular.

2 final steps

- Ultimate
- As global unbundling continues, SBBS pressures will mount.
- Impractical to do a PECS given PECS, NAFTA & ASEAN ROOs.
- Alternative is ITA-like agreement with coverage of most industrial goods.
 - Zero-for-zero.

WTO's role

- 2 assertions:
 - Regionalism is here to stay.
 - WTO has been an innocent bystander
- 2 implications
 - WTO risks erosion of its relevance if it does nothing (Barfield's bane).
 - Becoming more relevant means getting WTO back into the regionalism game.
- The wrong answer.

Some (weak) ideas

- Study the spillovers more.
- Think about ‘standing’ in FTA talks.
- Negotiate international standardization ROOs, ROCs.
- Sectoral initiatives like ITA.
- Set up a “Legal Advisory Centre” like thing in WTO to help small/poor members in FTA negotiations.
 - Sussex framework on steroids?

END

Thanks for listening:

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