Book Review: "A World Trading System for the Twenty-First Century," By Robert W. Staiger. The MIT Press. 2022.

Mostafa Beshkar
Indiana University
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A World Trading System for the Twenty-First Century by Robert W. Staiger is a timely book that offers a comprehensive analysis of the current state of the global trading system. From the establishment of the GATT in the post-WWII era to the creation of the WTO in 1995 and up to the present day, Staiger examines the success and challenges faced by these international cooperative arrangements in achieving their goal of increasing market access among countries. With the WTO facing unprecedented challenges in the twenty-first century, Staiger proposes a way forward that builds upon the core principles of the GATT/WTO system while addressing new issues arising from the changing nature of international trade. In addition to scholars of international trade, researchers interested in international relations and environmental regulations will find this book invaluable.

Numerous experts and policymakers have argued that the GATT/WTO's focus on tariff negotiation and market access commitments, known as the shallow-integration approach, is inadequate to tackle the intricate challenges confronting the global trading system. As a result, there is a growing interest in deep-integration initiatives, which involve negotiating over domestic policies to establish a more effective framework for international cooperation.

This book identifies new challenges that the world trading system is facing and suggests that the core principles of the GATT have the capability to respond to most of these challenges. It argues against the notion that in order to respond to new challenges we must abandon the shallow-integration approach of the GATT in favor of a deep-integration approach that curtails the governments' autonomy over their domestic policies. Instead, it maintains that insufficient market access is still the core problem that the governments try to solve using trade agreements and, therefore, the principles of the GATT/WTO system are still relevant.

According to this book, the WTO requires reforms only to the extent that the nature of international trade has changed. In particular, it identifies the policy issues related to offshoring and product standards as two areas in which reforms are necessary and offers a way forward.

The book is divided into three parts. Part I provides a comprehensive overview of the theoretical and empirical contributions to understanding the objectives and design of the GATT and WTO, which Staiger calls "The World Trading System of the Twentieth Century." This part builds upon and updates the previous book by Bagwell and Staiger (2002), which mainly focused on the theoretical contributions that elaborated the terms-of-trade theory of trade agreements.

Part I covers new developments in the theory of trade agreements, including modeling the agreement as an incomplete contract, which sheds light on the need and role of the WTO's dispute settlement process. Additionally, Part I delves into both anecdotal and empirical evidence, providing details on the bargaining process in various rounds of GATT negotiations, including the Torquay and Uruguay rounds. Furthermore, it sheds light on the emerging literature on the quantitative evaluation of trade agreements.

Part II of the book is expected to generate fresh interest in the subject matter and spark debates. It identifies five challenges that confront the current cooperative trade arrangements and determines if each of these challenges may be addressed using the shallow-integration approach of GATT, or if a new deep-integration approach is needed. The ideas presented in this part are ripe for controversy, especially from the perspective of international relations scholars and environmental economists, who may view the focus on market access exchange as too narrow.

Finally, Part III outlines a world trading system for the 21st century. It also offers insights about the clash between sovereignty and globalization, decline in the US hegemonic power, and pandemic preparation.

The five challenges to the WTO that are considered in this book are: (i) The emergence of China and other large developing economies, (ii) The implementation of environmental policies, (iii) The regulation of digital trade, (iv) Offshoring of production, and (v) Pursuit of regulatory convergence.

Staiger views each of the aforementioned challenges as arising from governments' inefficient use of domestic policy instruments in an open economy. He then poses the question of whether it is possible to attain global efficiency without directly negotiating these domestic policy instruments.

In response to this query, this book offers a simple formula: If the inefficiency in domestic policy stems from the government's use of it as a substitute for trade policy, a market access preservation rule will be adequate for achieving efficiency. Direct negotiations on domestic policies are only necessary if the government's choice of these policies is inefficient from a global standpoint even when it can use trade policy freely.

Following this formula, Staiger concludes that the GATT's shallow-integration approach can sufficiently address challenges related to the rise of China, environmental policies, and digital trade, whereas a deep-integration approach is necessary to tackle issues arising from the rise in offshoring and variations in regulatory standards across countries. The rest of this review provides a summary of how Staiger uses this formula to analyze the five challenges addressed in the book, drawing on his previous research with several co-authors.

The WTO's China Problem Staiger points out two common complaints about the integration of China into the world trading system. First, China appears not to have lived up to its market access obligations under the WTO. This apparent imbalance between China's market access rights and obligations may be due to China's manipulation of its domestic policy to deny other countries the market access that they were promised during negotiations. Other countries are increasingly frustrated with the inability of the WTO rules to discipline China's economic policies, owing to non-market features of China's economy and its opaque policy making processes and institutions. A second challenge related to China is that trade with lower-income countries appears to have contributed to income inequality in industrialized countries. This problem could arise even if China complies with its market access obligations.

Given that the WTO was essentially designed for market economies, the challenges outlined above have led numerous experts to argue that if China doesn't reform its economic policy institution to enhance transparency and minimize market intervention, the eventual decoupling of China from the free trade system may be unavoidable.

Despite these challenges, Staiger maintains that China's alleged use of domestic policy to manipulate trade flows does not alter the essence of the problem that the GATT/WTO system is meant to resolve. Specifically, the nonviolation clause of the GATT is designed explicitly to prevent the circumvention of the provisions in GATT Article XXVIII. In this context, affected countries could use GATT Article XXVIII to require China to provide more market access without necessarily demanding that China reform its government-controlled economy.

Staiger's proposed GATT-based solution faces several challenges. The primary obstacle is the difficulty in accurately quantifying the level of market access that China had promised but subsequently denied through its domestic policy manipulation. Although it is theoretically possible to measure market access if all relevant economic parameters are publicly available, in reality, this information is dispersed and privately held, making compliance monitoring difficult and expensive.

Moreover, in the broader context of international relations, the above approach to analyzing the problem of free trade with China may seem too narrow. This is because geopolitical rivalries and global security concerns may carry more significance in evaluating trade relations with China. Nevertheless, this book provides a solid foundation for "pure" economic arguments, which could serve as a starting point for analyzing international political issues related to trade relationships.

Climate Accords Staiger argues that the GATT's shallow-integration approach is also compatible with the implementation of climate accords. Under a model in which terms-of-trade and cross-border environmental externalities coexist, he shows that environmental and trade agreements could be decoupled: Trade agreements could solely focus on terms of trade externalities while an environmental treaty on domestic carbon taxes could reign in emission externalities. This also implies that import tariffs should not discriminate against exporters with higher carbon footprint. However, environmental activists may disagree with this approach since the nondiscrimination requirement would limit the use of tariffs as a potent tool to encourage carbon reduction by exporting firms.

Digital Openness Digital trade is another area where governments could potentially evade their market access obligations by imposing regulations that restrict foreign firms' activities in domestic markets. Nevertheless, according to Staiger, a market preservation rule can once again effectively prevent inefficient use of regulations in digital markets.

Staiger derives this result from a model in which a more open digital policy reduces trade costs but also creates a negative local externality, such as privacy and national security concerns. Under this model, because tariffs are a more effective tool to manipulate terms of trade, the government would use digital trade regulations inefficiently only if tariffs are unavailable.

Therefore, the inefficiency in digital policy is limited to underprovision of market access, which may be eliminated using a market access preservation rule. However, as is the case for rebalancing commitments with China, the rule's success depends on the availability of an agreed and objective method for quantifying market access gains and losses.

Staiger identifies two challenges that the shallow-integration approach cannot fully respond to, namely the rise in intermediate input trade and the divergence in product standards across countries.

Offshoring The increase in intermediate input trade, which is commonly linked with offshoring, has the potential to alter the primary method of international price determination. Instead of a standard market-clearing process, a bilateral bargaining system could emerge between specialized foreign suppliers and their domestic buyers. However, due to contract incompleteness, which is highly likely in transactions between firms from different countries, the suppliers and final good producers may underinvest in the production of specialized inputs, resulting in inefficient procurement.

The inefficiency in the procurement of specialized inputs creates a new incentive for government intervention in the market, which is different from the terms of trade motivation. Furthermore, since these inefficiencies are not confined to a single country, the government's policy does not fully internalize its impact on global welfare.

This new externality implies that unilateral government policy involves not only excessively high tariffs but also production taxes that are too high from a global welfare perspective. Therefore, the shallow-integration approach, which is effective in dealing with terms of trade externality, is not suitable for addressing this new international externality. Instead, an efficient trade agreement would require governments to facilitate intermediate input trade beyond what they would do without such an agreement.

Regulatory Convergence Regulatory standards are another area where the GATT approach to trade cooperation may be inadequate. In this regard, Staiger highlights an important insights about a type of policy externality that is distinct from standard terms-of-trade externality: When different countries have varying preferences for product specifications, each country may make use of regulatory standards to compel foreign firms to introduce a version of their product that caters more to local tastes.

This policy would benefit local consumers at the expense of foreign producers who would need to incur higher fixed costs to maintain a larger variety of their brand. Consequently, there would be an inefficiently high number of varieties of the same brand held by each firm.

To address this inefficiency, only a mild diversion from the shallow-integration approach of the GATT is needed. Specifically, a mutual recognition of standards would be enough to prevent governments from using product standards inefficiently and encourage the introduction of an optimal number of product varieties. The problem of regulatory harmonization would be more complicated, and the remedy for it more intrusive, if product standards have local externalities. In this case, negotiating the details of standards becomes necessary to avoid inefficient regulations in open economies.

Conclusion This book powerfully and lucidly demonstrates the strengths and limitations of the terms of trade theory as a framework for analyzing the contemporary global trading system. It also serves as an excellent foundation for further research about cooperative global economic arrangements. In particular, more research is needed to critically examine some of the key assumptions of the book, particularly the assumption that WTO members can fully monitor and measure the extent of domestic policy infringement on other countries' market access rights. In practice, this information is often dispersed and privately held, making monitoring compliance with obligations a costly and challenging process. As such, it may be necessary to explore alternative approaches that are more conducive to international cooperation, such as the adoption of different domestic institutions. Overall, this book provides valuable insights for researchers and policymakers alike seeking to understand and navigate the complexities of the global trading system.

References

Bagwell, K. and R. W. Staiger (2002). *The Economics of the World Trading System.* MIT Press.