Comments

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Professor Staiger has provided us with a highly consistent story of the economic foundations of GATT in his paper on the Economics of GATT, which is based on his path-breaking work published in the *American Economic Review* (1999). Although inefficiency of unilateral tariff determination had been well known at least since the work of Harry Johnson in the 1950s on tariff war, the work by Professor Staiger has gone much beyond that. He has given clear economic justifications to the two fundamental WTO principles, i.e. reciprocity and non-discrimination, in the framework of political economic determination of tariff (there exists an independent complementary work by Ohyama (1999) with similar conclusions⁽¹⁾). In his analysis, the combination of reciprocity and MFN requirement weakens or eliminates beggar-your-neighbor terms of trade motivation in the government objective function of each country and allows it to engage in more trade liberalization. His analysis of labor and environmental standard issues in this framework is also very thought provoking, since many economists simply hold a view that they are predominantly motivated by protectionism.

My role as a discussant, however, is not just to appreciate his work, but to pose some questions, which may help the readers of his paper think of future development of the research that would certainly be triggered by his work. I have comments both on his theoretical framework and on the policy implications.

As for theoretical framework, I have a fairly strong doubt on whether the concern over terms of trade drives import restriction in reality. My doubt can be illustrated by apparent inconsistencies between his theory and reality. Before doing that, I would like to clarify one important implication of his analysis. That is, an importing country should welcome the outward-shift of the foreign export supply curve, since it will result in the reduction of both home and world prices. In the Nash equilibrium the home government protects domestic industry too much (consequently the domestic price is too high), since it pursues the terms of trade gain from higher tariff, in addition to the goal of protection of domestic industry. Thus, the autonomous expansion of the foreign export supply is bound to increase the welfare of the home country, since it would not only improve her terms of trade but also corrects over-protection of the domestic industry. In the trade equilibrium negotiated through the GATT/WTO, the overprotection of the domestic industry due to the terms of trade motivation is weaker, or absent in the symmetric case (see Staiger (1999)), but still the home government prefers or at least is indifferent to the decline of the domestic price. Thus, it should also welcome the outward-shift of the foreign export supply curve.

In reality, however, the government does not welcome such change more often than not. This point is most clearly illustrated by the application of his theory to the labor standard. In the framework of Professor Staiger, the USA should oppose the idea of mandating the labor standard in developing countries. This is because it would most likely to cause the deterioration of her terms of trade as well as the increase of her domestic price of the import goods, given that the U.S economy imports labor-intensive goods from developing countries. How-

ever, in reality, the US and other developed countries would like to see stronger labor standard in these countries and have attempted to incorporate something like a social clause in the WTO. In my view they have done this because they would like to weaken import competition in labor-intensive industry.

The fact that an importing country often adopts restrictive trade measures yielding no tariff revenue against the outward-shift of the foreign export supply curve is not consistent with his theory either. In his framework, the home government does raise tariff in response to the outward-shift of the foreign export supply curve, since such shift increases the level of import, so that the terms of trade effect of tariff becomes larger. But higher tariff is imposed only for the purpose of more tariff revenue, not for wanting more protection of the domestic industry, since it is already over-protected, or optimally protected (in the symmetric case) in his framework. However, in reality, when import competition becomes intensified, the home government has been often compelled to increase protection of the domestic industry by measures producing no tariff revenues. In particular, the home government has used such trade instruments as VERs, and anti-dumping measures with prohibitive tariff rates.

The third gap between his analysis and reality is the ban of export subsidies by the GATT/WTO. Since export-subsidy worsens the terms of trade of the export country, each nation underutilizes such subsidy in the absence of coordination, if we ignore the rent-shifting effect discussed in strategic trade theory literature. The trade agreement, therefore, should agree on the expansion of such subsidy rather than its restriction. In reality, however, the GATT/WTO bans the use of export subsidy.

Let me move to the policy implications. My main point here is that the terms of trade concern is not a legitimate motivation for import restriction, even though his analysis assumes that such concern drives import restriction. First of all, we should not encourage the terms of trade motivation to be incorporated in real import policy formulation. Currently, in my view, the terms of trade concern does not drive import restriction much, because, while the treasury collects tariff revenue, it is passive in determining the level of tariff. If we allow privatization of tariff revenue by import-competing industry, the situation will drastically change for significantly more import restriction. The U.S. government has enacted the bill for distributing the duties from antidumping and countervailing duties to the petitioning industry. I think that the WTO would need an explicit provision against such privatization of tariff revenue.

Second, with respect to an environmental issue, it is not fair for a large country to demand approval of its tariff adjustment (i.e. higher tariff), as a compensation for stronger domestic environmental standard on its import competing industry. His analysis will predict such behavior when such country suffers from higher import price as a result of its own stronger environmental standard (This assumes that imposition of environmental standard would cause larger import demand, although, empirically, it is not clear how significant such effect would be). But small countries would collectively suffer from the same effect. The only difference is the difference of bargaining powers between a large economy and a small economy.

Finally, I would like to point out that politically efficient tariff depends on what policy instruments a government has for achieving domestic policy objective. His analytical framework is very general, so that it can cover

the case where a government is national-welfare maximizing. Thus, politically “efficient” tariff can be zero or positive. My point here is simply that such government objective function depends on the policy instruments available to the government, and should not be regarded as something predetermined. For an example, if direct income support program is available, the necessity of inefficient trade interventions for the purpose of income redistribution will decline. I think that the WTO has played and will play an important role not only in promoting the reduction of border barriers but also in promoting domestic reform for better assignments of policy instruments, such as seen in the case of the Agreement on Agriculture.

Notes

- (1) Ohyama (1999) has shown that the basic principles of non-discrimination and reciprocity can be given clear economic justifications as rules conducive to efficient trade negotiations, based on a very general economic principle of welfare comparison, while abstracting political economy dimensions.

References

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