
The WTO Is Not Passé



By Pushan Dutt , INSEAD Professor of Economics and Political Science

The WTO has played a greater role in the expansion of world trade than preferential trade agreements between small groups of nations.

As president of the United States, Donald Trump has acted in forceful accordance with the wave of **protectionist populism** that swept him into office. One of his first major actions in the White House was the withdrawal of the U.S. from the Trans-Pacific Partnership, and his subsequent moves have left transatlantic trade in limbo. Generally speaking, President Trump has shown himself more than willing to wield tariffs as a crude instrument in renegotiating trade agreements for more favourable terms for the U.S. And if the president's strategy succeeds, more countries may follow suit.

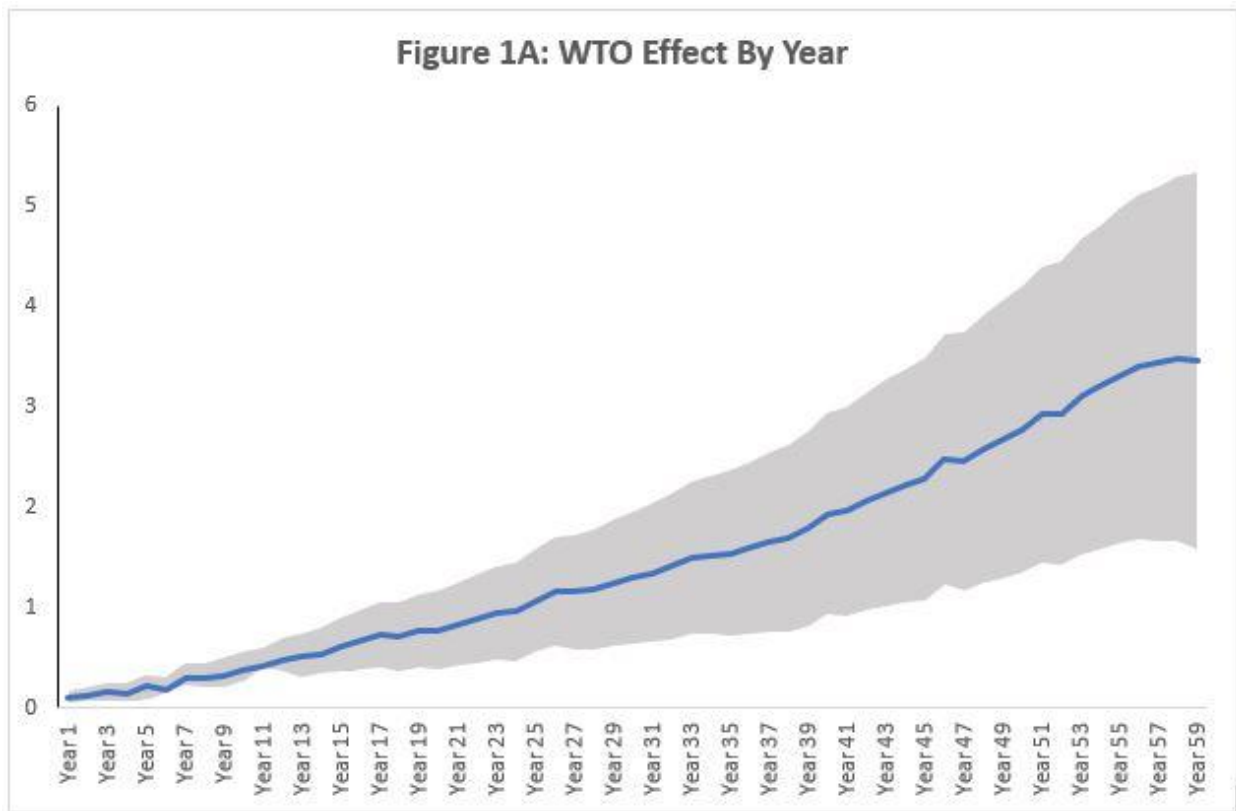
If the preferential trade agreements (PTAs) that shape our current globalisation were to dissolve, there would almost certainly be economic fallout. The only question is, how bad would it be? World Trade Organisation rules would still apply to countries affected by shredded agreements, theoretically placing limits on trade barriers and adjudicating trade wars. However, researchers **minimise the role of WTO membership** in increasing bilateral trade flows. PTAs, in contrast, have been found to **double bilateral trade** within 10 to 15 years. These results seem to make

sense, considering that PTAs usually extend beyond trade to issues such as intellectual property and labour laws. The deeper integration provided by PTAs presumably results in more fruitful trading relationships than WTO rules alone.

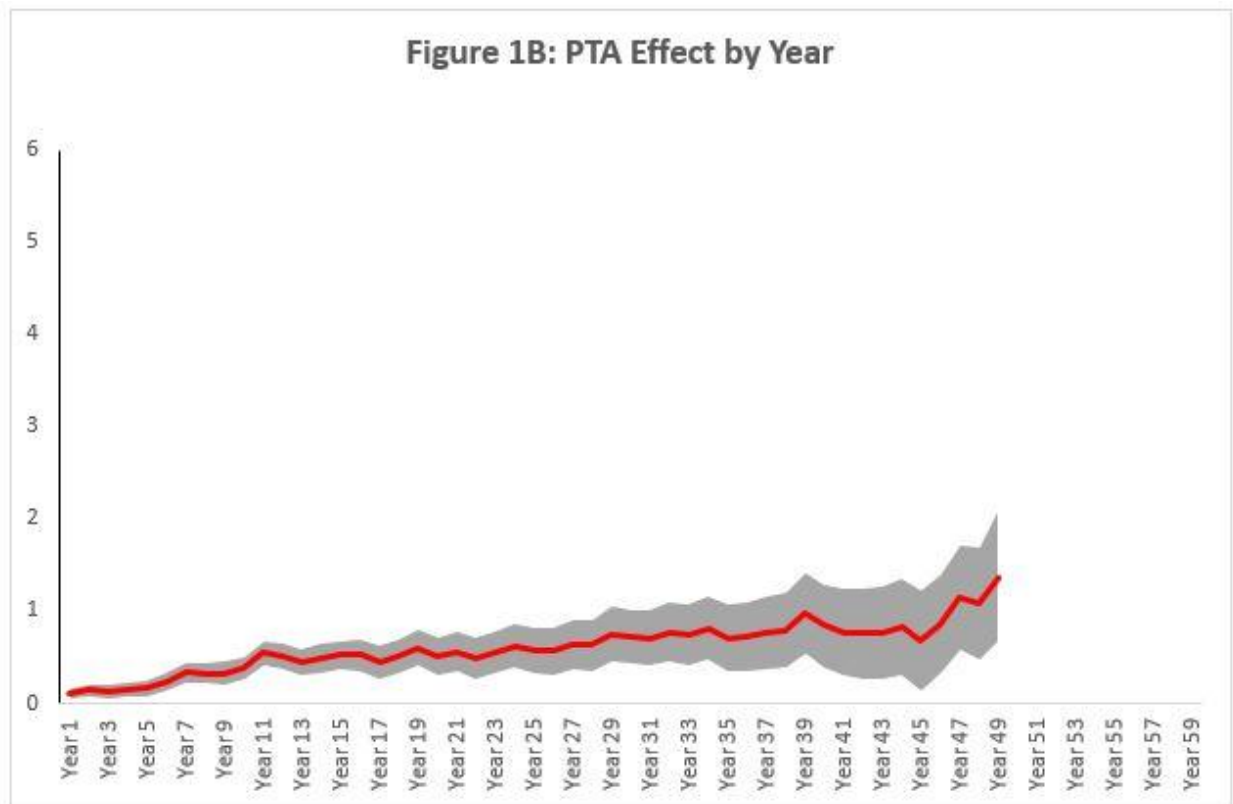
But [my recent working paper](#) argues that we shouldn't dismiss the WTO as a global trade catalyst. While PTAs are indeed more effective at firing up bilateral trading activity in the short term, the benefits of WTO membership dominate in the longer term.

Trade over time

A central hypothesis of my study is that for a given pair of WTO member countries, the longer both are part of the WTO, the more business they are likely to do together. Therefore, unlike previous studies, my research measures the intensity of WTO ties between country-pairs over time. Working from an export-import database covering the time period 1948-2006 (i.e. the entire history of the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT)), I broke out the data by year to create time-specific variables measuring the number of years of WTO/GATT membership for every possible member pairing. I did the same for preferential trade agreements going back as far as the European Economic Community, formed in 1958. My analysis also accounted for all variables within each country over time (e.g. GDP, per capita GDP), and all time-invariant variables for pairs of countries (e.g. distance, shared language, colonial links).



In keeping with my hypothesis, WTO membership's average effect on bilateral trade is quite modest for the first decade, after which it increases substantially and consistently.



PTAs, too, catalyse trade more strongly as they age, but in the long term the “WTO effect” is much greater. We can conclude that the sheer scale of the WTO, as well as its continual refinements over periodic rounds of trade negotiations, compensate for – and have come to dominate – the relatively shallow integration it provides initially, as compared to PTAs.

Agreement types

The graphs above are based on aggregate figures, lumping together the various types of PTAs: bilateral (such as the agreement between U.S. and the South Korea), multilateral (e.g. ASEAN), and “deep” PTAs such as the European Union or the Common Market for Eastern and Southern Africa (COMESA).

Performing separate comparisons for each of the three types, I found that the WTO’s impact handily surpassed bilateral PTAs in terms of bilateral trade, and gradually exceeded multilateral PTAs over the long term.

Deep PTAs, however, had a stronger impact than the WTO for the first 40 years of membership, but their advantage began to erode in the fifth decade and beyond. Ultimately, the two could be considered comparable in their long-term effects.

Developing vs. advanced economies

The study also took into account the state of development of exporting and importing nations. Making this distinction helps clarify why WTO membership is beneficial for trade flows. Some have attributed the WTO effect to a reduction in trade policy uncertainty that conduces to more trusting and committed partnerships between countries. If WTO is about uncertainty reduction, one would expect to see a spike in exports to emerging markets in the years immediately following their admission to the WTO, which would taper off as those countries became more established.

On the other hand, if the WTO effect is largely a product of developing markets gradually lowering their trade barriers, we should expect this effect to manifest slowly over time for exports into emerging markets.

My study found no significant impact of membership for the first ten years. Thereafter, it found a gradual upward trajectory in trade activity, for WTO-member importers that are also emerging markets. Therefore, the WTO effect is less about uncertainty reduction. Instead, the data indicates that the WTO effect's pace of growth is determined by how quickly developing economies phase in WTO compliance (which they are usually granted extra time to do).

Further, the discernible impact of WTO membership was almost exclusively confined to emerging markets. Advanced economies, though, tended to have low trading barriers prior to becoming a WTO member, making it difficult to isolate and quantify the WTO effect.

Nonetheless, advanced economies have benefited hugely from selling into gradually liberalising emerging markets joining the WTO. The WTO effect was at its strongest for emerging-market importers of goods from the developed world, surpassing the PTA effect by year 20, on average. Emerging economies also increased exports – both to emerging-market peers and to the rich world – following WTO membership.

Margins of trade

I also dissected the WTO and PTA effects upon the extensive and intensive product margins of international trade. Growth along the extensive margin occurs when new goods are exported. The intensive margin tracks the value of goods traded in pre-existing arrangements.

For the intensive margin, the PTA effect was stronger for the first 14 years but fell beneath the WTO in subsequent years. The extensive margin was no contest: The WTO effect dominated right out of the gate.

Since most of the actions in shaping the growth of world trade has happened at the extensive margin, it appears that the WTO has played a pivotal role.

Reassurance and recklessness

There's a mixed message here for concerned Trump-watchers. On the one hand, this revisionist phase of globalisation may hold fewer horrors for the world economy than alarmists believe. If PTAs are withdrawn (e.g. a hard Brexit), the economic repercussions for trade in goods, while severe, might be short-lived. WTO membership may be more than serviceable as a long-term substitute.

On the other hand, President Trump has reportedly raised the possibility of [removing the U.S. from the WTO](#) in private sessions with advisors. His public comments about the organisation have been nothing short of scathing, going so far as to [refer to the WTO as a “disaster”](#). A draft bill called the “U.S. Fair and Reciprocal Tariffs Act” would empower the nation to [disregard WTO rules](#) and set trade barriers at will. A U.S. exit – either declared or implicit – would cripple the WTO's legitimacy, possibly precipitating a collapse in global trade unlike anything we have ever seen.

[Pushan Dutt](#) is the Shell Fellow of Economic Transformation and a Professor of Economics and Political Science at INSEAD. Professor Dutt directs the [Asian International Executive Programme](#).

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About the author(s)

Pushan Dutt is a Professor of Economics and the Shell Fellow of Economic Transformation at INSEAD. He teaches in the MBA programme and the [INSEAD Leadership Programme for Senior Executives](#).