

The Economics of the World Trading System. By Kyle Bagwell and Robert W. Staiger. MIT Press, Cambridge Massachusetts, 2002. Pp 224. \$29.95. ISBN 0-262-02529-9

While this book is ostensibly about providing a theoretical explanation to help one understand the central features of the World Trade Organization (WTO) it manages to do much more. It contains insightful analysis about related topics such as the basic motivation for trade policy, the role of “Most Favored Nation” (MFN) treaties, the role of reciprocity in international trade and the interaction effects between reciprocity and MFN. The authors are also able to weigh in on the currently hotly debated question of whether regional trade agreements (such as the European Union or NAFTA) pose a threat to the multilateral trading system as embodied in the WTO? In addition, they have chapters that discuss how the WTO affects other important trade issues such as labor and environmental standards, competition policy, and agricultural subsidies.

The book begins by developing a simple model of trade relations that stresses the role of terms of trade effects of trade agreements. The model also incorporates the idea that countries might have political motives for trade policy that extend beyond the usual income maximization traditional in trade theory. Bagwell and Staiger make a compelling case for their approach and even devote a whole chapter (Chapter 11) to explaining it in very simple terms.

In this approach, the primary problem that the WTO must solve is that, countries pursuing their own interests, impose terms of trade costs on their trading partners. Thus, one of the primary goals of the WTO is to get countries to take proper account of the costs their trade policies impose on others. Two things complicate this problem. One is that there are many countries and hence, many potential conflicts. The second is that trade takes place over time. This means that agreements reached today affect the bargaining position next period.

Chapter 3 then provides interesting historical background concerning the origins of the General Agreements on Tariffs and Trade (GATT) which in 1995 became the WTO as part of the Uruguay Round. This sets the stage for the real meat of the book which is found in chapters 4 and 5.

Chapter 4 deals with reciprocity. The basic idea of reciprocity is that tariff reductions are reciprocal if they result in changes in trade volumes that leave the terms of trade unchanged. Such tariff reductions are said to have a “balance of concessions.” This principle is an integral part of how the WTO get countries to internalize the terms of trade externality. The chapter then goes on to show exactly how reciprocity facilitates trade liberalization.

The problem with reciprocity alone is that it does not deal with the multi-country problem. That is, two countries could sign an agreement to reduce tariffs, that adversely affects a third country who is not party to the agreement. In Chapter 5, Bagwell and Staiger show how MFN helps to deal with this problem. They also, discuss how MFN and reciprocity in concert, help solve dynamic bargaining inefficiencies that arise because concessions made today affect a country’s future bargaining position.

The problem of how international agreements are enforced is the subject of Chapter 6. Enforcement of international agreements is problematic in all international institutions. Bagwell and Staiger take the approach that international agreements must therefore, be self-enforcing. They show in Chapter 6 how the WTO can play a role in

providing arrangements that foster international cooperation. They argue that escape clause provisions lead to greater cooperation when agreements are self-enforcing. Another interesting point made in Chapter 6 is that gradualism in trade agreements results from the incentive properties of self-enforcing agreements.

In Chapter 7 they discuss the role of Preferential Trading Agreements (PTAs) within the WTO process. For the past decade there has been much debate about whether the existence of PTAs reduces the effectiveness of the multilateral WTO process. While they do not take a definitive stand one way or the other they provide an interesting framework within which one can analyze these issues.

Chapters 8, 9, and 10 discuss how labor and environmental standards, competition policy, and Agricultural policy interact with the WTO process. For those interested in these topics there are many useful points made in these chapters.

This book will be of interest to a broad spectrum of economists, but is a must for any economist interested in international trade policy. It provides a comprehensive theoretical analysis not only of the WTO, but also of many other international trade policy issues.