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# The Estey Centre Journal of **International Law and Trade Policy**

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## **Vested Interests in Queuing and the Loss of the WTO's Club Good: The Long-run Costs of US Bilateralism**

William A. Kerr

*Senior Associate, Estey Centre for Law and Economics in International Trade*

In recent years the United States has actively begun to engage in the negotiation of bilateral and regional trade agreements, a significant change from its long-standing commitment to the exclusive use of multilateral institutions for trade liberalization. While the “unequal economic power” effects of the strategic use of trade policy are well understood, the long-run implications of the creation of a queue for bilateral negotiations have been less fully explored. It is argued here that queuing creates vested interests that are antipathetic to multilateralism and threaten to erode the value of the WTO’s “club good”. As a result, the new two-track approach of the United States to trade negotiations may not be a sustainable policy

Keywords: bilateralism, club good, queuing

Just about every country seeks to foster its own trade position by means of preferential arrangements and, in a sense, we are witnessing a revival of beggar-thy-neighbor practices, even if in a context different from the 1930s. The United States is picking and choosing its partners in the hemisphere for special treatment ...

Sidney Weintraub, 2004<sup>1</sup>

The decision of trade policy makers in the United States to abandon trade liberalization through the exclusive pursuit of multilateralism has been met with dismay in many quarters. It is the single most important change in trade policy making since the development of multilateral institutions in the wake of the Second World War. Since the inception of the General Agreement on Tariffs and Trade (GATT) in 1947, the United States has been the major supporter of multilateralism and, given its importance to global trade, was able to maintain the position of the GATT, and subsequently the World Trade Organization, as the premier forum for trade liberalization. The consistent message was “if you want to foster a trade relationship with the United States you must be an active participant in the multilateral trade liberalization process.” This does not imply that the United States has been constant in its desire for trade liberalization, as clearly the influence of protectionists has waxed and waned through the various administrations of the post-Second World War era. The United States did, however, resist the temptation to use trade policy as an arm of strategic foreign policy even in the depths of the Cold War. The firm commitment to non-discrimination and national treatment in the multilateral context provided the incentive for other countries to take multilateralism seriously and to meaningfully engage in its often tortuous negotiation process. The recent open pursuit of bilateral arrangements by the United States has provided countries with an alternative to multilateralism for developing trade partnerships with it and can only serve to weaken the multilateral system that has served the international community so well for over fifty years. It is somewhat ironic that this change came after the major revamping and updating of the multilateral system that arose from the Uruguay Round and the creation of the WTO.

Some would argue that the change in U.S. trade policy making came before the completion of the Uruguay Round, with the negotiation of trade agreements with Israel and Canada. The agreement with Israel was largely political and in any case of little economic consequence for the United States (Weintraub, 2004). The negotiation of the agreement with Canada, it can be argued, was undertaken with the firm intent of

strengthening the multilateral system. The agreement with Canada provided models for reform of the GATT in a number of areas including dispute settlement (Apuzzo and Kerr, 1988) and investment (McLachlan, Apuzzo and Kerr, 1988). The agreement covered substantially all trade and was negotiated with the view that the regional agreement was a trade-opening mechanism that was simply a step along the road to multilateral trade liberalization. This view was held by both the United States and Canada. The same motivation can be attributed to the extension of the Canada-U.S. bilateral relationship to include Mexico although the North American Free Trade Agreement (NAFTA) actually consists of three separate bilateral arrangements (Clement et al., 1999). Of course, the Mexican government was also motivated by a domestic reform agenda that fit well within a philosophy of economic liberalization (Gerber and Kerr, 1995). At the time, Mexico did not see the NAFTA primarily as a way to gain a strategic advantage over other developing countries in accessing the U.S. market. It did not take long, however, for those advantages to become apparent to Mexican policy makers. Post NAFTA, however, the shift in trade policy making in the United States toward bilateral (or sometimes plurilateral and/or regional) agreements has taken on a strategic nature and the agreements violate the spirit of the “substantially all trade” requirement of the WTO’s provisions pertaining to regional trade agreements. President George W. Bush even referred to the Australia-U.S. agreement as a “Manufacturing FTA”.<sup>2</sup> Of course, the GATT, and subsequently the WTO, have never been able to enforce this provision, and many regional agreements, including initially the European Economic Community, did not fit within its parameters.

For the United States to embrace selective liberalization within regional agreements marks a distinct move away from forward looking liberalization toward the most basic form of strategic trade (and possibly foreign) policy premised on relative economic power. In the political system of the United States, selective sectoral trade policy allows the full brunt of the Congress’s protectionist instincts to be realized in trade agreements with less economically powerful trading partners. One has only to observe the active role members of Congress have taken in establishing the parameters of the bilateral and regional agreements being negotiated with countries in the Western Hemisphere to fully discern the effect of “unequal negotiations”. Without appeal to the “substantially all trade” constraint on negotiations, the Administrative arm of the United States Government, which negotiates trade agreements, has no means to fend off the mercantilist approach to trade that naturally arises in a Congress that has little party discipline and which is open to the pleadings of special interests.

The United States, however, can hardly be blamed for questioning its commitment to multilateralism, with its eschewing of power politics in trade relations.<sup>3</sup> It has been virtually alone in the world in this approach to trade policy. Other major economic powers have been much more strategically oriented in their approaches. The European Union, for example, has followed a long-term policy of negotiating bilateral arrangements – to the point where “better than WTO” agreements had been negotiated with all but a handful of WTO member states in over 25 bilateral or regional agreements. Excluded are countries such as the United States and Canada. While many of these agreements stem from a number of the member countries of the European Union having been major colonial powers that had preferential trading relationships with their former colonies, in recent years the negotiations have taken on a strategic role, particularly as a strategic counterbalance to the influence of the United States. It is only relatively recently that the European Union has rivalled the United States as an economic power and the significance of its multitude of bilateral arrangements has increased.

Regional agreements have long been accepted in other parts of the world, although many in Africa, the Middle East and pre-MERCOSUR Latin America were largely ineffective, while in Asia smaller countries were leery of entering into arrangements with Japan and latterly China due to fears that those countries would base their trade relations on the strategic use of their relative economic power (Yeung, Perdakis and Kerr, 1999) and India was largely inward looking (Kerr, Perdakis and Hobbs, 2000). Both the agreement between Australia and New Zealand and the Association of South East Asian Nations (ASEAN) showed that regional arrangements had some appeal in the Asia-Pacific region. A case could certainly be made that the trade model previously followed by the United States was increasingly at odds with the rest of the world, and the United States was forgoing opportunities to benefit from the strategic use of trade policy. As suggested above, however, the exclusively multilateral approach to trade policy making followed by the United States provided considerable positive externalities to the member states of the WTO by forcing them to take the multilateral approach seriously and, hence, to benefit from its non-discriminatory focus. The change in the approach to trade policy making will mean that the positive externality will no longer be there in the future, and a self-defeating scramble for preferential access to the United States has, it appears, already begun.

The benefit of the multilateral WTO system has been described as a “club good” (Kerr, 2002). A club good is one that is available to members of the club but not available to non-members. In retrospect, it appears that the important WTO club good

was exclusive access for member states to the U.S. market – access to the EU market, for example, was not part of the WTO's club good because bilateral arrangements could be negotiated with the EU.

If “better than WTO” access to the U.S. market is available to countries with which the United States is willing to negotiate separate agreements, then it seems likely that the value of the WTO's club good will be considerably eroded. There should then be a stampede of countries offering to negotiate with the United States. Given that the United States does not have unlimited resources to undertake negotiations, and skilled personnel are scarce, a queuing problem for negotiations arises. Since being early in the queue will have value because, if negotiations are successful, it gives a temporary access advantage relative to those later in the queue, the United States will be able to reward politically supportive countries or extract a price from others through its ability to determine the place of a country in the queue. For example, Australia, one of the most supportive members of the “Coalition of the Willing” in Iraq, was one of the first countries in the queue and has successfully negotiated a bilateral agreement with the United States. Similarly, the Dominican Republic was moved up the queue in the spring of 2004 with a proposal to include it when the Central American Free Trade Agreement already negotiated with Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua was presented to Congress for ratification. Just as quickly, its place in the queue was threatened when its government passed a 25 percent tax on imports of corn-based sweeteners in the fall of the same year. The tax was against the interests of U.S.-based producers of corn sweeteners. In the end, the Dominican Republic's senate gave in to the threat and rescinded the tax in late 2004. This is likely a lesson that will not be lost on other countries wishing to negotiate bilaterally with the United States. It also illustrates how disproportionate economic power will affect bilateral negotiations and shows the value of the lost WTO club good for smaller economies.

While the potential loss of the value associated with the WTO's club good in the short run may only now be becoming apparent, it is the dynamic long-run economic forces being created that will make a return to the pre-bilateral era status quo very difficult. The full cost of the loss of the WTO's club good may yet become apparent to the current U.S. Administration and it may wish to reverse course. Future administrations may wish to return to multilateral exclusivity, but this may be very difficult. New vested interests will have been created in whatever advantages have accrued from the preferred access that bilateral agreements provide to the trading partners of the United States that have been early in the queue.

Recent evidence suggests that beneficiaries of bilateral arrangements will fight hard to retain their preferred access. Further, over time, preferential access can allow industries to become isolated from international competitive forces. If the countries affected are small or underdeveloped the granting country may feel compelled to defend the previously granted preferred access on the grounds that the economic viability of their preferential trading partners would be threatened. One of the most acrimonious recent disputes between the European Union and the United States arose because of the potential erosion of the benefits of preferential access. The dispute over the EU's banana policy was centred on the inefficiencies that were allowed to persist in former colonies, primarily in the Caribbean, that had been given preferential access for their bananas (Guyomard and Le Mouél, 2003; Read, 2001). Mexico has worried about the erosion of its preferential access to the U.S. market under NAFTA as it watches its northern neighbour negotiate bilateral agreements with countries in Latin America. It has also worried about the eroding effect of China's entry into the WTO. Developing countries are not, however, the only ones to express concern about the erosion of the benefits arising from preferred market access. For example, when the Australia-U.S. agreement was being negotiated Canada not only fretted about the opening of the U.S. market to products such as Australian beef (which was, in the end, not granted access in the bilateral "manufacturing" agreement) but also worried that the benefits of its forty-year-old Commonwealth Preferences would be threatened when the United States received improved access to the Australian market (Yeung and Kerr, 2003).

The United States is apparently using the "carrot" of timely preferred access for some goods as a means of handling the delicate political problems associated with "sensitive goods" such as agricultural products (e.g., virtually exempting market access for sugar from the Central American Free Trade Agreement and for beef from the Australia-U.S. agreement). Hence, while countries do not receive concessions on market access in areas where the largest gains can be made, they do receive more timely access than other countries for those less sensitive goods that are included in an agreement.

As more countries negotiate bilateral agreements with the United States, they will come to see broadly based progress on trade liberalization at the WTO as a threat to the "better than WTO" concessions they have been able to negotiate bilaterally. As a result, they will perceive that it is not in their interest to have a round of WTO negotiations successfully concluded. While countries with bilateral agreements with the United States, and for that matter with the European Union, may not wish for the demise of the WTO, as it provides benefits in other areas such as dispute settlement,

they will have incentives to delay the reaching of a new agreement for as long as possible, to push for very long implementation periods and, in some cases, to thwart the successful conclusion of a round of negotiations. This will, in turn, reduce the value of the WTO for countries that do not have bilateral agreements with the United States and provide further incentives to seek such arrangements. With many competitors for an early place in the queue, the bargaining power of individual countries in bilateral negotiations will be reduced.

It can be argued, based on the basis of the behaviour of the Administration of President George W. Bush, that there has been a purposeful turning away from “multi-lateral entanglements” in favour of the unilateral use of diplomatic initiative, economic power and military might. The eschewing of multilateral environmental agreements such as the Kyoto Protocol and the willingness to deal with Iraq militarily without the blessing of the United Nations are often cited as evidence of this move toward unilateral action. If this is indeed the case, then a decline in the effectiveness of the WTO should be viewed as a success by those making U.S. policy. The public position of the United States, however, has consistently been that it is committed to the WTO while at the same time being open to entering into bilateral negotiations with WTO members. For example, Robert Zoellick (2001, 10), the U.S. Trade Representative has stated:

Stepping back, one can see that we are starting to move key pieces of the President’s trade strategy into proper position: We are advancing trade liberalization and America’s interests – globally, regionally, and bilaterally. We are creating a “competition in liberalization” with the United States at the center of a network of initiatives.

The elements of the President’s strategy – global, regional, and bilateral negotiation ... – are mutually supportive.

The administration still appears to be putting considerable effort into the Doha Round of WTO negotiations. It may well be that trade policy makers believe that they can “have their cake and eat it too”.

If the latter view of US motivations is correct then policy makers in the United States may have made a serious error. They may not have fully appreciated the nature of the economic forces that the queuing effect of bilateral negotiations can create nor the potential loss in the value to other countries of the club good produced by the WTO. For all its flaws, the WTO is based on a sound appreciation of the economics of protectionism and the economic harm that “beggar-thy-neighbour” trade relations can do. For a long time policy makers in the United States understood the value of the club good produced by the WTO. They were also willing to assume the role of

providing it by leaving aside the temptation to make use of their considerable economic power in strategic ways outside of the strict multilateral venue. The value of the positive externality provided by strict adherence to multilateralism by the United States was largely unrecognized, and unappreciated. This is not to suggest that the United States was not a hard bargainer in the multilateral forum or that it did not use its considerable economic power within the multilateral context. The United States has always been a formidable participant at the GATT and subsequently the WTO. Its commitment to multilateral exclusivity is all the more laudable given the willingness of the European Union to engage in the power politics of bilateralism – although admittedly many of its the EU's agreements were concluded before they could have had a major role in providing the WTO's club good. Latterly, however, the United States readily observed its primary economic competitor using trade policy strategically in ways calculated to gain a direct advantage in trade or other aspects of international politics. Those that provide positive externalities are likely to feel the injustice of the market failure more keenly than those that are its recipients.

Given the evolving international economy and the changing place of the United States in it, the giving in to the seductive temptations of strategic trade policy may have been inevitable. It appears, however, that the benefits of bilateralism may be short-lived while the possible loss of the club good produced by the WTO will be long standing. Without the multilateral club good the benefits of globalization will be reduced and the inequity of their distribution worsened internationally.

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## Endnotes

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1. See Weintraub (2004, xiii).
2. As reported in Zoellick (2004, 11).
3. Of course, one can point to numerous cases where, in the past, the United States has had to give in to the protectionist instincts of its Congress, notably with regard to the stillborn International Trade Organization in the early post–Second World War period, the waivers for agriculture granted in the early GATT years and the special arrangements arrived at for textiles. These were, however, grudgingly conceded by administrations fully committed to the multilateral ideal. The commitments of recent administrations in the United States have been much more muddled.

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