U.S. Trade Policy and Multilateralism—The Challenge of Bilateral Trade Agreements

by Kevin J. Fandl

> **The goal of the WTO has long been to seek elimination of all barriers to trade in each member country . . .**

The present United States approach to global trade liberalization might be characterized as a haphazard scramble to piece together bilateral and regional agreements with any willing country. The George W. Bush administration has pushed hard for the conclusion of bilateral trade agreements with several developing countries by arguing that the agreements will open the door to expanded U.S. markets and will encourage stronger protection of U.S. investors in those markets. The recent conclusion of agreements in Latin America exemplifies this pattern. However, is this rushed approach to trade liberalization bringing benefits to the U.S. economy faster, or is it sacrificing true economic growth conducted on a more equitable multilateral basis that might provide for more sustainable long-term economic development?

The decision to push for bilateral agreements to the potential detriment of ongoing multilateral negotiations can have a significant impact on the U.S. business community.

In the short run, U.S. businesses stand to gain from bilateral trade agreements through easier access to new markets, potentially lower import costs for raw materials, and better protection of their investments in the countries privy to the agreement. Yet in the long run, the effects may not be as positive. First, as trade diversion expands, less-efficient producers will become production centers, stunting further development of already efficient producers in other countries and preventing U.S. businesses from reaping the rewards of low-cost imports. Second, if multilateral talks continue to starve from lack of attention, global liberalization would fail to materialize, again harming businesses. Third, U.S. businesses that have no incentive to conduct business with countries involved in bilateral agreements with the U.S. will gain little from the agreements and may suffer compared to U.S. counterparts that do conduct business with the countries in the agreement. Finally, bilateral agreements tend to create tension between the U.S. and developing countries as many developing world citizens perceive the agreements as unbalanced. Accordingly, the resulting backlash can cut off business opportunities for U.S. investors, as has happened in Venezuela and other parts of the developing world.

Since the inception of multilateral trade and the World Trade Organization's (WTO) most-favored-nation principle, economists, policymakers, and business professionals have concluded that the most efficient means for acquiring sustainable gains from world trade is through global trade liberalization. This means that all countries—developed and developing—that subscribe to the WTO would act concurrently to lower tariff and nontariff barriers to trade, offering equal protections to all other members of the organization. The goal of the WTO has long been to seek elimination of all barriers to trade in each member country, leaving nothing but markets to determine the flow of goods and services across borders. The wisdom of this principle is supported by neoclassical economic theory, which forms the basis of many national economic policies as well as the WTO and thus attracts a large support base.

Bilateral and regional trade agreements are concluded between two or more countries outside the purview of the WTO. These agreements are most often, but not always, between a developing and a developed country. Because they are not regulated by the WTO, the parties are free to negotiate their own terms of trade and may include issues outside the basic exchange of goods and services. These additional issues can include security agreements, commitments to reduce corruption, investor protections, intellectual property rights, labor standards, environmental protections, international enforcement of judgments, and restraints on currency controls. The WTO does not generally negotiate such matters, as they are not considered direct components of trade.

Countries that engage in bilateral trade agreements generally argue that they are concluded in good faith with the intention of enhancing global trade. Developed countries that pursue such agreements contend that the agreements can lead to a more rapid liberalization process, thereby avoiding the long delays and barriers to concluding a full multilateral liberalization process, such as that sought by the WTO's current Doha Round of trade talks. They also argue that such agreements can work to improve geopolitical and political concerns, such as improving the judiciary, reducing corruption, and supporting economic development in the partner developing country.

Negotiation Imbalance

The WTO permits member states to enter into bilateral and regional trade agreements under certain conditions. These conditions specify that the agreement must not make any member state that is outside the agreement worse off than before the agreement; they must substantially eliminate all barriers to trade; and they must eliminate such barriers within a reasonable amount of time.[1] These agreements must be notified to the WTO in advance for review and subsequent approval. Of the more than two hundred such agreements in existence today, only one has been officially approved by the WTO.[2]

There are several concerns about countries entering bilateral rather than multilateral agreements to liberalize trade. On the economic front, the primary contention is that the long-standing WTO principle of most-favored-nation is compromised. This principle specifies that all member states of the WTO shall receive the same benefits as every other member—in other words, if one member state receives a benefit under the agreement, all member states must receive the same or an equivalent benefit. There can be, in effect, no favored nation. Bilateral and regional trade agreements do exactly the opposite—they provide special benefits to some member states that are not provided to other member states of the WTO. For example, if the U.S. offers Singapore duty-free entry of textiles under the U.S.-Singapore bilateral free trade agreement, yet it has negotiated a tariff of 5 percent for WTO member states under its WTO concessions, other WTO member states will suffer by having to pay more than Singapore for their textile exports to the U.S. A corollary of this concern is the likelihood of trade diversion.

In the example above, even if Singapore is not the most efficient producer of textiles, their exports to the U.S. will be favored by U.S. consumers because they will be sold roughly 5 percent less expensively on the U.S. market. If, in fact, India were the most efficient textile producer, Indian manufacturers would have to reduce their prices in order to remain competitive with Singapore, despite their quality and efficiency. The result is an imperfect market exchange, contrary to the free market aspirations espoused by the U.S.

On the noneconomic front, additional concerns about negotiating outside the multilateral context exist. Politically, there is a concern about the equitability of negotiations between developed and developing countries. Numerous trade experts have drawn attention to the power imbalance that exists between trade negotiators from a developed country and those from a developing country.[3] The U.S. has a specialized body that negotiates trade agreements on its behalf—the Office of the U.S. Trade Representative, which is home to a number of highly trained experts in all areas of trade deemed beneficial to U.S. industry. A developing country usually utilizes the services of its trade ministry or other body equivalent to the U.S. Department of Commerce to negotiate these agreements. Accordingly, it does not possess the cadre of experts that the U.S. enjoys, nor is it endowed with resources to dedicate to negotiating smaller agreements while also maintaining representation in WTO negotiations likely to be more friendly to developing countries.

Because these negotiations are not limited to trade issues alone, U.S. negotiators often push to receive noneconomic benefits. The two areas that have garnered the most attention in this area are labor and environmental protections. For example, the U.S. has made many of its agreements conditional upon developing countries adhering to strict labor practices and protections, such as paying reasonable wages to workers. Their primary concern here, altruistic as it may appear, is to protect U.S. industry that may wish to compete for market share in the developing country or to compete with lower developing-country export prices on the U.S. market. Lower wages, a common practice in many developing countries, allows those countries to remain competitive on global markets and to encourage the development of small businesses that could not afford to pay higher wages. Tougher laws mean less competitive edge against the incoming U.S. businesses and less competitive exports on world markets.

Environmental protections also greatly limit a developing country's economic prowess. In the early stages of industrialization, as is evident today in India and China and historically in the U.S. and

Western Europe, pollution is rampant. The infrastructure to limit this toxic proliferation is often not yet in place. Developing-country governments have neither the money nor expertise to invest in pollution reduction schemes. In many instances, their limited funds are devoted to debt repayment and poverty reduction programs. Yet developed countries—typically the largest global polluters—have used these provisions to further restrain developing country competitiveness by raising the cost of doing business through required environmental safeguards.

U.S. Trade Policy

The United States has used bilateral and regional trade agreements for a number of reasons, the least of which is economic gain. In fact, most of the recently ratified or negotiated trade agreements outside the multilateral context have generated only minor economic benefit for the U.S. For instance, the recent U.S.-Australia free-trade agreement has increased the trade surplus for the U.S. by 32 percent for a total of only $2 billion. The increase was only $4 billion for the agreements with Chile and Singapore. Even over the long term, economic gains have been small. The Congressional Budget Office reports that U.S. Gross Domestic Product increased only slightly because of the North American Free Trade Agreement (NAFTA), and not necessarily due to its direct effects.[4] In developing countries, the news is even less positive. Consider NAFTA, which, more than ten years after signing, is hotly debated by economists as to the benefits for the Mexican economy. Also consider the Free Trade Area of the Americas, which not only was unsuccessful as an agreement, but also may have increased regional backlash against the U.S.

U.S. trade policy is highly protective of its own innovative economy. Accordingly, the protection of intellectual property is a top priority for its trade negotiators. On any street corner in a developing country, vendors pawn off copies of the latest U.S. films and music, Rolex watches, Coach sunglasses, and almost anything that can be copied. The price for these items is rarely more than 20 percent of what someone would pay in a developed country, unless of course the buyer were a bad negotiator. The U.S. wants developing countries to implement more rigid laws to prohibit the manufacture and sale of these infringing goods, and stronger enforcement of such laws. Language requiring stronger laws and better implementation of such laws has become standard in trade agreements, despite the WTO's multilaterally negotiated intellectual property agreement.

I can speak firsthand of the effect of these clauses from my time living in Colombia during the negotiation of that country's trade agreement with the U.S. I witnessed one of their popular black markets, San Andrecitos, shutting down in anticipation of a raid by police—something much more frequent since the conclusion of the agreement.

These constraints on trade also can serve to weaken economic growth in developing countries. Much of the contraband sold in developing countries is copied because original research, development, and production are not yet feasible. Lack of investment in innovative technologies limits the growth of an innovative sector in most countries (with the obvious exceptions of China and India), leaving developing countries with the options of copying existing technology or reverting to primary commodities such as agriculture to sustain their incomes, which is becoming increasingly difficult.

So why does the U.S. insist on pursuing such agreements rather than remaining focused on the floundering Doha Development Agenda and other multilateral negotiations? The rationale is largely noneconomic. A recent Heritage Foundation report suggests that the primary basis for evaluating a free trade agreement includes the partner country's support of U.S. economic and foreign policy interests. As an example, the report discusses the U.S.-Bahrain agreement, which may be used as a stepping stone toward the conclusion of a Middle East Free Trade Area that would greatly promote the U.S. security goals in the region by expanding U.S. economic linkages there.[5]

The Bush administration has pursued a policy of trade negotiations with developing countries that uses the threat of removing existing trade preferences or aid if the country does not enter the agreement on U.S. terms—meaning that a developing country party to a negotiation has little negotiating room to debate the demands of the U.S. in exchange for small openings in the U.S. market. In the case of Colombia, the threat was the potential removal of the Andean Trade Preference Act (which has expired and was extended while Congress debates implementation of the FTA). Removal of these trade preferences, which gave Colombia duty-free access to much of the U.S. market, would be very detrimental to the Colombian economy. This coercive approach has caused many developing countries to balk at working on trade deals at all with the U.S. Consider Venezuela, for example, which has opted instead to negotiate with China and its regional partners, thereby diverting potentially beneficial U.S. market exchange. Singapore's own minister of foreign affairs, George Yeo, said that developing countries negotiate out of fear and insecurity, rather than economic considerations.[6]

Presidents William J. Clinton and George W. Bush have enjoyed Trade Promotion Authority (TPA), which allows them to negotiate a trade agreement and, once signed, present the agreement to Congress for an up or down vote. With TPA, Congress may not amend or modify anything in the agreement. This authority is a sharp sword for negotiations, as it provides confidence in the negotiating parties that the agreement will go forward without changes by the U.S. Congress. Without TPA, anything that the parties agree to is subject to modification before approval. However, President Bush lost this TPA in June 2007, taking away this powerful weapon and making the conclusion of trade agreements more challenging. Since the Republican Party lost control of the Congress, Democrats have asserted that they will not approve any pending agreements without strong labor and environmental safeguards. Agreements with Peru, Colombia, and Panama hang in the balance as the administration tries to attract sufficient support to ratify these pending deals.[7]

One example of the controversy brewing in Congress today involves the pending U.S.-Colombia FTA, which, despite the support of Colombian President Alvaro Uribe and the Bush administration, is faltering under congressional pressure. Congress is pushing for more prosecution by the Colombian government of right-wing paramilitaries and better enforcement of the law against human-rights abusers. With a growing scandal of political ties to paramilitary groups in the Colombian Congress and the hesitation of the U.S. Congress to consider moving forward without certain assurances from Colombia, it seems less and less likely that the agreement will be approved before a change in U.S. administration. The situation is similar in Panama, where the leader of their Congress was accused, tried, and acquitted of killing an American soldier in 1992. Pedro Miguel Gonzalez is still wanted in the U.S. on these charges. With Gonzalez at the head of the Panamanian Congress, the U.S. Congress is unlikely to approve the FTA.[8]

Thus far, the U.S. has successfully concluded agreements with Israel, Canada, NAFTA, Jordan, Chile, Singapore, Australia, Morocco, El Salvador, Nicaragua, and Honduras. With the recent Costa Rican referendum, an agreement also will be concluded with the Central American region. Agreements with Bahrain, Guatemala, the Dominican Republic, and Costa Rica have been approved but not yet entered into force. Agreements with Oman, Peru, and Colombia are currently under Congressional review. Peru's agreement is likely to be approved later this year.

Public opinion in the U.S. lately has turned sour on trade agreements, attesting to a growing concern about the loss of U.S. jobs due to competitive foreign firms and outsourcing to lower-wage countries. Congress noticed this sentiment and, with the approaching election, again has made trade a central issue. Secretary of State Condoleezza Rice recently argued that the current sentiment both in the Congress and among the public at large could lead to protectionist tendencies, "and we know from any number of historical experiences that that impulse to protect always leads to bad outcomes."[9]

Yet the U.S. is not the only country pursuing bilateral and regional trade agreements with developing countries. The European Community has engaged in at least twenty-three bilateral trade agreements with countries such as Turkey, Egypt, Israel, Iceland, and Mexico, and has four regional agreements in place with South Africa, Chile, Mexico, and the European Free Trade Area. The European Union (EU) pursues a policy of using bilateral and regional agreements as stepping stones to larger, multilateral integration. Peter B. Mandelson, EU trade commissioner, argued last year that the EU does not pursue bilaterals as quick-fix solutions to trade problems, but rather as a testing ground for liberalization issues that the WTO has not yet successfully tackled, such as trade in services.[10] He argued that the EU is only interested in deep free-trade agreements that liberalize all trade.

Negative Consequences of Bilateral/Regional Trade Agreements

Liberal free traders—as described by the libertarian Cato Institute, for instance—suggest that all varieties of trade agreements are beneficial to global economic growth. They argue that individuals receive economic freedom when their governments lower barriers, so it makes no difference whether the other parties to the agreement reciprocate in order to see gains.[11] However, trade economists such as Jagdish N. Bhagwati and Arvind Panagariya at Columbia University argue the contrary. They say that agreements concluded outside the protections of the multilateral forum severely disadvantage developing countries by restricting their much-needed flexibility in adapting to the growing pains of development.

There is also concern about backlash from uneven trade liberalization. Inequality has been steadily growing throughout the developing world, and trade liberalization is considered by some as strengthening existing inequalities. It also is seen as a mechanism for exerting U.S. influence in the domestic political affairs of countries with which the U.S. has strategic interests. This is most evident in Latin America, where the Free Trade Area of the Americas—the keystone of the Bush administration's foreign policy in the region—met with significant resistance and eventually failed. Several countries in the region, including Venezuela, Brazil, Bolivia, and Ecuador, have recently elected left-leaning leaders that have chosen to slow the pace of liberalization and even in some cases to turn back previous liberalizations by nationalizing some industries. This backlash is not surprising given the failed U.S. economic interventions in the region over the past thirty years. However, the reversal of trade openness has been cause for concern because it is antithetical to the goals of the WTO, and makes multilateral liberalization goals harder to achieve.

The Bush administration and other proponents of unrestricted free trade are wise to seek reductions in trade barriers around the world and to pursue the goals of economic development; however, trade at all costs is not necessarily an intelligent approach to achieving this goal. Trade negotiations outside the multilateral context give rise to a significant number of concerns, as highlighted by this brief survey. While they bring the potential for economic growth and improved livelihoods for some, they also ignite concerns over inequities and imbalance in trade between developed and developing countries. The U.S. has long pushed for a reduction in barriers to trade, but by employing a haphazard bilateral and regional approach, they may be effectuating more negative consequences than positive.

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To be successful in raising global living standards, eliminating tariff and nontariff barriers, and allowing markets to operate freely, the U.S. should be concentrating its vast resources on concluding the Doha Round of negotiations at the WTO. The successful conclusion of this trade and development agenda will do far more for economic growth than any number of smaller agreements, and will do so without the potential for severe backlash among developing countries that threatens to derail all efforts to conclude a multilateral agreement. A wise trade policy is an essential component of an effective foreign policy, and the two are largely interlinked. Pursuing U.S. economic power by coercing developing countries with little to offer the U.S. into trade agreements may weaken the U.S. position in global trade negotiations as well as on the foreign policy stage. ⚖

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Endnotes:

1 General Agreement on Tariffs and Trade, art. XXIV (1994).

2 Referring to the customs union between the Slovak and Czech Republics. *See* CONSULTATIVE BOARD, WORLD TRADE ORGANIZATION, THE FUTURE OF THE WTO: ADDRESSING INSTITUTIONAL CHALLENGES IN THE NEW MILLENNIUM *21-22* (2004), *available at* **http://www.wto.org/english/thewto_e/10anniv_e/future_wto_e.pdf**.

3 *See, e.g.,* Kevin J. Fandl, Bilateral Agreements and Fair Trade Practices: A Policy Analysis of the Colombia-U.S. Free Trade Agreement (2006), 10 YALE HUMAN RTS. & DEV. L.J. 64 (2007).

4 Robert McMahon, *The Rise in Bilateral Free Trade Agreements*, Council on Foreign Relations (June 13, 2006).

5 Daniella Markheim, *America's Free Trade Agenda: The State of Bilateral and Multilateral Trade Negotiations*, Heritage Foundation Backgrounder (Nov. 2, 2005).

6 Guy de Jonquieres, "The Challenge for the Multilateral Trade System", Yale Global Online, Nov. 18, 2002.

7 Neil Irwin, "A Shift in Bush's Trade Politics," *Washington Post* (Oct. 10, 2007).

8 *Id.*

9 *Id.*

10 Peter Mandelson, "Bilateral Agreements in EU Trade Policy" (speech at London School of Economics, Oct. 9, 2006).

11 Edward L. Hudgins, "Regional and Multilateral Trade Agreements: Complementary Means to Open Markets," 15 *Cato Journal* No. 2-3 (Fall/Winter 1995/96).