

“The US’s ‘Power-Based’ Bargaining and the WTO: Has Anything Really Been Gained?”

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Invited Paper

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What’s Next for Agricultural Trade Policy?”**

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US Shift to “Power-Based” Bargaining

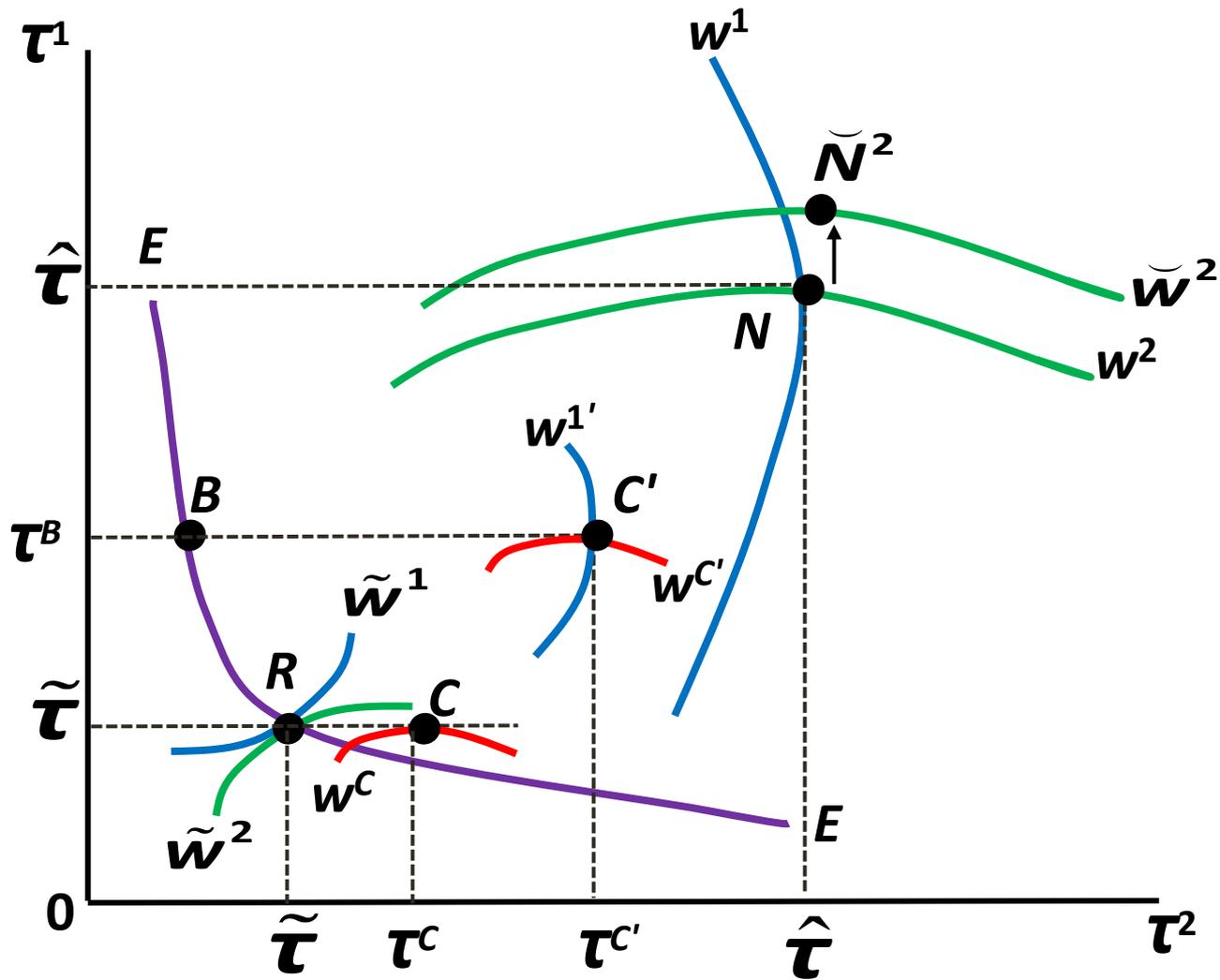
- **“Rules-based” trading system of GATT/WTO resulted in progressive reduction of tariffs post-1947 (Baldwin, 2016), and increase in global trade (Subramanian and Wei, 2007)**
- **Mattoo and Staiger (2020): US has shifted from “rules-based” to “power-based” approach to trade negotiations**
- **Superficially, it has worked, i.e., 2020/2021 import commitments by China under USCTA**
- **However, does not “...avoid a narrow, deficit-focused bilateral deal...” (Hillman, 2018)**
- **Approach comes at considerable economic cost to consumers, taxpayers, and exporters, and fails to address fundamental issues relating to China’s economic model**

“Rules-Based” Trade Negotiations

- **Logic of GATT/WTO: resolution to terms-of-trade prisoner’s dilemma (Johnson, 1953-54; Bagwell and Staiger, 1999)**
- **Lower tariff equilibrium under GATT/WTO supported by credible enforcement mechanism avoiding reversion to Nash equilibrium (trigger strategy)**
- **Zissimos (2007) models repeated game between countries over infinite time horizon with common discount rate:**
 - **If deviation from tariff concessions by one country not “abusive”*, withdrawal of equivalent concessions by other country is sub-game perfect**
 - **If deviation is “abusive”, trigger strategy is optimal**
- **GATT/WTO mechanism minimizes chances of trade war**

*** Abusive deviation: sufficiently deep breakage of tariff commitments honored for some time (Zissimos, 2007)**

“Power-Based” Bargaining



Shift to “Bargaining” Tariffs

- **“Rules-based” approach also neutralizes imbalance in bargaining power (McLaren, 1997)**
- **Given asymmetry between US and Chinese tariffs post-2001, and extent of China’s bilateral trade surplus with US – choice made to implement “bargaining tariffs” in 2018**
- **Ignored possibility China could present credible threat of their own, pushing tariffs towards Nash equilibrium**
- **Over two-year period, average tariffs on 58.3 (66.4) percent of US (Chinese) imports from China (US) rose to 19.3 (19.3) percent – Smoot-Hawley (1930) tariffs averaged 32.3 percent (Bown and Irwin, 2018)**
- **Sequence of tariff increases suggests both countries have adopted trigger-type strategies**

Impact of “Power-Based” Bargaining

- US-China trade war represents natural experiment given size of tariff increases, plus other countries, e.g., Canada, EU, Japan, and Mexico dragged into conflict
- Notable studies of impact: *Amiti et al. (2019)*, and *Fajgelbaum et al. (2020)* – finding US net real income losses of \$8.2 and \$7.3 billion respectively
- Studies of impact of retaliatory tariffs on US agriculture by *Carter and Steinbach (2020)* and *Grant et al. (2021)* – latter estimated annualized trade losses of \$13.5-18.7 billion
- Long-run implications for multilateral trading system:
 - Potential to undermine cooperation necessary for multilateral trade negotiations (*Maggi, 1999*)
 - Harder for China to make credible pre-commitments to “rules-based” system (*Mattoo and Staiger, 2020*)

What Has “Power-Based” Bargaining Missed?

- **Broad USCTA goal: reduce trade deficit with China (Bown, 2021) – squaring with specific targeting of “bargaining” tariffs (Mattoo and Staiger, 2020)**
- **Public focus on China’s progress in meeting USCTA import commitments supports this rationale, e.g., FarmPolicyNews**
- **Despite USCTA chapters covering wide range of other issues – no mention in agreement of disciplines on SOEs and China’s use of implicit subsidies, export taxes, and differential VAT export rebates**
- **Many have argued China’s economic model, combined with weakness in WTO disciplines on subsidies is fundamental reason for US concern(s) with WTO and functioning of DSB (Wu, 2016, 2019; Bown, 2019a; Bown and Hillman, 2019)**

Subsidies and China's Economic Model

- **2001-17, extensive US use of WTO-consistent trade restrictions, followed in 2018 by reliance on use of US trade laws (Sections 201, 232, 301) (Bown, 2019a)**
- **Reflects US concerns about Chinese economic model:**
 - **SOEs face soft budget constraints (Lardy, 2019)**
 - **Firms influenced directly/indirectly by Chinese Communist Party (CCP) – subsidies targeted informally, i.e., “China Inc.” (Wu, 2016)**
 - **Use of export taxes and discriminatory use of VAT rebates on exports (Garred, 2018)**
- **Also informed debate about impact of China import shock on US labor market and shift to economic nationalism (Autor *et al.*, 2013; Grossman and Helpman, 2021)**

Subsidies and the GATT/WTO

- **Orthodox theory: *export* subsidies not optimal (Bagwell and Staiger, 2001), while *production* subsidies are first-best instrument for targeting market failure(s) (Johnson, 1965; Bhagwati and Ramaswami, 1963)**
- **Original GATT rules allowed CVDs to be targeted at use of export subsidies, and NVNI complaint could be filed if negotiated market access affected by use of other subsidies**
- **Tokyo Round: export subsidies deemed *per se* violation of GATT rules – agricultural trade an exception**
- **Uruguay Round: subsidy definition - “financial contribution” from “government or public body” that confers “benefit” on firm receiving it (ASCM Article 1)**

Subsidies and the GATT/WTO

- **ASCM perhaps too restrictive relative to first-best rationale for subsidies – provides incentive for indirect/non-transparent policies (Bagwell and Staiger, 2006)**
- **ASCM ineffective practically (Bown and Hillman (2019):**
 - **WTO (2011) ruling on definition of “public body”**
 - **Heavy burden of proof to show governmental control**
 - **Difficult to apply in context of “China Inc.”**
 - **WTO unable to issue retrospective remedies (Wu, 2019)**
- **Stalemate over AB partly driven by US view it has been constrained in its use of trade remedies against China (Bown and Keynes, 2020), and what it perceives as AB judicial “overreach” (Payasova *et al.*, 2018)**

How to Deal with China's Economic Model?

- With subsidy issue invisible in USCTA, reasonable to argue “power-based” bargaining has failed – what is the alternative?
- Hillman (2018) argues for coalition of WTO members putting together comprehensive case against China, i.e., VNI and NVNI complaints under GATT Article XXIII
- Wu (2019) less optimistic – regards current WTO rules as incomplete – not well-designed to deal with “China Inc.,” and burden of proof for NVNI complaint too high
- Solution: fundamental modality required for WTO members to negotiate/update trade rules, and reform of AB procedures to allow for “legislative remand” (Bown and Hillman, 2019; Wu, 2019)