Chapter 7

Bilateral and Multilateral Trade Treaties and Negotiations

I. Basic Overview

Every country in the world is in the process of negotiating trade agreements of one sort or another. However, each negotiator has a problem. The negotiator wants high prices for his producers and low prices for his consumers. He wants less competition for his producers and more competition for his consumers. He wants less substitutes for his producers' goods and more substitutes and choice for his consumers. Ideally, he would give his producers a worldwide monopoly while giving his consumers a worldwide perfectly competitive environment. Of course, you can see the problem. You cannot help domestic producers without hurting domestic consumers. However, we have seen that it is possible to enforce free markets and allow the markets to create specialization. In such cases, both consumers and producers can be better off. Even those who are at first harmed by free trade can be compensated for their harm and allowed to adjust to the new environment. Moreover, the increased exports and imports generate huge increases in international transactions that require intermediate work to be done. This causes new firms and industries to be born. Total trade increases scale and this drives productivity higher along with standards of living. Countries that engage in extensive trade with other countries always provide greater opportunities for advancement of their people. Adam Smith saw this over 220 years ago and we continue to see it today. Trade expansion encourages growth.

This is why that trade agreements aim at liberalizing the rules. The object is not to liberalize you neighbor and protect your home markets. The goal is to liberalize all countries and all markets. With the same resources, more can be produced, since the greater trade flows increase productivity, the division of labor, and the specialization of industry. What is the fastest way to grow your economy. Answer - increase imports and exports. Greater total trade means greater scope to the market, which increases division of labor and specialization of industry, which drives productivity higher, and creates a higher standard of living and more optimistic expectations. Exports are what we produce, imports are how we produce. Exports are what we pay to get our imports. Trying to favor one against the other is wrongheaded. Our economy needs both to grow in a balanced and sustainable fashion. But, always governments fall prey to protecting certain segments of the public, special interests, and domestic industries. This protection is often seen as long lasting, so those who are protected come to believe they are entitled to the protection. They never mature to meet the global challenge.

The solution to this is to have bilateral and multilateral agreements on trade that carefully reduce the barriers to trade and allow all countries to enjoy the benefits of free trade. Naturally, these agreements must be transparent and verifiable. The so-called bilateral free trade agreements (FTAs) will not succeed if there are surreptitious barriers to trade in the form of non-tariff barriers, also known as non-tariff measures (NTMs). From 1947 with the creation of GATT up to 1995 with the establishment of the WTO, protection in the form of tariffs has been substantially removed. There are still some tariffs remaining on products, but most have been eliminated and what is most troubling are the pernicious NTMs.

It will be instructive for us to look at an FTA and see the elements that go into a bilateral agreement. As a good example of one, we will look at the so-called Korus FTA signed between the US and South Korea. US and South Korean leaders approached the KORUS FTA from different perspectives that were reflected in the conduct and outcome of the negotiations, despite some broad shared objectives. A primary objective of the United States was to gain greater access to South Korean markets in agricultural products, autos, pharmaceuticals and medical equipment, some other high technology manufactured goods, and services, particularly financial and professional services — areas in which US producers are internationally competitive. In addition, the United States sought to establish updated trade and investment disciplines in the dynamic and trade-oriented East-Asian region.

II. The Korus FTA[1]

The U.S.-South Korea Free Trade Agreement (KORUS FTA) entered into force on March 15, 2012. It includes provisions to reduce and eliminate bilateral tariff and non-tariff barriers and enhance the rules and disciplines governing the bilateral trade and investment relationship, including issues such as: trade in manufactured goods, agricultural products, and services; foreign investment; government procurement; intellectual property rights; and worker rights and the environment, among other issues. While most of the agreement's provisions went into effect immediately, some are being phased in over the next several years.

The United States and South Korea entered into the KORUS FTA as a means to further solidify an already strong bilateral economic relationship. The United States specifically sought increased access to South Korean markets for agricultural products, manufactured goods, services, and foreign investment. The United States likely also sought to maintain its competitiveness in South Korea in the face of Seoul's FTA negotiations with other major trading partners, including the European Union. For South Korean leaders, the KORUS FTA was a mechanism to promote reform in its own economy and also to gain greater access to the U.S. market for autos and other manufactured goods.

In general and in the short- to medium-term, the KORUS FTA's largest commercial effects are expected to be microeconomic in nature. In other words, from the perspective of specific industries, the agreement may have a noticeable impact even if its economy-wide effects are modest. However, the increase in the U.S. trade deficit with South Korea since the agreement's entry into force has caused some observers to question the benefits of the agreement, although other factors—including a decrease in South Korea's rate of economic growth—may have been the main drivers of evolving trade patterns.

Some U.S. companies have argued that certain aspects of the KORUS agreement are not being implemented appropriately. For instance, U.S. exporters have claimed the agreement's

---

[1] This section is taken from Brock R. Williams, Mark E. Manyin, Remy Jurenas, and Michaela D. Platzer, (September 16, 2014) "The US-South Korea Free Trade Agreement (KORUS FTA): Provisions and Implementation", Congressional Research Service, 7-5700, RL34330 https://fas.org/sgp/crs/row/RL34330.pdf.

effectiveness has been diminished by South Korean customs authorities requiring allegedly excessive documentation to certify rules of origin of imports of U.S. products. U.S. manufacturers also have raised concerns that a proposed South Korean tax credit/tax penalty program for car purchases may discriminate against imports of U.S.-made cars. South Korean and U.S. officials are reportedly working to resolve these issues.

Agriculture:

Under the KORUS FTA's agricultural provisions, South Korea immediately granted duty-free status to almost two-thirds of current US agricultural exports. Tariffs and import quotas on most other agricultural goods will be phased out within 10 years, with a few commodities and food products subject to provisions that phase out such protection by year 23. However, because of their sensitivity, duty-free access for several US products will slowly expand in perpetuity but remain subject to South Korean import quotas. Much effort went into negotiating provisions covering four agricultural commodities of export interest to the United States. Under the KORUS FTA, South Korea agreed to eliminate its 40% tariff on beef muscle meats imported from the United States over a 15-year period. However, negotiators did not reach a breakthrough by the end of the talks on the separate but parallel issue of how to resolve differences on the terms of access for all US beef in a way that would address Korea's human health concerns arising from the 2003 discovery of mad cow disease in the US cattle herd. It was only following the conclusion one year later of a difficult series of negotiations on a separate bilateral understanding on the terms of US beef access to the South Korean market—accompanied by widespread public protests in Korea—that shipments resumed in July 2008. Negotiations on access for US rice and oranges into the South Korean market also were contentious. Rice was a "make-or-break" issue for Seoul, and excluded at South Korea's insistence out of US recognition that if pushed, the talks would likely have collapsed. Special treatment for US oranges was agreed to at the last moment, when negotiators compromised on a multi-part solution expected to increase US navel orange exports over time. In the December 2010 changes to the initial agreement, Korea secured a two-year extension in the tariff phase-out for one commercially important line of US frozen pork product in return for changes the United States sought in its commitments under the auto and other provisions.

Automobiles

Trade in autos and auto parts proved to be among the most contentious areas tackled by U.S. and South Korean negotiators. In recent years, South Korean auto manufacturers have increased their market share through imports and expanded car production in the United States and other major automotive markets like the European Union. U.S. industry argued that South Korea should eliminate policies and practices that seemingly discriminate against U.S. auto imports. In December 2010, the United States and South Korea reached a joint understanding on automotive trade.[2] Due to these modifications, all three U.S. automakers ultimately supported the KORUS FTA. A detailed discussion of the auto-specific provisions is provided later in this report. A few of the most important provisions are discussed below.

- The United States will eliminate its tariff of 2.5% on passenger cars, including electric and hybrid vehicles, as of 2016. South Korea cut its passenger car tariff to 4% upon implementation of the KORUS FTA and will remove the remaining tariff in 2016.[3] For trucks, South Korea dropped its 10% duty upon implementation, while the U.S. tariff of 25% will remain in place for seven years and then be phased out entirely by 2021.[4] The KORUS FTA also includes a "snapback provision" that allows the United States to reinstate its 2.5% passenger car tariff, once the duties are completely eliminated, if U.S. automakers claim and the dispute settlement panel finds that South Korea is in violation of the agreement. The snapback could also be imposed due to violations regarding imports of trucks. South Korean commitments regarding a specified group of new and already proposed regulations on automobile fuel economy and greenhouse gas emissions do not seem to be

[2] The December 2010 commitment modifications adjusted the tariff elimination schedule for passenger cars and trucks, allowing for a longer phase-out period, which was a key priority for Ford Motor Company and the United Auto Workers (UAW). A special vehicle safeguard was added to protect the U.S. market from a possible surge in South Korean auto imports exempting U.S. car manufacturers that export 25,000 or fewer autos and trucks to South Korea from South Korean safety standards if they meet U.S. federal safety standards.

[3] In the initial 2007 agreement the United States and South Korea had agreed to phase out their respective electric and hybrid car tariffs of 2.5% and 8%, over ten years.

[4] The U.S. Department of Commerce's FTA tariff tool shows the tariff elimination schedule for specific industrial goods, http://export.gov/fta/ftatarifftool/TariffSearch.aspx.

enforceable under the dispute settlement provisions of the KORUS FTA; presumably the snapback will not apply to these commitments.[5]

- A special motor vehicle safeguard allows the United States to take action if there are "any harmful surges in South Korean auto imports due to the agreement." A safeguard can be initiated by the United Auto Workers union, the domestic auto industry, or the U.S. government. The remedy for finding injury is a snapback to the original tariff levels in place prior to the implementation of the FTA. This remedy can be used more than once and is available for a period of up to 10 years after the concerned tariffs are eliminated. As a remedy under the auto-specific safeguard, the United States will be able to re-impose the 2.5% passenger vehicle tariff. South Korean assembly production in the United States rose to almost 770,000 cars and light trucks in 2013. At more than 750,000 units, nearly an equal number of passenger vehicles and light trucks were imported from South Korea in 2013, up 28% from two years earlier.[6] If U.S.-based producers— including foreign-owned automakers such as BMW or Toyota—meet U.S. federal safety standards, each manufacturer can export as many as 25,000 cars directly to South Korea from the United States without complying with South Korean safety standards. Additionally, they must satisfy KORUS FTA domestic content provisions. U.S. automakers also have some flexibility to be considered in compliance with new South Korean fuel economy and greenhouse gas emissions standards. The Koreans made some concessions on issues that were seen as non-tariff barriers to auto trade involving safety and environmental (e.g., fuel economy and emissions) standards.

Trade data show that exports of U.S. autos to South Korea have risen in recent years measured by dollar value and number of units. Sales of "Detroit 3" cars in Korea grew 20% to more than

---

[5] For more information see pp. 2-4 of CRS Report R41544, Trade Promotion Authority and the U.S.-South Korea Free Trade Agreement, by Emily Barbour.

[6] North America Vehicle Production by Model, 2009-2013," WardsAuto, February 25, 2014, http://www.wardsauto.com and Statistical Overview of the Korea Automotive Industry/Market & U.S. Trade Relationship, 1990-2013, provided to CRS by the American Automotive Policy Council.

11,600 cars in 2013, a difference of almost 2,000 cars from 2012, with Ford vehicles representing the majority. However, it is too early to make any conclusive observations about the benefits or disadvantages of the KORUS FTA for the auto industry. A two-year snapshot can be misleading, especially since tariffs are still being phased out. Some U.S.-based automakers continue to raise concerns about non-tariff barriers that impede their exports to South Korea.

Other Key Provisions

The KORUS FTA covers a broad range of other areas. According to the Office of the United States Trade Representative (USTR), 95% of U.S.-South Korean trade in consumer and industrial products will become duty-free by 2016 and virtually all remaining tariffs will be lifted by 2021. The two countries agreed to liberalize trade in services by opening up their markets beyond what they have committed to do in the World Trade Organization (WTO). About 60% of U.S.-South Korea trade in textiles and apparel became duty-free immediately, and the KORUS FTA will provide a special safeguard mechanism to reduce the impact of textile and apparel import surges. Trade remedies were a critical issue for South Korea and a sensitive issue for the United States. The FTA allows for the United States to exempt imports from South Korea from a “global” escape clause (§201) measure if they are not a major cause of serious injury or a threat of serious injury to the U.S. domestic industry. The FTA also provided for a binational consultative committee for information sharing on trade remedy matters.[7]

In addition, South Korea and the United States agreed to establish an independent body, a Medicines and Medical Devices Committee, to review recommendations and determinations regarding South Korean pricing and government reimbursement for pharmaceuticals and medical devices and to improve transparency in the process for making those determinations.

Furthermore, one year after the KORUS FTA entered into force, a binational committee was to be formed to study the possibility of eventually expanding the agreement’s coverage to products from “Outward Processing Zones,” including the Kaesong Industrial Complex and/or other future

[7] “Trade Remedy Piece of Korea FTA Ignores Korean ADF Demands,” Inside U.S. Trade. April 13, 2007.

zones located in North Korea. The committee met in November 2013 to discuss the issue and will continue to meet annually.[8]

III. Why Multilateral Instead of Bilateral – or Perhaps Regional?

There are multiple ways for governments to advance free trade; trade liberalization can be negotiated via multilateral, bilateral or regional mechanisms. Each strategy carries a mix of benefits and costs.

Multilateral Trade Talks

Historically, multilateralism has been the dominant approach, embodied in the World Trade Organization. The WTO currently has 159 members, who exchange tariff preferences in line with the non-discriminatory "most-favored-nation" principle. Multilateralism is the "policy purist" approach to trade liberalization. Since Russia's accession to the WTO in 2012, practically all significant economies have become members, creating a single integrated system of global trade rules. But size has also proven to be one of the WTO's major weaknesses. Having many members makes consensus difficult to forge, and recent years have seen the formation of a complex array of "coalitions" with competing, and often-incompatible, agendas. Disagreement among these coalitions - particularly over the sensitive issue of agriculture - is one of the main reasons the Doha round is currently deadlocked after 12 years of talks.

Bilateral Free Trade Agreements

With the WTO in deadlock, attention has turned to bilateral free trade agreements (FTAs). Practically unheard of before the mid-1990s, these agreements have expanded exponentially during the last decade as governments sought to deepen trade ties with key economic partners.

The primary appeal of bilateral FTAs is their ease; with only two parties, deals can be negotiated efficiently. But as the quick-and-easy option, they often fall short of promoting genuine free trade. Important but sensitive trade issues (agriculture, for instance, and services) are often excluded from bilateral FTAs, and very few deal with trade-related measures substantially. They also pose

---

8 "KORUS FTA Panel Holds 'Introductory' Talks on North Korean Factory Park," Inside U.S. Trade, November 8, 2013.

the vexing “spaghetti bowl problem” of creating a complex set of overlapping and inconsistent rules that erode the integrity of the global trade system.

Regional Trade Agreements

Regional free trade agreements are the third option, although they are technically still multilateral. Midway between (global) multilateralism and bilateralism, they involve a group of countries within a geographic region negotiating a free trade area. Trade regionalism picked up during the 1990s, through the formation of the Mercosur bloc (1991), the ASEAN free trade area (1992) and the NAFTA agreement (1994).

Regional free trade agreements are sometimes considered a trade sweet spot – easier than multilateralism, but more substantial than bilateral deals. Indeed, regionalism advocates have also described them as a building block where multilateral deals can later be built. Still, they face their own challenges. Power asymmetries within regions are often highly pronounced, leading to deals that favor the largest member at the expense of smaller partners. They also pose the risk of “balkanizing” the global trading system by dividing the world economy into competing trade blocs.

Discussion Questions:

1. Why are trade talks always about lowering barriers to trade?
2. What does the Latin term “*quid pro quo*” and why is it crucial in trade talks?
3. Large countries will always win against small countries in trade talks. Agree of not? Explain.
4. Would large countries favor bilateral or multilateral talks? Explain.
5. GATT was a very long set of trade talks. Was GATT successful? Explain.
6. Trump does not like NAFTA? Why does he favor renegotiating NAFTA?
7. Trump does not like the KORUS FTA. Why does he feel its was a bad deal?
8. TPP was not accepted by the US Congress. Both Trump and Hillary did not like it. Why?
9. The WTO was recently shown as ineffective in the Doha Talks. Explain why Doha failed?
10. The failure of the WTO with the Doha talks has caused a surge in bilateral talks. Why?