

**“US Power-Based Bargaining Redux:  
Implications for the WTO and Global Trade Flows”**

**Ian Sheldon (Ohio State University)**

**Concurrent Session: “Deal or No Deal? Re-Thinking U.S. Trade Policy”**

**IATRC Annual Meeting  
Washington DC, December 14-16, 2025**

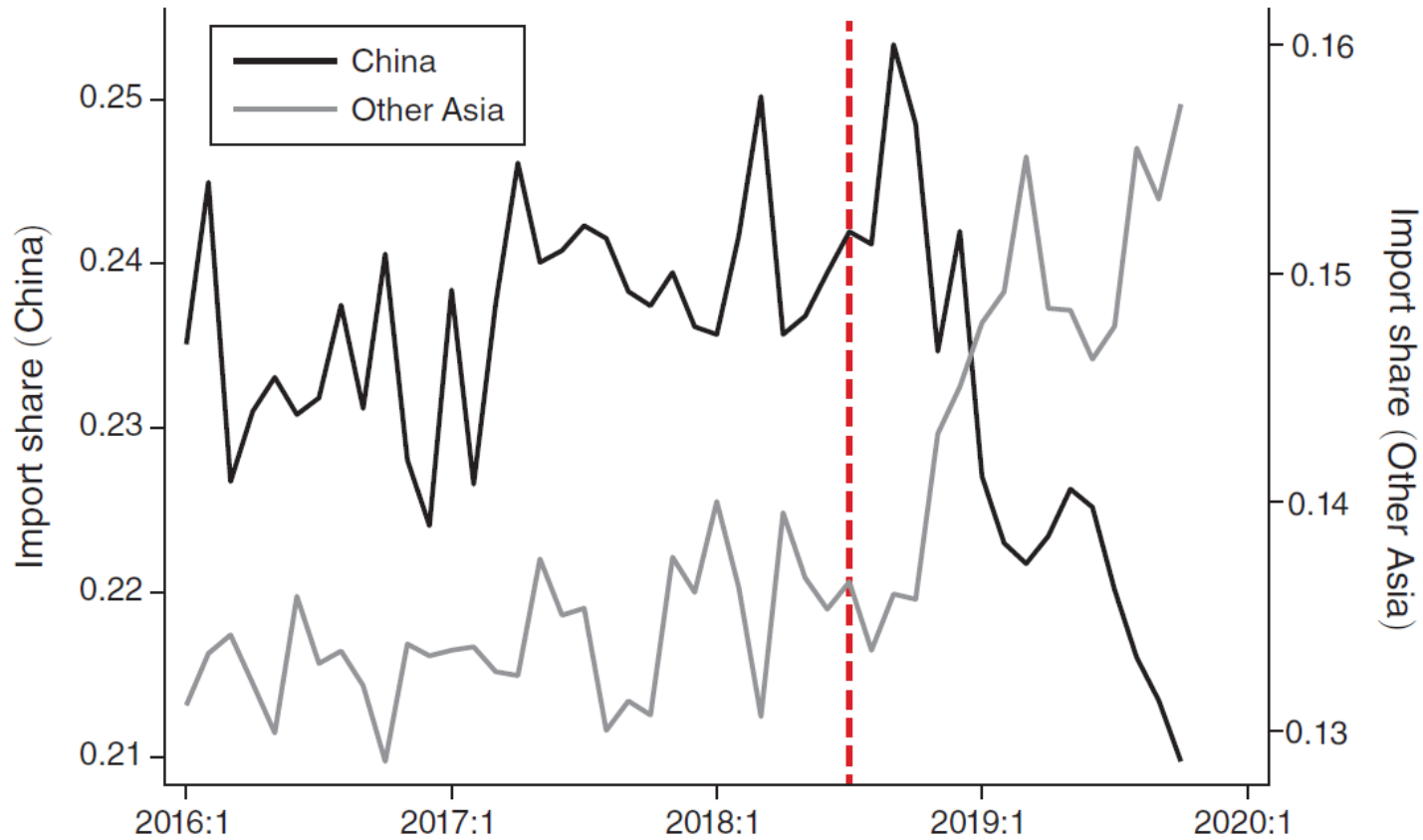


## **Initial US Shift to “Power-Based” Bargaining**

- **Creation of WTO dispute settlement mechanism described as move from a “power-oriented” approach to “rule-oriented” (Jackson, 1997)**
- **In 2018, US adopted “power-based” approach to trade negotiations with China (Mattoo and Staiger, 2020)**
- **Superficially, it worked, i.e., 2020/2021 import commitments made by China under USCTA**
- **Came at significant economic cost to US importers, consumers, taxpayers, and exporters (Fajgelbaum and Khandelwal, 2022; Grant *et al.*, 2021)**
- **Also saw reallocation of global value chains (GVCs) by both US and Chinese firms (Freund *et al.*, 2024)**

# GVC Reorganization

## Share of China and Other Asia in US Imports

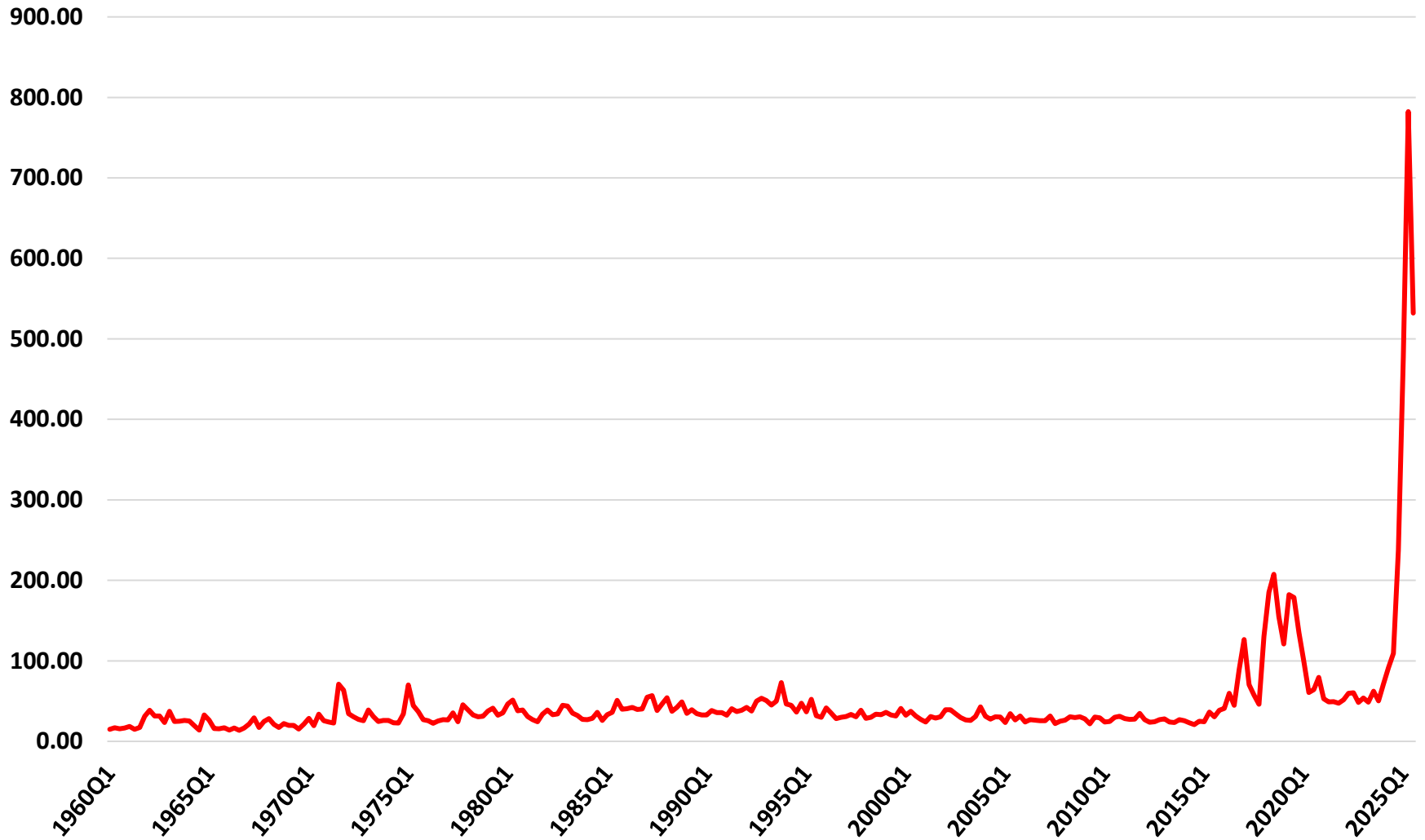


Source: Grossman *et al.* (2024)

## **“Power-Based” Bargaining Redux**

- **April 2, 2025, across-the-board-tariffs of 10% applied to all US trading partners, plus additional “reciprocal” tariffs with range of 11-50% - adjusted August 7 – but are they legal?**
- **Cross-cutting theme: targeting of countries with whom US runs bilateral trade deficits – underlying basis for published tariff formula (USTR, 2025)**
- **Average effective US tariff rate now stands at 16.8% - highest since 1935 (Yale Budget Lab, November 17, 2025)**
- **Repeated changes to/announcements about tariffs have significantly affected uncertainty about US trade policy (Baldwin, 2025) - likely to affect trade and investment choices (Handley and Limão, 2022)**

# Trade Policy Uncertainty



Source: Caldera *et al.* (2025)

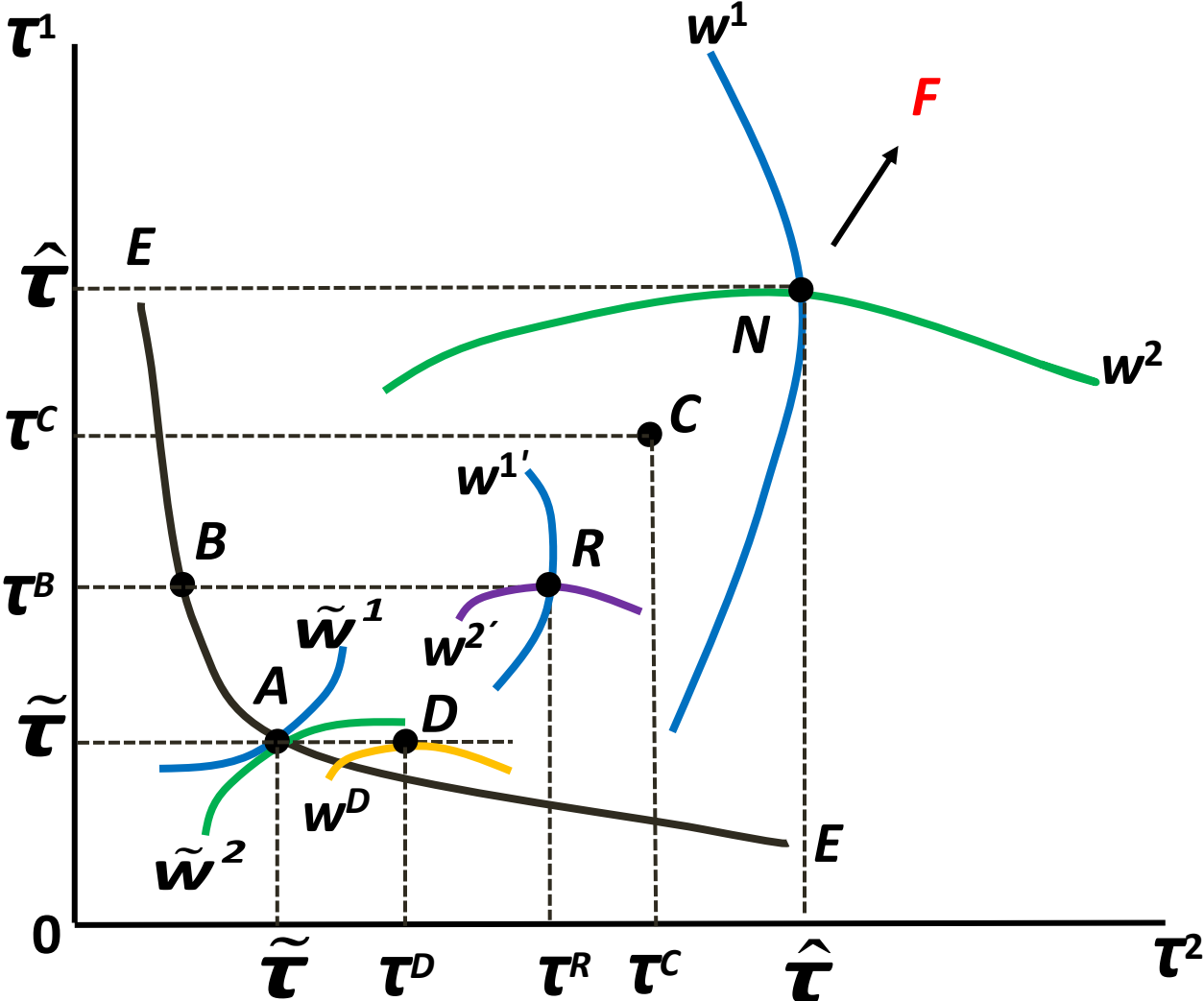
# **“Rules-Based” Trade Negotiations**

- **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 is modest, withdrawal of equivalent concessions by other country is sub-game perfect**
  - **If deviation is substantial, trigger strategy is optimal**
- **“Rules-based” approach has also neutralized imbalance in bargaining power (McLaren, 1997)**

## Simple Model of “Bargaining” Tariffs

- Two sets of countries,  $i=1$  is US, and  $i=2$  all other countries
- $i=2$  split into two sub-groups:  $A$ =developed and  $D$ =developing countries
- Welfare of  $i$  dependent on tariffs,  $w^i(\tau^i, \tau^j)$ ,  $i \neq j$ ,  $dw^i / d\tau^i > 0$
- In non-cooperative game,  $i$  have incentive to set Nash equilibrium tariffs at  $\hat{\tau}$
- Successive rounds of GATT moved average tariffs from  $\hat{\tau}$  to  $\tilde{\tau}$
- Key to process under GATT has been:
  - *First-difference* reciprocity (GATT Articles II and XXVII)
  - Non-discrimination (MFN) (GATT Article I)

# Tariffs and “Power-Based” Bargaining



## Simple Model of “Bargaining” Tariffs

- Prior to 2018, average tariff equilibrium at  $A$ , driven by “coalition of the willing”, i.e., US and developed countries
- Developed/developing country tariff equilibrium at  $D$ , with bound tariffs of  $\hat{\tau}$  and  $\tau^D$
- Two asymmetries in equilibrium tariffs at  $A$  and  $D$ :
  - At  $A$ , while average developed country tariffs are equal, variation across both sectors and countries
  - At  $D$ , average developing country tariffs exceed average developed country tariffs,  $\tau^D > \hat{\tau}$  - combination of special and differential treatment, and “latecomers” problem
- US regards asymmetries as discriminatory, administration seeking *full* reciprocity

# “Reciprocal” Tariffs

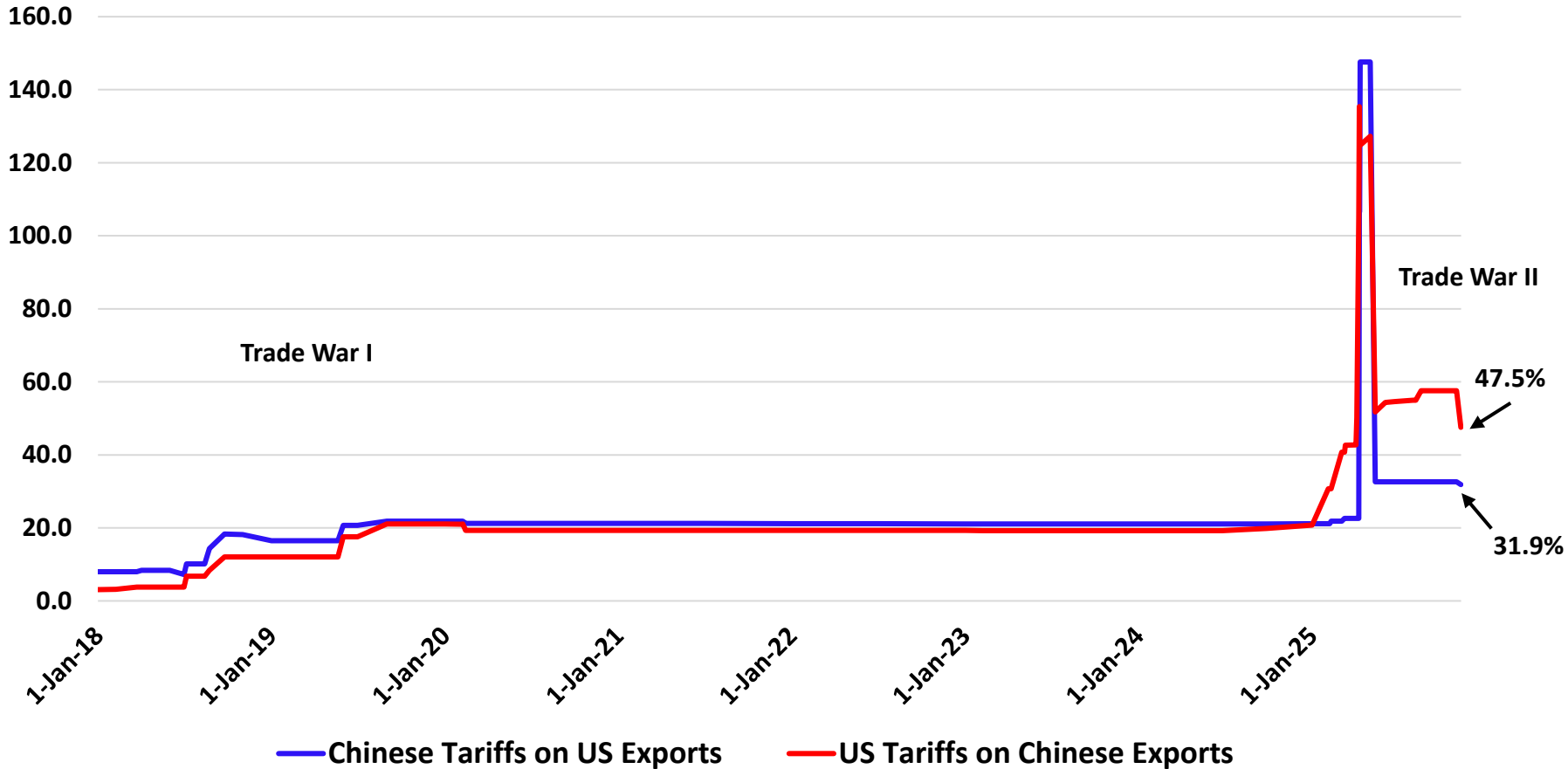
- Post-April 2, 2025, US raised its average tariff to  $\tau^B$
- In principle, objective is to push both developed and developing countries to reduce their vector of tariffs
- However, “deals” negotiated so far see trading partners such as UK and EU making concessions on market access, but still facing higher US tariffs
- Surprisingly, only muted/threatened retaliation to increase in US tariffs, i.e., no move to an equilibrium such as  $R$ :
  - differential tariff rates, e.g., Laos (40%) vs. Singapore (10%)
  - problem assumed short-term
  - security and defense concerns
  - coordination problem in face of unilateral retaliatory threats

## US and China: Trade War II

- Exception is China, which has engaged in tit-for-tat escalation, at one point moving equilibrium towards  $F$ , i.e., an autarky Nash equilibrium - moved back to  $C$  eventually
- How do current tariffs compare to “optimal” Nash tariffs?
  - Ossa (2014) calculated median US and Chinese Nash tariffs to be 59.6% and 58.6% respectively
  - Follow up study by Lashkaripour (2021), calculated Nash tariffs to be 43.6% for the US and 40.7% for China
  - Context: average Smoot-Hawley (1930) tariffs were  $\approx 50\%$
  - Laffer tariff revenue curves max out at about 50% (Clausing and Obstfeld, 2024; Evenett and Muendler, 2025)

# US and China: Trade War II

## US and Chinese Average Bilateral Tariffs



# Alternative Views

- **As economists, obviously tempting to view current US trade policy in context of our typical models**
- **US trade policy over 2018-20 was perhaps part-consistent with trade models, i.e., administration seeking to impose negative terms-of-trade effects on trading partners**
- **However, current US trade policy appears highly chaotic – why? Baldwin (2025) suggests following:**
  - **A real estate negotiator meets trade policy**
  - **Tariffs as performance rather than policy**
  - **Dismantling of machinery of US trade policy making**

# Impact of “Power-Based” Bargaining

- Unilateral violation by US of its bound tariffs is in direct contradiction of key GATT principles of reciprocity and non-discrimination
- Expected to generate significant deadweight losses to US economy (Clausing and Lovely, 2024), as well as being highly regressive (Clausing, 2025)
- Threats of and actual retaliation may reinforce transition from era of hyper-globalization to one of “slowbalisation” (Antràs, 2020)
- Continued costly reallocation of GVCs, i.e., search and matching costs (Grossman *et al.*, 2024)
- Additional costs due to transshipment of goods interacting with rules-of-origin

# **Undermining of WTO Dispute Resolution**

- **Credibility of multilateral trading system has depended on monitoring and enforcement by GATT/WTO**
- **Expectation if country considers unilaterally violating its commitments, either credible penalties are costly enough to act as deterrence and/or WTO panel will rule against**
- **However, dispute settlement paralyzed by US refusing to accept new appointments to WTO's Appellate Body (AB)**
- **If WTO panel rules against US, it can appeal it “into oblivion” – undermines two-stage adjudication**
- **In principle, if US feels there has been imbalance in its trade concessions, it should have sought to renegotiate under GATT Article XXVIII (Jouanjean *et al.*, 2025) – but current administration has little regard for “rules-based” system**

# **Future Governance of Global Trade**

- **Return to non-cooperative world 1930s-style – WTO totally undermined**
- **Regional and bilateral trade deals dominate – diminished WTO survives, its rules covering trade deflection from US**
- **Countries become members of specific trading blocs led by key players (US/China/EU) - WTO effectively sidelined**
- **Defense of trading order through plurilateral arrangements – possible revival of WTO:**
  - **EU-led coalition has already created replacement for WTO's AB (Multiparty Interim Appeal Arbitration Agreement)**

## **Concluding Observations**

- **US adoption of “power-based” bargaining in trade negotiations overturns its role in establishing governance of trade post-1947**
- **Expected to generate significant deadweight costs, policy is highly regressive, it will disrupt GVCs, and increases uncertainty**
- **Unilateral breach by US of GATT principles and undermining of WTO Appellate Body, threatens multilateral trading system – uncertain where this will end up, i.e., total breakdown vs. plurilateral leadership**
- **Transactional/erratic nature of current policy makes it difficult to rationalize in context of orthodox trade policy models**