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POLITICAL ECONOMY OF MULTILATERAL TRADE NEGOTIATIONS

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ABSTRACT

Multilateral trade agreements, while primarily negotiated on economic grounds also have significant political determinants and underpinnings. The package negotiated in a trade-round contains both political and economic benefits requiring judicial concessions and trade-offs, including carefully balancing sometimes conflicting domestic political interests, as well as advancing strategic considerations in foreign affairs. This article looks at the international political economy of trade negotiations at the WTO; and how politics influences concessions in multilateral trade negotiations.

BACKGROUND

Since the end of the Second World War and the formation of the World Trade Organisation (WTO) in 1995, the world has witnessed the vigorous revival of multilateralism and regional multilateral economic cooperation. This cooperation has brought the interplay of politics onto the world trade stage, resulting in further cooperation among states for concessions on market access. The multilateral trading system is itself both a political process, which rests upon negotiations and acceptance of trade rules to govern the behaviour of states toward each other and open their markets to each other's exports through the bargaining process. The institutions, initially the Secretariat of the General Agreements on Tariffs and Trade (GATT), and now the WTO, provide the rules, facilitate the negotiations, and more generally promote cooperation. Trade has expanded so rapidly since World War II, in large part because governments have used the multilateral trading system to progressively eliminate national barriers to international trade. The politics of international trade can only be understood through an understanding of the political dynamics of the multilateral trade system.

Box 1. Political Economy and its role in MTNs

Political economy analyses the economic and political factors that lead states to create or join regional institutions; a role which cannot be ignored, as more often than not governments are forced to negotiate for concessions that are in line with demands linked to re-election. Politics ensures that governments will care more about the distributional effects of the outcome of negotiations and the satisfaction of the vested interests of domestic stakeholders. The more skilful and powerful parties often dominate and influence the outcome of negotiations to their advantage, while the less powerful participants who have less ability to influence the agenda or the outcome of negotiations are forced to go along with the winners. The outcome of the agricultural package under the Uruguay Round is a clear demonstration of how politics influenced the signing of the largest trade agreement ever agreed, which brought limited subsidies and opened up agricultural trade more fully.

Source: Gómez-Mera L., and Barret B. (2012) Critical Debates: The Political Economy of Preferential Trade Agreements - Latin America and Beyond. University of Miami

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Implications of the political economy ensure that negotiations focus on the implementation of a series of universal principles to set the right incentives, which focus on good governance practices and the establishment of transparent institutions that support trade. This involves simulating incentives for changes in business practices, or building trust between trade regimes, trade institutions and governments through concessional negotiations on different packages, including market access and negotiation with transit regimes for access to transit corridors. It also focuses on forging mutually beneficial arrangements and partnerships with concerned institutions, including calling for reforms and policy intervention by governments in order to improve the political and economic framework concerning trade.

Issues under negotiation, often appear in the form of a package that contains the issue and all its accompanying elements. For example, a package for Landlocked Developing Countries (LLDCs) would likely contain issues concerning concessions for transit passage with transit regimes through transit corridors, to allow access to the sea and subsequently the world market. More often, this will involve negotiating with two or more states; for example Rwanda, an LLDC has to negotiate with Uganda and Kenya to gain access to the port of Mombasa in order to export products to the international market. Such a negotiation becomes more complex when LLDCs have to negotiate with coastal countries that may have military or economic incentives that will result in more costs for LLDCs and complex infrastructural development². Negotiators therefore, work toward the establishment of policies that are intended to result in best practice, with the overall objective of opening up access to markets.

POLITICS AND TRADE NEGOTIATIONS

FIRST DOMESTIC...

Governments care about the political, as well as the efficiency consequences of trade policies. Political economy models of negotiations argue that governments shape their trade policy not only in pursuit of economic efficiency, but also in relation to the political consequences of their tariff selection in order to prevent subversion of the national interest that could result in collusion within the private sector. Governments negotiate trade agreements with the aim of maximising national welfare and Pareto efficiency, which is all subject to the continual political constraint under which

Various issues under discussion at the WTO include:

For goods (under GATT)

- Agriculture
- Sanitary and Phytosanitary Issues (SPS)
- Textiles and clothing
- Product standards (TBT)
- Investment measures
- Anti-dumping measures
- Customs valuation methods
- Pre-shipment inspection
- Rules of origin (RoO)
- Import licensing
- Subsidies and counter-measures
- Safeguards

For services (the GATS annexes)

- Movement of natural persons
- Air transport
- Financial services
- Shipping
- Telecommunications

Other:

- Trade Related Intellectual Property Rights (TRIPS)
- Trade Related Investment Measures (TRIMS)
- Dispute Settlement Mechanism (DSM)
- Rules
- Environmental Goods and Services

² Arvis et al. (2010). *The Cost of Being Landlocked: Logistics, Costs, and Supply Chain Reliability*. World Bank

governments operate, that is re-election³. They have to respond to the demands of citizens and corporations who provide the votes and the funds, respectively for their re-election. Governments will negotiate for trade policies that maximise a weighted sum of the contributions offered by individuals and firms, as well as their likelihood of being re-elected. Tariffs are chosen to balance the supply and demand of protection in the political market, much as prices balance demand and supply in the goods market. Governments have to counter sectoral lobby group influences and related competitiveness concerns, and balance business perspectives with political economy considerations in the interest of promoting growth, equity and domestic employment. Demands for tariff concessions based on the political influence of domestic interest groups influence negotiation outcomes, which often reflect the lobbying power of these groups.

All these have important ramifications for the negotiation approach and strategy. International trade negotiations can carry a certain gravitas that can be tapped by reform minded constituencies to overcome resistance to liberalisation on the part of entrenched domestic interests. Prospects for reforms geared towards a country's best interest, but opposed by politically powerful domestic constituencies, can improve when external pressure is harnessed and brought

Box 2. The Politics of the DR-CAFTA Referendum in Costa Rica

In October 2007, Costa Rica became the first developing country to hold a public referendum on an international trade agreement. The Referendum asked voters to decide whether or not the country should enter into DR-CAFTA, an FTA between five Central American Countries (Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua), the Dominican Republic and the United States. The "Yes" vote narrowly won on October 7, 2007, with 51.6% of voters approving of the DR-CAFTA agreement for their country.

The debate during the lead up to the referendum was highly politicised, both domestically and internationally. Costa Rica, along with the other countries involved, had signed the DR-CAFTA agreement in 2004. However, while the others had gone ahead to ratify it, the timing of elections in Costa Rica, combined with a high level of popular opposition had delayed ratification. The government eventually called a referendum on the FTA. While the government and large industries were strongly in favour of the agreement, a large social movement, including labour unions, students and religious groups vigorously opposed it. Ultimately, the government was able to sway a sufficiently high number of voters to back its negotiating position. This appears to have been largely attributable to the strength and resources of the well-established political party, the PLN (Partido Liberacion Nacional) that backed it. Mayors in the rural areas and other state officials were placed under a high level of political pressure to support the government backed 'Yes' campaign.

Internationally, significant pressure from the US on Costa Rica to ratify DR-CAFTA preceded the referendum. Republican leaders threatened the withdrawal of the Caribbean Basin Initiative (CBI) that had eliminated tariffs on many of Costa Rica's exports to the US if the terms of DR-CAFTA were not agreed to, while US companies also threatened to leave Costa Rica. The then US ambassador to Costa Rica, Mark Langdale warned of future economic difficulties for Costa Rica if DR-CAFTA was not ratified. The CBI already ensured low tariffs on Costa Rican goods so there was little to be gained for Costa Rican exporters as a result of DR-CAFTA. Voters approved the ratification of the referendum and the government went ahead and ratified DR-CAFTA.

Source: Jones, E. (2013). *Negotiating Against the odds: A Guide for Trade Negotiators from Developing Countries*.

³ WTO, 2007. World Trade Report 2007: Sixty Years of the Multilateral Trading System : Achievements and Challenges

to bear. Trade negotiations can become highly politicised in the domestic setting as became apparent in Costa Rica in the national referendum on the Dominican Republic-Central America FTA (DR-CAFTA), an agreement between five Central American Countries, the Dominican Republic and the United States (US)⁴. In the Referendum, politics, namely domestic political parties using their organisational strength to cue and frame messages for voters, influenced the country into ratifying the DR-CAFTA (Box 2). The referendum provides a unique example on the role of domestic politics in shaping voter preferences over trade policy, presenting the first occasion in history whereby a final decision on a free trade agreement was made by the entire electorate of a country⁵.

Trade agreements have taken centre stage in debates surrounding the ongoing 2016 US presidential election campaigns, where White House contenders seem to be sceptical of FTAs. Contenders such as Donald Trump to the right, and Bernie Sanders to the left, are using the argument that free trade agreements, in particular the Trans-Pacific Partnership (TPP)⁶ trade deal, are disastrous and will encourage American companies to cut the number of domestic jobs, all in a bid to win electoral support and votes from the high number of displaced American voters⁷. While trade agreements have a role to play in consolidating and buffering domestic reforms from subsequent political motivation to backtrack, negotiations could also cause countries to recoil from reforms they might otherwise undertake unilaterally, since a single country may be more willing to liberalise when they do it on their own terms, with the knowledge that if push comes to shove they can reverse course⁸.

...THEN INTERNATIONAL

Economists have identified specific results from the political-economic interplay of trade negotiations. Governments are assumed to voluntarily enter into multilateral trade negotiations (MTNs) and trade agreements. Multilateral negotiations focus on establishing cooperation in order to provide mechanisms through which foreign exporter interests are taken into account in a domestic government's trade policy decisions, so as to ensure that efficient levels of protection are chosen. The result is market access for market access based negotiations. However, at times politics may make it difficult for governments to realise the gains available from free trade. Governments may feel reluctant to enter into free trade agreements and offer market concessions, out of fear that partner states may be pursuing their own interests at the expense of the signatory states. The arising concern within governments is that the other party might cheat in an agreement, and the conjunction of an inability to prevent such cheating may prevent governments from concluding reciprocal agreements. Crafting reciprocal trade agreements therefore, requires governments to balance political gains (both domestic and international) and losses, as well as economic gains and losses. The inability to enforce reciprocal trade agreements is a major political problem in the negotiation for trade liberalisation.

⁴ Jones, E. (2013). *Negotiating Against the odds: A Guide for Trade Negotiators from Developing Countries*. Commonwealth Secretariat

⁵ Hicks et al. (2011). *Trade Policy, Economic Interests and Party Politics in a Developing Country: The Political Economy of CAFTA*

⁶ The Trans-Pacific Partnership Agreement (TPP) is a free trade agreement under negotiation between the United States, European Union and other countries in the Pacific.

⁷ TPP trade deal 'a disaster,' other countries will 'dupe' US - Donald Trump. <https://www.rt.com/usa/257377-tpp-deal-trump-criticism/>

⁸ Ikenson, D. (2006). *Leading the Way: How U.S. Trade Policy Can Overcome Doha's Failings*. Trade Policy Analysis, June 19, 2006 No. 33

INTERNATIONAL INSTITUTIONS

International institutions that govern multilateral trade are more often the result of international politics, and the role they play in MTNs cannot be overlooked. For example, the WTO provides a platform for the governance and regulation of international trade to ensure equal terms for all members and a level playing field. This works to prevent countries with greater market power from manipulating the terms of trade at the expense of their trading partners. Manipulation of the terms of trade creates negative externality for other countries, as it often involves the imposition of an optimal tariff, and if all countries imposed optimal tariffs, none of them would realise the welfare gains – the reason behind trade negotiations – and which could lead to a costly trade war. The WTO and the multilateral trade regime stimulates free trade by placing an obligation that compels members to lessen their ability to supply protectionism to domestic interest groups. The result is a theoretically equal playground for all since there is no agreement unless all agree⁹. Successful MTNs may help governments to foster the political support needed to implement a freer trade policy, if it is mutually beneficial to all parties. While accountable, transparent and democratic institutions are necessary, and do regulate international trade, there exists “no ‘free’ baseline, untouched by politics, history and culture, to which we can aspire”¹⁰.

Effective and sustainable international cooperation builds on a predictable institutional framework that embodies a pre-commitment by governments to certain policy stances¹¹. International economic policy should not only be about trade protection since the treatment of international capital flows and exchange-rate policies also exert a strong influence on *its* outcomes. According to the WTO, governments engage in trade negotiations in order to reap the benefits of free trade for consumers and are willing to offer access to their markets in order for their exporters to benefit in other free markets. A series of political decisions and special interests exist that control and impact every aspect of trade deals being made. Politics is at the centre of every aspect of trade, both at the domestic and international level.

ABBREVIATIONS

CBI	Caribbean Basin Initiative	MTNs	Multilateral Trade Negotiations
DR-CAFTA	Dominican Republic-Central America Free Trade Agreement	PLN	Partido Liberacion Nacional
DSM	Dispute Settlement Mechanism	RoO	Rules of Origin
FTA	Free Trade Agreement	RTAs	Regional Trade Agreements
GATS	General Agreement on Trade in services	SPS	Sanitary and Phytosanitary Standards
GATT	General Agreements on Tariffs and Trade	US	United States
LLDCs	Landlocked Developing Countries		

⁹ Theoretically since in some cases, pressures are placed on countries to agree to certain deals

¹⁰ Unlearning Economics (2013). *The Politics of Free Trade*. July, 23, 2013.

www.pieria.co.uk/articles/the_politics_of_trade

¹¹ WTO, (2007). *World Trade Report 2007: Sixty Years of the Multilateral Trading System: Achievements and Challenges*

HOW CAN WE HELP?

Support C-level executives and boards to prepare for different challenges

International Economics can help facilitate internal discussions on strategy by providing technical insights, developing dashboards of key performance measurements, and giving advice to executive boards on building resilience to possible disruptions related to exogenous trade shocks, such as Brexit or Donald Trump's Presidency. We work closely with our clients to brainstorm and identify challenges and opportunities based on our professional experience.

Map market access

In order to quantify the potential costs to your business in engaging in trade, including tariffs, standards, and customs procedures, among many others, we (i) undertake a mapping of which terms are most at risk of changing and by how much, depending on the type of agreements; and (ii) quantify and forecast the potential effect on your business using predictive analytics to generate insights into future outcomes.

Navigate through trade and investment agreements

With more than 400 trade agreements and 2,400 investment agreements already in place, *International Economics'* team is able to navigate through them, guiding and identifying which specific agreement will better suit the interests of our client. Additionally, we have developed optimization techniques, through the use of sophisticated rules and algorithms, to analyse the Free Trade Agreements (FTAs), which are growing in space, depth and complexity, in order to offer insights into investment and trade decisions. With increasing fragmentation of global production networks and the need for careful evaluation of supply chain risks, the tools developed by *International Economics* offer a solid foundation for the adoption of critical decisions by businesses.

Prepare briefings and strategic papers

Our clients need to prepare strategic position papers to assess the issues and prepare responses, whether it be internal restructuring, supply chain re-engineering or addressing policy risks. We assist our clients with short, impactful, and relevant position papers, including setting out the possible impacts of risks at different business levels (policy, financial, structural, etc.) and provide the latest thinking on the issues to date, based on a holistic economic framework.

Undertake a full economic and legal review of the trade and investment exposures to worldwide events

We conduct independent and objective reviews of the impact of different worldwide events on your business and industry. We use deep learning tools, large multi-country macro models and the latest unstructured data to offer insights into the risks, exposure assessments and likelihood of disruptions to supply chain. These provide our clients with a competitive advantage as they prepare mitigation strategies and leverage identified opportunities. We work with our clients to develop the right strategies and make breakthrough decisions.

Brexit: Help the private sector position itself during the UK's trade negotiations

Brexit will affect our clients' business strategies, supply chains, funding, tax positions, regulations, growth and opportunities. *International Economics* works with public affairs companies and specialized firms to offer the full range of trade-related technical support and advice to help companies position themselves and ensure that their interests are addressed in the negotiations.

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