

Cashing in on Cooperation

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February 1, 2010

Protesters in the streets view international economic organizations such as the World Trade Organization (WTO) as hostile to democracy. Critics on both the left and right warn against the restraints of international rules, which they portray as the product of corporate interests or self-serving international bureaucrats. Yet the rise of legalization in international affairs over the past 20 years has taken place alongside the spread of democracy. The trend of democratic governments confronting challenges of economic interdependence by turning to international organizations for help has proven predominant and shows few signs of abating. The role of these organizations is not simply to solve coordination problems among states but also to solve coordination problems within states, especially democratic states. Rather than seeing international organizations as a threat to democracy, we should view them as a necessary tool for democratic leaders trying to balance conflicting pressures at home. A closer look at trade policy highlights the complementarities between democracy, economic interdependence, and international law.

How do democratic governments manage trade policy? Electoral incentives create conflicting pressures to provide economic growth that will benefit the general interest and to respond to special interest groups that offer money and votes. To the extent that free trade raises income levels, it will please everyone, but all recognize that trade brings winners and losers. Support for free trade in democracies therefore depends on whether export industries mobilize to counterbalance protectionist groups and whether the government is able to

persuade the public of a broader interest in free trade. Research shows that, over the past 30 years, democracies have undertaken trade liberalization at a higher rate than other governments. How have they harnessed the pressures for aggregate welfare gains while resisting protectionist lobbies? International institutions play a critical role in this process. The WTO has been on the frontlines of the international financial crisis in ways that are not widely recognized, and it deserves credit for holding back the kind of protectionism that occurred after the stock market crash of 1929.

The Mixed Record of Democracy and Free Trade

The rise of democratic governments in the early 20th century contributed to the unraveling of the first golden era of globalization. Leaders who sought support from newly organized and enfranchised labor movements and trade associations could not be indifferent to unemployment and the devastation wrought by falling world prices. The United States took the lead in the turn to protectionism with the infamous Smoot-Hawley Tariff Act of 1930. In a classic example of log-rolling across narrow interests in democratic legislatures, Congress passed the tariff legislation that increased tariffs across both agricultural and light industry products. President Herbert Hoover had campaigned in 1928 with promises to address the grim situation of farmers who were facing low prices and foreclosures brought on by rising mortgage debt. He faced pressure from strong protectionist sentiment in the Republican Party, and so he reluctantly signed the bill even while he criticized it for the negative effect on international cooperation and the global economy. Indeed, the legislation led to other countries imposing similar tariff hikes that choked off US exports. The Great Depression witnessed the rise of beggar-thy-neighbor policies, as governments hoped that protectionist walls and currency devaluation could shelter their home markets from downward trends in world prices. Instead, the turn toward trade protection only worsened the crisis.

The second era of globalization following World War II was made possible by

two key institutional changes that helped to make democracy more compatible with free trade. First, the leading economic power, the United States, enabled a free trade coalition to emerge at home with a Congressional decision to grant the President authority to negotiate trade agreements for reciprocal market access. The Reciprocal Trade Agreements Act of 1934 encouraged mobilization by exporters and countered the tendency for a protectionist log-roll in Congress where narrow interests held sway over representatives concerned about re-election in their district. Second, the General Agreement on Tariffs and Trade (GATT) was established in 1947 as a multilateral agreement to engage in liberalization with public commitments and to monitor cheating. Bringing together a large number of issues in a package negotiation among major trading states further increased the stakes for both aggregate welfare gains and specific exporter interests in order to counter-balance appeals from protectionist groups. By increasing the credibility of international free trade, the international institution offered reassurance to exporters that market access gains would be sustainable. At the same time, flexibility was built in to allow for temporary protection, and levels of liberalization varied across sectors as governments continued to shelter their most sensitive industries. A dispute system helped to manage the trade conflict that arose when countries cheated or had different interpretations of the agreement.

Nevertheless, political pressure in representative governments continues to complicate trade policy. In the United States, rising trade deficits spark Congressional proposals for protectionist legislation and restrictions on the executive mandate for trade negotiations. Farmers across most democracies gain protection as a result of their political influence in electoral systems that favor highly mobilized interest groups and provide greater representation to rural areas. The timing of elections, whether in the United States or India, has held up progress in the recent Doha Round of WTO negotiations. Leaders, fearful that concessions in the trade negotiation could alienate powerful constituencies important for electoral victory, take inflexible positions while trade partners also hold back concessions to wait for the election outcome.

Compliance with trade rules is fraught with difficulty for democratic states. Democracies are more likely to be brought before the WTO dispute process with complaints about policies inconsistent with WTO agreements. Moreover, failures to meet compliance deadlines in the United States and Europe have largely occurred for cases that required new legislation from Congress or policy change by the Council of Ministers. While an executive cognizant of broader interests in the trade system can implement changes to comply with negative rulings against trade measures, representatives must defend industry interests with a show of resistance, such as being dragged to court and waiting out the last appeals and compliance deadlines.

Balancing Conflicting Interests at Home

Governments face a two-level game in negotiations where they must attempt to find an agreement that is acceptable to both the international trade partners and the domestic legislature that must ratify the agreement. Careful structuring at the international level is necessary to facilitate consensus-building process at home. The progress made in the Uruguay Round trade negotiation (1986-1994) to reduce agricultural tariffs and subsidies occurred because the “single undertaking” negotiation encouraged exporters in Europe and Japan to see agricultural liberalization as a necessary price to achieve lower tariffs on industrial goods and service liberalization. At the same time, countries like Brazil faced pressure from their agricultural export interests to negotiate a strong agreement, which helped persuade those reluctant to accept new commitments for service liberalization and protection of intellectual property rights. The final agreement broadened the scope of liberalization and strengthened enforcement by reforms of the adjudication process. By linking issues in a package deal, all members could build support for the agreement based on expectations of gains for some to offset the losses for others. The eagerness with which non-members have lined up to join the WTO shows that many are convinced by the promise of market access and rule enforcement.

The current Doha Round negotiation, however, continues to encounter difficulties. Negotiations remain bogged down over talks about formulas for cutting tariffs and offering flexible exceptions without entering the heart of negotiations about quid pro quo liberalization of individual products. As a consequence, with no specific gains in sight, exporters have not lobbied for the agreement. Moving more quickly to engage in negotiations that promise tangible and credible market access is necessary to generate mobilization. Multilateral negotiations help domestic coalition-building processes by visible reciprocity that widens the appeal of the agreement at home. The abstract call for liberalization combined with tedious debates over reduction formulas fail to have this positive effect on domestic politics.

As governments attempt to respond to conflicting domestic pressures and build a free trade coalition, the international realm can help them to rally support at home. The “crisis” of imminent negotiation failure can help spotlight the tradeoffs for those with a stake in long-term open and stable trade relations. When negotiations appear on track and removed from everyday business, exporters lose focus; only the voice of importers—who face the daily struggle for business survival—is heard by representatives. It requires the drama of negotiation collapse to attract media headlines and to rally exporters. When the trade system appears on the brink, then opinion editorials and exporter associations will demand concessions for the sake of the trade system. While there are risks to moving forward by means of crisis, fading into obscurity in the realm of technocrats presents an even greater danger.

For the maintenance of the free trade system, adjudication plays a critical role by allowing democratic governments to blow off steam without launching a trade war. States enforce trade rules through using a dispute settlement process

whereby states file complaints against their trade partners to initiate a process that can lead to legal rulings by panels of trade diplomats and an appellate body. But in a system where more than half of the disputes are settled out of court before any ruling and where 90 percent of rulings find a violation against the defendant, political utility of the law can be as important as the value of legal interpretation. The complainant state is able to take action against unfair trade policies while the defendant can appear tough in defense of its own trade protection measures.

The classic example is the use of steel safeguards by President George Bush in 2002 that offered relief to the US steel industry and fulfillment of an election promise. Eight WTO members joined to file complaints against the measure and won the legal ruling in 2003. With retaliation pending and US exporters and steel users both mobilized against the measure, the Bush administration removed the safeguards following the ruling. All sides had played through the ritual to reach the expected outcome—the United States had achieved the temporary cheating it needed for domestic political reasons while the other WTO members had been able to show they were doing something to defend their own exporters who were being denied market access. Neither side wanted extended protection or a trade war. Absent the formal process of dispute settlement, either of these options would have been a very real possibility. The same scenario appears to be repeating itself now as President Obama imposes safeguard measures against imports of tires from China and the Chinese government initiates a WTO complaint to protest the measure. The administration offers a symbolic victory to the United Steelworkers union that demanded the measure, while China warns trade partners it will respond to protection against its exports. In the long run, both sides care more about the overall gains from economic interdependence and diplomatic cooperation than the goals of narrow interests in the dispute.

In sum, the international trade regime facilitates the building of support for free

trade to counter pressure for protectionism. Linking issues helps to mobilize exporters whether in a trade round or against a policy ruled as a violation in court. Staging a negotiation crisis creates a focal point to rally support for broader interests in free trade. Filing a lawsuit against trade partners offers a way to challenge unfair barriers without launching a trade war with unilateral policies. These tricks are useful for democratic governments that not only recognize the aggregate welfare gains from free trade but also need to respond to specific interests. Yet they go beyond public displays to offer genuine accountability. Reciprocal liberalization rests upon a promise of market access in exchange for liberalization. Combining issues in a package deal and enforcing agreements through adjudication offers assurance that genuine market access results will be achieved. The same strategies could be pursued without the institutional framework if leaders did not have to worry about mobilization of interest groups and public opinion. The democratic process of building support for free trade, however, places a premium on rule-based commitments and enforcement.

A Vanguard against Protectionism

The WTO has played a central role in holding back the protectionism that one would otherwise have expected to arise in the current economic crisis. As incomes fall and unemployment rises, most governments face unprecedented pressure to impose new trade barriers. World merchandise trade fell by 10 percent in 2009, but this can largely be attributed to a contraction of demand rather than a massive increase of protectionist policies. In his annual report to the Trade Policy Review Body on November 18, 2009, WTO Director-General Pascal Lamy concludes, “Although there have been instances of slippage, in general terms the world economy is about as open for trade today as it was before the crisis started.”

Anti-dumping measures represent one of the most common barriers erected when industries suffer from declining incomes. The current crisis has witnessed

a modest increase of anti-dumping duties as the number of new anti-dumping investigations reported to the WTO rose 15 percent from July 2008 to June 2009 compared with the previous year. Safeguard measures are another policy to protect markets from a surge of imports. In 2009, governments initiated 26 safeguard measures as of the end of October, which represented an increase over levels in recent years but was still well below 2002 when 34 safeguard measures existed. Distortion from government stimulus packages is an area of concern since programs may favor national producers indirectly. But generally there has been “legal protection” within the rule framework. Some governments have raised applied tariff rates closer to their bound tariff rates as allowed in their tariff schedule, but no government has declared that the emergency is a reason to exceed bound tariff rates. All remain committed in principle to negotiating an agreement for more liberalization in the Doha Round even if it appears likely to take another year or more to reach agreement on the terms. Where unfair trade measures are encountered, governments continue to use the rule-based adjudication system to enforce their rights. These disputes are at a comparable level with past years—14 new WTO complaints were filed in 2009, which is below the average number of 21 complaints filed per year since 2000. In short, across a range of measures there is no indication that states are making a dramatic turn toward protection. The contrast with the response to the 1930 economic crisis is sharp.

Renewed Commitment

Yet the trading system now faces a similar threat to the interwar economic period when much of Europe erected trade barriers while turning to rely on imperial preferences to sustain their trade needs. Well before the onset of the current economic crisis, governments were entering a wave of bilateral and regional preferential trade agreements (PTA). Currently 186 PTAs have been reported to the WTO, and another 100 or more are at some stage of negotiation. These agreements offer quick results with important gains for some exporters and more flexibility to offer exceptions to sensitive industries. Moving forward with liberalization among a coalition of the willing can advance economic gains and foreign policy goals. Yet it undermines the ability to counter protectionist

interests. PTAs are often pairings of states with large asymmetries in economic size. The United States and Europe are not being forced to make any hard compromises in order to conclude preferential trade agreements. As exporters find their interests met in bilateral agreements, the free trade coalition for broad multilateral liberalization grows weaker. The retreat into regional trade blocs in the 1930s took place in a vacuum without an overarching multilateral trade regime, and this extreme scenario is unlikely to recur. Nonetheless, regional and bilateral trade agreements threaten the multilateral system as we observe exporters showing less interest in the fate of the Doha Round. The political capital that must be used in efforts to persuade legislatures to approve PTAs takes away from leverage that could otherwise focus on building support for multilateral talks.

The observation that democratic states lead in economic openness does not arise automatically. Democratic institutions give rise to conflicting pressures between aggregate welfare and the demands from narrow interest groups. Under the hostile economic conditions and lack of international institutions in the 1930s, democratic institutions facilitated log-rolling for US protectionism. Today the economic crisis has not undermined free trade because international institutions lock in policy commitments made during better times and offer venues for resolving disputes in ways that are at once responsive to domestic interests and supportive of the overall rules system.

The past century of international relations has been shaped by the parallel trends of increasing democratization, economic interdependence, and legalization of international affairs. This essay has examined how these trends are closely inter-related. The international context of institutions provides necessary support to allow democracies to manage economic interdependence. The ongoing economic crisis may tempt leaders to focus on job creation and banking regulations while putting off the hard decisions in the Doha Round. Doing so would be a mistake. Reciprocal trade liberalization creates jobs, and a

system of rules ensures that temporary cheating during hard times does not lead to a permanent reversion to protection and trade wars. Without these rules, democracies would likely retreat into policies that pander to narrow interests for protection. Leaders take for granted the stabilizing force of the WTO in the current crisis at their own risk.

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June 13, 2014