



# WTO/ESCAP Third ARTNeT Capacity Building Workshop on Trade Research

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Six Decades of Multilateralism:  
What Have We Learned?

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(forthcoming)



# Outline

- Economic perspectives on trade agreements
  - Three main approaches:
    - Terms-of-trade approach
    - Political economy approach
    - Commitment approach
  - Secondary justifications
- International Relations perspectives on trade agreements
  - Neoliberal institutionalism approach
  - Neorealism approach
  - Liberalist approach
  - Social constructivist approach
  - Security approach



# Outline

- Legal perspectives on trade perspectives
  - The inward-oriented constitutional approach
  - The Outward-oriented (transnational) constitutional approach
  - The inward-outward constitutional approach
  - The cosmopolitical constitutional approach
- Relationships between approaches
- Cooperation among diverse nations
- Conclusions



# Economic Perspectives on Trade Agreements: The Three Main Approaches

- Trade agreements must alleviate inefficiencies that would otherwise arise in their absence
- Three approaches regarding the source of inefficiencies:
  - Terms-of-trade approach (the “received theory”)
  - Political economy approach
  - Commitment approach
- Approaches not mutually exclusive



# Terms-of-Trade Approach: Overview

- Rooted in “optimal” tariff theory
  - Torrens (1884), Mill (1884)
- Unilateral “optimal” tariff setting is a beggar-thy-neighbour policy, i.e. imposes terms-of-trade externalities on trading partners
  - Johnson (1953-54)
- A terms-of-trade-driven prisoner’s dilemma thus arises



# Terms-of-Trade Approach: Bagwell and Staiger (1999, 2002)

- Two things positively affect government welfare:
  - Removal of domestic distortions (RDD)
  - Terms-of-trade improvements (TOT)
- “Optimal tariff” rationale for protectionism:
  - $TOT \uparrow$   $RDD \downarrow$
- Prisoners’ dilemma when both A and B adopt non-cooperative “optimal tariffs”:
  - $RDD \downarrow$
- Each government would like to liberalise for RDD reasons but doing so unilaterally would reduce TOT:
  - $TOT \downarrow$   $RDD \uparrow$



# Terms-of-Trade Approach: Bagwell and Staiger (1999, 2002)

		B	
		Free Trade	Protection
A	Free Trade	10	20
	Protection	-10	-5



## Terms-of-Trade Approach: Scepticism

- Lack of practical relevance for policymakers
- Lack of correspondence between predictions and observed tariff patterns and instruments of protection
- Lack of correspondence between predictions and observed characteristics of trade agreements
- Lack of empirical support
- Provides no explanation of small country participation in trade agreements



# Political economy approach: Overview

- Governments care about the political as well as the efficiency consequences of trade policies
- Individuals and firms are demanders of particular trade policies, such as import protection, and governments are suppliers
- More protection is provided than would be efficient from economic reasons alone
- Reciprocal concessions via a trade agreement serves to mobilise exporter support in favour of liberalization



# Political economy approach: Overview

Modelling trade agreements in this way facilitates explanation of 3 key points that traditional models neglect:

- the process of liberalization has been gradual
- much liberalization has taken place in products where two-way trade is prevalent
- trade agreements generally do not prohibit terms-of-trade manipulation



## Commitment approach: Overview

- Trade agreements correct domestic inefficiencies resulting from interactions between governments and the private sector
- Such inefficiencies arise from time-inconsistency problems
- By "tying the hands" of a government, trade agreements improve the credibility of government commitments and thereby mitigate time-inconsistency problems



## Commitment approach:

### Removal of infant-industry protection

- Inefficient industrial sector developed behind high tariff barriers
- Government announces that industry will be opened to foreign competition
- If credible, industry will restructure
- If not credible, industry will not restructure
- If the industry does not restructure, future liberalization will be sub-optimal
- Without a trade agreement that enhances credibility, countries will be unable to liberalize



## Commitment approach: Distortion minimizing trade agreements

- Apparent contradiction with political economy models?
- Trade agreements minimize distortions in the present that may arise in the future:
  - Long-run costs of lobbying activities
  - Costs of temporary delays in adjustment process
  - Over-investment



## Commitment approach: Scepticism

- Weak incentives to enforce rules in dispute settlement proceedings with small and developing countries
- Contradictory “escape clause” features of trade agreements
- Other credibility enhancing measures available
- Lack of, and contradictory nature of, empirical evidence
  - Staiger and Tabellini (1999)
  - Eshenbach and Hoekman (2006)



## Secondary Justifications of Trade Agreements

- Less dominant approaches can also be used to interpret trade agreements
- Some of these secondary reasons apply mainly to preferential agreements:
  - Protectionism
  - Increasing bargaining power
- Some apply to both preferential and multilateral agreements
  - Increasing market size
  - National security
  - Insurance motive



# International Relations Perspectives on Trade Agreements: Overview

- “Rationalist” approaches:
  - Neoliberal institutionalism
  - Neorealism
  - Liberalist
- Social constructivist approach
  - Constructivism less frequently applied than rationalist approaches
- Security approach



# International Relations Perspectives on Trade Agreements:

## Neoliberal institutionalism

- Cooperation between states can be explained in terms of calculations of self-interest
- Pursuit of self-interest leads to a prisoners' dilemma situation
- Institutions facilitate cooperation by:
  - Providing information
  - Reducing uncertainty
  - Lowering "transaction costs"
    - costs of making, monitoring and enforcing rules



# International Relations Perspectives on Trade Agreements: Neorealism

- Neorealists question the relevance of the prisoner's dilemma metaphor:
  - Where states will end up on the Pareto frontier is the most prominent issue
  - “Battle of the sexes” game more relevant
- Also argues that states are “defensive positionalists” rather than “rational egoists”
- Fearon (1998) argues for a hybrid between Neorealism and Neoliberal institutionalism:
  - Trade agreements involve bargaining (neorealist) and enforcement and monitoring (neoliberal)



# International Relations Perspectives on Trade Agreements:

## Liberalist

- Establishes the link to domestic politics
- The state represents a subset of domestic society
- Domestic politics makes international cooperation more difficult
- Certain design features of trade agreements can be explained by domestic political considerations



# International Relations Perspectives on Trade Agreements:

## Social Constructivist Approach

- Argues that rational choice theories fail to account for the role of ideas and knowledge in shaping the identities of states
- “Epistemic communities”
- Learning
- “Strong cognitive” theories reject the use of the utility-maximizing states assumption
- “Embedded liberalism”



# International Relations Perspectives on Trade Agreements: International trade and security

- Trade agreements are more likely to occur within than between military alliances
- “Commercial liberalism”
- Multilateral, non-discriminatory nature of the post-World War II trading system was influenced by the idea of facilitating commercial liberalism



# Legal Perspectives on Trade Agreements: Overview

- Legal perspectives more descriptive than explanatory
- Basis:
  - The individual citizen is the legitimate principal in all domestic and world affairs
  - “Government failure” needs to be corrected by a constitution
- Constitutions
  - Rights-based
  - Contractarian



# Legal Perspectives on Trade Agreements: Overview

- This leads to four rationales for trade agreements:
  - The inward-oriented constitutional approach
  - The Outward-oriented (transnational) constitutional approach
  - The inward-outward constitutional approach
  - The cosmopolitical constitutional approach



# Legal Perspectives on Trade Agreements: Inward-looking approach

- Trade agreements serve as an international “anchor” against government misdemeanour
- Several reasons why an international agreement is necessary:
  - International agreements increase costs of protectionism
  - External “hand-tying” is easier to monitor
  - Reciprocity
  - Easier than a constitutional amendment
  - Superior binding force



# Legal Perspectives on Trade Agreements: Outward-looking approach

- Outward-looking rationale focuses on international externalities
- Foreign barriers strip domestic citizens of their basic economic rights, without representation
- Trade agreements allow the foreign representation of domestic interests



# Legal Perspectives on Trade Agreements: Inward-outward-looking approach

- The inward-outward rationale seeks to strike a balance between the previous two perspectives
- Governments consist of often conflicting elements, i.e. executive, legislative and judicial branches
- The legislature realise that short-term gains will be outweighed by foreign retaliation
- Trade agreements are delegated to the executive by the legislature
- Trade agreements are more in line with the objectives of the executive



# Legal Perspectives on Trade Agreements:

## Cosmopolitical constitutional approach

- Cosmopolitical constitutional approach assumes the world to be like one nation
- Critical of the previous three rationales which are fundamentally state-centric
- “World citizens” give themselves a global trade constitution



# Legal Perspectives on Trade Agreements: Comparison of approaches

- General criticisms:
  - No explanation of how constitutions are written
  - No explanation (apart from in the inward-outward approach) of why governments would negotiate agreements against their interests
  - Predominance of normative overtones



# Pulling together the strands

Four main clusters:

1. Agreement contributes to solving a domestic efficiency problem (political economy, commitment, liberalism, legal inward-oriented)
2. Agreement addresses international spillovers or externalities (terms of trade, neoliberal, institutionalism, inward-outward legal)



## Pulling together the strands (2)

3. “Ideational” – normative perspective (constructivism, hegemonic stability, neoliberal institutionalism, cosmopolitan approaches)
4. The “realpolitik” argument – power-based (distributive efficiency) to define power relations, offensively and defensively (neorationalism, hegemonic stability)



# Cooperation Between Diverse

- Other motives for cooperation
  - Attract FDI
  - Insurance
  - Increased bargaining power
  - National security and protectionist measures
  - Increasing market size



# Some policy conclusions

- ◆ Varied motivations for cooperation – need for something for everyone
- ◆ Post-agreement uncertainty:
  - ◆ Not all eventualities foreseen (incomplete contract)
  - ◆ Change of circumstance
  - ◆ Change in underlying interests