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Making Trade Policy

In each of the cases in this volume, we see a variety of participants working to influence and design trade policy. Interested parties debate four basic questions as they negotiate international trade agreements and policy changes: What issues and sectors should be included in the agreement? How deep should trade agreements be? How will any decisions be enforced? And should all signatories be treated equally—in particular, how should developing countries be treated?

The answers to these policy questions are not determined by quiet analytical reflection in an ivory tower. Rather, decisions are made in a political context through negotiations between governments, corporations, nongovernmental organizations, and interest groups. Therefore, addressing two other questions that are fundamental to any political debate can help to clarify how trade policy is made. First, who wins and who loses? Any new policy will benefit some groups more than others. And second, how does the agreement affect governance? International agreements not only determine rules, they also determine who makes those rules and who enforces them. In short, international trade agreements are highly political endeavors because they affect the distribution of both income and power.

For each case, we provide an introduction that considers each of the above questions and its application to the decision at hand. Here, we briefly note some commonalities—themes that emerge repeatedly from these highlighted trade talks. In all the cases, we find changes that add to the comprehensive scope of trade agreements, deepen their requirements, make their enforcement stronger, and place more demanding requirements on developing countries.

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Coverage

What issues and sectors should be included in any particular trade agreement? What is the appropriate scope for discussions? On the one hand, some believe that the scope of trade agreements should be narrow, limited only to policies that are directly related to trade (such as tariffs, quotas, and export subsidies) and to those aspects of domestic policy that explicitly discriminate against foreign goods. Proponents of this view, concerned about mission creep, argue that having too many targets may prevent any from being attained. An institution that takes on too much can blunt its effectiveness and even call its own legitimacy into question. The World Trade Organization (WTO), for example, may be well suited to deal with trade liberalization, but it lacks the expertise or legitimacy to tackle environmental policies, competition policies, or labor standards—not to mention human rights. In addition, some argue, any WTO rules in these areas threaten national sovereignty by compromising a nation's ability to determine its own domestic policies. They worry that by increasing efforts to create rules on issues such as labor and the environment, the WTO would increase the difficulties of its members (especially developing countries) in implementing them, and thus increase their likelihood of becoming subject to trade sanctions. Finally, some say, broadening the coverage of trade agreements could ultimately stymie liberalization by attracting political actors whose main interest is in promoting their policies, not in trade.

On the other hand, others believe that the trading system *requires* rules on a broad range of issues. Some emphasize the need to include under the trade umbrella additional economic concerns, such as investment and competition policy. Investment rules, proponents argue, further facilitate economic integration, especially since multinational corporations play such an important role in the services trade. Competition rules ensure that international markets are contestable, blocking anticompetitive behavior by private firms that can inhibit trade. Other advocates of a broader trade agenda emphasize the need to explicitly address social issues. In order to build broad support for free trade, they argue, policymakers must alleviate concerns that globalization will undermine standards in areas such as labor rights and environmental regulation. Since trade rules affect workers and the environment, some believe that these issues need to be considered when agreements are negotiated.

In the early postwar years, trade agreements were limited in scope, covering mainly border barriers such as tariffs and quotas that protected markets for manufactured goods. From its inception in 1947 until 1967, multilateral trade negations under the General Agreement on Tariffs and Trade (GATT) concentrated on reducing these tariffs. In the Tokyo Round, concluded in 1979, the GATT's purview was extended to nontariff barriers; six codes were negotiated on import licensing, technical barriers to trade, customs valuation, subsidies and countervailing duties, antidump-

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ing provisions, and government procurement. However, the focus remained on rules and barriers that were clearly related to trade in goods.

But in the 1980s, the scope of trade agreements was dramatically broadened in numerous bilateral, regional, and multilateral negotiations. The United States and Japan, for example, negotiated the Structural Impediments Initiative (SII), which covered such issues as Japan's laws regarding large retail stores, the behavior of corporate groups known as *keiretsu*, enforcement of antitrust laws, and spending on infrastructure. The United States and Canada negotiated a free trade agreement that covered not only goods but also services and investment. Europe launched its EC92 initiative to complete its internal market and facilitate the movement of goods, services, capital, and labor by removing barriers and reconciling regulatory differences. The Uruguay Round, negotiated between 1986 and 1993, also reflected this trend as it liberalized the flow of services, agricultural goods, and investment. Finally, the North American Free Trade Agreement (NAFTA) both pushed further into these areas and also included side agreements on labor and the environment.

The cases in this volume demonstrate the expanding scope of trade agreements. The introduction of intellectual property rules, as described in the case on the 1994 Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), exemplifies the broadening of multilateral trade rules to include new concerns. The case that treats the fight to grant China permanent normal trade relations (PNTR) reveals how trade agreements have grown to cover all goods (including the agricultural), as well as services, investment, intellectual property, and domestic regulatory regimes. In addition, the China case illustrates the role trade agreements are asked to play in establishing the rule of law and promoting domestic economic reform.

Nonetheless, as several cases bring out, the question of what issues should be included in trade agreements remains controversial. Efforts to negotiate more extensive rules on foreign direct investment through a Multilateral Agreement on Investment (MAI) ended in failure. Debate continues as to whether trade should be used as a mechanism for enforcing human rights, as seen in the China case. The case on fast-track authority (now called trade promotion authority, or TPA) demonstrates the deep divide in Congress over the use of trade agreements to enforce workers' rights and environmental standards. And finally, in the case on the US-EU mutual recognition agreements (MRAs), legislators and government officials wondered if a trade agreement was the appropriate venue for dealing with regulatory issues.

These controversies over the scope of trade agreements are unlikely to be resolved anytime soon. The WTO ministerial in Seattle failed to launch a new round in 1999, in part because of strong disagreements over the issue of labor standards. And although a round was launched at Doha in 2001, negotiations on the so-called Singapore issues (competition, invest-

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ment, and transparency in government procurement and trade facilitation) were postponed. Later, because of the fundamental international conflicts on these issues, only trade facilitation remained on the Doha agenda.

Depth

How deep should trade agreements be? What should they require of their signatories? The central issue here is how deeply trade agreements should reach into areas generally controlled by domestic governments. In their least invasive form, agreements can simply require that governments operate without discrimination and transparently. At the other extreme, agreements can seek full policy harmonization. An intermediate approach sets minimum standards that all signatories must adhere to.

The first approach facilitates diversity and allows nations to express their own preferences by minimizing constraints on domestic policies. Harmonization, though imposing a greater constraint on national sovereignty and autonomy, brings greater benefits: uniformity, similarity of treatment, and economy in information costs. For some, the use of trade agreements to constrain or change domestic rules presents an attractive opportunity. For others, it results in an unwarranted intrusion on domestic sovereignty.

The traditional approach of the GATT was to require only that nations (1) engage in reciprocal reductions of border barriers, (2) treat all GATT members equally—commonly referred to as most favored nation (MFN) treatment, and (3) treat foreign and domestic goods in the same way—known as national treatment. The GATT did not seek to harmonize standards or policies; it simply required the same treatment of domestic and imported products. Provided they respected this principle, countries remained free to implement any domestic policies or rules they desired. After the Tokyo Round, GATT parties were subject to more constraints under the Code on Technical Barriers to Trade. However, although members were encouraged to adopt international standards, they could set their own so long as those standards were applied transparently, were not discriminatory, and erected no unnecessary obstacles to trade.

By contrast, the agreements in the cases in this volume were all intended to move beyond the basic requirements of national treatment and nondiscrimination. The TRIPS agreement, for example, requires countries to implement policy regimes that achieve a minimum level of intellectual property protection. The draft MAI required signatories to grant foreign firms guarantees against expropriation (a government's seizure of an investor's property). This and other rights could actually have resulted in better than national treatment for some foreign investors—that is, foreign investors could be entitled to compensation under circumstances in which domestic firms would receive nothing. The case on the MRAs also illustrates the

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deepening of trade agreements. While the MRA allowed the United States and the European Union to maintain their own regulatory standards, it required them to mutually recognize certifiers. In addition, some representatives of business and industry saw the MRAs as a steppingstone toward harmonization of standards. And in the China case, China was required to implement a large number of domestic policy changes; these included abandoning its interventionist industrial policies and limiting agricultural subsidies in order to enter the WTO. Each of these examples shows how the new issues in trade are moving beyond national borders into the arena of domestic policy.

Enforcement

How should trade agreements be enforced? For international agreements to be effective, they must be adhered to. Some agreements are nonbinding; countries proclaim their intention to comply but suffer no consequences if they fail to follow through. Other international agreements are binding but lack a formal enforcement mechanism; countries adhere to them out of self-interest, respect for international law, and concern about their reputation. In a third group, the primary enforcers of binding agreements are domestic, but international participants may respond to noncompliance by withdrawing benefits. In a fourth type, noncompliance can result in fines or penalties. Finally, in a fifth type, countries may actually turn over to an international body their ability to determine or regulate certain policies. Thus countries within Europe have ceded sovereignty to the European Union in trade and other matters.

The GATT is an example of the third type of system, though implemented without much force before the Uruguay Round. A country's failure to comply with the GATT agreement could be challenged by other parties, but full consensus was required before a dispute could be heard, panel findings accepted, and the withdrawal of concessions authorized. The requirement for unanimous agreement in essence gave each country veto power. Moreover, some of the codes negotiated under the Tokyo Round were separate instruments to which all GATT parties did not necessarily subscribe; several had their own dispute settlement systems. In addition to the challenges within the GATT system, sometimes member nations—particularly the United States—would take matters into their own hands and attempt to enforce trade agreements unilaterally by threatening trade sanctions. Though other international organizations outside of the GATT dealt with trade-related issues, including intellectual property (the World Intellectual Property Organization, or WIPO), health standards (the Codex Alimentarius Commission, or Codex), labor standards (the International Labor Organization, or ILO), investment (the Organization for Economic Cooperation and Development, or OECD), and the environ-

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ment. However, aside from publicizing violations, these organizations generally had limited or no ability to enforce agreements.

The WTO dispute settlement system enhanced the power of the dispute settlement body (DSB) to enforce trade rules. Because the new system required unanimity not to undertake but to prevent proceedings, no one country could block the panel from hearing a dispute. The Uruguay Round was also a single undertaking in which all WTO members agreed to all rules, rules that were subject to a single dispute settlement mechanism. This change dramatically increased enforcement by giving WTO members the option of cross-sectoral retaliation. For example, if a country violated the TRIPS agreement's intellectual property rules, it might lose other trade benefits, such as low tariffs on manufactured goods. As a result, advocates of labor and environmental standards (as well as of other causes) strengthened their efforts to have their issues taken on by the WTO, which could use the trade dispute settlement mechanism to enforce its decisions. These efforts were controversial, however, and led among other things to difficulties in securing fast-track negotiating authority for the US president.

As the world economy becomes more deeply integrated, countries face the prospect of increasingly sharing their sovereignty. For example, enforcement measures outside the WTO have been considered. The MAI negotiations took place under the auspices of the OECD, so the agreement was not intended to be subject to the WTO's procedures. Nonetheless, the MAI would have required signatories to commit to a binding process of settling disputes between investors and states. Thus, in principle, an independent body could have had the authority to challenge a country's laws and policies that violated the agreement. That possibility gave rise to concerns that the agreement would eventually undermine national sovereignty.

Developing Countries

Should developing countries be provided with special and differential treatment in the trading system? On one view, they should, as their experiences with global integration have not all been positive. In particular, colonialism is widely seen as having retarded development. After world commodity and debt markets collapsed during the 1930s, many developing countries in the 1950s sought to reduce their dependence on the world economy by pursuing import substitution and protection strategies. Their suffering also gave rise to the view that developing countries should not be obligated to extensively open their domestic markets as a precondition for GATT membership. In addition, countries with limited means—and with governance a scarce resource—are often seen as unable to enforce commitments undertaken in trade agreements. For example, poor countries may simply lack the resources needed to implement social policies to

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regulate labor standards. Another widely accepted argument in defense of favorable terms is that an increase in exports can contribute significantly to a country's economic development. All these considerations suggest that developing countries should be expected to meet relatively less stringent legal obligations and conditions for market access than more developed countries.

But others do not see the need for such favorable treatment. In particular, many developing countries themselves have decided that liberalization is in their interest, believing that a commitment to binding international agreements will encourage potential investors by heightening the visibility, credibility, and apparent permanence of their domestic reforms. Other critics of special treatment question the assumption that the value of economic policies differs in developed and developing countries. If particular rules are well crafted and promote growth, they argue, then shouldn't those rules be applied to all members? In addition, as several developing countries have become formidable international competitors, the developed world has pressed for the removal of their special market access. Finally, though providing special treatment is relatively easy in matters of tariffs and quotas, rules are more difficult to manage. Thus, while tariffs can be set at different levels for different members, most rules either are or are not enforced. Accordingly, as trade agreements increasingly focus on rules, special treatment has become more difficult to implement.

Developing countries were granted differential and special treatment in the GATT. For example, unlike developed countries, developing countries were allowed to promote infant industries and to raise trade barriers in the face of balance of payment problems. They also were given more freedom to form preferential trading arrangements among themselves. Finally, a special Enabling Clause adopted in the Tokyo Round made permanent a set of waivers originally adopted in 1971 that allowed, but did not require, developed countries to provide developing countries with better than MFN treatment through the Generalized System of Preferences (GSP). Practice and principle do not always jibe, however. Developing countries were subject to more restrictive arrangements in textile trade than developed countries, and trade barriers against their most competitive goods, especially agricultural and labor-intensive products, often remained high.

The cases in this volume reveal a noteworthy shift regarding developing countries. Though they continue to enjoy more lenient treatment in some areas, in many others they are expected to meet the same obligations as other members. For example, the TRIPS agreement enforces the same regime on both developed and developing countries, although the latter are given more time to adjust. Moreover, since the trading system has dramatically extended its coverage and depth, countries that hope to join the WTO find themselves saddled with many more commitments than the developing countries that entered years ago. In particular, the

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United States insisted that China enter the WTO on "commercial terms"—that is, complying with the rules—rather than on more lenient terms. The expansion of the system has raised questions about whether developing countries can undertake such far-reaching international obligations—and indeed about whether enacting strict disciplines at early stages of development is desirable. At the same time, developing countries often have had little input into the system. For example, most were excluded from the MAI negotiations, and the attempt to design multilateral investment rules that would have been presented to them on a take-it-or-leave-it basis created great controversy. Participants in the 1999 Seattle WTO ministerial meeting had already raised concerns about the failure to incorporate the particular needs and interests of developing countries.

Winners and Losers

Who wins and who loses in trade agreements? Traditionally, trade agreements affected readily identifiable interests, of both producers and consumers. Altering border barriers, for example, has a fairly predictable effect on prices and thus on incomes. Economic theory suggests that under competitive conditions, trade in general benefits a nation. But trade liberalization can also create winners and losers: specifically, import-competing producers and consumers of exports can lose while export producers and consumers of imports can gain. Theory also suggests some aggregate effects on the distribution of income, with gains in the relatively abundant factors of production and losses in the relatively scarce factors of production. Thus, in a typical developed country, the beneficiaries of trade liberalization will be skilled workers and capitalists; in developing countries, they will be unskilled workers and farmers (if the country is an agricultural exporter). Conversely, unskilled workers in developed countries will lose, as will skilled workers in developing countries. China's entry into the WTO may affect distribution significantly along these traditional lines—benefiting producers associated with exports, hurting those involved in imports. The impact of WTO membership could be even greater, as domestic reforms and the rule of law are imposed. For example, state-owned enterprises and financial institutions could be required to downsize, hurting workers, and Chinese farmers could receive fewer subsidies.

As trade agreements have penetrated more deeply into formerly domestic matters, many potential winners and losers have emerged. Intellectual property protection, for example, obviously rewards the producers given that protection and, at least in the short run, could raise costs for consumers. The hope is that over the long run, consumers will also gain from enhanced intellectual property rights (IPRs) as productivity increases and new products are developed. But for intellectual property, unlike trade, there is no reason to believe that enhancements will benefit nations

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as a whole. Indeed, countries that lack innovations could be losers, although they might gain more foreign investment and diffusion of technology if stronger protection of intellectual property rights removed the worry of theft.

Introducing workers' rights and environmental standards into trade agreements could similarly create new winners and losers. For example, guaranteeing workers the rights to freedom of association and to collective bargaining could lead to higher wages for unionized workers and lower profits for owners. Stronger environmental controls might improve a nation's environment but add to the costs of pollution-intensive industries. Because developed countries have already enacted many labor and environmental standards, the initial burden of adjusting to such agreements would fall heavily on developing countries. However, the impact would also be felt in developed countries, as the heated debate over labor and environmental issues that arose in connection with US fast-track authority illustrates.

The MAI was clearly intended to increase the rights of multinational corporations and to enhance their ability to operate abroad. Corporations and host countries believed that benefits such as increased exports would follow its implementation. But some workers in home countries objected to enhancing the international mobility of firms. The MRA was similarly an opportunity for firms to reduce their costs, but it also reduced the power of some government certifiers in the United States, who went from holding a monopoly to being forced to compete with private-sector certifiers in Europe.

Governance

How do the new trade agreements affect governance? The arrangements detailed in trade agreements can change who makes decisions, what is decided, and who enforces the rules. For example, fast-track authority/TPA alters the balance of power between the president and Congress. While the Constitution empowers Congress to regulate international trade, fast track gives the president the ability to insist that trade agreements not be amended, thereby taking power from Congress. As trade agreements become more far-reaching, congressional committees that work on international trade gain some of the power formerly wielded by committees drafting domestic legislation. With the introduction of issues relating to labor and environment into the trade debate, new political alignments may arise that increase the partisanship in arguments over trade policy. For example, parties aligned with the workers and unions might be hard-pressed to support trade agreements that fail to enforce workers' rights. The same is true of issues relating to the environment. Rather than focusing, as is traditional, on purely economic concerns (e.g., free trade versus protection), trade policy becomes a forum where all social concerns are addressed.

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Trade agreements' effects on governance extend beyond the executive and legislative branches of government. As noted above, the MRA raised concerns among US domestic regulators deprived of their monopolies to certify compliance (though they retained the right to set their own rules). By entering into the international negotiations on this issue, firms also gained a new opportunity to change their relationship with their regulating bodies.

Of course, the United States is not alone in feeling the consequences of trade agreements on power relationships in domestic government. In China, the impact of WTO membership on governance will be profound. WTO accession may enhance the power of reformers to implement market-oriented changes that promote the rule of law and reduce bureaucratic discretion. But it also may enhance the role of the central government and reduce provincial autonomy. By signing the MAI, most developed countries would have agreed to new constraints on their domestic policy autonomy. In particular, environmentalists and others raised concerns that the MAI could have constrained environmental initiatives: independent arbitration panels, reviewing government decisions on the environment, could have required compensation for adversely affected foreign firms.

Trade agreements affect not just domestic governance but also the relationships between governments of different countries. By granting China permanent MFN status, Congress reduced the United States' ability to threaten or impose trade sanctions in response to human rights violations. As this brief account makes clear, international trade negotiations can profoundly shift power relations among interest groups, corporations, and policymakers—an outcome that helps to explain why they have become increasingly controversial.

Looking Forward

In sum, the cases in this volume illustrate how trade agreements are being transformed. Coverage has become broader, commitments have become deeper, enforcement has become stronger, and the requirements placed on developing countries have become more demanding. In addition, we find new losers and winners, and fundamental changes to governance. However, we must also take a closer look at how different parties work to influence the far-reaching effects of trade policy. The next chapter will detail some tactics these groups use and how their strategies are changing as they seek to control the important variables in reaching a final agreement—not just power and knowledge but also building coalitions, setting agendas, determining the location of the negotiation, and organizing grassroots support.

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