

When will Leaders of Developing Countries Negotiate South-North Preferential Trade Agreements?

Lucie Lu

July 25, 2018

Introduction

In 1994, South Africa took an opportunity to negotiate a preferential trade agreement with its most important economic partner in history, the European Union (EU). The same year also featured a prominent leadership change: the victory of Nelson Mandela and African National Congress from the first universal suffrage elections ended decades of Apartheid regime. However, the regime is measured as one of the most extremely unstable and insecure one immediately when Mandela starts his tenure. Mandela's government wanted to conduct substantial privatization and further economic reforms to restore the collapsing economies due to decades of isolations. However, this new government's initiatives were challenged by the other influential domestic political players that strongly opposed privatization and foreign investment. Mandela immediately approached to the EU to start the process of PTA negotiation. After five years of negotiations, the preferential trade agreement with the EU put in force in 2000 helped South Africa to undergo the transition smoothly. The government was fully prepared to adjust its trade policy by moving away from import substitution industrialization towards a competitive trade liberalization. Finally, the reforms have successfully rebuilt the confidence of the foreign investors not only from the EU but also other countries.

South Africa's experience is a successful case for developing countries to pursue its reform-oriented trade strategy in the negotiation of PTAs with the major trade powers. Domestic economic reforms usually provoke controversy and organized opposition, so often times the ability of leaders to implement such liberal economic reforms is limited. A credible international trade agreement with the leading economies has the potential to help facilitate this process. This paper is interested in explaining what motives a leader from the developing countries to negotiate this particular type of international treaty – the South-North preferential trade agreement (PTA) with the provisions of economic reforms.

Research Question

Under what conditions will leaders in the developing countries negotiate the South-North preferential trade agreements with provisions of economic reforms? After all, not all the leaders in the developing countries who conduct economic reforms negotiated a PTA with the major trade powers.

Context and Rationale

Preferential trade agreements (hereafter PTAs) are binding international treaties that help states to foster trade and economic integration among member-states. Current literature on the PTA mainly focuses on the effects of this institution. Scholars examine to what extent the PTAs have achieved their desired economic purposes: lowering tariffs, facilitating trade and increasing the welfare of the states in the long term. Notice that the political purposes of the leaders in the developing countries to negotiate trade treaties are currently understudied. In addition to studying the consequences of the PTAs, emerging political economy literature has offered explanations for why states form the PTAs. One possible reason is, government negotiates PTAs for domestic political reasons. To advance the literature on understanding the formation of PTAs, this paper focuses on the strategic behaviours of leaders to form PTAs to consolidate their power vis-à-vis the opposition.

Current scholars also tend to treat the PTAs as one concept and analyze the potential benefits of it on selected outcomes. They overlook the design differences of the PTAs, some of which are designed to go beyond tariff reduction. I argue leaders have political motivations to commit to different designs of the PTAs with the expectation to adjust their policies. Some PTAs require deeper levels of the cooperation and higher degrees of market integration, such as opening domestic markets to foreign direct investment, removing competition rules that discriminate foreign traders. From the 1990s and onward, the numbers of active PTAs have increased more than four folds. This paper focuses on the PTAs with the provisions of structural economic reforms, which is defined as a deep PTA. The specific type of South-North PTAs this paper focuses is one of the most costly and deepest ones because it requires the state to change trade policies, conduct reforms and open its domestic markets for competition. You can conceptualize the ‘depth’ of an agreement as to how much the states’ behaviours are constrained by agreements.

This paper also intends to focus on the leaders from the South and their rationales of initiating a negotiation with the North. Countries are more interested in building bilateral PTAs because it is easier to realize the countries’ initiatives to achieve agreements when the participants are limited during the negotiations. From a research perspective, it is an arena to observe the power imbalances between the contracting parties, which is especially starker in the South-North PTAs. This power imbalances will reflect the different potential costs for the contracting states. The costs of complying the PTAs for developed countries are relatively low. The developed countries do not need to make substantial concessions or change the current economic structures to comply with the South-North PTAs. The costs for developing countries, in contrast, are much higher. To understand under what conditions a leader in the developing country will self-select in opting in such a costly treaty motivates this paper. Therefore, this paper will only focus on the bilateral South-North preferential trade agreements.

The puzzles I am trying to unpack are: **What motivates leaders to participate in this particularly costly game? When is the optimal time to do so?**

Theory

The PTAs with the leading liberal economies, for instance, E.U., U.S., Japan, Australia, include a wide range of reform provisions in their agreement packages. Most of these deep PTAs generally require structural economic reforms in the partner countries. When developing countries negotiate with these major liberal powers, the developing countries may bargain specific provisions but have little room to change the whole package. In other words, when they approach these major powers to negotiate a PTA, they more or less anticipate they have chosen the deep PTAs by design. In contrast, when developing countries negotiate a PTA with an emerging trade power, China or India, they will not anticipate this type of power partner to promote and enforce such liberalizing reforms to a large extent.

When the developing countries negotiate the deep PTAs, they anticipate a forthcoming structural economic transformation. To comply with these provisions, leaders in the developing countries are required to go through economic reforms across various sectors of the economy. Economic reforms here refer to the institution-buildings that protect foreign direct investment, dismantle trade protection and privatize state-owned enterprises. However, such structural reforms will reduce the possibilities of rent-extracting activities of the current interest groups in autocracies. Economic liberalization is very costly because the elites benefit from the clientelism will have important losses and hence strongly oppose it. The PTA is an effective instrument for promoting economic reform that can potentially cut off the power sources of the elites that compete with leaders in power-seeking in autocracies.

The rationale of my argument is a leader can use the international commitment to facilitate the liberal economic reforms originally curtailed by the domestic political opposition. He even watches for strategically optimal situations to negotiate the treaties, especially when he feels insecure or threaten by the opposition. A leader can view economic reform as one of his toolkits to remain in power. I argue that a leader has different strategies to consolidate his power: co-optation to buy off loyalty, further repression against the opposition, restrictions on the freedom of the press and so on. Economic liberalization is also one of these toolkits. Using

such tool, a leader can wash out the oppositions' power, help coerce the cooperation and consolidate his own power in the regime. I argue the leaders in the developing countries choose to negotiate the PTAs to lock in the economic reforms for the primary goal of political survival.

My **main argument** in brief is: The balance of power between leaders and opposition evolves over time, so a leader strategically chooses the optimal time to negotiate the PTAs to shift such balance of power in favours of himself when he feels insecure.

My **hypothesis** is: The more insecure a leader is, the more likely a leader negotiates a PTA as a tool to secure his power in office and overcome domestic opposition. Leaders who experience an insecure shock are expected to have higher probabilities of negotiating a PTA than those do not.

Research Design

My design compares the likelihoods of leaders with insecure shocks and those without to negotiate the South-North PTAs. Also, for one leader who has negotiates with a South-North PTA, the likelihood for him to negotiate one at different spells of his power trajectories is also a question of interest.

Independent Variable

The hypothesized treatment in this study is an insecure shock that a leader experiences. You may ask, how should I conceptualize it? There are two types of insecure shocks. Before getting into it, here I use two indices to measure the secureness of a leader in autocracies: 1) a leader's secureness when he starts his tenure at time 0, and 2) the secureness of the regime when the leader holds office at time t .

The secureness of leaders in non-democratic regimes at time 0 is coded as authoritarian leaders' affiliation with their previous leaders. An authoritarian leader is coded as secure at time 0 when he is politically affiliated and from the same ruling coalition with his previous leader. An authoritarian leader is insecure at time 0 when a leader is in the opposition party of the previous leader, overthrows the previous leaders, openly opposes the previous leader, or he is unaffiliated (defined as not openly oppose or support) with the preceding government. In other cases, if he is in a military regime or the regime with no authority, he is also defined as insecure when he starts his tenure at time 0.

The secureness of the regime over time t measures the vulnerability of the regime to collapse at any given year. I use political effectiveness score in the state fragility index to measure the political secureness of a regime to capture the dimensions of political opposition, citizen's confidence in political process, political violence of a regime etc. The index ranges from 0 to 3: 0 means the regime is the most secure, and 3 means the most insecure one. I recoded the regimes with score 0 as secure, otherwise insecure, if the score remains unchanged during one's tenure in one regime. I also coded a change of a worsening security score (for example, from 0 to 1) as a period of the regime experiencing an insecure shock over time t .

So here are two types of insecure shocks.

Type 1: a leader is secure at time 0 and becomes insecure immediately onward at time 1.

Type 2: a leader experiences a in-secureness shock during his tenure a time t .

Dependent Variable

If a leader in the developing country has ever negotiated a South-North PTA with the provisions of economic reforms during his tenure, then this event happened. The dependent variable *event* is coded as 1, otherwise 0. Notice that a leader may negotiate a couple of PTAs at different points of his tenure, however, the event will be only counted once, which is the first PTA he negotiated. Notice that in this dataset a majority of the PTAs have been put into force, while some of them were still in the negotiation process.

The dataset covers the period 1995 to 2015. The unit of analysis is *leader*. The original design is to include all the leaders in the developing countries that at some point between 1995 and 2015 have at least one PTA negotiation with the developed countries. For now, I only conduct the model in developing countries under autocratic system. The total number of observation is 94 leaders in 31 autocratic regimes – a subset of cases in the dataset.

Control Variables

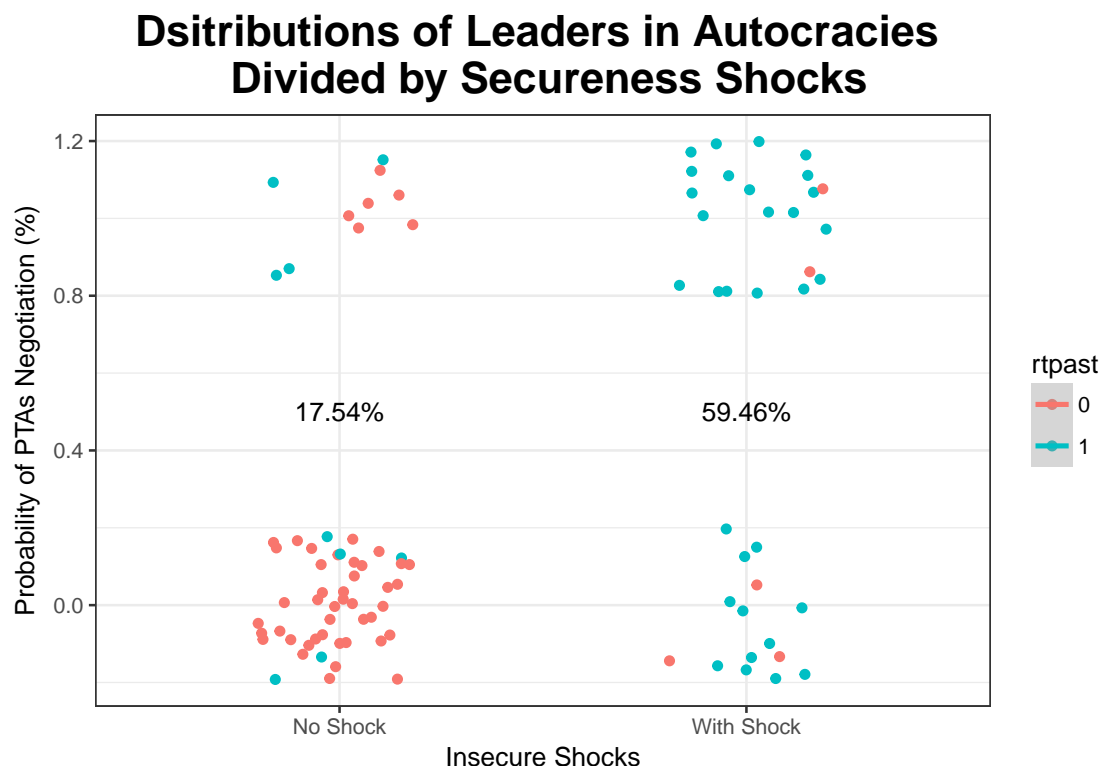
Essentially, the causal relationship I want to present is: when a leader in a developing country experiences an insecure shock, he is more likely to negotiate a PTA with a developed country partner. What are some confounders that both likely influence a leader's likelihood of experiencing an insecure shock and the likelihood of PTA negotiation?

1. **Leader's tenure.** A leader's tenure is a confounder because the longer a leader holds office, the probability of engaging in the PTA negotiation may be higher, and the risks of being exposed to the in-secure risk may also be higher. In the following empirical model, for now, I only control for the leader's tenure.

The other two potential control variables:

2. **GDP growth.** In a period when a country experiences poor economic performance, a leader in the developing country perceive the potential economic benefits of the PTA with the South can help with the economic recovery. During the recession period, many leaders in the developing country will choose to negotiate and form the PTA out of economic reasons. Also, when there is an economic decline, the citizens in the society may lose confidence in their leaders or the society may become insecure as one of the consequences of the economic downturn. In other words, this regime may be more likely to experience an insecure shock when the economy declines. Therefore, a country's GDP growth is an important confounder for both my explanatory and outcome variable.
3. **Human rights condition.** This control variable takes into account whether there is a worsening practice of widespread abuses of legal, political and social rights in a regime. The worsening CIRI human rights index should capture any outbreaks of violence against the politically targeted elites or general civilian. This is a confounder because as I argued, both torture and economic liberalization are the tools that leaders use to consolidate their power. Torture (measured in the human rights index) is an alternative to PTA negotiation in this regard, so when a leader has an insecure shock, he may choose to torture the challengers rather than to negotiate a PTA with the South. Also, when a country's human rights records are too low, leaders in the developed countries, fear of being associated with immoral leaders, may refuse to negotiate with this particular country. On the other hand, a worsening human rights condition may be a precondition or a consequence of civil conflicts and political in-secureness in a regime. Therefore, a worsening human rights condition is a potential confounder that both influences the likelihood of PTA negotiation and a leader having an insecure shock.

Data Summary

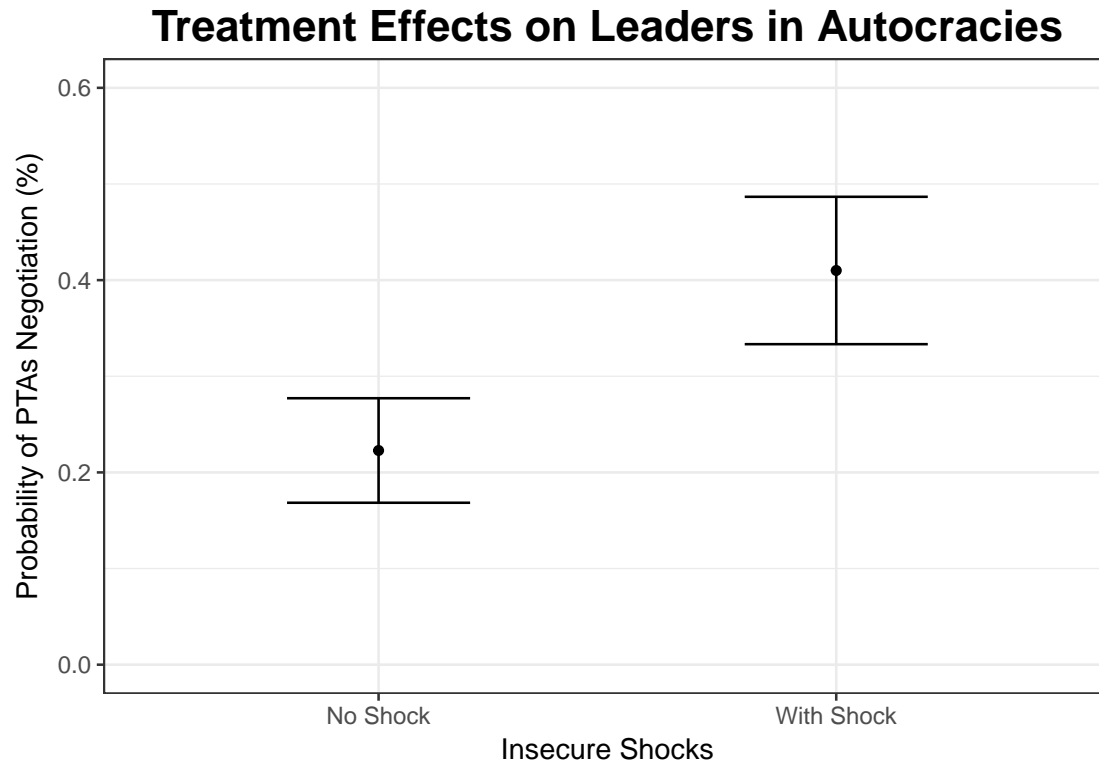


In non-democracies, 60.64% of leaders have not experienced an insecure shock, while 39.36% have experienced one at some point during the time of their tenures. It is also worth noticing that for a majority of leaders who experienced an insecure shock, when he first starts his tenure, he is normally considered a “secure” leader (represented in the blue dots) because he is politically affiliated with his previous leaders. Quite surprisingly, 78.0488 % of them have encountered different overt challenges by the oppositions over time. Among leaders in autocratic regimes, 17.54% of those who have not experienced an insecure shock have negotiated a South-North PTA. In contrast, 59.46% of those who have experienced an insecure shock negotiated one.

OLS model

$$Event = Insecure\ shock + Median\ Tenure + Error$$

Originally, I have 94 cases in the autocratic regimes. Then I removed 7 cases where the PTA negotiation (*event*) happened before the insecure shock (*treatment*). I have 87 cases now. There are 25 events out of 87 cases, therefore, the PTA negotiation is not a rare event in general.

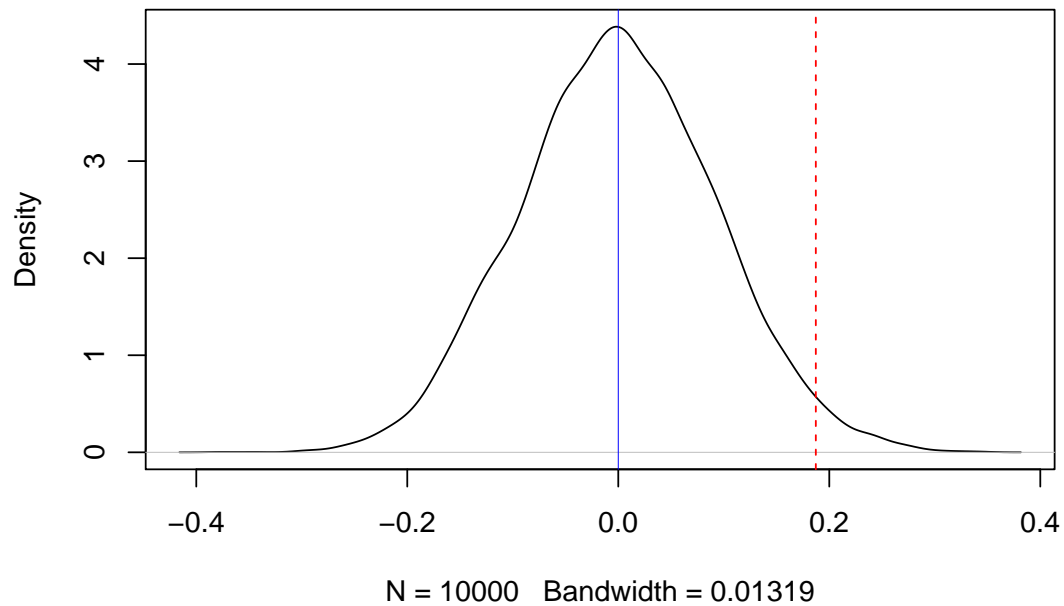


Holding leaders' median tenure constant, on average, without an insecure shock, a leader's probability of negotiating a PTA in autocracies is around 22.28%. In contrast, those leaders who have experienced insecure shocks were on average 41% more likely to negotiate a PTA than those without such "treatment". You can see there are no overlaps between the two confidence intervals, which suggest that the treatment effect is statistically significant.

Statistical Inferences: Permutation test

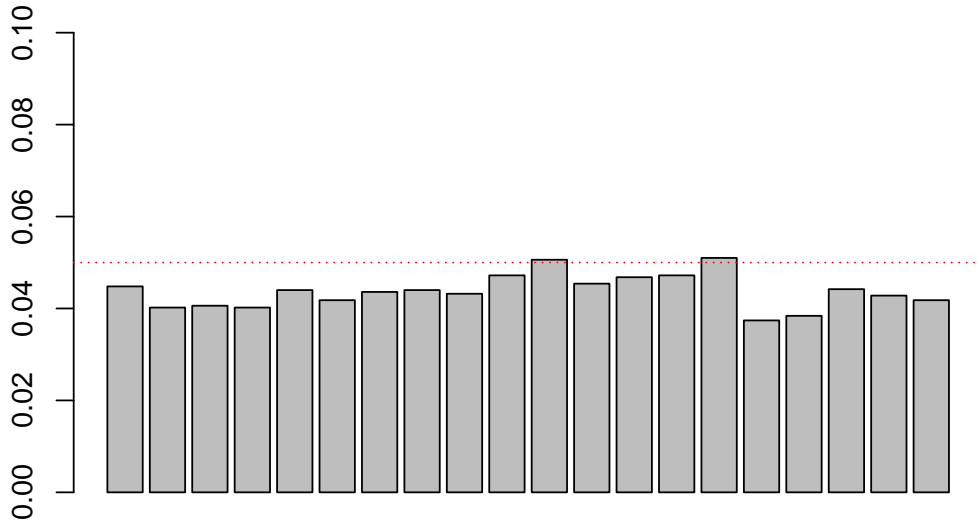
P-value tells us how likely I can get the observed treatment effect from my experiment under the no treatment effect null hypothesis. Here, in this study, the hypothetical experiment is that countries are "randomly assigned" to experience an insecure shock (*treatment group*) or not experience one (*control group*). The worrisome is the Fisher's sharp null hypothesis: there is a possibility of no effect for all the units in this hypothetical experiment. Instead, I just observe the differences in means by chance. My null hypothesis is there is no treatment effect between the treated and control groups for each unit.

Sampling distribution under null hypothesis and Observed Statistic



First, I use a test statistic to summarize my observed data from the experiment: 0.1872 is my test statistic of mean difference in tariff rates. Second, I set the null hypothesis of no effects: I create a new experiment and shuffle the labels of countries. Here, I break the relationships existing in the data structure to create an experiment of no effect. Then, by using the computing power, I replicate the experiments of no effect in the testing on the computer as if I run the experiments 10000 times. Then I observe the differences-in-means 0 under the null hypothesis, and we compare how likely it is to get the differences-in-means greater than or equal to the observed data. This probability is the two-sided p-value 0.0448. It means we have 0.0448 (less than 1 in 20 replications of the no effect experiment) to produce the values as large as or greater than the estimators in the *lm* function. The p-value here is the probability that value as extreme or more extreme will be observed under the null hypothesis. This probability gives me the information that I may not have much evidence to against the null effect hypothesis, which is the difference between the observed treatment effect and the effect under the null hypothesis is not due to chance.

P-value distribution with Permutation in 100-times simulation



To check the error rate of the *p-value*, I created a null effect in the error rate test knowing that my null hypothesis is true. I replicated the process of permutation for 100-times to produce the p-values and calculate the means. If the falsely positive rate is 0.05, this means in 5 out of 100 times, the permutation test falsely rejects the nulls (knowing the null is true but I still reject it). If the false positive rate is slightly lower than or close to 0.05, it means the permutation test fulfils its promises. The distribution of the false positive rates is as plotted. If we repeat this process for 20 times, the false positive rates are slightly different, but they are around 0.04. This suggests the *p-value* from the permutation test is reliable.

Questions for our meeting:

1. Right now, the unit of analysis is leader. I want to incorporate the other two covariates (GDP growth and human rights conditions of the regimes across time span 1995-2015), I may need to 1) either collapse those data points for each leader, 2) notice whether there is a worsening economic or human rights condition, if yes, code as 1, otherwise 0; or 3) do multilateral linear model. How should I move forward if I am not comfortable with doing Bayesian analysis?
2. I'm also interested in analyzing this question. After experiencing a shock, how long does it take for leaders to negotiate a PTA? Do you have any suggestions on how to model this? I've tried survival analysis, but I am concerned about misunderstanding the model.
3. I'm curious about your general impression. Are you convinced by my research design? Do you have any suggestion on improving it?