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

Lucie Lu

August 1, 2018

Introduction

My first-year paper is interested in the political motivations of leaders in developing countries to negotiate a particular type of international treaty with developed countries, the South-North preferential trade agreement. When are they more likely to do so? I hope this study can shed some new lights on exploring how leaders can use trade agreement as a political instrument to consolidate their power at home.

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 new transitioning democratic regime was measured as one of the most extremely unstable and insecure ones immediately when Mandela started 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 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 its transitioning economies 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 from 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. Economic reforms usually provoke controversy and organized opposition domestically, so often times the ability of leaders to implement such liberal economic reforms is limited. A credible and binding international trade agreement with the leading economies has the potential to help facilitate this process. PTAs provide member governments with a mandate to make policy changes, while they supply material benefits and mechanisms to reward and punish members' behaviours.

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

This paper is interested in explaining what motivates a leader from the developing countries to negotiate this particular deep and demanding international treaty. This paper also intends to focus only on the leaders from the South and their rationales of initiating a negotiation with the North. The reason is the power imbalances between the contracting parties is particularly stark in the arena of South-North PTAs negotiations. I assume both the South and North voluntarily participate in the negotiation. However, I anticipate developing countries make larger concession to play the rules of the game mainly set by the major players. 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. 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, these developing countries may bargain specific provisions but have little room to change the whole package. 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 demand such liberalizing reforms to a large extent. To understand under what conditions a leader in the developing country will self-select in opting in such a costly treaty motivates this paper. The puzzle is: What motivates leaders to participate in this particularly costly game?

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. In parallel with studying the effects of the PTAs, emerging political economy literature has offered explanations for why states form the PTAs. Notice that the motivations of the leaders in the developing countries to opt into such costly trade treaties are currently understudied. Yet, to understand when and why a leader of developing countries commits to such treaty is important because economic reforms will have immense consequences for the citizens of that country and beyond.

This article is in line with the argument proposed by Mansfield and Milner (2012): "governments sign PTAs for domestic political reasons" (p. 23). They argue democratic countries are more likely to join a PTA than nondemocratic countries because these governments can send a positive signal of their commitment of liberal trade policies to the median voters (Mansfield & Milner, 2012; Mansfield, Milner, & Rosendorff, 2002). Grossman and Helpman (1995) also focus on the interest groups who benefit from the expanding market promised by the PTAs. The pro-free trade beneficiary groups lobby the incumbent governments to sign such agreement to serve their political objectives. On the other hand, trade policy affects groups in society differently. Some private sectors benefit from the protectionist policy. Over time, they will expand too much, create rents and inefficiencies to distort the economy. Governments make international commitments in the free trade international agreements to tie their hands to avoid making an excessive concession to those sectors in the expectation of protection and subsidies in the future (Staiger & Tabellini, 1999). All of these theoretical frameworks capture the interaction between a government and its domestic audience: median voters, interest groups or private sectors. Leaders generally use the international trade agreements to signal the domestic audience of their welfare-enhancing economic policy for the purpose of retaining office.

To advance the literature on understanding PTA formation, this paper focuses on the strategic behaviours of leaders to negotiate such deep PTAs to consolidate their power vis-à-vis the opposition. In this story, opposition matters. The focus here has shifted to understand PTA negotiation because there might be leadership change between years of treaty negotiation and signatory. I argue PTA negotiation is a deliberate choice that a leader makes to signal his intention to his audience of committing to the binding and stringent policy changes in the treaty package.

Theory

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 elites. Economic liberalization is very costly because the elites benefit from the clientelism and political patronage 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.

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 threatened 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 following: 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.

Research Design

I design a quasi-experiment in my observational data. My design compares the likelihoods of leaders with secureness shocks and those without to negotiate the South-North PTAs. The hypothesized treatment in this study is *secureness shock*. You may ask, how should I conceptualize it? I defined two types of secureness shock. Before getting into a shock, here I use two indices to measure the secureness of a leader:

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.

In non-democratic regimes, the secureness of leaders 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, or he is unaffiliated with the preceding government. In other cases, if he is in a military regime or a regime with no authority where by assumption there are higher risks of coups d'etat and popular uprisings, he is also defined as insecure when he starts his tenure at time 0. However, note that in democracies, a leader's relation to his past is irrelevant; hence, a leader is automatically assumed as a secure leader at time 0.

The secureness of the regime over time t measures the vulnerability of the regime to collapse in 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 the political process, political violence of a regime etc. The index ranges from 0 to 3, 0 means the most secure, and 3 means insecure. I recoded all the regimes with score 0 and 1 as secure otherwise insecure starting at time 1, if the political effectiveness score remains unchanged during one's tenure. I coded a change of worsening scores (for example, from 0 to 1) as a period of the regime experiencing an insecure shock over time t.

Here I develop two types of secureness shocks:

Type 1: a leader who is secure at time 0 becomes insecure immediately onward at time 1. Substantively, it means a leader starts his tenure in an unstable and contested environment in which the leader is highly constrained by the opposition.

Type 2: a leader experiences a secureness shock during his tenure at time t. The political crisis captured in such a secureness shock can be a result of threats from the fractionalized ruling coalition, popular uprisings, or even the actual use of force.

The *unit of analysis* is a leader. The dataset covers 286 leaders in 62 developing countries in the period 1995 to 2015. Note that at least one of the leaders in these developing countries negotiated one PTA with the provision of competition policy with a developed country at some point during this period. It excludes leaders in the liberal democracies (V-Dem's Electoral Democracy Index above 0.75) where the rule of law and constraints on the executives are respected most of the time. In a regime as such, leadership change is routine and institutionalized. Therefore, there are lower risks for leaders losing power and hence lower

incentives for leaders to use binding trade agreements for political survival. Furthermore, it removes leaders whose tenure is less than one year, in such case they have no time to pursue any substantial policy changes given the short amount of time in office.

The *dependent variable* is a binary one. 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, 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. In this dataset, a majority of the PTAs have been put into force, while some of them were still in the negotiation process.

The *independent variable* is the hypothesized treatment of secureness shock. If a leader experienced either or both types of secureness shock, he is considered treated.

I completely aware that the treatment assignment is not random in an observational study, so I used a matching design on balancing the following observed *covariates* so that the treatment and control group are comparable. The covariates in this study are qualities of democratic or autocratic authority measured by V-Dem's Electoral Democracy Index, GDP per capita measured by World Bank, human rights conditions measured by Political Terror Scale, and the length of uninterrupted regime duration up to a leader starts his tenure. The covariates by definition are variables measured prior to treatment assignment and unaffected by the hypothesized treatment. Therefore, I only concern about all of these indices of the covariates for each leader in the same year when he starts his tenure at time 1.

I also include two confounding variables in my model. The first one is 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 secureness shock is be higher. One is GDP decline. 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. Also, this regime may be more likely to experience an insecure shock when the economy declines. Therefore, a country's economic growth is an important confounder for both the explanatory and outcome variables.

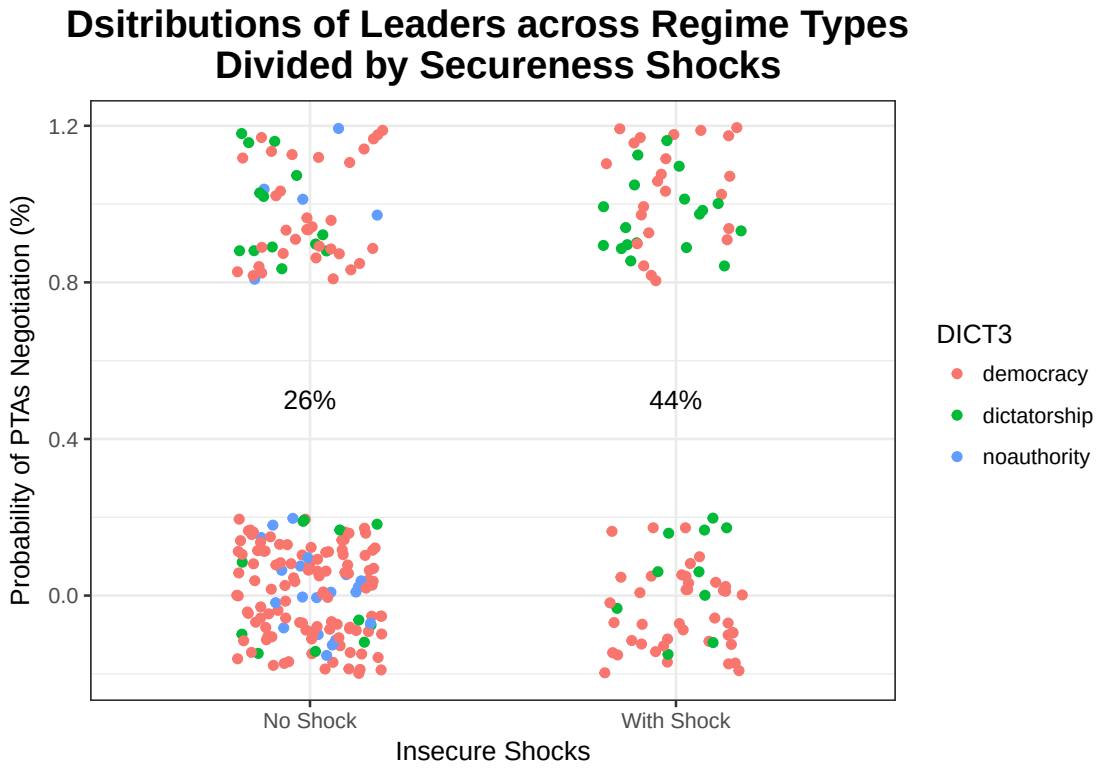
Other potential control variables: **Human rights condition**. This control variable takes into account whether there is a worsening practice of widespread abuses of legal, political and social rights in a regime. The worsening CIRI human rights index should capture any outbreaks of violence against 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.

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 a secureness shock are expected to have higher probabilities of negotiating a PTA than those do not.

Data Summary

The dataset originally covers 406 leaders in the developing countries across regime types between 1995 to 2015. It excludes leaders in the liberal democracies (V-Dem's Electoral Democracy Index above 0.75) where a more demanding notion of democracy that the rule of law and constraints on the executives are respected. The rationale of PTA as a result of power consolidation, as argued, does not apply to stable and consolidated democracies. This dataset also excludes 7 cases where the PTA negotiation (*event*) happened before the insecure shock (*treatment*). Furthermore, it removes leaders whose tenure is less than one year, in

such case they have no time to pursue any substantial policy changes given the short amount of time in office. Currently, the dataset covers 293 leaders in 61 developing countries.

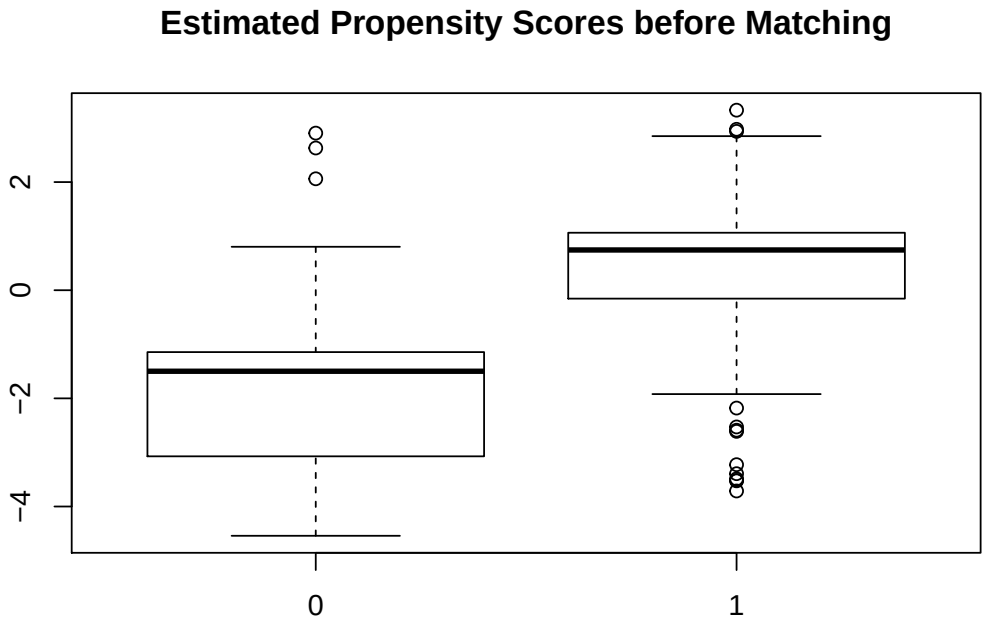


	All Regime Types	Democracies	Nondemocracies
Percentages of leaders being treated (%)	32.52	31.10	36.36
Percentages of those treated negotiated a PTA (%)	44.09	35.38	64.29

Table 1: Percentages of Leaders being Treated and those Trated Having an Event

There are 93 events out of 286 total observations. Across regime types, 32.52% of the leaders have experienced secureness shocks. Among leaders across regimes, 44.09% of those who have experienced a secureness shock have chosen to negotiate a PTA with a developed countryy at some point in their tenure. 26.42% of those who have not experienced an insecure shock have negotiated a South-North PTA. Now, let us look at the relative frequency distribution divided by regime types. In non-democracies, 64.29% of leaders have experienced an insecure shock, while 31.1% in democracies have experienced one at some point during the time of their tenures. Among leaders in non-democracie regimes, `percent_leader0_event_auto`% of those who have experienced a secureness shock negotiated a South-North PTA. In contrast, only 31.1% of those who have experienced a secureness shock in democracies negotiated one.

OLS model



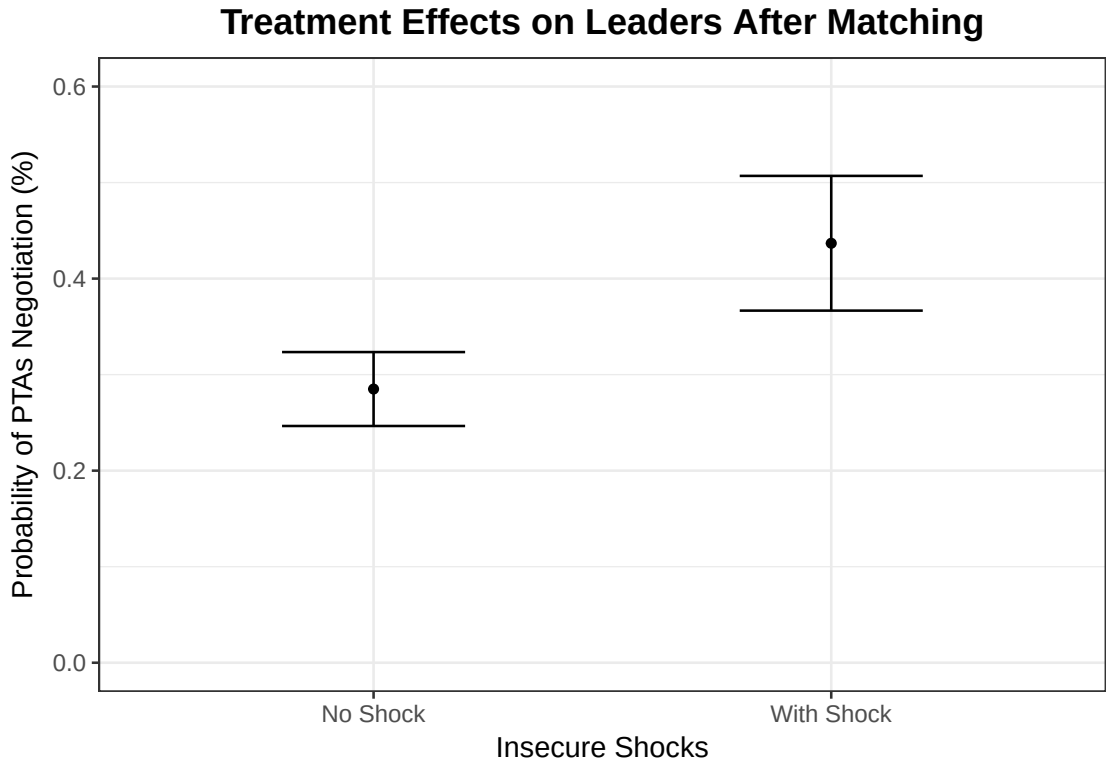
Before matching, we can see the estimated propensity scores, the fitted probabilities of being treated given five covariates, are substantially different. This suggests those leaders who have experienced a secureness shock are different from those who have not in terms of regime type, human rights conditions, regime duration, GDP per capita. After full matching, the two groups are balanced.

Event = Secureness shock + Mean Tenure + GDP decline + Error

Table 2: Ordinary Linear Squared Regression Model (After Full Matching): Results

	Dependent variable:
	Preferential Trade Agreement Negotation Rate
Constant	0.049
	(0.154)
Secreness shock	0.152*
	(0.090)
Mean Tenure	−0.026
	(0.068)
GDP Decline	0.036***
	(0.006)
Observations	228
R^2	0.318
Adjusted R^2	0.180
Residual Std. Error	0.426
F Statistic	2.316***

Note: *p<0.1; **p<0.05; ***p<0.01
Automatic reporting p-values, need to be replaced with Fishers' Null

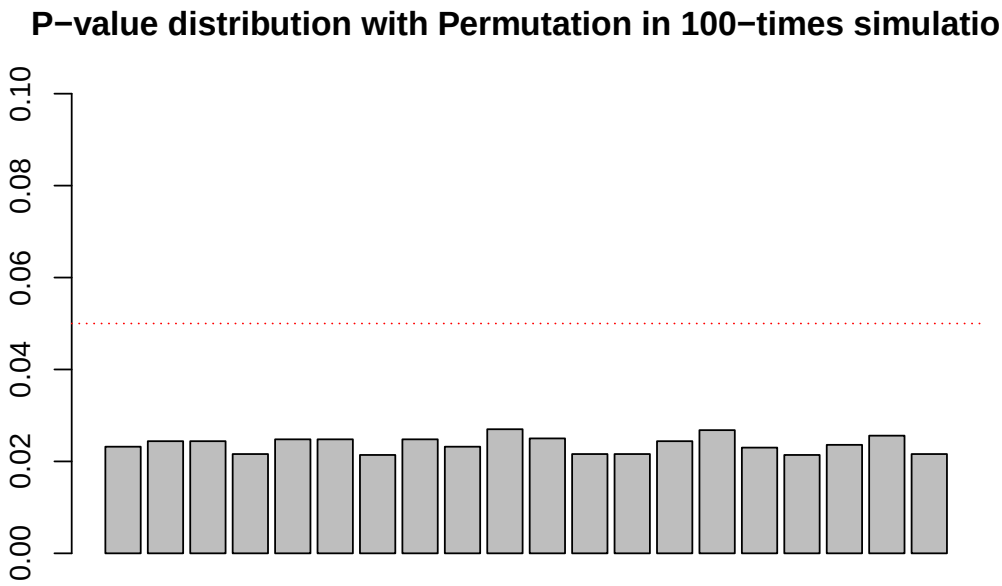


Holding leaders' mean tenure constant, after matching on five observed covariates, when there is no GDP decline, those leaders who have experienced secureness shocks on average have 15.1799% higher probability to negotiate a PTA than those without such "treatment". You can see there are no overlaps between the two confidence intervals, which suggest that the treatment effect is statistically significant.

So far, my hypothesis is empirically supported. When leaders experience political crisis, they are more likely to negotiate a South-North preferential trade agreement with the provision of economic reforms.

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.



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. In this test, we observe we have 0.024 (less than 1 in 50 replications of the no effect experiment) to produce the values as large as or greater than the differences-in-means (*treatment effect* 0.1518). That suggests by using the computer power as if I were to replicate the experiments for 10000 times, the probabilities of observing effects while in fact there is no relationship between the variables are less than 0.05 in both settings.