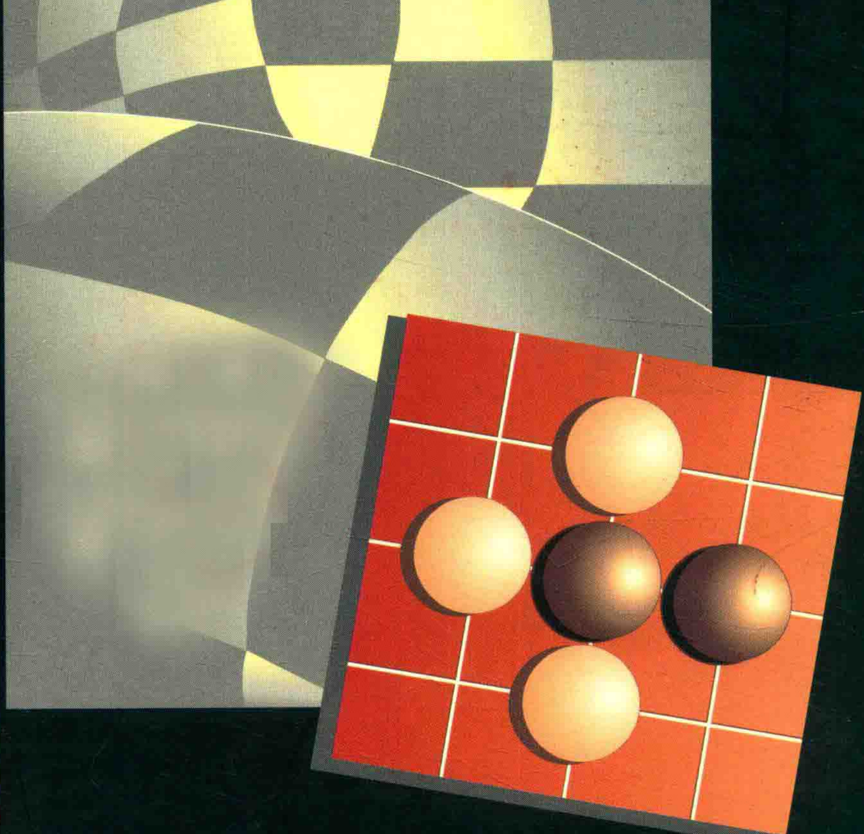
NEGOTIATING the World Economy



JOHN S. ODELL

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NEGOTIATING THE WORLD ECONOMY

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To my parents

Earl Todd Odell and Jeraldine Busby Odell

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An International Affairs Fellowship from the Council on Foreign Relations permitted me to spend a year in Washington in 1984–85. For nine months I was attached to the office of the U.S. Trade Representative, where I observed the process from the inside and learned more from experienced practitioners. I came to know the GATT in Geneva for the first time, and that year I also began a fruitful period as a Visiting Fellow at the Institute for International Economics, directed by C. Fred Bergsten. The main product was *Anti-Protection: Changing Forces in United States Trade Politics,* co-authored by I. M. Destler.

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JOHN S. ODELL

NEGOTIATING THE WORLD ECONOMY

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Introduction

Hidero Maki and Michael B. Smith sit across the table from each other, staring in silence, for nearly an hour. Meeting in Tokyo in June 1988, Maki represents Japan; Smith, the United States. Their two governments are embroiled in a long-running dispute over Japanese quotas that limit imports of beef and citrus products. Producers in each country are well organized and vocal, and their preferences are diametrically opposed. Each industry enjoys substantial political support in the national legislature. One deadline has already passed, and the chief executives, Prime Minister Takeshita and President Reagan, are scheduled to meet a few days hence. The delegations are at an impasse.

Suits around a table: the image has become commonplace in our understanding of the contemporary world. Normally we expect a soundtrack as well, and indeed Ambassadors Maki and Smith did eventually resume their exchanges. At the eleventh hour they managed to fashion an agreement that no observer had expected: an end to Japanese beef and citrus quotas.

The image may be commonplace, but the outcomes are often surprising. Currently we work with much less than full understanding as we contemplate the international economic negotiations that shape and reshape our world. What do government negotiators do when bargaining with one another over trade and finance? Why do some talks yield agreements but others end in impasses or ratification failures? What difference does the process make? Can they do better?

Since the end of the Cold War many have said that economics has become as important as security in international relations. Yet even though we embrace the cliché, we still have no general book devoted to the experience of the United States, the most influential player of all, in international economic negotiations.

We are told that world affairs become ever more complex. Yet governments have been conducting economic negotiations ever since sovereign states came into being. To be sure, many Americans, and probably many Chinese and Russians as well, paid less attention before 1989, and especially before 1970, but people in less-gigantic countries took notice long before. If Americans believed during the Cold War that international relations were nothing more than a matter of war and peace between East and West, their thinking was oversimplified. Much of this book's evidence comes, in fact, from the Cold War era, and it shows that that era was certainly not as simple as some would have us believe. If its propositions were valid even then, they ought to be just as relevant, perhaps more so, for periods of lower security threat.

In the future, reliance on negotiation surely will not decline. The much-noted opening of nation-states to integration with regional and world markets has also opened them to new forms of friction and conflict. Considering the depth and speed with which their policies penetrate each other's societies, governments' negotiations may cover more aspects of world society today than at any previous time. With this liberalizing policy trend, governments have constrained their abilities to decree economic and political outcomes and empowered other actors: commercial firms, banks, international agencies, and nongovernmental organizations concerned with the environment, human rights, and peace. All these actors seem destined to be thrown together repeatedly in multiple, overlapping processes of conflict and bargaining. Whatever institutions may prevail in future world affairs, negotiation will determine what they mean in practice for states, firms, and people.

We cannot understand international economic conflict and cooperation without a better grasp of the process of economic negotiation. The central idea of this book, in a nutshell, is that variations in this process make a significant difference to outcomes, and that we can understand the process and practice it better than we do. Current political-economy knowledge emphasizes structures. Sounder understanding of the process would be valuable to any citizen or nation affected by it.

The book expands this main idea into a set of specific causal propositions. It is organized around two core questions: (1) What strategies do international economic negotiators use and why do their strategies vary from case to case? (2) Why do negotiators gain more in some cases and less in others, even when using the same strategy? I concentrate on ten negotiations involving the United States, all from the last half of the twentieth century.

Here is a preview of these specific conclusions. Trade and finance ministers use different negotiating strategies in different cases, and the options are not limited to defecting or cooperating, as other theories have assumed. What negotiators do varies along a theoretical spectrum (spelled out in chap. 2) from a pure distributive strategy on one end to a pure integrative strategy on the other, or from what I call "value claiming" through mixed strategies to "value creating." In many episodes since 1985, for example, Washington's trade negotiators have employed strict value claiming, demanding unrequited concessions from another country and threatening penalties otherwise (chap. 6 develops two cases). In other cases, though, U.S. negotiators have chosen a mixed strategy dominated by distributive tactics but including some integrative moves (chap. 7). On many other occasions the Americans bargained with a roughly-balanced mixed strategy (chap. 5), and in still others with a mixed strategy dominated by tactics from the value-creating end (chaps. 4 and 9). Purely integrative behavior is rarely observed.

The economic negotiator's choice of strategy will vary, among other things, with objective market conditions (chap. 3). Unlike diplomats working for the same government on other issues, the finance or trade official is embedded in interactions with markets as well as with other states. Often, for example, reliance on markets as they stand represents an alternative to creation of a new governmental agreement. The better that market alternative looks to the negotiator, the more she is likely to demand inside the official negotiation, and the less she will concede to get the agreement, other things equal. Should her market alternative worsen during the talks, she is likely to soften her bargaining position (chaps. 3 and 5).

Actual strategy variations may not necessarily track objective conditions perfectly. The real economic diplomat must act with less than complete information. In a hazy atmosphere, her ideas also influence her behavior. Negotiator A's belief about how B will respond to possible strategies—a belief based on more than objective conditions—will also shape A's strategy choice (chap. 4). If the real world is one of bounded rationality, identifying such key beliefs and their effects becomes a productive way to advance knowledge about, and the practice of, economic bargaining.

Strategies in turn shape outcomes. In 1942–44, for example, had either Washington or London used a strict distributive strategy during their financial bargaining, they probably would not have produced the Bretton Woods agreements as we know them (chap. 9). In 1967 Brazil stirred an integrative element into what was an otherwise purely distributive strategy responding to U.S. demands concerning coffee trade, and almost certainly lost less than it would have had it stuck to strict value claiming. In 1988, agreement was out of reach for Ambassador Michael Smith, who was attempting to claim value from Japan on beef trade, until he too added an element of value creation to the mix (chap. 7).

External strategies are not alone in shaping outcomes. Along the way the average negotiator will be subject to common judgment biases, just like the rest of us, and those biases will affect the values that the negotiator places on alternatives to agreement and proposed deals, and how she responds to negative feedback. For example, the more A uses tactics to offset biases on her own side, the more she will gain in the end on average, even without a change in strategy or the broad power structure (chap. 5).

Finance and trade ministers also are embedded in complex two-level political games. While they are doing business with each other on one level, constituents and other officials at home are trying to influence their dealings. Thus, for example, the gains achieved abroad by a threatening distributive strategy will diminish to the extent that domestic politics at home undermines the threatening negotiator's credibility in a foreign capital (chap. 6). Domestic politics also affects the minister's perception of her alternative to international agreement.

Domestic political institutions structure the process of negotiation and ratification after the signing ceremony. These institutions may not change often, but when they do the alterations can improve or worsen outcomes. Chapter 8 shows that requiring the agent to consult with principals more intensively during the negotiation reduces the odds of ratification failure. This chapter also extends earlier analysis to multiparty regime bargaining.

All these propositions focus on the process of international economic bargaining in some way. They emphasize market conditions, negotiators' beliefs, and domestic politics as three key influences on strategies and outcomes. Some claims are specific to economic negotiations whereas others may apply more generally. Chapter 3 highlights what most clearly makes economic negotiations distinct from those confined to political-military issues.

This book's primary audience is scholars interested in the world's political economy. Most of them are not specialists in negotiation, though that is changing. Most of all I write for those who wish to learn in depth about international economic negotiations and to improve theories about them. Simultaneously the book reflects dissatisfaction with the gap between academic theory and real-world policy making—a frustration shared by many academics. It aspires to contribute to theory that will be more useful. Thus I hope the book will also intrigue readers outside the academy—all those in any country who wish to understand the world political economy or negotiation at any level.

This volume grapples with two enduring intellectual challenges in the study of international relations. The first is the phenomenon of negotiation, which is recurrent, widespread, and important. It is far more pervasive than war, fortunately, yet far less studied.

Briefly, *negotiation* and *bargaining* refer to a sequence of actions in which two or more parties address demands and proposals to each other for the ostensible purposes of reaching an agreement and changing the behavior of at least one actor. Concretely, the process of international economic negotiation refers to what finance and trade ministers and diplomats as a group, joined sometimes by others, do with one another. The process includes which strategies negotiators choose, how markets and negotiators influence each other, whether they add tactics to unearth possibilities for joint gains, how much they use tactics to guard against their own biases, and how they go about forming and splitting coalitions. This process includes how the negotiator's moves shift domestic politics in her own and other countries and the odds of subsequent ratification. The *outcome* refers to the terms of a government agreement or implicit settlement (or an impasse), and not the effects official settlements may have later in markets or politics. The *context* involves the surrounding conditions that monetary and trade diplomats normally inherit and cannot influence much in the short run—cultures, international security conditions, international institutions, or domestic political institutions.

Despite substantial good research, social science still does not understand the international economic negotiation process nearly well enough. This shortfall has left vivid marks on public debates about particular negotiations. For example, debates about other areas of public policy—early childhood development programs, pollution regulations, or even trade policy—often show at least some signs of exposure to relevant scientific findings. But when it comes to bargaining, the foundation is often no deeper than common sense homilies. Opinions are expressed with great confidence—"Our diplomats must be tougher with those foreigners"; "Don't damage our long-term political relationships"; "Agriculture must have higher priority this time"—but rarely is an argument for a particular bargaining strategy based on empirical findings of any kind. Many economic negotiators themselves, at least in the United States, are making do with improvisation—based on briefing papers on technical issues and intuitions from personal trial and error, but precious little systematic framework grounded in wider evidence—to guide the bargaining itself.

The second perennial challenge to which this book speaks is methodological: How can analysts of international relations develop theories that will prove valid and empirically more useful? This ultimate purpose—theory that is valid empirically—gets short shrift in too much theoretical writing about international relations (IR). With phenomena like negotiation, where practice poses obvious barriers to the outside observer, what empirical research methods are capable of uncovering relevant facts about real negotiations while simultaneously strengthening generalizations and inferences across cases? This book responds to this challenge primarily by proposing explicit hypotheses and supporting several with focused contrasts between pairs of case studies selected to provide variation on the causal variable but matched with respect to other possible causes.

The resulting book is, I believe, unusual, both empirically and theoretically. Empirically, most work on IR bargaining and conflict resolution is based on observation of only military crises, peace settlements, arms control talks, or the like. This is one of only a handful of books to concentrate on conflict and bargaining over economic issues in general, rather than on one or two cases. It is also the first general analysis, to my knowledge, of the experience of the United States in both monetary and trade bargaining. It reports the inside back-and-forth among diplomats, markets, and constituent organizations. These case studies are not limited to Washington's behavior; each analyzes the experience of at least two governments seen from each side. Readers interested in how agents for Brazil, the European Union, Japan, or Mexico behave in economic bargaining and in how to influence them, will find interesting material here.

Much of our concrete knowledge about monetary and trade negotiations comes from case studies that have not been conducted primarily to develop negotiation theory. This book's cases are selected for theoretical purposes, its main method is comparative, and its main points are relevant beyond the events studied. This volume illustrates a promising method for additional comparative studies on other countries, issues, and times.

Theoretically, this book departs from the most popular meaning of bargaining, as only a devious, manipulative business. Many commentators impose the metaphor of warfare or an athletic contest to interpret examples. Journalists try to evaluate outcomes by asking which side won. Even some specialists define the parties as "opponents," loading conclusions into the language itself. Yet many bargaining outcomes are not like those of wars or most games—they have positive sums. Not all moments in the process look like the eyeball-to-eyeball standoff in the snapshot of Mr. Maki pitted against Mr. Smith.

On the other hand, some negotiation and cooperation studies concentrate on behavior and arrangements that might help everyone win, but neglect distributive behavior. Many actual agreements are not "win-win," despite soothing rhetoric at