How a Retreat from Global Economic Governance May Empower Business Interests

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After decades of broad, bipartisan support for global economic integration, US politics has been shaken by a backlash against global economic governance. The promise of internationally derived gains no longer suffices to smooth over domestic distributional consequences. The Trump administration has turned inward, shunning multilateral governance and raising the following question: If the US and other protectionist governments step back from global economic governance, what will step forward? We contend that weakened global governance is unlikely to cause economic integration itself to unravel. Powerful business interests that benefit from the global economy can use private governance to set their own regulatory agendas using their market power. By stepping away from global governance, states weaken their own bargaining power vis-à-vis powerful domestic groups and curtail the influence of civil society groups. Paradoxically, the Trump administration's step back from global governance would leave power in the hands of firms that predominantly benefit from the status quo.

Of the issues that dominated the 2016 US presidential election, international trade was the most unexpected. After decades of broad, bipartisan support for global economic integration, both progressive and populist politicians joined in denouncing existing and future trade agreements. On the left, Hillary Clinton, who had once referred to the Trans-Pacific Partnership (TPP) as the "gold standard" in trade agreements, suddenly withdrew her support from the treaty during the Democratic primaries (Nicholas and Mauldin 2015). On the right, Donald Trump was consistently critical of the North American Free Trade Agreement (NAFTA), the TPP, and other international trade agreements throughout the campaign. He criticized the agreements on populist grounds, arguing that international trade agreements hurt American workers. After his election, President Trump made good on his earlier campaign promises: he promptly exited the TPP, imposed new tariffs on a number of imported goods, and threatened both Canada and Mexico as his administration pursued NAFTA renegotiations. Even after signing the newly negotiated US-Mexico-Canada Agreement (USMCA), the Trump administration kept steel and aluminum tariffs in place on Canada and Mexico, not to mention other allies.

Some countries have responded by reiterating their commitment to global economic governance, by which we mean state-led multilateral institutions and rules intended to shape economic activity. In a news conference announcing the text of the newly negotiated USMCA, Canadian Prime Minister Trudeau pivoted his focus away from the United States and toward "a global free trade network governed by rules" (Porter 2018). More unexpectedly, Chinese President Xi Jinping has made similar calls for rallying around global economic governance. Yet other countries have mimicked the United States: Brazil, the United Kingdom, and a number of other European states have drifted toward populism, protectionism, and nationalism. Politicians in these countries

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have seized on a political opportunity. In this way, the particular policy choices of the Trump administration—engaging in a trade war with China and blocking the appointment of judges at the World Trade Organization (WTO)—are unique to the United States, but we are interested in the broader trend these policy moves fall under. Global economic governance appears to have lost its veneer across the very countries that originally championed the development of international economic institutions. Should this trend continue, what will come in to fill the space left by retreating states?

We argue that Trump's withdrawal from global economic governance reflects changing beliefs about the "legitimate social purpose" of government (Ruggie 1982). Politicians have largely failed to cushion the domestic impact of international integration, generating resentment against further economic integration in developed democracies and providing opportunities to political entrepreneurs like Trump. Yet a return to a preglobalized world is unlikely. A step back from state-led global economic governance will create a vacuum in the enforcement of existing rules and the creation of new ones. Multinational corporations (MNCs), which have grown in power over recent decades, have a strong incentive to fill this vacuum, through both lobbying and participation in private governance. One major role of the current system of global economic governance is to empower leaders to deny the distortional demands of vested interests; greater autonomy thus renders leaders paradoxically more vulnerable to firms' calls for favorable but discriminatory treatment. Should the United States and other countries continue to withdraw from state-led global economic governance, the result is likely to be a system of global governance that (i) is less transparent; (ii) generates more variation in the treatment of business interests, favoring the largest firms; and (iii) grants less power to civil society organizations seeking to impose checks on business interests.

UNDERSTANDING THE WITHDRAWAL FROM GLOBAL ECONOMIC GOVERNANCE

A defining characteristic of the post–World War II liberal world order has been reliance on international-level solutions to domestic challenges. The international economic institutions set up immediately after World War II were designed with balance between international commitments and domestic autonomy in mind. Since the 1970s, with events like the end of the Bretton Woods monetary regime and postcolonial nationalizations, state power came to be mistrusted. Voters supported constraining their own governments' distortional, rent-seeking, expropriating, and repressive powers, and states supported constraining those powers in each other. International law became accepted as the best alternative to states' inability to self-bind domestically, as states created formal commitments to refrain from certain domestic policy choices and to tie their hands vis-à-vis various audiences.

Global economic governance is built on the dual pillars of trade openness and investment protection. In both of these areas, international agreements like NAFTA and the TPP were designed to solve commitment problems believed to limit the flow of capital, goods, and services across borders. In the realm of international trade, domestic politics can create demands for trade protection. While the aggregate benefit from international trade outweighs the aggregate costs, the distributional impact of trade across society can generate pressure on governments to protect declining firms (Johns and Rosendorff 2009). Trade agreements thus credibly commit a government to liberalization by raising the cost of trade barriers and publicizing distortional measures to domestic voters (Mansfield, Milner, and Rosendorff 2002).

In the realm of foreign investment, decolonization and the emergence of developing countries led to a growing concern over governments' own powers to mistreat foreign investors. A surge in bilateral investment treaties reflected the desire to restrict the expropriating powers of governments. Here, too, governments faced a similar commitment problem: their inability to credibly commit to a favorable investment climate would deter foreigners from investing in their economies. By signing international investment agreements and creating institutions to uphold them, governments increased the cost of mistreating foreign investors (Guzman 1998). This self-imposed constraint on government behavior was designed to increase foreign investment, benefiting both developing and capital-exporting countries.

Yet global integration does not just affect the flow of capital, goods, and services across borders; it also changes the distribution of these flows and the allocation of the costs and benefits of integration. When manufactured goods flow into the United States, this exerts pressure on competing US manufacturing sectors. Politicians expected that trade-affected workers would swiftly find new work in another growing sector. But recent studies suggest that this reallocation of resources has been less than swift. The US areas most exposed to trade competition from China have experienced decreased earnings, lower employment, increased disability, and early retirement claims, even a decade later (Autor, Dorn, and Hanson 2013). These economic effects have spilled over into other realms: the same trade-exposed areas have seen rising opioid use and lower marriage and fertility rates, as well as a rise in authoritarian values among individuals (Autor et al. 2017; Ballard-Rosa et al. 2017; Pierce and Schott 2016).

Investment agreements also create potential winners and losers in the domestic economy. Adam Smith himself, in the famous passage about the invisible hand in *The Wealth of Nations*, was referring to the way in which a merchant might be led ("by an invisible hand") to keep investment at home, rather than abroad, in a way that would increase the domestic capital stock (Grampp 2000).[1] A view prevalent among Trump's advisors holds that investment agreements artificially reduce the risk of investing abroad, leading to a state-subsidized reduction of the domestic capital stock, to the detriment of American workers.[2]

In developed democracies, the concerns of workers have been compounded by the fact that politicians have largely failed to address these domestic distributional concerns. Developed democracies, and the United States in particular, have over the last 30 years steadily decreased the support offered to workers exposed to trade competition: the provision of Trade Adjustment Assistance (TAA) in the United States, for example, has decreased considerably relative to rising import exposure since the 1990s (Kim and Pelc 2018b). Scholars may actually be partly to blame: the economic view of liberalization focuses on the average citizen, who is expected to gain principally through consumption effects. Yet there is no political party of consumers. Compounding the problem is the fact that technological change is occurring alongside economic integration and can cause similar economic hardship for workers. Distinguishing the prime mover generating grievances is analytically difficult for scholars, not to mention affected workers.

Politicians who dutifully toed the economic line of argument in support of economic integration are reckoning with concentrated domestic opposition to that integration. Economic integration has long carried political costs for US presidents: Jensen, Quinn, and Weymouth (2017) show that increasing imports in disadvantaged sectors have led to decreasing vote shares for presidential incumbents in data stretching back to the 1950s. Yet today, Donald Trump is prominently capitalizing on concentrated domestic opposition, particularly by seeking to tie economic grievances to social anxieties over immigration, loss of status, and out-group hostility. Other populist political entrepreneurs in the United States and elsewhere are following suit, and evidence suggests that workers' economic grievances are offering more opportunities to right-wing than to left-wing parties. Autor et al. (2017) have demonstrated how the China Shock is associated with increased polarization and increased Republican votes in the 2016 election. Accordingly, efforts to provide support to trade-affected workers through TAA appear to favor Democratic candidates (Kim and Pelc 2018a).

Trump's beliefs about global governance have remained consistent since the earliest days of his presidential campaign: the claim is that by withdrawing from global economic governance, the United States can more effectively protect its own economic interests, particularly those of its manufacturing workers. By untying American hands at the international level, the Trump administration believes it can strong-arm US-based MNCs into keeping capital and jobs at home and threaten traditional allies and adversaries into giving the United States better terms of trade.

WHY MULTINATIONAL CORPORATIONS WOULD STEP FORWARD

However, Trump and other politicians cannot simply step back from global economic governance and thus unwind economic integration. Three key economic and political transformations make this unlikely. First, MNCs are more economically powerful than they have ever been, with a greater concentration of market power in the hands of a smaller number of top firms, especially in industries with rapid technological advances (Autor et al. 2017; Díez, Leigh, and Tambunlertchai 2018). Trade and investment liberalization has privileged those MNCs that are large and productive enough to survive in the global market, leading to industry consolidation and the dominance of "superstar exporters." This concentration of economic power has also led to a concentration in the political power of firms: superstar MNCs can more easily lobby for their preferred policies at both the domestic and the international level. Rather than having to coordinate their activities through industry associations, individual MNCs can now more easily lobby on their own behalf, as they have more resources for political activities, and can more fully internalize the benefits of successful political action. The result is not only an overall increase of lobbying but more lobbying by individual firms rather than through industry associations, contributing to what Drutman (2015) has described as "growing particularism" in corporate lobbying.

Second, product differentiation has steadily increased in most industries. Rather than producing homogenous goods that are direct substitutes with one another, modern firms produce a larger variety of goods. In a way that mirrors increased particularism in lobbying, we have thus witnessed increasing rates of tariff dispersion, whereby firms are able to obtain high protection for specific products in countries that otherwise apply low tariffs (Kim 2017). As products grow increasingly diversified, measures such as taxes and regula-

1. See Smith (1776), bk. 4, pt. 2. Smith was especially interested in how this retention of capital at home might enhance military power.

2. See *Inside U.S. Trade* (2017). In this vein, the Trump administration has become an unexpected ally of groups on the left concerned with governments' regulatory autonomy.

tions can be narrowly targeted at the product level. When public policy is so narrowly targeted at the firm or product level, successful political activism more closely resembles a private rather than a public good. Product differentiation thus alleviates the free rider problems that historically have made it difficult for firms to organize their political activities. The result is that governments face more mobilization and more insistent demands on the part of large firms for favorable, and distortional, measures.

Third, complex supply chains spill across borders in the contemporary globalized economy, with implications for firms' political behavior (Johns and Wellhausen 2016). Modern industrial organization is characterized by a world of largely "deverticalized" firms, as MNCs routinely subcontract or outsource the development and distribution of new products and services to other firms. Today, MNC-coordinated supply chains account for 80% of global trade (OECD/WTO/UNCTAD 2013, 5). Because local suppliers in a given country share the fate of the lead firm in the supply chain, lead firms gain political power to play states that are eager to attract capital against one another. If economic conditions in one country become less favorable, lead firms can look for alternative suppliers in other markets, whether through subcontracting, mergers and acquisitions, or greenfield expansion.

These three changes in the global economy—the consolidation of market power, growing product differentiation, and the development of complex supply chains—have dramatically strengthened the political power of individual business interests. If the United States and other countries decide to step back from global economic governance, demands made by individual business interests will no longer be checked by countries' commitments at the international level. Our central argument is that despite how global integration has been associated with the growing power of MNCs, international rules derived from state-led agreements are also the best tool governments have to impose disciplines on firms and to deny their demands for distortional measures. A weakening of state-backed international rules would lead to a decrease in governments' bargaining power domestically, as MNCs would face fewer constraints in imposing their preferences.

Further, civil society groups have long benefited from state-led global economic governance to influence international regulation. When a cell phone is manufactured in China rather than the United States, it is produced under health, environmental, and labor standards that are outside of US authority. Civil society groups have argued that international trade and investment create a regulatory "race to the bottom" in which global integration harms values that compete with economic openness. Yet alongside economic integration, the growth of global economic governance has also provided space for environmental, public health, and labor rights groups to fight for values that may compete with economic openness (Mosley 2010; Pelc 2017).

Nonstate environmental groups have thus supported a number of multilateral agreements on particulates, emissions, wildlife, and other issue areas, with some notable successes like the 1987 Montreal Protocol on ozone-depleting substances and the institutionalization of the Trade and Environment Committee within the WTO. Environmental advocates have had particular influence within regional trade agreements (Morin, Dür, and Lechner 2018), which have served as a testing grounds for ambitious environmental provisions that have subsequently informed multilateral talks. Similarly, public health advocates have projected their power internationally; for instance, antitobacco advocates supported Uruguay when Philip Morris sued the country in 2010 for allegedly violating international investment law (Moehlecke 2018). Further, activist campaigns have had success in shaping global trade to reinforce labor rights: Distelhorst and Locke (2018) find that compliance with social standards improves manufacturers' sales to retailers, especially in the apparel industry.[3] Activist-driven innovations in global economic governance now shape production and trade, as firms up and down supply chains reckon with voluntary regulatory standards and product and producer certifications on health and safety concerns, human rights, and other social issues (Vogel 2008). In the absence of a state-led emphasis on international coordination, civil society would lose a key channel that its work at the international level has relied on.

WHAT MIGHT THE WORLD ECONOMY LOOK LIKE UNDER WEAKER GLOBAL GOVERNANCE?

If the United States and other states were to step back from global economic governance, business interests would have the incentive and the ability to fill the resulting space, which would in turn lead to profound changes in international politics. One way in which firms are likely to exert influence outside of current international institutions is by building on existing substitutes for government-led regimes. The rise of private governance, via "private transnational regulatory organizations," offers a preview of what this could look like (Abbott, Green, and Keohane 2016). Private interests have already shown themselves able to establish international regulatory standards outside of conventional government

3. By comparison, labor unions have been less successful in influencing global economic governance, with many union members upset at the possibility of their union dues being used to protect workers abroad (Brookes 2017).

structures, allowing them to reduce transaction costs without relying on bottom-up lobbying of domestic governments (Green 2013). The climate regime complex, consisting as it does of not only governments but also subfederal units, municipalities, large firms, civil society groups, and even scientific communities, is the classic example. These stakeholders do not come together through a single legalized institution but rather are loosely linked through a constellation of institutions ranging from the G20 to technical bodies, MNCs, and ad hoc nongovernmental organization initiatives. If conventional forms of state-led regimes are weakened, such arrangements are likely to rise in importance, as is the role of MNCs within them. The result on global welfare is ambiguous.

Some observers have been enthusiastic over the adaptability and flexibility of these regime complexes (Keohane and Victor 2011). But others have convincingly argued that given how they are often made up of disparate actors with divergent interests, and given the lack of a common forum in which to settle these differences, complex regimes are prone to internal contradictions. Overdevest and Zeitlin (2014), for example, argue that the fallback of the international forestry regime on a weaker international public regime that relies on voluntary participation by stakeholders has resulted in a weakening of global forestry standards. Margulis (2013) has similarly argued that the transformation of the international food security regime into a food security complex has resulted in conflicting inner norms and rules, all of which have come at the cost of the fight against global hunger. Along the same lines, regime complexes reduce predictability by multiplying focal points (Drezner 2009) and generate competing expectations about state and firm behavior. When it comes to enforcement mechanisms, such a proliferation of options leads to forum shopping (Busch 2007) and may lead to an overall decrease in compliance pull.

A withdrawal by the United States from global economic governance may also have paradoxical effects on transparency. A recurrent criticism of global economic governance is that international negotiations are insufficiently open to public view. In international trade, observers bemoan how the negotiations that drive much of the rule making and dispute settlement in the trade regime are conducted in private. Yet the WTO has become significantly more transparent over time, largely in response to these criticisms. Civil society organizations increasingly participate in rule making by providing expert testimony for WTO committees and submitting amicus briefs in disputes that involve social values that compete with trade, such as environmental regulation. The WTO also encourages developing states to be a part of dispute settlement by providing them with legal assistance and the ability to participate as third parties, thus gaining access to otherwise private negotiations (Johns and Pelc 2014, 2016). States may still be tempted to free ride on the enforcement efforts of others (Johns 2018; Johns and Pelc 2018), yet they have many opportunities to participate within the WTO if they choose to. By contrast, bilateral trade negotiations are less transparent than multilateral negotiations, allowing MNCs to shield their demands from public view. A move away from multilateralism would likely result in less, rather than more, transparency.

A weakening of the de facto international investment protection regime leads to similar expectations of reduced transparency. Currently, the de facto regime is composed of thousands of mostly bilateral treaties that commit states to protect foreign investors' property rights, as well as international institutions that facilitate ad hoc arbitrations in which MNCs can sue host states over alleged property rights violations. The counterfactual to this current regime is not an absence of investor protection; it is a more fragmented, less transparent state of affairs in which disagreements are adjudicated behind closed doors. Bolivia, Venezuela, and Ecuador have withdrawn from the World Bank's International Center for the Settlement of Investment Disputes (ICSID), but most MNCs in those countries remain protected by treaties and contracts that allow arbitration in other, less transparent venues (Peinhardt and Wellhausen 2016). Even if a country managed the difficult task of fully extricating itself from all international legal commitments to investor protection, MNCs can lean on a variety of strategies to secure their interests, as they did before the explosion of international investor-protection treaties in the 1990s (Wellhausen 2015). Policy makers and practitioners have called on states and institutions to increase transparency in this issue area, but even at ICSID, which has grown considerably more transparent, the full legal details of the cases are often shielded from view, and the final terms of arbitration awards are sometimes kept private at the request of the litigants (Hafner-Burton, Steinert-Threlkeld, and Victor 2016). A shift away from state-led treaties and international institutions would only exacerbate this issue, rendering disputes between MNCs and governments more, rather than less, opaque.

Questions of transparency and participation are tightly connected. Given how multilateral institutions have been forced to respond to pressure for greater participation by a variety of nongovernmental organizations, any withdrawal from global economic governance is likely to diminish the influence of civil society groups that challenge the path taken by liberalization. Especially since the 1990s, civil society groups have focused on global economic governance as a means to extend higher safety, labor, and environmental standards to countries that faced fewer domestic incentives to uphold them (Kahler 2018). The result has been a balance of power at the heart of global governance.

A weakening of global economic governance entails a weakening of the mechanisms that civil society groups have adopted to balance corporate interests. MNCs have little incentive to use their market power for the sake of the competing values that are currently represented by civil society organizations. When MNCs are empowered, they are unlikely to take civil society groups along for the ride. MNCs may be influenced by consumer or investor preferences that align with the values represented by civil society. Recent examples suggest that the private sector can lead progress on issues like climate change. However, a weaker voice for civil society could also lead to deterioration on other issues, like the human rights records of countries in which MNCs operate. Market-based mechanisms are ill designed to address shortcomings far down complex supply chains (Distelhorst and Locke 2018).

Weaker global economic rules also make it more difficult for governments to deny claims by the most powerful domestic actors. The Trump administration is seeking greater autonomy by untying its hands, but this will render it more prone to political pressure from MNCs. Large MNCs are likely to be especially good at capturing government resources and bending policies toward their interests in the absence of formal constraints, which will come at the expense of smaller firms. In sum, if states retreat and MNCs step in, we are likely to see growing divergence in the treatment of firms by governments.

In the realm of international trade, large MNCs should be better able to pressure governments to remove barriers to trade on intermediate goods or the finished goods they reimport into home markets, facilitating the further growth of supply chains and other economic ties. Firms that seek protection from competition, in turn, will also be able to push for their own preferred policies, using both tariffs and regulatory protection. We would thus expect even greater tariff dispersion, as governments would be pushed to narrowly target their trade policies. The most potent tool that firms would turn to as a shield against competition is national regulation. Consider the legislation that France implemented in 2017, requiring all dairy and meat products from the European Union (EU) to be labeled with their country of origin, rearing, and processing. The move proved effective from the point of view of French industry: French milk imports from Belgium fell by a quarter. Italy then copied the French regulation and applied it to pasta, requiring that labels show the origin of the wheat contained in the pasta (Pelc 2018; see also Livingstone and Barigazzi 2017). Similar labeling measures have been struck down at the WTO (2015), but because these French and Italian measures targeted intra-EU trade, they were not actionable under WTO rules. And while the EU Commission would normally have denounced such provisions, in this case it found itself under pressure to condone them, from fear of further backlash at the eve of key elections in France and Italy that featured anti-EU parties. The result is a case study in what happens when supranational institutions have to countenance domestic politics, a phenomenon that is only likely to grow in importance.

If global economic governance around international investment were weakened, we expect to see divergence in government treatment of MNCs. For example, powerful MNCs will be able to protect their interests using firm-specific contracts reached directly with governments, while smaller, less powerful firms are likely to lose out. We are likely to see variation in government treatment across industries as well: firms hold more political power when they can profitably leave a country in response to mistreatment (because of high asset mobility) and when it is harder for the government to replace existing firms because the costs of starting up new production in its market are high (Johns and Wellhausen 2018). Firms in such industries can extract more favorable investment terms and treatment than firms in sectors with less mobility or lower startup costs. Weakened state-led global economic governance would not only empower business interests, it would also empower some business interests over others.

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A weakening of global economic governance is unlikely to lead to a return to the status quo ante. Those who believe, like President Trump, that global economic governance limits their regulatory autonomy and their ability to protect workers may be surprised that much of their bargaining power vis-à-vis large MNCs depends on that same system of global governance. Much has already been made of the political costs at the international level of throwing around the weight of American market power, by threatening to increase barriers on foreign governments that do not give into US demands. Trade partners are likely to react by discounting future US concessions, on the basis that these may be retracted following a change of leadership. Our point is that the weakening of global rules may also have a less expected effect at the domestic level, empowering large MNCs that would step into the space left by a hollowing out of global governance. The international commitments states make increase their ability to deny powerful domestic groups the distortional policies they demand. It follows that a weakening of global governance is likely to favor the largest firms, who are able to secure favorable, discriminatory treatment from governments in ways that smaller firms cannot. Large firms would be likely to step up their participation in private governance regimes, which we argue may have effects that run counter to the initial objectives of these regimes. Transparency and the influence of civil society and other stakeholders would suffer. In sum, leaders underestimate the domestic benefits of international commitments at their peril.

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