The implications of a democracies-only trade pact

1. This note provides a preliminary assessment of some of the potential implications for the United States (US) of recent proposals to establish a successor to the World Trade Organization that is open only to liberal democracies.

2. This concept was, most recently, put forward by former US Trade Representative Robert E. Lighthizer who wrote in a New York Times essay that "[c]ountries with democratic governments and mostly free economies should come together and create a new trade regime. This system could enforce balance by having two tiers of tariffs".[1]

3. For the purposes of our initial analysis, we assume that a new regime of this kind would:
   I. admit countries deemed to be "full democracies" and "flawed democracies" under the Economist Intelligence Unit's *Democracy Index*[2];
   II. apply tariffs of 25% to all imports of goods from non-qualifying states (i.e., those categorised as "hybrid" and "authoritarian" regimes).

Implications for the United States

Tariff coverage and average rates

4. In 2023, the US imported goods worth US$1,202 billion from hybrid and authoritarian regimes, which accounted for 38% of total US imports and 4.3% of US GDP. These regimes contributed to 44% of dutiable US imports (US$429 billion) and 35% of duty-free US imports (US$734 billion).

5. Under a new democracies-only trading club, all imports from these regimes would become dutiable – raising the proportion of US dutiable imports from 32% to 56% of total imports. Following the methodology of Douglas A. Irwin,[3] our analysis indicates that average tariff rates for US imports would increase from 2.4% to 12.1% (+9.8 percentage points), while the average tariff on dutiable imports would jump from 7.4% to 21.8% (+14.4 percentage points).

[1] www.nytimes.com/2025/02/06/opinion/tariff-free-trade-new-system.html
[2] www.eiu.com/n/democracy-index-conflict-and-polarisation-drive-a-new-low-for-global-democracy/
[3] www.piie.com/blogs/realtime-economics/2025/historic-significance-trumps-tariff-actions

6. Building further on Irwin's work,4 the below table sets the tariff implications of this proposal in historical context.

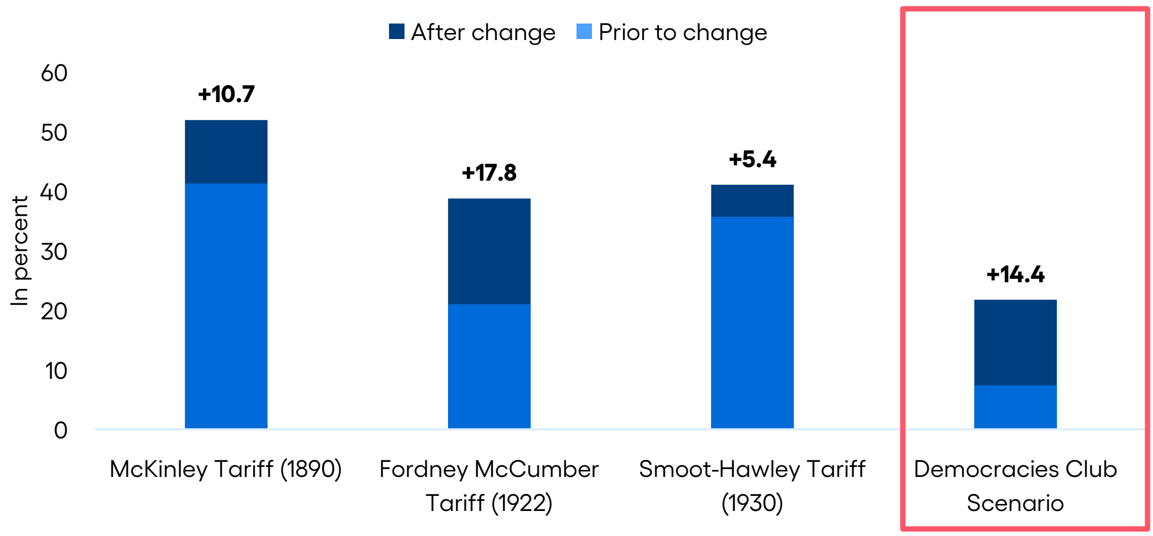
Table 1: Historical tariff comparison

	Affected imports (share of US GDP)	**Average tariff** (dutiable imports) **prior to change** (in percent)	**Average tariff** (dutiable imports) **after change** (in percent)	**Percentage point increase in rate**
McKinley (1890)	2.70%	41.3	52	+10.6 points
Fordney McCumber (1922)	1.30%	21	38.8	+17.8 points
Smoot-Hawley (1930)	1.40%	35.7	41.1	+5.4 points
Democracies club scenario	4.30%	7.4	21.8	+14.4 points

Source: Irwin, D., February 2025, The historic significance of Trump's tariff actions, PIIE and ICC calculations based on US ITC Trade data from 2023 (accessed in February 2025)

Not only would the democracies-only trading club scenario affect a much larger share of the US economy (4.3% of GDP) than previous major US tariff actions – triple the level of Smoot-Hawley (1.4%) and Fordney-McCumber (1.3%), and more than 50% higher than the McKinley Tariff (2.7%) – it would also trigger a tariff rate increase on dutiable imports nearly three times larger than the infamous Smoot-Hawley Tariff Act of 1930 (+14.4 versus +5.4 percentage points). This unprecedented combination of scope and scale in tariff suggests that care needs to be taken to understand the potential economic consequences of any such regime.

Figure 1: Average tariff on dutiable US imports



Source: Irwin, D., February 2025, The historic significance of Trump's tariff actions, PIIE and ICC calculations based on US ITC Trade data from 2023 (accessed in February 2025), [Data Request | DataWeb]

[4] Ibid.

Revenue gains

7. Based on existing trade flows and exchange rates, imposing a 25% tariff on all imports into the US from hybrid and authoritarian regimes would bring additional revenue of US$301 billion (1.1 % of GDP). This could increase the total duties collected by the US Treasury from US$72 billion to US$373 billion, with 95% of the total duties coming from non-democratic regimes. However, even this maximum theoretical revenue gain would offset only circa 9% of the estimated US$3.5 trillion ten-year cost of extending the Tax Cuts and Jobs Act of 2017 – illustrating the practical difficulties in financing the modern federal budget through tariff increases alone.[5]

8. Moreover, this projection is likely to overstate any realisable revenue gain, given the – almost inevitable – trade dislocation and currency depreciations that would occur as a result of applying blanket tariffs on 93 countries.

9. By way of example, these estimates do not account for the potential drop in imports due to tariffs. A decline in imports would partially offset revenue gains as US importers shift to alternative products, trading partners adjust their supply chains, or some exporters stop selling to the US altogether. By way of reference, in a previous study we have estimated that removal of WTO-based trade benefits could significantly increase trade costs, resulting in a reduction of exports from developing and least-developed economies by the order of 30-50% over a five-year period.[6] Thus, the actual revenue available to offset tax cuts or other fiscal priorities would likely be substantially lower than any theoretical maximum.

Exports

10. The U.S. currently exports over US$650 billion in goods to hybrid and authoritarian regimes according to the 2023 Economist Intelligence Unit classification – thus leaving one third of all American exports by value potentially to retaliation. The share of US exports exposed to potential retaliation (33%) substantially exceeds the exposure during previous major trade conflicts, including the US-China trade war of 2018-19.

Issues for further analysis and consideration

11. The brief review presented above suggests that a democracies-only trading system would likely catalyse one of the most dramatic tariff increases in US history – around triple the scale and scope of Smoot-Hawley – while leaving a broad swathe of American industrial output subject to retaliatory risks.

[5] www.cbo.gov/system/files/2024-05/60114-Budgetary-Outcomes.pdf
[6] iccwbo.org/wp-content/uploads/sites/3/2024/04/2024-ICC-The-impact-on-developing-economies-of-WTO-dissolution.pdf

12. Should democratic governments wish to explore this concept further, we suggest a number of additional questions to assess the risks/returns of this concept – including:

    a) impacts on supply chain security – including access to critical raw materials produced in countries classified as hybrid or authoritarian regimes;

    b) the full scope of retaliatory risks (beyond tariff barriers) as a result of removing existing WTO disciplines;

    c) impacts on domestic inflation for participating countries – particularly for essential goods;

    d) the costs/benefits for other (qualifying) democracies in entering into such a pact – which may differ from the US based on existing trading patterns/dependencies;

    e) implications for preferential rules of origin and value transformation thresholds for products with mixed of democratic/non-democratic inputs, which are then sent to members of the trading pact;

    f) potential adverse effects on development outcomes in least developed countries and small island developing states;

    g) interaction with existing trade remedy mechanisms – including safeguards/anti-dumping;

    h) status and continued validity of existing free trade agreements;

    i) implications for services trade and government procurement – which comprise significant portions of democratic economies' trade flows; and

    j) the corresponding impact on trade flows between nations deemed "authoritarian" in nature.

Data disclosure

The data underlying this analysis can be downloaded here.

Please cite as:

ICC (2025), The implications of a democracies-only trade pact, www.iccwbo.org/news-publications/policies-reports/the-implications-of-a-decocracies-only-trade-pact/

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