

**TRADING FOR VOTES:
DOMESTIC AND INTERNATIONAL INSTITUTIONS AND THEIR INFLUENCE
ON TRADE DISPUTES UNDER THE GATT AND WTO**

By

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All errors that remain in this work are solely my own.

To my mother, Linda

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ABSTRACT

This project explores the impact of international and domestic institutions on the decisions of political leaders. A theory of two-level institutional incentives is developed that seeks to explain how institutional context at the domestic and international levels affects the incentives, and thus the behavior of political leaders when making decisions related to trade policy. This theory argues that the institutional context in which political leaders make policy decisions has a significant effect on their decision-making. Further, the institutional context must include both domestic and international institutions. Building on previous work on the impact of institutions at both the domestic and international levels, this project seeks to test the theory of institutional incentives in the context of trade disputes under the GATT and WTO.

A series of empirical tests are conducted using a dataset of GATT disputes combined with a new dataset of disputes under the WTO. These tests demonstrate strong support for the theories set forth in this project that domestic and international institutions combine to affect the behavior of political leaders. Domestic institutions affect the impact of international institutions and vice versa. This project extends previous work in two-level institutional incentives by demonstrating that institutional change at both levels has significant effects on the behavior of political leaders.

CHAPTER 1: PERICLES BOUND

The world of the twenty-first century is a world characterized by complex interdependence between states. This creates the conditions in which political leaders must seek to balance the domestic political concerns that arise from their domestic supporters and the international pressures generated by complex relations with other states, each of whose political leaders feels similar pressures. This process is complicated for all political leaders, but it is particularly complex for those who lead democratic states. Democratic states require large and diverse groups of supporters in order for political leaders to gain and retain power. To win office and hold onto power once in office, democratic leaders must balance the conflicting interests of supporters in ways that autocrats, with their much smaller bases of support need not.

This project started with a puzzle of sorts that arose out of the literature on international conflict. If the democratic peace tells us that democratic states don't use militarized force to resolve their conflicts, then does that mean that democratic states don't have as many conflicts of interest? Or does that mean that democratic states resolve their conflicts through some other means? As it turned out, trade conflict is almost exclusively the purview of democratic states as discussed further in Chapter Three of this work. Trade disputes thus became an intriguing phenomenon with which to look at how democratic states resolve their conflicts.

In the process of investigating trade disputes, the author discovered that trade disputes are qualitatively different from the militarized disputes that are the focus of most of the conflict literature. They are similar in that they represent a fairly clear conflict of

interest between two states over policy choices. Choices by State A offend State B and State B decides to do something about it. The problem for a close analogy between militarized disputes and trade disputes is that trade disputes are highly constrained affairs. They involve the recourse to a specific body that follows specific, highly structured rules to reach a conclusion that both parties agree (at least in theory) to abide by. Trade disputes are thus as much the products of the institutions of the organization in which they take place as they are a reflection of conflicting state interest.

If democratic institutions make leaders more likely to engage in trade disputes, and the disputes are the products of institutional arrangements at the international level, then trade disputes are products of the interaction of two levels of institutions affecting the decision-making of political leaders. What is more important, the trade regime that institutionalizes this interaction underwent a clear change to the key institutions that manage these disputes. This meant that trade disputes offered a virtually unique opportunity to test the impact of two-level institutional interaction in the context of changes at both domestic and international levels.

What follows in the remainder of this work is the product of a labor to understand the complicated institutional interactions that affect how decision-makers will be influenced by the pressures of domestic and international institutions. This relationship is of growing importance in a world of complex interdependence where a growing number of issues defy purely national solutions to collective problems. The quest for more effective global governance of complex problems often founders on an inability to make institutions effective at the international level. This work builds on the growing literature

concerning the role of institutional design in promoting cooperation and coordination at the international level.

This work offers a theory of two-level institutional incentives for political leaders. This theory combines the domestic need to ensure political survival on the part of political leaders with the need to constrain policy flexibility within the bounds of international commitments. The resulting theory argues that democratic institutions at the domestic level are problematic for international cooperation as they will encourage short-run defection in the face of the day to day politics of political survival. To maintain cooperation in the long-run, the trade regime incorporates key institutional elements that allow for flexibility within the rules of the regime. This flexibility is constrained in turn by a set of mechanisms to ensure compliance in the long-run. The result is that states may engage in short-term violations necessary for political survival, but remain committed to the regime as a whole to reap the benefits of long-term cooperation.

Under the trade regime, this flexibility mechanism is dependent on the presence of a dispute settlement mechanism through which member states can bring members who are violating the regime back into compliance. This is an institutional mechanism with which member states can constrain each other. The structure of this institutional mechanism plays a key role in providing incentives to the member states. It is this institutional mechanism that changed when the General Agreement on Tariffs and Trade (GATT) was replaced by the World Trade Organization (WTO). The change in this institutional design allows us to test how an international institutional change interacts with a domestic institutional change to change the behavior of political leaders.

This work argues that institutions at the domestic and international levels mutually affect the decisions of political leaders. To understand the actions of political leaders in the context of international institutions, domestic institutions must be considered. To understand how to effectively bind political leaders to their international commitments, we must see how their domestic institutions will press them in the context of such commitments. Democratic institutions are more likely to create pressure to break the trade regime's rules. Thus, if we want effective trade cooperation, we must bind the hands of Pericles. Democratic leaders must face effective international constraints in order to ensure that they will comply with their international commitments, but these constraints must be flexible enough that democratic leaders can comply in the long-run without facing political suicide in the short-run.

1.1 The Organization of this Work

The chapters that follow set forth a theory of how the interaction of domestic and international institutional incentives drive political leaders to behave in predictable ways in trade disputes at the GATT and WTO. The theory is explained in detail and then subjected to a series of empirical tests to determine whether or not the theory is borne out in practice. These empirical tests demonstrate strong support for the theory.

Chapter Two sets forth the core theory of this book. The international environment following the end of the Second World War has been one that is characterized by complex interdependence between states. Economic and political relations have become increasingly enmeshed in a web of complex relationships that

make political decisions at the domestic level significant for a wide range of actors outside of the domestic institutions of the state in which the decisions are made. The ripple effects of domestic decisions lead to responses in other states that in turn have their own ripple effects in the international environment. In this context, cooperation to maintain the mutually beneficial open trade system is key.

Without cooperation, the system cannot maintain itself. The mechanism by which political leaders ensure cooperation in keeping trade relatively open and stable compared to other historical periods is the GATT/WTO trade regime. The trade regime binds political leaders to a set of international institutional commitments that force them to behave in a way that is mutually beneficial over the long term, but that can have serious short term negative effects on their political survival within their domestic institutions. This creates an inherent tension in the behavior of all political leaders. They bind themselves to an agreement that is mutually beneficial over the long term, but that may result in their removal from office if its terms are strictly adhered to. This tension provides political leaders with a strong motivation to defect from the trade regime. And yet they don't.

The trade regime has been successful in practice due to its flexibility. The GATT/WTO regime allows for short term breaks with the rules of the regime, but includes mechanisms to enforce long term compliance. The regime has built in mechanisms that allow states to adapt to the political survival needs at home in the short term, but also for states harmed by such policies to engage in enforcement action to bring wayward states back into the fold. It is this enforcement mechanism that is the focus of

the theory in this project.

The flexibility mechanisms in the GATT/WTO regime are important, but they also have a moment of major change. The transition from the GATT to the WTO institutions offers an excellent means to examine the impact of institutional design on the behavior of political leaders in member states. The design of the Dispute Settlement Mechanism, the key means by which members enforce compliance, changed significantly in the transition from GATT to WTO. This institutional design change allows us to specifically test how such a change, with its attendant change in institutional incentives, affects the behavior of the leaders of member states in deciding whether or not to engage in enforcement action.

Key to understanding how the international institutions affect the behavior of political leaders is understanding the domestic institutional context in which political leaders operate. Differences in domestic political institutions have a significant impact on how political leaders will be affected by trade policy as well as on how they are likely to select policy responses. The broader the support base that a political leader requires, the more likely that leader is to be pressured to engage in actions that will stretch or break the rules of the trade regime. The broader the support base, the more likely that a political leader will need to enforce rules of the trade regime to maintain the support of key players in the political support base. These two pressures often lead leaders whose institutions require large support bases to simultaneously pursue both protection of domestic interests and enforcement against other states' protectionist actions. Thus the more democratic a state's domestic institutions, the more likely that state is to undertake

actions that make them potential targets of disputes and the more likely that state is to initiate disputes. Domestic institutional pressure will make leaders more likely to engage in trade disputes within the trade regime if their institutions are more democratic.

The institutional change from the GATT to the WTO affects the decisions of political leaders in determining whether or not to initiate disputes under the trade regime. Behavior leading to a state being targeted is relatively immune to institutional changes in the enforcement mechanism. The decision to initiate, however, is strongly influenced by the cost of the dispute relative the likelihood of a favorable outcome and to the relative cost of policy alternatives. If the relative cost of disputes is lowered by the change in institutions, dispute initiation will become more frequent. This leads to a series of testable hypotheses regarding the influence of institutional change on political leaders. These hypotheses are set forth in Chapter Two and tested in Chapters Four and Five.

Chapter Three explains the GATT/WTO institutions and gives a detailed explanation of how the data on trade disputes was converted into the dataset used in this project. Several key decisions regarding the operationalization of variables and several other key research design decisions are also discussed.

Chapter Four tests how institutional change at the international level affects the trade dispute behavior of political leaders. This chapter focuses on the change in dispute settlement institutions that took place with the transition to the WTO. The significant lowering of the costs of a dispute led to political leaders in more democratic states increasing the number of disputes that were initiated. This chapter provides the details of the statistical models used to test the relevant hypotheses. These models demonstrate that

international institutional change has the predicted effect on the decisions of political leaders, but only when the domestic institutional incentives provide the necessary context.

Chapter Five tests how institutional change at the domestic level affects trade dispute behavior. This chapter examines how changes to the domestic institutions affect the relative costs of trade disputes to political leaders and how this, in turn, affects dispute behavior. This chapter demonstrates that changes in the domestic institutional context in which political leaders operate has a significant effect on the behavior of these leaders. This chapter presents the results of statistical models that test the relevant hypotheses regarding domestic institutional change and trade dispute behavior. The models strongly support the stated hypotheses.

Chapter Six takes a step back and addresses several key issues of research design raised in Chapter Three. There is not yet agreement on how to operationalize several important aspects of trade disputes under the GATT and WTO in studies such as this. Chapter Six tests the robustness of the statistical results from Chapters Four and Five under different model specifications. Chapter Six presents the statistical results from a series of models testing various specifications. The results of these robustness checks demonstrate that the results presented in Chapters Four and Five are generally robust across alternative specifications.

1.2 Two-Level Institutions

This work contributes to the study of two-level institutional effects in several key

ways. It examines a key international institution through a period of institutional change. This allows the study of the international institutional change in the context of relative stability of rules and purpose in the organization as a whole. This contributes to our understanding of how international institutional design functions to constrain the actions of political leaders. This work highlights the point that international institutional design cannot be considered independent from the domestic institutions of the member states. The domestic institutional incentives make political leaders operating in different institutional contexts likely to respond in different ways to international institutions.

This work demonstrates that flexibility mechanisms built into international institutions are an important element of institutional design. While the formal design elements are important, informal elements of flexibility must also be considered. What will be termed in this work as the “fog of law” reflects how international law can itself become a mechanism for flexibility within institutions when that law is vague or when it becomes complex enough that there is no agreed upon meaning. While this may, on its face, seem a flaw in international law, the experience with trade law suggests that this uncertainty can be a useful mechanism for flexibility when combined with a dispute settlement mechanism that allows for effective enforcement.

This work also demonstrates that an important element of the impact of institutions is institutional change. Changes within international and domestic institutions affect the behavior of political leaders and they do so in complex and interrelated ways. The change in domestic institutions affects incentives which in turn affect the behavior of leaders within the international institutions. Within the context of

international institutional changes, changes in domestic institutions complicate the process of predicting how leaders will behave. To understand the behavior of leaders in these contexts, we must look at their institutional incentive at both the domestic and international levels.

The overall thrust of this work is that political leaders are aware of and responsive to the institutional incentives they face at both the domestic and international levels. To design effective institutions to solve the collective problems we face in an increasingly interdependent world, one whose governance issues increasingly require international solutions, we must be very careful to consider the complex interrelationships between institutions. We must also accept that there may be cases in which domestic institutions make our international goals difficult to achieve given the constraints of this two-level institutional relationship.

When seeking to design institutions to promote international cooperation, we must consider not just the design of the international institution, but how this will interact with the domestic institutions of its members. This work seeks to help explain both how this manifests in trade policy, but also what this can teach us about the design of future institutions for global governance.

CHAPTER 2: DOMESTIC POLITICAL LEADERS AND INSTITUTIONS

The effects of domestic political institutions on political leaders has been the focus of a great deal of scholarship in comparative politics (Downs, 1957; Taagepera and Shugart 1989; Buchanan and Tullock, 1965; and others). Increasingly scholars of international relations recognize that political leaders are constrained in their behavior by both domestic and international institutions (Drezner, 2003; Koremenos 2005; Rogowski, 1989). These dual-image approaches focus on how political leaders must account for the complex relationships between their domestic political supporters and their commitments to wider international institutions.

What follows adds to the growing literature seeking to explain how domestic and international institutions combine to influence the policy decisions of political leaders. This chapter will introduce a theory of two-level institutional pressure on political leaders. This theory will argue that leaders in the context of complex interdependence are constrained by institutions both from the domestic level and the international level. These constraints are flexible, but they do impose clear incentive structures on political leaders that pressure them to act in particular ways. This theory argues that the GATT/WTO system, with its formal rules and a clearly defined dispute settlement mechanism is an ideal test of this two-level institutional pressure.

This chapter begins with the international context in which such decisions are made. This context is one of complex interdependence (Keohane and Nye, 1989). The domestic economic decisions of political leaders can have ripple effects throughout the global economy. Decisions that were once seen as purely domestic in nature, now can

often involve a powerful international dimension, multiplying the sources of policy pressure on political leaders.

In trade policy these ripples are channeled through a set of governing institutions at the international level that provide a range of policy options for political leaders. The GATT/WTO trade regime places limits on what actions on the part of political leaders are considered permissible for member states. In setting these limits, the trade regime constrains the actions of member states in important ways. The trade regime is unusual among international institutions in that it provides an impartial system of dispute adjudication. When member states cannot agree as to whether or not a policy violates the rules of the regime, they can appeal to an impartial mechanism to seek adjudication of the dispute.

While domestic political leaders must concern themselves with their international commitments, it is domestic institutions that ensure their political survival. To appease the political support groups that are critical for continued political survival, leaders are frequently pressured to engage in policies that will severely test the rules of the international trade regime. Such policies are often characterized as cheating on the rules set by the trade regime, but this is not necessarily the case. The complex body of international trade law is vague on the specifics of policy. Political leaders can find a great many gray areas in which to press for their own interpretations of international trade rules. The rules are also replete with mechanisms for political leaders to violate the basic rules of the regime for short periods and in unusual circumstances. The combination of vague rules and temporary escape clauses creates a “fog of law” in which states may

challenge the rules of the trade regime while claiming that their policy actions are permissible under the rules.

As domestic political institutions become more democratic, the pressure on political leaders to meet the needs of large and diverse support groups increases. As the sources of this pressure increase in size and diversify, it increases the likelihood that political leaders will feel pressure to both engage in policies that potentially violate the trade regime and simultaneously pursue enforcement actions against other member states. The more democratic a state's institutions, the more likely they are to become engaged in what appears (at least on the surface) to be a hypocritical policy stance. They will simultaneously stretch the rules to the breaking point in support of their political supporters both in attempting to gain protection from the market (potentially illegal policies) and in opening other nations' markets (pressing for their interpretation of policy through the initiation of disputes against other states' protection). In short, the more democratic a state's institutions, the more likely they will both engage in action that makes them likely targets, but also the more likely they will be to target other states using the dispute settlement mechanism.

The GATT/WTO system allows us to engage in some unique tests of the effect of political institutions in this context. The underlying nature of the trade regime has remained consistent over time. It has gradually expanded both membership and the areas of trade that it covers.¹ Unlike its basic functions, however, the dispute settlement system

¹ While the expansion has been gradual, it has not been continuous. The GATT/WTO system has expanded through a series of trade "Rounds" that have expanded the areas covered by the regime as it adapted to the actions of its member states. More on this later in this chapter and in Chapter 3.

underwent a single major institutional change in 1995. The implementation of the WTO Dispute Settlement Mechanism (DSM) changed the nature of dispute settlement within the regime. This is an important change in international institutions and it changes the incentives that the international institutions provide to domestic political leaders. This change allows us to test a series of hypotheses based on the change in dispute settlement institutions. We can test how domestic and international institutions jointly affect the actions of political leaders by examining the impact of a change in dispute settlement institutions operating under a consistent wider legal framework.

What follows is a more complete discussion of the existing literature on how institutions at domestic and international levels affect the decisions of political leaders in the context of the global trading system. The discussion begins with a brief overview of the international economic context in which these decisions are made and how this context has changed since the end of the Second World War. This contextual discussion is followed by a concise history of the trade regime and a brief summary of the role it has played in constraining political leaders through the gradual expansion of international legal institutions. From here, the discussion moves to the role of domestic institutions in the decision-making of political leaders. The key elements of democratic decision-making are discussed in terms of the incentives they provide to political leaders during coalition formation. Following this section are two sections examining previous literature on the impact of democracy on policy decisions. The first of these sections examines the role of democratic institutions in the area of armed conflict. This section addresses the important theoretical differences between trade disputes and militarized

disputes and why this logic implies that the simple translation of democratic peace in militarized disputes cannot be applied in trade disputes. The second section examines the role that democratic politics plays in the manipulation of the domestic economy. This section will demonstrate that trade is just one of several economic areas in which political leaders seek to gain electoral advantage.

Finally the last section of this chapter will set forth a theory of how the incentives created by domestic political institutions combine with those created by international institutions to influence the political decision-making of leaders. This section will argue that political leaders will be greatly influenced by their domestic political institutions, but that changes in the international institutional context will also have a strong impact on the decisions of political leaders. This section will also set forth a series of hypotheses that will be tested in subsequent chapters.

2.1 Economic Interdependence – The international environment

Environment matters for all of the participants in the policy process. It also sets the background in which institutions operate. Political institutions play a major role in structuring the incentives of political leaders, but the overall international environment plays a significant role in shaping this relationship. Changes in the environment change the underlying incentives faced by political leaders. Changes at the systemic level can also change the terms under which the institutions at both domestic and international levels operate.

Economic interdependence is a feature of the contemporary international system

that affects both domestic and international institutions. The period following the Second World War is often discussed as being characterized by “complex interdependence” (Keohane and Nye, 1977). States are not merely dependent on a single other state or a handful of trading partners. Under these conditions, states are embedded in a complex network of ties that bind them not just to the interests of other states, but also the wider system of interactions. In other words, the states are dependent on the continued existence of the network of ties. Shocks to the system, even if not directly related to the state itself, can affect the state through its network of interconnections with other states. Under complex interdependence the domestic political decisions of states may affect the system in ways that impact on other, seeming unrelated, states. In short, even domestic policy actions can have wide ranging ripple effects under complex interdependence that they would not have in its absence.

Academics and pundits, indeed even pop culture figures love to speak of our contemporary period of complex interdependence as something new and unprecedented. In fact, the integration of the modern period is not unprecedented, and the lessons of the period of global integration of 1870 – 1914 has some potentially chilling lessons for the contemporary period.

By most economic measures the world of 1900 was nearly as integrated as that of the year 2000 (World Bank, 2002). This integration led to economic growth and prosperity, but it ultimately collapsed in the face of strong international competition in

other areas, notably the successive military crises of 1898 to 1914.² The central problem was that the complex interdependence of the late colonial period was based largely on informal relationships. While hegemonic stability was provided by the United Kingdom for part of this period, the ability of any single state to manage the incredibly complex relationships that emerge under complex interdependence is limited even under ideal conditions. As the UK lost its relative dominance in the face of rising US, Japanese, and German challengers, each pursuing domestically driven industrial and foreign policies, the system began to collapse.

The marked difference in this period is the singular lack of any effective international institution to moderate and constrain the impact of conflicting national interest. The integration of the period survived so long as the states within the system saw it serving their national interest. As competition in other areas moved international economics further to the back of the minds of policy makers, the economic interdependence was increasingly seen as something states could do without. In the absence of any systemic constraints the system of economic integration died a fiery death in the trenches of World War One.³ (World Bank, 2002)

The end of this early period of integration is followed by an interregnum characterized by two World Wars and the Great Depression. This interim period is marked by mercantilist economic policies on the part of most major states throughout the period, but most obviously characterized by the self-defeating “beggar-thy-neighbor”

² The Spanish-American War, Russo-Japanese War, Balkan Wars, and of course World War One in addition to several smaller conflicts between and within the colonial powers.

³ The decline in economic integration begins in the late 1890's and the downward trend continues until the system collapses entirely with WWI.

tariffs following the American adoption of the Smoot-Hawley Tariff of 1930 (Simmons, 1994).

The historical fluctuations in this period are important for understanding the complex interdependence of the contemporary period for a variety of reasons. The first is that this period demonstrates that even decades of complex interdependence can be reversed quickly in the face of changes in the international system. This is an important lesson, particularly as many tend to see current economic and political trends as irreversible or deterministic. This is also important due to the critical role that the international system played in shaping the goals of policy-makers in the immediate post-war period in the United States and, to a lesser extent, its allies in the West. The lack of coordination to solve international problems across a wide range of issue areas was seen as a critical factor that led to three decades of instability and war. The central question in the minds of policy-makers and academics at the time was how to avoid the problems of this period.

The solution to these problems of coordination was the creation of a family of international institutions that would manage the international system and regulate the competition between states. The period of 1943 – 1953 saw the creation of a veritable alphabet soup of organizations designed to promote cooperation and coordination across a wide ranging set of issues. In security the UN was created to be a more viable successor to the League of Nations. In economics the World Bank, International Monetary Fund, and General Agreement on Tariffs and Trade were created. While these organizations were the pillars of what was hoped to be a new era of global cooperation,

their potential for true global impact foundered on the rocks of the Cold War.

The decades spanning the end of WWII to the end of the Cold War saw global coordination limited by the global security environment. In spite of this, there was a growth of integration within the two blocks. Most significantly, the Western block experienced a great deal of integration under the umbrellas of the Western economic organizations. The cooperative framework of these organizations provided economic stability and coordination, albeit not exactly in the way the designers had planned.

What is key in this period is that complex interdependence again rises, at least within the Western block and growing number of the non-aligned states. The World Bank discusses this period as the “Second Wave” of globalization (World Bank, 2002). A wave characterized by growing integration of the non-Soviet dominated world under the auspices of the Western economic organizations. It is in this context that complex interdependence reemerges as a key element of our economic thinking, driven particularly by transportation and communications technology changes in the 1960's and 1970's. These changes were accelerated by the end of the Bretton Woods system of fixed exchange rates and their replacement with a fully floating system of exchange between the major currencies of the West in the early 1970's.

In short, complex interdependence within the Western block was firmly in place by the 1980's. A growing number of non-aligned developing states were also integrated in this system. While the economic interdependence drove on, supported by international institutions designed to promote cooperation and coordination, this process took place in the shadow of the larger global security competition between the US and Soviet blocks.

When the Cold War abruptly ended in 1989, virtually every political leader was caught by surprise. There were no real plans for what to do, and so the existing institutional structure was the forum for the integration first of the newly free former Soviet satellite states and later the former Soviet republics into the world economic system. Thus began the “Third Wave” of globalization: the integration of the entire world economy into a single integrated institutional structure based on the system that had dominated in the American block during the Cold War (World Bank, 2002). This is the institutional context in which contemporary political leaders find themselves.

This process is important to understand for a variety of reasons. Foremost, it highlights the fact that the institutional framework of the system was specifically designed to eliminate problems of instability and promote cooperation in areas where cooperation provides mutual benefit, but is often held hostage to national interest. Secondly, it highlights the fact that states not only had the chance to opt out of elements of the system that they did not like, but that many states did opt out of the system for decades (some voluntarily, others not so) during the Cold War period. The rules of the system as it exists today are largely the result of negotiations between the states that chose to “opt in” during the period of the Cold War.

What does this mean for our, more focused discussion of political leadership within the framework of domestic and international institutions? There are several important lessons of this period. First, political leaders design international institutions to solve specific problems. The GATT system was designed to promote cooperation in order to prevent a repeat of the destructive cycle of economic competition from 1900-

1914 and 1930-39. Political leaders are well aware of their domestic political pressures that mediate against open trade and designed institutions with the specific intent of constraining themselves for mutual benefit.

Second, the process by which states became enmeshed in a system of complex interdependence has been uneven. The advanced industrial states of the West were fully integrated even before the collapse of the Bretton Woods System.⁴ The post-colonial states entered the system in a wave following independence, but their economies took time to adapt to post-colonial realities of competition. Some, arguably have still not adapted in spite of having become part of an integrated system. Further, the second (post Cold War) wave of new states also needed time to adapt to the new political and economic realities of their situations. One can think, then of an international environment represented by a core of highly integrated states gradually drawing into their web of relations a growing number of states that are simultaneously creating ties to each other as well as to the integrated core.

A result of this progressive integration increasing numbers of domestic policy decisions have become important at the international level. The setting of US interest rate policy affects commercial loans taken out by developing state governments. National energy policy affects the market price of oil, or may harm production and refining industries in other countries. As complex interdependence spreads, more domestic industries become dependent on decisions in other states. This complex

⁴ It can be argued that the failure to adapt the fixed exchange rates of the Bretton Woods System rapidly enough to keep up with market reality is a major factor of its collapse. Thus it can be claimed that the collapse of the Bretton Woods System is symbolic of the integration of the markets of the advanced

interdependence means that political leaders must increasingly pay attention to the narrow actions of the decision makers in other states within the network of interdependence. They must also consider ways of putting pressure for changes to these policies on political leaders in other states.

In trade policy, these pressures are especially strong. Trade policy by state A can have ripple effects throughout the entire trade system. Political leaders in many states may have a reason to pressure the leaders of state A to change harmful policies. Unlike many areas of policy (economic and non-economic), political leaders of states in the GATT/WTO trade regime have an institutional mechanism to apply pressure on leaders in other states. Where such policies violate (or can be argued to violate) the rules of the trade regime managed by the GATT and WTO, political leaders can use the DSM to leverage changes in policy by leaders in other states.

Complex interdependence in the context of the GATT/WTO institutions thus creates a world in which political leaders' decisions have wide ranging ripple effects, but those whose political boats are upset by these ripples have a means of applying pressure in return. As a result, the institutions of the GATT/WTO system provide a unique forum for the study of how changes in these institutions affect the behavior of decision-makers under conditions of complex interdependence.

2.2 International Institutions – managing the environment, constraining leaders

The structure of international institutions provides important constraints on the industrial states. Their markets are integrated to a point where market reality out paces the ability of

behavior of political leaders. Successful IGO's promote cooperation by creating incentives for political leaders to comply with the rules of the institutions in spite of their often strong reasons for defection. For institutions to be successful and to stand the test of time, they must incorporate a range of features to promote and at times enforce cooperation by member states. Institutional structures must combine enough rigidity to ensure compliance with a core set of rules while leaving enough flexibility for political leaders to stretch the rules in times of domestic crisis. Failure to strike this balance of institutional design can lead to the failure of the organization to achieve its goals.

The GATT/WTO regime was originally created as a means of preventing just such destructive competition, but has evolved into a complex system to ensure the compliance of members with a complex set of rules and procedures. There are several key design elements of the GATT/WTO system that allow the organization to succeed. The first is that its basic rules and areas of coverage are periodically renegotiated in a series of trade rounds. This provides progressive adaptation of the regime as a whole to the changing conditions of the global environment. This gives member states the constant promise of renegotiation of unfavorable terms in return for continued membership and reduces the incentives for permanent defection. In the daily operation of the organization, rules exist that allow states to violate the basic rules of the regime in response to short-term changes in domestic political realities. This system provides for temporary violations of the regime's rules in response to changing domestic politics. At the same time, the regime also provides institutional mechanisms for forcing eventual compliance with the rules of

politics to adjust.

the system. A key element of this is the complexity of the system of rules itself and the many areas in which interpretation of the rules of the regime are unclear.

In short, the GATT/WTO institutional design provides member states with strong incentives to pursue policies that are broadly compliant with the regime even in the face of strong domestic opposition to some or all of the terms of membership. The institutional design of the GATT/WTO system provides both short and long term flexibility in order to ensure continued compliance with the regime as a whole. These features were included in part by design and in part by fortunate accident, but they combine to create an institution that is unusually effective at promoting its key areas of cooperation.

2.2.1 A Brief History of the Trade Regime

The international trade regime that exists today manages economic interactions through a complex set of institutions. While the WTO is largely seen as a venue for the promotion of free trade, it is more properly considered a forum for the management of a complex system for the design, implementation, and enforcement of rules for controlling international trade. While the WTO remains rhetorically and philosophically committed to the promotion of an increasingly open trading system, in practice the WTO, like the GATT before it, is institutionally designed to manage a trading system based on a complicated web of rules that determine what barriers to trade are permissible. The system leads to a global economy that is more open to trade than it would be in the absence of coordination, but trade is by no means free.

The central function of the GATT/WTO regime has been to set an agreed upon framework within which states can manage their trade policies. According to the WTO "The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business."(World Trade Organization 2003b) The trading system managed by the GATT and WTO is designed to provide stability in the international trade system through an agreed upon framework of rules.

While most of the post-Westphalian period has been characterized by a lack of systemic international trade policy coordination, the period following World War Two has been the exception to this. While international trade flourished under the Pax Britannica in the last half of the nineteenth century there was no institutional structure built into the system. The system was dependent on each state retaining an interest in the maintenance of its own policies, with Great Britain acting as the hegemon in order to keep the system functioning (Lake, 2000). In the decade prior to the First World War, economic interdependence and trade had begun to decline (World Bank, 2002). As British hegemony declined, the trade system began to break down as there were nothing to hold together the competing interests of individual states. When the shock of the First World War impacted the international system, trade cooperation between states collapsed

(World Bank, 2002).⁵

International trade collapsed during the inter-war period under the weight of domestic political pressure to protect local industry. Wartime controls over the economy had led to much greater government intervention in industry in the pursuit of war aims, and this carried into more direct management of industry as a means of furthering national power following the War. The end of the war saw a relaxing of government involvement in the economy overall, but with it a return to mercantilist policies that had characterized the period before the free trade boom of the late 1800's. The governments of the various major powers retained a strong involvement in the management of industrial policy during the inter war years. From an international perspective, this was based on the national interests of the various states without consideration for the impact on the wider international economy. The result was a lack of coordination in trade policies. In essence, trade policy was seen as a purely domestic decision, devoid of international context.

The result of a lack of coordination at the international level was a series of disastrous trade policies that led in turn to the collapse of the world trade system in the economic crises of the 1930's. The assumption that trade policy could be implemented as a purely domestic policy act proved utterly false. The attendant collapse of international trade contributed to the advent of the Great Depression and the Second World War (World Bank, 2002).

⁵ It should be noted that the twenty years prior to WWI contained significant stress to the existing international system. In the absence of collective management of the system, efforts to moderate these rising tensions were ad hoc (such as American mediation of the Russo-Japanese War.) While economic

One of the major lessons that policy-makers drew from the inter war period was that lack of international coordination exacerbated the frictions that led to conflict. Without means of encouraging (and enforcing) cooperation, the international system would be prone to further cycles of collapse and conflict. The solution in the minds of policy makers in the United States was the creation of a system of international organizations to provide institutional support for cooperation. These organizations would combine carrots and sticks to promote international cooperation.⁶

As part of this larger effort the United States undertook to create an international organization to govern international trade. The International Trade Organization (ITO) was intended to be this organization. The ITO was a comprehensive organization with the power to manage the international trade system. While the ITO was largely the creation of American effort, it went too far for the US Senate. The Senate failed to support the Havana Charter creating the ITO as it was felt the provisions would rob the US of its independence in trade policy. The failure of the primary promoter of the ITO to ratify the Havana Charter effectively killed the ITO as an organization, although at the time it was hoped that additional negotiations could resolve the key problems of the ITO. By 1950 the Truman administration admitted that the Charter would never pass in the foreseeable future and gave up any hopes of ratification (Spero and Hart, 2003).

interdependence was strong (as described earlier) the institutionalization of international relations was meager at best.

⁶ The immediate post WWII period is characterized by an explosion in the number of major intergovernmental organizations as part of an effort to solve what was perceived by political leaders, most notably in the United States, as a failure of coordination in the inter war period that could have prevented the conditions that set the stage for WWII. The UN, the IMF, IBRD, and the ITO were key elements of this system. They were soon followed by a range of other organizations in the next decade intended to manage a wide range of issues in international politics.

The GATT had been included in the Havana Conference as a temporary organization to coordinate international trade until the ITO could gain ratification by the proposed member states. The GATT had emerged through the efforts of a handful of states to promote trade liberalization starting in 1945 in what became known as the Geneva Round of trade talks (WTO, 2003). Progress in the GATT framework continued from 1947-1950 in the expectation that the ITO may yet be salvageable.⁷ Contrary to the best laid plans, the issues surrounding the ITO were not resolved as hoped and the organization died a quiet death. With the death of the ITO, an organization intended to be an interim fix for a complex problem became the primary coordinator of international trade for nearly five decades. The GATT provided coordination by creating a uniform set of rules to manage international trade. These rules were enforced by a simple dispute settlement mechanism that adjudicated disputes between members, but which lacked the effective power to enforce its decisions.⁸

As time passed, the GATT was largely successful in its efforts to coordinate the international trade system. The range of issues covered under international trade rules expanded over the decades in a series of trade Rounds, gradually coming to include rules for evolving trade areas such as non-tariff barriers, services, and intellectual property. During these Rounds the dispute settlement mechanism functioned as a means of resolving disputes over the interpretation of the growing set of rules of the trade regime. The growing complexity of international trade law made a system of impartial adjudication a critical part of the trade system.

⁷ The Annecy and Torquay Rounds (WTO, 2003)

In spite of the general success of the GATT system at lowering barriers to trade, a range of issue areas continued to present problems to the GATT system. Most notably, states became adept at creating new barriers to trade that evaded GATT rules, requiring the progressive expansion of the GATT's purview. Eventually it became apparent that the institutional structure of the GATT was not sufficient to handle the contemporary trade issues facing its members and the growing complexity of international trade law.

The GATT was replaced by the WTO in 1995 following the Uruguay Round of negotiations. The advent of the WTO system brought a range of new issue areas into the trade regime and made significant changes to the dispute settlement process. Most significantly, the WTO Dispute Settlement Mechanism (DSM) incorporated a series of institutional reforms that gave the DSM teeth that the GATT process had lacked.

The changes to the DSM were significant. These represented a fundamental change to the nature and power of the DSM in enforcing the rules of the WTO. The WTO DSM had two fundamental innovations that are critical to understanding the role that its institutions play in managing the trade regime. First, the DSM was changed to place the decision-making power in the hands of impartial professionals. The WTO DSM uses a panel of international trade law experts as a pool from which panelists are drawn to sit in judgment of trade disputes. Second, the WTO DSM was given the power to enforce its rulings through a system of retaliatory sanctions. When a member state fails to comply with DSM decisions, the DSM can authorize the harmed party to retaliate against the state that fails to comply. While this system still relies on the power of the

⁸ See chapter 3 for a more detailed discussion of the dispute settlement process at the GATT.

complainant to impose harmful costs on the violator, the system is a significant improvement from the non-existent enforcement power of the GATT.⁹

Under the WTO, the DSM strongly resembles domestic courts, including professional (and nominally neutral) members for both the Panel process and the Appellate Body (Davey, 2002). As the DSM has functioned since its creation in 1995, it has also set forth a growing body of case law (Steger, 2002). This expansion of the power of the WTO reflects the growing complexity of its role as an arbiter of the rules of a complex international trade system. It should also be noted that the WTO system continues to expand the scope of its rules, adding to the complexity of the trade regime (Esserman, 2003).

In understanding GATT and WTO disputes it is important to remember that the GATT and WTO function primarily as managers of a system with a large body of complex rules that regulate how trade is controlled. The WTO does not simply mandate free trade. If it did, the dispute resolution system would be much simpler. Any barrier to trade would violate the trade rules. By setting rules on what types of protection are permitted and which are not, the system creates vast regions of uncertainty in interpretation of the system's rules. The institutional mechanism for resolving disputes over these interpretations is the Dispute Settlement Mechanism.

It is the complexity of this system that allows states to engage in policy decisions on given issues that vary widely, while all the time claiming that the WTO rules permit such actions. In short, the complexity of WTO rules creates a “fog of law” in which

⁹ See Chapter 3 for a more complete discussion of the WTO DSM and its differences from that of

political leaders within states can undertake actions favorable to themselves and/or their supporters while claiming that even strongly protectionist policies comply with WTO rules. In this context, then a state can claim adherence to the rules of free and open trade allowed under the trade regime while simultaneously seeking trade protection for key industries.

It is in this context that the WTO dispute resolution process is best understood. The system is designed to encourage and enforce cooperation with a complex body of international rules that are subject to multiple, competing interpretations. The institutionalization of the system creates durability and stability that will avoid the problems of the later years of British hegemony and the inter war period. The system has the institutional power to determine which interpretations of its rules are correct and acceptable.

2.2.2 Institutional Design

The GATT/WTO system was intended to prevent the destructive trade competition that contributed to the increasing conflict in the periods before the two World Wars. As such, the design of the institutions are particularly important in understanding both how they fulfill their functions and in how political leaders evaluate the impact of these institutions when making policy.

The GATT/WTO system is designed to solve several key problems common to international organizations broadly, but that are particularly problematic in international

trade. The first of these problems is that of uncertainty across time. Generally this is the problem that the goals of member states and their power relative to one another is flexible over time and that this will lead to changes in the relative benefits that accrue to member states over the life of the organization (Koremenos, 2005). Uncertainty is a problem for states in that they must agree to join an organization with limited knowledge of its potential future costs and benefits. This is particularly problematic in the realm of trade policy under complex interdependence. Political leaders at the time of the Havana negotiations knew that the state of the world in 1947 was subject to widespread changes as the post WWII recovery continued and the world returned to something approximating normalcy in future years. This created potential problems in making credible commitments to a powerful organization the powers and responsibilities of which were not clear to the leaders of the time.

The GATT system solved this problem of uncertainty by adopting a flexible agreement: an agreement that includes the provision for progressive renegotiation of the terms of the agreement at future times. While this would appear to be an excellent element of institutional design meant to overcome the problem of contracting for the long term, it was not a design element of the organization. It was the result of fortunate accident. As previously discussed, GATT was meant as a temporary facilitation agreement. When it became clear that GATT was going to be the de facto governing institution for trade relations, changes were needed. This need to make changes led to what would become the system of trade rounds. As successive trade rounds dealt with particular problems, the expectation emerged that such rounds would continue and that

the terms of the institution were changeable with future talks. In short, the GATT created by accident a key system for promoting compliance in the long term and for overcoming the incentive to withdraw from the system.¹⁰

The GATT agreements contingent beginnings allowed it to operate with an informal assumption of continuous negotiations that permitted the adjustment of the rules of the wider regime to changes in the composition of the membership and the international environment in which the regime operated. Table 2.1 provides a summary of the Rounds under the GATT and WTO and their respective subject areas. Note that the complexity of these rounds increases as the GATT system grows and expands. As the institutions become entrenched and as the number of member states rises, the negotiations increase in both length and complexity as members seek to adapt the institutions to the growing diversity of interests.

While the GATT system solves the problem of contracting for the future through the use of a flexible negotiating system, it must also manage the day to day operation of the system. This involves managing the system between renegotiations in order to ensure compliance of member states with the rules of the system. Thus the second key problem faced by the GATT/WTO system is the enforcement of rules to ensure cooperation. In this phase of the process, the key element of the system is the institutional mechanism by which disputes are resolved. Details of this system are provided in Chapter 3 and later in this chapter. For our purposes here it is enough to note that the dispute settlement

¹⁰ Koremenos argues that such flexibility is a key element of institutions with the implication that such designs will be more successful. It is interesting to note here that the GATT system evolved into this design as progressive expansions of the membership and the purview led to the need to continually discuss

procedures of the GATT and WTO vary significantly in their operations with consequences that are important for understanding how these institutions affect political leaders. In spite of these differences, the basic role of enforcement of cooperation remained consistent across the two bodies.

The enforcement of daily rules is part of a key process of ensuring compliance with the rules of the system as a whole. This presents several problems in practice. The first is that an absolute system of strict enforcement is likely to increase the incentives that states have to abandon the organization (Rosendorff 2005). Domestic political pressure on leaders in the member states will constantly press for policies that violate the rules of the regime in favor of domestic political supporters.¹¹ Strict enforcement of the rules of the regime would thus create strong incentives for defection from the regime by political leaders seeking survival and lower the likelihood of the regime's survival (Rosendorff 2005). Fortunately the GATT system was not built around a principle of strict enforcement of the rules of the system. The GATT system had a very weak enforcement mechanism based on specific cases of violations brought by member states against other member states. This system allows temporary and minor defections to take place with little or no consequence, but allows major or long-term violations to be brought to book. As with the trade rounds, this system emerged largely due to the humble origins of the GATT rather than as a clever design.

The GATT system was intended to solve a narrow range of problems in a short

the future of the organization. The GATT thus represents almost an accidental contracting around uncertainty rather than a clever design.

¹¹ The details of this process and how it is affected by domestic institutions appear later in this chapter.

window of time between states that had already agreed on the basic parameters of the reductions of trade barriers. It was only after it became clear that the ITO was doomed and that the GATT would be governing not just a handful of very like-minded states, but a growing body of states only loosely committed to the specifics of reducing trade barriers that the GATT system took on the role of flexible arbiter of disputes.

The institutions of the GATT/WTO system thus serve two basic and related functions. These two functions address different aspects of the problem of cooperation in international trade. The first function is the establishment of rules for the international trade system within a framework of progressive adjustment. This function is carried out by the GATT Council, the formal decision making body of the GATT. The Council works by consensus and has gradually expanded the range of international trade covered under the GATT since the original GATT treaty came into effect in 1947. The basic nature of the Council and its role in the coordination of negotiations regarding the rules of the system has remained remarkably consistent even through the change to the WTO in 1995. The second function is the enforcement of the rules of the regime. Under the GATT this was considered to be part of the function of the Council and was essentially part of the larger political function of the GATT system in maintaining general commitment towards the gradual opening of world trade. It is the dispute settlement function that has undergone significant changes under the WTO. The process by which disputes are adjudicated has changed significantly and this has led to major changes in the calculations of political leaders.

The GATT/WTO system is relatively open by the standards of most global

economic organizations. The rule of consensus allows, at least in theory, for even small states to ensure that their interests are looked after. While it makes major change difficult (as is currently the case in the Doha Round) the system does ensure that all member states can have a meaningful say in major decisions, reducing the incentive for defection.

While the system is not perfect by any means, it is significantly more open than are the equivalent systems at the World Bank and IMF (Zamora, 1980).

As the GATT was not intended to be anything other than an interim body to help pave the way for the ITO, little actual attention went into designing its institutions. As such, they were somewhat rudimentary. The Council served as the primary deliberative body (at least in theory) responsible for the maintenance of the GATT system. While the WTO represents the culmination of decades of gradual expansion of the powers of the trade regime, the WTO largely retained the loose institutional structure of the GATT in its general capacity for negotiating the trade rules. The General Council of the WTO is largely similar to the GATT Council in its daily operation.

The openness of the GATT negotiating system and the small number of states during its formative years established the basic GATT system in the context of relatively low costs for cooperation. The small number of states in the original GATT rounds and the high degree of agreement meant that the early GATT system was characterized by a general agreement on the direction of the organization. As the GATT expanded its membership and its purview, the GATT negotiation and dispute settlement processes took on more of the characteristics of other IGO's. While much of this change took place in the practical negotiations, the actual formal institutions of the GATT remained

underdeveloped relative to the significance they were taking on as managers of the trade regime. As it turned out, this was a blessing for the trade system and the GATT institutions. The nature of the institutions allowed flexibility both in the application of the rules of the regime and in the negotiations regarding what those rules should be. In the hectic decades of the second wave of globalization, the GATT survived because its institutions were flexible enough to constantly adapt to changes in international economic and political conditions, but also firm enough that they could maintain incentives for compliance.

This combination of flexible long and short term management creates a strong set of incentives on the part of political leaders to comply with the regime. In the near term, leaders are free to adjust policies to political realities at the domestic level that require violations, or at least severe stretches of the rules of the regime. While such policies may eventually lead to a trade dispute and eventual repeal, the time between implementation and repeal will likely be long enough that the domestic situation will have changed and the political realities will have shifted. Even in cases where the changes leading to domestic pressure are structural and will not change, the flexibility of the trade regime offers the chance to raise these policy concerns at future negotiations, even if the policy is found to be illegal and repeal is forced today.

The international institutions of the trade regime thus provide strong incentives for compliance over the long term for political leaders. The regime shapes what policies are allowed and how leaders can go about changing the policies of recalcitrant states. The changes to the regime with the shift to WTO dispute settlement institutions changes

only the procedure by which states can seek compliance of other states. This is a significant change as we shall see, but it leaves much of the flexibility of the system intact.

2.3 Domestic Politics – institutions, survival, and economy

Political leaders cannot worry only about their international commitments. In a world made up of nation states, it is domestic politics that keeps the vast majority of leaders in power. For all leaders, neglecting domestic politics is done at their peril. In this context, the institutions that select and retain political leaders have a significant effect on how leaders gain and retain power. Leaders must respect their domestic institutions if they seek to survive.

Domestic institutions thus create a strong set of incentives for political leaders. These incentives drive the quest for attaining and maintaining power in the hearts and minds of political leaders. As such they play a key role in forming the policy incentives faced by political leaders. Leaders must act within the institutions in which they find themselves, be they democratic, theocratic, or fascist. Regardless of the leader, the institutions matter.

What follows is a discussion of domestic institutions with a key focus on democracy and autocracy. This spectrum of political institutions is key for understanding how political leaders must react in order to gain and retain power. The more open a society, the larger the support base a leader needs and the more people that must be kept happy. The more democratic a society is, the more the political leaders will be pulled in

competing directions by their supporters and the more flexible they will need to be in their policy responses. This will have key implications for our study of dispute settlement at the GATT and WTO.

2.3.1 The Survival of Political Leaders

Political leaders seek to survive in their positions of power and authority. This is an axiom of political science research in virtually all aspects of the study of leaders (Downs 1957; Buchanan and Tullock 1965; Bueno de Mesquita, et al 1999). To survive, political leaders make policy choices intended to maintain their position of power within the institutions of the state in which they rule. To gain power, political leaders must promise policy alternatives that can gain the support of key groups within the state and secure the ouster of the current leadership in favor of the alternative leader.

The basic process of survival calculation is the same in all states and at all times. Leaders seek to do that which will bring them to power and keep them there. If all states were the same, this would make the analysis of political leadership a very simple exercise. All states, however, are not the same. Political institutions at the domestic level vary widely. Some states are dominated by the personality cult of a single individual. Other states are nearly fully democratic, giving a say in political policy decisions to a broad sweep of the population. Between these two ends of the institutional spectrum there is a wide range of alternatives.

The nature of the institutions that select political leaders from the ranks of the contenders for power are important in understanding many aspects of policy decision-

making by political leaders. The nature of the support base a leader must build affects how that leader will make policy decisions when in power and how the potential leader builds support for a chance to take over the leadership.

While institutional variation is exceptionally complex in its broadest conception, taking in political, cultural, historical, and many other aspects of the state in question, a great deal of the variation in policy choice by political leaders, particularly in economic areas can be attributed to the variation in the degree to which the institutions of the state reflect the principles of democracy (Olson 1994; Przeworski, et al. 2000; Feng 2003). Further, institutions that are more democratic require larger bases of support than those that are less democratic, thus increasing the size of the group that political contenders and leaders must rally to their cause in order to maintain or take power (Bueno de Mesquita, et al. 1999; Persson and Tabellini 2003). It is the need to gain the support of increasingly large coalitions that leads political leaders to feel the pressure from larger and larger numbers of distinct groups within the state. As the number of groups from whom leaders must seek support grows, it becomes increasingly likely that leaders will be pulled in contrary directions by the demands of key political supporters. In states with highly democratic institutions, the size of the body of supporters needed to secure and retain power can potentially be a super-majority of the population of eligible voters (Lijphart 1999).

To understand economic policy decisions, and particularly those related to international trade under conditions of complex interdependence, it is this aspect of political institutions that is key. The more democratic a state's political institutions, the

larger the base of political support required to gain and retain power. As this coalition size rises, it increases the likelihood that political leaders must build into their long-term coalitions groups that will have divergent views and needs in trade policy. In the context of complex interdependence, rising coalition size also increases the likelihood that a group in the governing coalition will be affected by the policies of other states within the context of the international economy.

Political leaders making policy decisions thus operate in a context that mixes domestic institutional constraints and incentives with international constraints and incentives both from international institutions and also the international marketplace. The decisions regarding international trade policy reflect domestic economic and political needs (Hiscox, 2002; Reinhardt, 2000 ; Rogowski, 1989; Stolper, 1941). It is the international results of these policy decisions (sometimes intended, sometimes not) that lead to the international trade disputes between states that will be focus of the last sections of this chapter.

Only a handful of works have attempted to approach international economic conflict as a process that bridges domestic and international institutions (Busch, 2002; Reinhardt 2000, 2001; Sherman, 2001). While these works have made a considerable start to the process of understanding how domestic political institutions affect international trade conflict, they have only begun to explore the process through which the incentives created by institutions at the domestic and international level drive the policy process. Most critically they have failed to recognize the key ways in which institutional changes at the international level have affected the behavior of policy-

makers within the member states.

States are not unitary actors and their actions in international relations cannot be understood unless we explore the domestic political conflicts that result in international policy decisions. States are collections of groups with differing access to the levers of power. In all states access is asymmetrically divided within the population. Some groups are completely without a say in the policy process, others have a say vastly disproportionate to their share of the population. The distribution of power within the nation state is an important element of how international behavior emerges from within the nation state, but it is only one dimension. It is also critical to consider how the distribution of power is channeled into the policy process through the political institutions of the state. To understand this, it is critical to understand the difference between the incentives of political leaders in different institutional contexts.

The drive to gain and retain power is a key motivating force for all political leaders. To do this, leaders must play a complicated game. Policy decisions reflect inputs from many different actors with competing interests. While political leaders face policy pressure from many groups, what follows will focus on pressures emerging from three basic forces: 1) market forces (domestic and international) 2) Domestic institutional forces (particularly the relative democracy of institutions) and 3) international institutional forces.

Market forces respond to the actions of political leaders. Unlike political actors, markets are impersonal. They are the aggregate forces created by the decisions of billions of people both domestically and internationally. In this sense, their pressure is

indirect and highly variable. Markets can pressure political leaders directly, through negative or positive reactions to the decisions of political leaders. At the same time, markets can pressure leaders indirectly, by creating winners and losers in the domestic political arena who will apply pressure to political leaders via the domestic political institutions of the state. (See Figure 2.1)

Leaders of states must seek economic growth in the long-term in order to retain office. Economic growth in the long-term is aided by the integration of the national economy into the international marketplace (World Bank, 2002). As states seek economic integration, their economies experience greater long-term growth, but at the cost of economic and social dislocation in the short-term. Further, the integration of the national economy into the international one makes domestic actors vulnerable to shocks resulting from the actions of other states' leaders as well as international market forces. This economic and social dislocation creates pressures on national governments to engage in policies designed to lessen the harmful effects of economic integration. At times, this comes in the form of pressure to avoid further integration or to protect local businesses from their international competitors.

All states face this problem. Long-term growth is in the interest of political leaders. It is a public good that can be used to promote political survival for the ruling government and increase the overall economic well being of society as a whole. The short-term negative impacts of economic integration create pressures to limit or prevent integration against the interests of political leaders and the majority of the residents of the state in the long-term. Governments are constantly faced with a tug of war between trade

openness and protection. International trade and integration thus present governments with a serious political problem. To retain power over the long-term, international integration is required to increase economic growth and provide public goods to the population.¹² To retain power in the short-term, a government may be forced to pursue policies that hinder or even reverse integration, harming long-term survival (Bueno de Mesquita and Root, 2000). All states must balance these conflicting tendencies in their international trade policy.

Nation states are primarily vehicles for the appropriation and dissemination of resources. The nation state emerged as a form of organization that allowed monarchs to control the productive resources of a geographic space in the interest of harnessing the resources of the state. The monarch was able to use the resources extracted from the geographic space to govern their territory. The resources of the territory were controlled by the monarch and used to maintain order within the state. The monarch provided the resources of the state to different groups in different measures in order to maintain control of the state and to build the power of the state relative to other states for the purpose of defense and/or conquest.

As monarchy has given way to democracy, the use of state resources to retain power in the hands of the ruling elite has not fundamentally changed. The ruling elite uses the power of the state to provide goods both to supporters and to the population as a whole. In the modern context, the emergence of democratic governance has changed the

¹² Some would argue against that this is not always the case. Recent evidence from the World Bank, however provides strong evidence that economic openness does in fact lead to higher rates of long-term growth in both developed and developing economies. (World Bank, 2002) This same report also argues

nature of the nation state from the monopoly of control over resources for the purpose of warfare and defense to the monopoly of legitimate control over resources for the promotion of the good of the citizenry variously defined (Acemoglu and Robinson 2006).

The contemporary community of nation states consists of states with various forms of domestic governance. The regime types of these states are diverse and even within states of the same regime type, institutions can be widely different. Despite these differences, all nation states are still organized around the same basic principles of sovereign control and the right of the state to control the resources within its territory. Regardless of regime type, the basic driving force for leaders' decisions remains the same, a desire to retain leadership and control.

The nation state expropriates a portion of the resources produced within the state's borders in order to serve the collective interest of the political leadership and its key supporters. In authoritarian states, the group of supporters is very small, resulting in a highly concentrated provision of goods by the state (Bueno de Mesquita 1999). In spite of the concentration of provision, the expropriation of resources by the state remains diffuse. The state collects resources from all members of society in the form of taxation (and frequently corruption) and provides payoffs in the form of government provision to a small elite. As political institutions become more democratic, the political support base of the leadership expands and the nation state expropriates goods from the population at large in the form of taxation, but the provision of goods is extended to a much larger proportion of the population. The more extensive provision of goods is required by the

that economic inequality is reduced in states that embrace economic liberalization and integration in the

larger proportion of the population whose support is necessary in order to secure power.

Bueno de Mesquita, Morrow, Siverson, and Smith (1999) describe the basic relationship between expropriation of resources and provision of goods to the privileged segments of society in terms of the provision of public and private goods to groups that support the ruling group within the state. This model assumes that all leaders seek to retain power and that leaders will engage in any policy action that serves this interest. In brief, political leaders are concerned only with survival. The Bueno de Mesquita et al. assumptions about political leaders in the context of international relations reflects a classic model of opportunistic political leaders from the comparative politics literature on electoral politics (Alesina, 1999).

A further important distinction raised by Bueno de Mesquita et al. (1999) is in the nature of the goods provided by the states. The state can provide goods in essentially two forms. The first is private goods; goods that provide direct payment to the individual supporters of the leadership. The second is public goods; goods that provide benefits to society as a whole and the benefits of which cannot be limited to the members of the winning coalition. For Bueno de Mesquita et al. the separation of public and private goods also divides the manner in which regime types are able to maintain their winning coalitions. Private goods can be provided directly to political supporters as a means of securing support for the ruling coalition. The provision of private goods directly to individual supporters can take a range of forms, including the awarding of government contracts and direct tax subsidies. These payments are directed at specific individuals or

global economy.

groups and can be denied to the public as a whole. The more democratic a state's institutions, the less able leaders are to turn to private payments. No leader has an unlimited budget, and the provision of private goods cannot win enough supporters for leaders in states that require large coalitions to secure power.

International trade has the characteristics of both public and private goods and can thus be used for both public and private provision. In the long term, and across the economy as a whole, free trade is a public good which raises the living standards of all members of society by increasing efficiency, which results in lower relative costs to consumers and higher rates of economic growth. In the provision of trade policy, however, leaders must balance the long-term benefits to be gained from free trade with the short-term dislocations caused as the economy adjusts to more open trade policy (Rogowski, 1989). The dislocations caused by movement towards free trade policy have effects that are analogous to private goods. Groups that are favored by protected trade policy experience private costs if public policy shifts to favor free trade. If these groups are members of the winning coalition, they are in effect being harmed by the policy of the government they support.¹³ This cost is highly variable depending on the nature of the wider economy and the sector of the economy in which the supporter is located. Even in the most open and fluid economies, however, there exist groups that will be harmed (sometimes irreparably so) as the public policy shifts from protection to free trade. In order to prevent defection to potential challengers, the ruling coalition must ameliorate this cost or seek a new supporter from outside the present coalition. Given the risks

¹³ This would be analogous to imposing a negative private good on the group in question.

entailed in pursuit of a new supporter, political leaders will generally prefer to retain their current support base rather than risk failing to secure a new supporter.

The political problem for those seeking to maintain a ruling coalition is that free trade does not affect all groups equally and its impact varies across nation states and across levels of relative development (Stolper, 1941; Rogowski, 1989; Hiscox, 2002). Trade policy presents a problem for political leaders because long and short-term effects can frequently be in conflict with each other. The short-term costs of moving towards a policy of free trade are concentrated while the benefits are both concentrated and diffuse. Depending on the structure of the economy (Stolper, 1941; Rogowski, 1989) and inter-industry factor mobility (Hiscox, 2002) free trade policy will affect groups in widely different ways. The distribution of political power between these groups has a tremendous impact on how these groups' policy demands will be articulated, but in all cases the mechanisms of interest articulation are the political institutions of the state.

The key element of domestic political institutions in the understanding of trade policy is thus the size of the coalition of supporters that leaders must secure in order to gain and retain power. As the size of the required support base rises, the greater the likelihood that the leadership will need to secure the support of interests that have conflicting (if not directly opposite) interests in trade policy.

2.3.2 Past Research on Trade Policy Pressure

Domestic politics affect the international trade policies of states. While international trade and open economies produce higher rates of economic growth in the

long term, short-term adjustments to the structure of the economy can have serious social, economic, and political effects. The impact of these short-term effects are often significant in the domestic political context and generate pressure on the national government to adjust international trade policy to reflect the interests of domestic political supporters (Stolper and Samuelson, 1941). The traditional approach to this problem has been to examine the ways in which political pressure from various groups will affect the decisions of policy makers (Rogowski, 1989; Simmons, 1994; Hiscox, 2002). These studies focus on the ways in which groups within the polity pressure their political leaders to achieve favorable political outcomes. The focus of these studies is the division of relative power between groups in society. Trade policy choices are essentially divided between openness and protection, with various groups representing each position. These groups engage in political conflict over control of policy. Political leaders opt to support the policies favored by the strongest groups.¹⁴

International trade affects different groups in society in different ways. Some groups benefit from open trade while others are harmed. While it is generally accepted that the benefits of growth from open trade will outweigh the costs to the economy as a whole in the long term, this is of little consolation to those feeling the short-term effects of economic adjustments. These groups have a strong incentive to use the political system to protect themselves from the harm inflicted by the reduction of trade barriers and increased international competition. While groups in sectors harmed by international trade have an incentive to apply pressure to prevent moves towards open trade, groups in

¹⁴ Hiscox (2002) provides a very elegant summary of this diverse literature in Chapter 1 of

sectors that benefit from international trade have strong incentives to promote the liberalization of trade policy. The conflict that emerges from the tensions between these groups manifests in the domestic political system of all states engaged in international trade. The precise nature of these divisions and how they manifest in political conflict within states is the subject of debate in the trade policy literature. While there is general agreement on the fact that groups divide along lines of those who benefit and those who are harmed (Hiscox, 2002) the debate ranges as to how this division will manifest itself.

The Stolper-Samuelson theorem implies that this division will emerge along factoral lines (Stolper and Samuelson, 1941). The core argument is that international trade liberalization increases the return on investment for firms whose operations require factors in which the state in question is well endowed. International trade liberalization reduces the return on investment for firms whose operations require factors in which the state is poorly endowed. It is the groups that are dependent on factors with which the country is poorly endowed that will suffer under free trade and which are thus likely to benefit from protection. Stolper-Samuelson argues that, while economy as a whole is harmed by protection, specific groups within the country can be made significantly better off by protection if they are employed in sectors dependent on scarce factors of production (Stolper and Samuelson, 1941).

Rogowski (1989) uses the Stolper-Samuelson theorem to explain the nature of political coalitions that arise to lobby governments on trade policy issues. Rogowski argues that coalitions will form along lines based on the factors required to support given

industries. This implies that coalitions will form based on the inputs involved in production. If a state is well endowed with labor, but poorly endowed with capital, the shift towards liberal trade policy benefits labor and harms capital (through the mechanism of changing returns on investment) which leads to an alignment of labor in favor of trade liberalization and capital against. Trade coalitions will always tend to form along factorial lines pitting capital, labor, and land groups against each other in coalitions based on the natural endowments of the state (Rogowski, 1989).

The Ricardo-Viner model argues that the returns of various factors are conditioned by the industries in which they are put to use (Mussa, 1974; Hiscox, 2002). In this argument, the factors alone are not sufficient to drive the formation of domestic political groups. The variation in return on investment depends on the industry that uses the factor (Mussa, 1974). Some industries use labor more efficiently than others, which leads to a higher return on investment in the more efficient industry even with the same input of labor. In this argument, industrial differences are the key to domestic political coalition formation. Mussa (1974) argues that the short and long term interests of industries are perpetually in conflict due to differences in factor dependence. In this application of Ricardo-Viner, the central conflict between economic interests will be those interests who have an long-run interests in free trade, but who may benefit from short term protection and those whose interests in both terms benefit from trade openness (Mussa, 1974). Political coalitions in this case should form along industrial lines as broad class coalitions related to factor endowment will be split by the impact of relative efficiency across industries (Hiscox, 2002).

Hiscox (2002) argues that both Stolper-Samuelson and Ricardo Viner models are inadequate to explain domestic political alignments emerging from the varying impact of trade liberalization. For Hiscox, the key element is neither factor endowment nor relative industrial efficiency, but the degree to which factors are mobile within the economy of a given state. High factor mobility allows the same factor to be rapidly deployed across industry lines. Labor can quickly move from one industry to another. Capital can rapidly be withdrawn from a slowing industry and reinvested in a growing industry. Under these conditions, factor mobility limits the importance of industry-specific declines as factors can rapidly be re-deployed to growing industries. When factor mobility is low, however, industry becomes critical as factors cannot re-deploy rapidly readily from one industry to another. In cases of high mobility, Hiscox argues that broad, class-based coalitions will emerge. In cases of low mobility, Hiscox argues that narrow, industry-based coalitions will emerge (Hiscox, 2002).

All three positions share an essential agreement: political coalitions will form both for and against trade policy and that these coalitions will manifest within the political system of a state in a wide variety of forms. What is common to all is the political conflict that emerges as trade liberalization impacts the local economic, political, and social systems. Trade policy, in all three arguments, is a clear source of strong domestic disagreement.

While most studies of the domestic influences on international trade policy have focused on democracies (Stolper and Samuelson, 1941; Rogowski, 1989; Hiscox, 2002) the pressure to alter international trade policy will be felt in all states regardless of regime

type. Any state experiencing a period of trade liberalization will experience social and economic dislocations that will be manifested in the political system. All political systems have mechanisms for dealing with these pressures, but the mechanisms differ greatly depending on the political institutions within the state. Autocratic institutions largely suppress mass dissent, but are very careful to secure support from their core ruling group. Democratic institutions by nature must listen to mass dissent and adjust policy in response. These differences lead to significant differences in international behavior.

The strict dichotomous choice offered by these approaches is also problematic in understanding trade disputes. They all divide the trade policy debate between openness and protection, broadly defined. They do not allow for simultaneous openness and protection. A brief examination of the rules of the international trade regime demonstrates that international trade rules under the GATT and WTO systems did not present a simple open vs. protected choice. While the early GATT period sought a broad reduction in tariff rates, the application was neither universal across sectors, nor evenly applied between members.¹⁵ The analysis of trade disputes in the context of domestic and international institutions requires a refinement of the understanding of how domestic political pressure leads political leaders to make international policy decisions.

2.3.3 Political Survival and Economic Policy Manipulation

One area in particular where political leaders attempt to promote their survival

¹⁵ The original GATT agreement was dealt only with a limited range of issue areas. While these were significant, they were by no means comprehensive. The GATT system was targeted towards a selective reduction in barriers to trade. The terms of the GATT excluded a fairly wide range of economic

through complex policy choice is in macroeconomic policy. Political leaders seek to alter the economic conditions within the domestic economy to increase their chances of retaining the support of the population. Most studies of this type of macroeconomic manipulation have focused on democratic states and the relationship between policy manipulation and electoral cycles (Alesina et al. 1999).

A key problem for political leaders is that economic activity largely takes place outside of the direct control of governments in democratic states. Policy tools aimed at manipulating economic growth are at best crude, and at worst counterproductive (Buena de Mesquita and Root 2000). In spite of the electoral benefits of economic growth, political leaders lack the tools necessary to directly control economic growth in the short term (Alesina et al., 1999). Democratic states also present the additional problem that direct attempts at manipulation in the interest of political survival can backfire if the electorate becomes aware that the economy is being manipulated in the interest of the survival of the ruling party.

Alesina et al. (1999) have argued persuasively that political leaders will seek to control the macro economy, but will use fiscal and monetary policy as the means of control. This represents a rational attempt to promote economic activity indirectly. While Alesina et al. argue that the impact of these attempts at macroeconomic manipulation are mixed at best, governments consistently engage in this type of manipulation of economic policy.¹⁶

activity from GATT rules. Further, rules exempting LDC's from the MFN provisions of the GATT agreement were incorporated in the Kennedy Round of GATT talks (1964-1967)

¹⁶ Alesina et al argue that the particular tools of policy manipulation may be changing over time. They cite various historical trends such as the ballooning of developed country deficits as potential sources

Work by Feng (2003) demonstrates that economic policy on the part of political leaders is effective at promoting growth when it provides stability and effective rules within which economic actors can undertake planning with a minimum of risk. Democratic states are better than non-democratic states at achieving this state of affairs due to their broad commitment to the rule of law and the need for political leaders to provide growth over time to retain power (Feng 2003). Barro (2000) also highlights the power of the rule of law in democratic states as a key element of their ability to promote economic growth, although he does so with the important caveat that effective rule of law requires effective institutions through which the rules are enforced (Barro 2000).

Past research in the manipulation of the economy for political ends thus demonstrates that political leaders are more than willing to manipulate the economy for survival purposes. The institutional framework in which leaders make their decisions matters, with democratic states being more likely to attempt to manipulate the economy indirectly through public policy rather than by direct intervention (Alesina 1999). The key element of these attempts, however are effective political institutions that can make indirect manipulations of the economy without undermining the overall rule of law (Barro 2000; Feng 2003).

The previous discussion illustrates that political leaders are heavily influenced by the domestic institutional context. The drive to use policy tools to secure power and to retain it is a key element of the decisions of all political leaders. Political institutions set

of change. They also argue that it is likely that policy manipulation is affected by the ideological viewpoint of the party in power, but that this effect has become moderated in the last decade as left/right policy differences have converged.

the rules for this contest as well as defining the range of policy options that are likely to be chosen. The larger the base of support required for a leader to gain and retain power, the more likely that leader is to be driven to public policy tools to promote the interests of supporters. At the same time, the larger the support group required, the more likely that competing interests must be accommodated within the coalition. This implies that the more democratic a state's institutions, the more likely the leader is to turn to policy measures that may be contradictory. The short-term survival interest may trump the long-term necessities of the economy. This is demonstrated in the means by which leaders seek to manipulate the macro economy, even in cases where such manipulation is risky, in order to promote electoral success.

In trade policy in particular, domestic pressure will be a complex combination of forces. The more democratic the political institutions of a state, the more likely that the political leadership will be forced to include groups that seek protection and groups that seek openness in international trade within the ruling coalition. Further, the larger the coalition required, the more likely that members will be harmed by the churn of the global economy in ways that lead them to seek political redress.

In short, the more democratic the political institutions, the more pressure to pursue policies that serve the narrow interest of political supporters that are likely to conflict with the trade regime. At the same time, domestic groups that are harmed by the actions of other states are likely to press for action to enforce the rules of trade regime when violated by other states. The more democratic the state's institutions, the greater the pressure on political leaders for simultaneous defection and enforcement.

2.4 Formal Fixes for Uncertainty and Competing Interests

Political leaders are aware that they make decisions in a complex institutional environment. Decisions relating to trade policy are made with one eye on domestic politics and one eye on the international implications of their decisions. Political leaders are aware of the complexity of these institutional interactions and they make decisions in the complex context created by the institutions at two levels.

At the domestic level, political leaders promote survival by adhering to the institutional requirements needed to gain and retain power. They keep their support base happy to the best of their ability. At times this requires the pursuit of policies that may go against the international rules of the regime. When domestic and international institutions are in conflict, political leaders face a difficult choice. To ignore international institutions is costly and it can lead to disruptions of the international system that are at best costly and at worst disastrous. The problem is that ignoring domestic institutions is a good way to lose political power and be relegated to the world of *former* leaders. Political leaders must thus find ways to reap the benefits of international institutions while remaining true to their domestic interests.

This chapter has previously raised two key elements of how leaders do this: 1) contracting around uncertainty (Koremenos 2005) and 2) institutional mechanisms to allow temporary suspension of compliance (Rosendorff 2005). These two elements are key to the function of the GATT/WTO regime and are critical in understanding how international institutions affect the incentives of political leaders.

The problem of “contracting around uncertainty” is one that can be solved in a variety of ways. A variety of mechanisms exist to resolve the problem of uncertainty for domestic political leaders. Koremenos (2005) demonstrates that institutional elements designed to increase the flexibility of the organization can overcome questions of both domestic and international uncertainty when incorporated into the structure of an organization. She identifies several kinds of institutional flexibility: limited or finite duration, escape clauses, and withdrawal provisions. Each of these flexibility mechanisms allows states to adjust their policies within the overall structure of the organization over time, reducing the likelihood that they will be “stuck” with untenable provisions.

Limited duration, often combined with renegotiation, allows states to revisit the terms of international cooperation within the IO periodically. This allows them to make adjustments to problem provisions without necessarily dumping the entire system of cooperation. Many international agreements include this type of provision. Cooperation is set for a limited period, often with the provision for renegotiation of the terms of cooperation at the expiry of the agreement (Koremenos, 2005)

Withdrawal provisions allow states to leave the organization with a minimal penalty. These are different in kind from both renegotiation and escape clauses. Withdrawal provisions allow states to leave an organization in response to major changes in perceived interest in cooperation (Koremenos, 2005). If a state no longer considers its national interests to be served by cooperation, it can leave the IO without destroying the

IO itself.¹⁷

Escape clauses provide a similar function to limited duration in that they allow states to temporarily suspend compliance with cooperation when an “emergency” arises. This allows states to suspend compliance during times of domestic turmoil or serious political strife. In short, when domestic political concerns seriously conflict with international commitments, political leaders can opt out temporarily, with the option of returning once the “crisis” is over. This allows political leaders to retain the benefits of cooperation without the need to renegotiate entry to the IO (Koremenos, 2005). Koremenos demonstrates both using formal modeling and empirical evidence that the provision of escape clauses helps to resolve the problems created by uncertainty in international organizations. The inclusion of these clauses makes overall compliance more likely, and these provisions are often included in IO's.

Rosendorff (2005) makes a similar argument to that put forth by Koremenos'. He argues that the WTO dispute settlement mechanism is a means by which states can opt out of compliance with the terms of the organization, but still retain the benefits of membership. The WTO DSM is essentially a system by which states can pay a fine for non-compliance while still retaining the benefits of overall membership. Rosendorff (2005) argues that political leaders are subject to political pressures to violate the rules of the trade regime. Having recognized this, political leaders have negotiated into the WTO system a means by which they engage in policies that fail to meet commitments, but pay a fine to those states harmed by the non-compliance. By paying the fine (in the form of

¹⁷ Unless the agreement is a bilateral one, in which case, the IO would cease to exist if one member

retaliatory tariffs on their own goods) the political leaders can serve their domestic interests through non-compliance in the system without damaging the system as a whole.

Although he does not use this language explicitly, Rosendorff argues that the DSM at the WTO is a de facto escape clause. Rosendorff's larger argument is that the presence of a DSM-like dispute settlement mechanism will prolong the longevity of an organization as it allows states to comply with the broader terms of the agreement while taking opt-outs as needed to serve the domestic political needs of the leaders of its member states.

Previous work on the role of uncertainty and institutional design thus suggests that the GATT/WTO system has incorporated into it several elements designed to recognize the domestic political realities of the leadership of the member states. In doing so, the WTO agreement is more likely to see overall, long-term compliance by states as they have a mechanism within the IO for engaging in short-term violations of the agreement without undermining the cooperation of the system as a whole.

The GATT/WTO system incorporates a number of mechanisms that fit these arguments about institutional design. As discussed earlier, while the GATT/WTO system does not have a fixed duration or a set timetable for renegotiation, it does have an implicit assumption of ongoing renegotiation built into it. This is exemplified in the Uruguay Round negotiations in which the developed states were given a series of concessions in key issue areas on the explicit promise that the developing states would be the focus of the first WTO sponsored round of negotiations (what became the Doha Round) (Evenett

state withdrew.

and Hoekman, 2006).

A number of escape clauses are built into the GATT/WTO system. One of the most important is the “safeguards” provision. This is essentially a system by which a state can impose temporary restrictions on almost any product. The key here is that there must be a “surge” of imports in order for a safeguards action to be initiated.¹⁸ (WTO, 2007) As with other elements of the GATT/WTO system, the safeguards provisions changed with the GATT/WTO shift in 1995. The safeguards system under the GATT had allowed a wide range of “grey area” measures such as voluntary export restraints (VER's). The WTO eliminated the grey area provisions and set time limits on the period for which safeguards could be imposed. Even with the new restrictions, however, the system is still riddled with loopholes that can allow states to engage in dubious safeguards actions in response to domestic political circumstances.

While there are withdrawal provisions in the GATT/WTO system, these are used only in exceptionally rare cases. Withdrawal is very simple in that it requires only that member states inform the WTO Council in writing six-months prior to withdrawal from the organization.

The GATT/WTO system is thus very flexible in its design. The organizations that manage the trade regime are thus designed to allow the political leaders of the member states to react to the changing domestic political environment within the framework of the institution. This allows political leaders to pursue political survival within their

¹⁸ While this would seem to set real limits on when safeguards actions can be used, the definition of surge is highly flexible. It can include changes in market share as well as overall levels of imports. This opens a huge range of potential safeguards actions of dubious merit. As with most elements of the WTO system, the ultimate enforcement is through the DSM.

domestic institutions while remaining broadly committed to the trade regime as a whole.

2.5 The Fog Of Law: Informal Fixes for Uncertainty and Competing Interests

While these formal mechanisms exist, there is also a key element of informal flexibility as well: the vagueness of international trade law. International trade law, especially the increasingly legalized version practiced by the GATT/WTO system is often described as being a clarifying force in international interactions. There is an agreed upon set of rules that sets limits on national policies. What is often less appreciated is that this system is incredibly complicated, covers a dizzying range of domestic policies that have potential international implications, as well as creating a dispute settlement system that has the final say as to whether or not any domestic policy undertaken by a member state violates the rules of the wider regime.

While the institutions as drawn up offer what appear to be clear rules, the devil is is hiding in the details. And he brought friends. There are tens of thousands of pages of international trade law covered within the GATT/WTO framework. There have been fewer than one thousand disputes at the GATT and WTO to settle competing interpretations of these laws. The actual policy implications for these laws is also not clear until they are adjudicated. It was rarely considered that the GATT/WTO system would affect national environmental regulations and other seemingly national policies. Brazil challenged the American Clean Air Act for its provisions regarding the refining of fuels to reduce pollution (WTO-DS/2, WTO 2007a). This dispute challenged American environmental regulations over the differences between domestically refined and

internationally refined fuels. The result was a dispute in which the WTO panel clearly agreed with the US that the Clean Air Act was directed at protecting fragile natural resources within American, but that in spite of this the refined fuels provisions were illegal due to the actual harm caused (WTO, 2007a).

This case is instructive on two levels. The first is that the provisions imposing harsher conditions on fuels refined outside of the US was clearly a protectionist measure designed to protect US fuel refiners. It was a classic form of protection that attempted to hide rent-seeking by the fuel refining industry within the provisions of an environmentally friendly bill. This was clearly a violation of the spirit of the free trade regime, but not clearly of the law of the regime until the DSM had issued its ruling.

It is these grey areas in the law that provide additional flexibility for domestic political leaders. They can select interpretations of the complex rules of the trade system that allow particular protectionist policies. These policies can remain in effect without harming the trade regime so long as no other member seeks to adjudicate the issue. When the issue is raised for adjudication, there is a formal, legal process through which the issue can be resolved.

The GATT/WTO system is thus doubly flexible for political leaders. There are clear measures in the design of the institution (accidentally in the GATT, but intentionally in the WTO) that allow member states flexibility in their application of trade rules to national policy. There are also significant areas of international trade law that remain vague. These areas remain open to multiple interpretations of the rules of the regime until such time as the DSM makes its rulings on the matter. In other words, the system

leaves lots of wiggle room for political leaders to engage in behavior aimed at promoting their own political survival without damaging the overall cooperation with the regime itself.

2.6 Changes in Institutional Design of the Dispute Settlement Mechanism

Thus far this chapter has explored a range of existing literature on the institutional effect of domestic and international institutions on political leaders in the context of complex interdependence. Essentially, political leaders are faced with strong economic pressures from an international environment characterized by complex interdependence. Political leaders have a strong incentive to embrace complex interdependence as it provides long term economic growth and expands both the well being of the citizenry as a whole, but also expands the base of resources available to political leaders to serve their interest in retaining power.

The pressures of the international environment are channeled through political institutions at the domestic level through the pressure placed by key domestic interests on their political leaders in the face of the costs and opportunities of complex interdependence. As the degree to which these domestic institutions are democratic rises, political leaders find themselves faced with much more complex pressures, often pulling them simultaneously towards openness and protection in the global market. For members of the GATT/WTO trade regime these pressures must be acted upon within the limits created by the international institutions. The international institutional pressure forces political leaders to limit their actions to those acceptable within the international

institution's rules. In many cases, the pressure of national political survival might make commitment to the international regime difficult or even impossible. The institutional design of the GATT/WTO regime, however, makes it possible for political leaders to react to the domestic pressures created by momentary dislocations resulting from complex interdependence by using the flexible mechanisms of the GATT/WTO regime to serve their interest.

While the basic institutional design of the GATT/WTO system includes mechanisms for flexibility in the application of its rules, it also offers a unique opportunity for the study of how specific institutional design changes can affect the decisions of political leaders. The design flexibility represented by the trade rounds process led to a major change in the institutional design of the trade regime with the transition to the WTO in 1995. The GATT institutions had been designed as an interim solution and had been left deliberately flexible as a result. In particular the design of the Dispute Settlement Mechanism (DSM) was made highly flexible and, at least on paper, relatively weak. The shift to the WTO DSM significantly changed the dispute settlement process, making it much more predictable as well as providing "teeth" that the GATT DSM had lacked.

This shift in institutions provides the opportunity to explore the impact of a major institutional design change on political leaders. The theoretical work done by Koremenos (2005) and Rosendorff (2005) as well as previous work on the role of democracy in militarized conflict offer a key foundation for the study of how political leaders react to a significant institutional change. The remainder of this chapter will highlight the nature of

the institutional changes from the GATT and WTO DSM's, review the very limited previous work on the subject, and set forth the framework of a theory of how institutional design changes in the DSM have changed the incentives for political leaders engaged in complex decisions about international trade policy. The chapter concludes with a set of hypotheses that will be tested in the following chapters.

2.6.1 Democracies and Trade Disputes: Previous Work

Relatively little work has been done that systematically explores the linkage between democratic institutions and trade conflict. The three published studies that have explicitly explored this link are Reinhardt (2001) and Sherman (2001 and 2002). Both authors explore the linkage between democracy and trade disputes in the context of the GATT DSM. The results from both studies empirically demonstrate that democracies become engaged in significantly more disputes than non-democracies, even when controlling for other factors such as overall trade volume. Neither author deals explicitly with the question of institutional design, instead drawing on research from the militarized conflict literature. Both articles attempt to test the democratic peace theory in economic disputes and find that the democratic peace does not apply to trade disputes. Reinhardt argues that this weakens the causal relationship between democracies and peace (Reinhardt, 2001). Sherman argues that the increased tendency to engage in trade disputes helps to understand how the democratic institutions affect conflict behavior. Sherman's argument largely follows the argument laid out earlier in that it focuses on interest group pressure stemming from complex trade relationships, as well as a

normative commitment to judicial dispute resolution on the part of democracies (Sherman, 2001). Sherman argues that in trade conflict the state acts as an intermediary between interest groups and other states (which are in turn acting as intermediaries for their own interest groups). In this model, the behavior of domestic leaders is conditioned by a different set of processes than those found in militarized conflict.

Both authors demonstrate that domestic institutions affect the behavior of leaders in the context of the GATT DSM. Neither author explored the changes in the actions of political leaders in the context of the institutional change from GATT to WTO DSM's.¹⁹ The change in DSM from that used by the GATT to that used under the WTO is an important change that has a significant impact on the calculations of political leaders when they determine whether or not to engage in disputes over the rules of the trade regime. While it is clear from the work of Reinhardt and Sherman that trade disputes are largely democratic affairs, the lack of available data at the time made it difficult to draw conclusions regarding the response of leaders to the institutional changes in the regime.

This project argues that democratic leaders, in seeking their own political survival take into account the full environment in which their decisions are made. This includes the international institutional environment in which policy decisions are made. Changes to this environment can lead to changes in the behavior of leaders as the incentives created by the international institutions change. Changes to international institutions change the incentives they provide to political leaders when they are evaluating policy options. When institutional changes take place, there are observed changes in the

¹⁹ Reinhardt has done this elsewhere in a somewhat different context. (Reinhardt and Busch 2002)

behavior of political leaders in response.

Previous research has also assumed that the incentives created by institutions at the domestic level change instantaneously with the change in political institutions. They do not account for years of transition and the time it takes for leaders to become better informed of the impact of the new institutions on the preferences of the key players within the new institutions.

This project argues that trade disputes are the manifestation of leaders incentives to engage in policy actions and the degree of uncertainty facing political leaders as to the outcomes of possible policies in the face of institutional change.

While this project deals exclusively with GATT and WTO disputes, it has wider implications for the study of both trade and conflict. By exploring more deeply the mechanisms through which domestic institutions affect international behavior, this project contributes to a growing literature on two level institutional interaction. A key focus of this project is how the change of institutions at the domestic and international levels affects the behavior of political leaders operating within these institutions.

The theory set forth below and the hypotheses derived from it argue that changes in institutions affect the decision making process of political leaders. International institutional change affects the responses of political leaders to domestic policy pressures as well as their likelihood of utilizing the mechanisms provided at the international level. Further, domestic institutional change affects the information available to political leaders in ways that are significant in determining their behavior within the context of international institutions.

2.7 Between a Rock and a Hard Place – The Institutional Squeeze

Domestic institutions are critical to the survival of political leaders. Leaders that do not follow the rules of their domestic institutions face ouster and replacement. This is true of all leaders in all institutional contexts. In even the most autocratic of states there is still a small core of critical followers that must be appeased in order for the leader to retain power. The more open a state's political institutions, the larger the groups of supporters needed to gain and retain power. This forces political leaders to seek larger and larger winning coalitions, often resulting in circumstances in which leaders must gain the support of groups that have contrary interests in trade policy. In this context, these groups are aware of their importance to the political leadership and can demand policies that suit their interests. In trade policy, we have seen that the larger the support base required in order to retain power, the greater the likelihood that political leaders will need to simultaneously pursue protection and openness.

The international institutional context of the GATT/WTO regime allows for this as part of its institutional flexibility. The GATT/WTO system allows for political leaders to violate the trade rules in limited circumstances and for limited periods. The complexity of international trade law also allows for the competing interpretations of just what the rules mean in particular cases. Both the formal and informal flexibility mechanisms thus allow political leaders to engage in survival behavior in the face of domestic pressure within the structure of the trade regime. Decision making in the context of international and domestic institutions is illustrated in Figure 2.2. The choice

for leaders is thus not one of comply or defect. It is the choice of comply, fudge on compliance, or defect. The choice of fudged compliance offers a wide range of temporary solutions that accommodate domestic political supporters but in a way that does not undermine the trade regime as a whole. In short, the institutions of the trade regime allow substantial flexibility for political leaders.

This flexibility is not infinite, however, and the trade regime does require that states comply in the long term. A critical mechanism for ensuring long-term compliance is the enforcement mechanism provided through the DSM. The DSM allows member states to bring states that fudge on compliance back into line with the rules of the regime over time. The DSM thus serves an important role as the mechanism by which the rules of the regime can retain substantive meaning in the face of frequent temporary violations. The DSM is how the GATT/WTO system prevents flexibility from making the rules meaningless and leading to the fall of the regime. Thus the DSM represents an important piece of institutional design. The basic rules of the regime are flexible, but within limits.

The nature of the regime and the DSM leads to an important distinction between two elements that go into creating a dispute within the DSM. Most previous work has focused on the initiation of the dispute as the key moment in the process and thus focused on the dispute as the start of the action. This has derived from the conflict oriented origin of the previous studies by Reinhardt and Sherman.

To understand the two level institutional effect on political leaders it is important to start with the decision to fudge on the rules of the regime rather than starting with the dispute. Flexibility is part of the institutional design, just as is the enforcement.

Following Koremenos, the inclusion of mechanisms that allow a response to domestic pressure increases the overall effectiveness of the organization. Taking this perspective, it is clear that the decision by political leaders to fudge on the rules of the regime is in fact the first stage of the dispute process. The political leaders in State A face a problem from groups in their support base and need to respond. They can either cheat outright on the trade regime or they can elect to use a grey area in the rules of the regime as a means of responding to their supporters. The decision to fudge on the rules serves the domestic political interest of the leaders in State A and makes their supporters happy. If this decision has little or no impact on key actors in other states, the process will end here. If, however, key actors in states B and C are harmed by the actions of State A, the key actors will lobby their political leaders for action. The leaders of states B and C are then faced with a key policy choice. They can choose to engage in the same type of fudge behavior as State A, only in support of their own harmed groups. They can also choose direct compensation with private payments to the harmed groups. Alternatively, they can also pursue enforcement action within the rules of the trade regime using the DSM.

It is in this second stage that political leaders are most effected by the rules of the DSM and by the cost and uncertainty of the process. If the cost of enforcement action is high relative to the cost of fudging or making a direct payment, then the leaders are less likely to engage in enforcement action. A key component of this cost is the uncertainty of success in the enforcement action. Enforcement is costly. It requires lawyers trained in international trade law to act on behalf of the state in question at the GATT/WTO headquarters in Geneva, often for extended periods of time. Uncertainty of the outcome

raises the potential cost of this type of action by discounting the expected payoff to be had from the dispute. There is also the key question of uncertainty at home. If the political institutions at the domestic level change frequently, or are relatively new, the degree to which the loyalty of supports can be relied on is reduced. The payoff of a long running dispute may not come until a state's institutions have changed. The result here is that uncertainty of outcome at the international level and uncertainty of payoff at the domestic level both reduce the likelihood that political leaders will engage in disputes.

The sources of this uncertainty are largely the result of the respective institutions. Uncertainty of the enforceability and outcome of the trade dispute is a function of the DSM. Uncertainty of the longevity of domestic institutional circumstances is largely a function of the duration since the last institutional change at the domestic level. The longer institutions are in place, the greater the likelihood that they will remain so. From this logic we can derive some testable hypotheses about how institutions should affect political leaders.

The change from the GATT to the WTO DSM was a significant change in institutional design. The GATT DSM suffered from a range of flaws detailed above and in chapter three. Concisely, the GATT DSM allowed states to draw the process out for long periods as well as allowing defendants to veto unfavorable rulings in case of eventual loss. This institutional structure essentially allowed states that fudged on the rules of the trade regime to at least put off unfavorable rulings for long periods, or in the worst case prevent an unfavorable ruling from taking place at all. This was a situation that Reinhardt called “Adjudication Without Enforcement”: Impartial rulings with no

teeth. For political leaders this has the practical effect of raising the cost of trade disputes due to the uncertainty of victory or enforcement. Disputes were very costly due to a high degree of uncertainty.

The WTO changed this in important ways. The imposition of strict limits on time (described more fully in chapter three) meant that disputes now had a firm time limit. The creation of an impartial group of expert panelists meant that decisions on trade law were being made by legal experts, not national representatives. The change in the rules for the adoption of panel reports meant that defendants could no longer block unfavorable rulings. The creation of a system of retaliatory sanctions meant that enforcement with teeth was now possible, at least in limited ways. In total, the changes in the DSM under the WTO significantly reduced the effective cost of trade disputes by significantly reducing the uncertainty surrounding three key areas: dispute duration, likely outcome of panel decisions, and enforcement of favorable rulings.

The change from GATT to WTO DSM thus lowers the uncertainty costs of a dispute considerably. This changes the institutional incentives for political leaders from the international level. Critically, it changes the incentives at the stage where leaders must choose whether the trade dispute is the optimal policy response to domestic pressure. The flexibility of the rules of the regime remain and the DSM still has a long enough time frame that leaders can still respond to momentary political crises through fudging for survival in the moment. The WTO DSM thus should increase the number of disputes, since the cost of a dispute is lower. This should be particularly felt by states with highly democratic institutions as the larger number of interest groups pressuring for

redress will increase the likelihood that political leaders will be pressured to engage in disputes.

In short, political leaders with large support bases will feel the effects of the reduced cost of disputes to a much greater degree than those with smaller support bases. Further, this should be felt by states deciding to initiate disputes, but should not affect the underlying process by which states decide whether or not to fudge on the rules of the regime. Domestic political survival will trump short-term regime compliance consistently under both international institutions. The lower costs of disputes under the WTO will make states that face pressures from larger support bases more likely to elect to engage in trade disputes once the cost has been lowered. The larger the support base needed, the greater the effect of these reduced costs.

This can be operationalized using conventional definitions of democracy. The more democratic a state, the more open political leaders are to policy pressure from their supporters. This implies several key things about the impact of the WTO DSM on potential targets and potential initiators. The first is that the findings of Reinhardt and Sherman based on GATT disputes should be replicated with WTO disputes. The more democratic a state, the more likely they are to fudge compliance and thus be targeted in trade disputes. The more democratic a potential initiator, the more open political leaders will be to pressure for redress by states harmed by the policy actions of fudgers and thus the more likely to initiate a dispute.

Beyond the previously demonstrated relationships, however, we can posit further impacts of institutions by the inclusion of the institutional change into our models. While

the pressure to fudge compliance is likely to be constant across institutions due to its origins solely in domestic institutions, the decision to initiate a dispute is determined both by the domestic institutional pressure and the costs of the dispute resulting from the international institutions. The lower costs of a dispute under the WTO DSM will change the calculations of potential initiators. The more democratic a state, the more open to multiple pressures, and thus the more likely to be pressured to pursue trade disputes. Further, the lower cost of the dispute will make potential initiators more likely to engage in disputes.

This logic generates the three key hypotheses to be tested in chapter four of this work.

- ***Hypothesis 4.1:*** The number of disputes overall will increase with the change from GATT to WTO institutions.
- ***Hypothesis 4.2:*** As the institutions of a potential initiator become more democratic the marginal effect of the change from GATT to WTO institutions will increase.
- ***Hypothesis 4.3:*** There will be no statistically significant marginal effect of the change from GATT to WTO institutions for potential target states.

At the level of domestic institutions, political leaders must face uncertainty in the period following institutional change. When institutions change there is a period of uncertainty in which political leaders and their key supporter must adapt to the new incentives created by new institutions. This process creates uncertainty and the possibility that institutions may change again in the near future if the present institutions prove problematic, inadequate, or if they collapse entirely. In the face of this uncertainty, political leaders will be more reluctant to engage in policies that require extended periods of time to generate a return in political support. Political leaders are likely to opt for

shorter term policy solutions. As political institutions stand the test of time, leaders and supporters experience reduced uncertainty about each others' preferences as well as gaining confidence that the institutions will endure into the future. As institutions remain in place for longer periods, political leaders can extend the time horizon on their expected political payoffs.

This process has an effect similar to that of the GATT/WTO institutional change. The degree of uncertainty created by new institutions raises the cost to political leaders of policy responses that require time to generate political payoffs. Also, the supporters confidence in political institutions will also be uncertain and supporters will be less willing to accept policies that may not pay off within the current institutional context. This uncertainty makes policy responses requiring long period of time to reach fruition more costly than short-term policy solutions. Trade disputes are time-consuming policy responses. They potentially require years to achieve their ends and to pay off political supporters. During periods following institutional transition, these time horizons will make trade disputes relatively costly when compared to other policy options. For political leaders in the early years after an institutional transition, a low cost policy option is to prioritize domestic politics over international commitments. This implies that it is likely that in the early years following a transition political leaders will remain as likely to fudge on international commitments such as the trade regime as they are at other times. This reflects the desire to invoke the flexibility provisions of the international institutions.

This implies that the longer a set of political institutions is in place, the lower the uncertainty costs of trade disputes. The longer a given set of political institutions has

been in place, the more likely it is that political leaders will opt to engage in trade disputes relative to other policy options.

This logic generates the hypotheses that are the subject of chapter five:

- ***Hypothesis 5.1:*** As the durability of the institutions of a state increases, the probability of initiating a dispute will rise for potential initiators.
- ***Hypothesis 5.2:*** Institutional durability will have no significant effect for potential targets.
- ***Hypothesis 5.3:*** For potential initiators, the marginal effect of regime durability will increase as the level of democracy rises
- ***Hypothesis 5.4:*** For potential targets, the marginal effect of regime durability will not be significantly affected by democracy

This project seeks to demonstrate that changes in international and domestic institutions have a significant effect on the behavior of political leaders. As the institutions at these two levels change, they affect the behavior of the political leaders operating in the shared institutional context. In a world characterized by complex interdependence these institutional interactions are constantly affecting the decisions of political leaders in important ways. The chapters that follow explore these ideas in greater detail and demonstrate that the hypotheses set forth above stand up in the face of empirical testing.

Table 2.1: Flexibility in Uncertainty: GATT and WTO Trade Rounds

Year	Name of Round	Number of Members	Key Issue Areas
1947	Geneva	23	Tariff Reduction
1949	Annecey	13	Tariff Reduction
1951	Torquay	38	Tariff Reduction
1956	Geneva II	26	Tariff Reduction
1960 – 1961	Dillon	26	Tariff Reduction
1964 – 1967	Kennedy	62	Tariffs, Anti-dumping measures
1973 – 1979	Tokyo	102	Tariffs, Non-Tariff Barriers (NTB's), “Framework Agreements”
1986 – 1994	Uruguay	123	Tariffs, NTB's, rules, Services, Intellectual property, Dispute settlement, Textiles, Agriculture, Creation of WTO
2001 – present	Doha	150 (as of Jan 11, 2007)	Agriculture, Services, Market access for non-agricultural products (NAMA), Balance between agriculture and NAMA, Trade-related aspects of intellectual property rights (TRIPS), Trade facilitation, WTO rules: anti-dumping (GATT Article VI), WTO rules: subsidies, WTO rules: regional trade agreements, Dispute Settlement Understanding, Trade and environment, Electronic commerce, Small economies, Trade, debt and finance, Trade and transfer of technology, Technical cooperation and capacity building, Least-developed countries, Special and differential treatment, Implementation-related issues and concerns, Integrated Framework, Commodity issues, Coherence, Aid for trade

Source: World Trade Organization, *Understanding the WTO, 3rd Edition* (2007)

Figure 2.1: Domestic Pressure on Leaders Without International Institutions

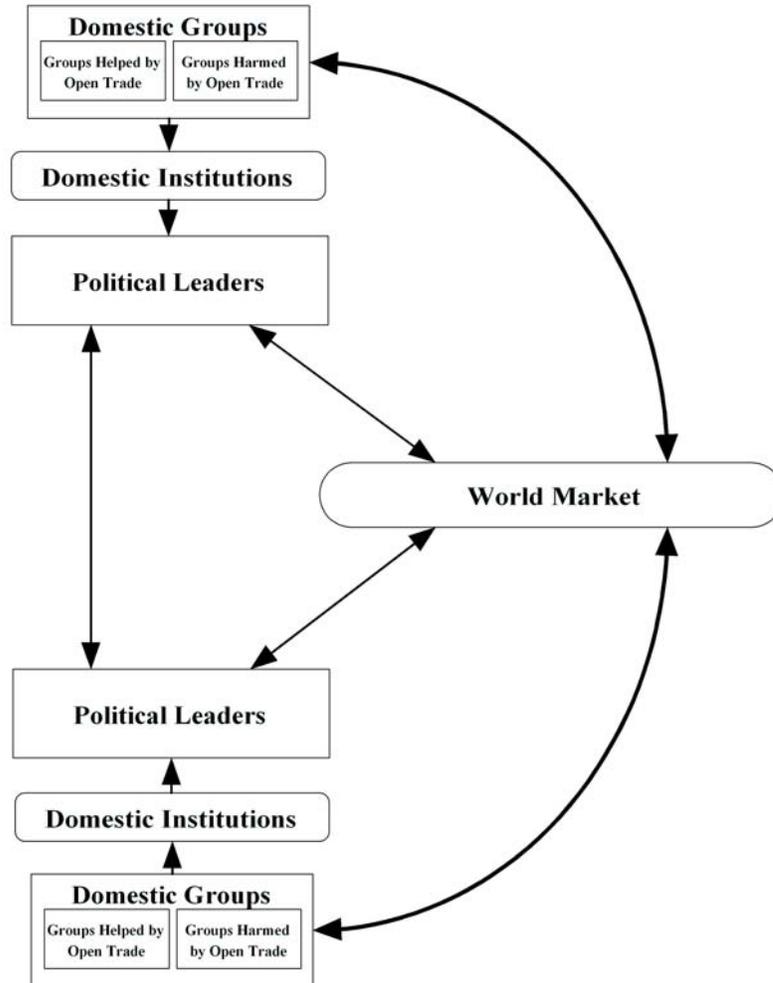
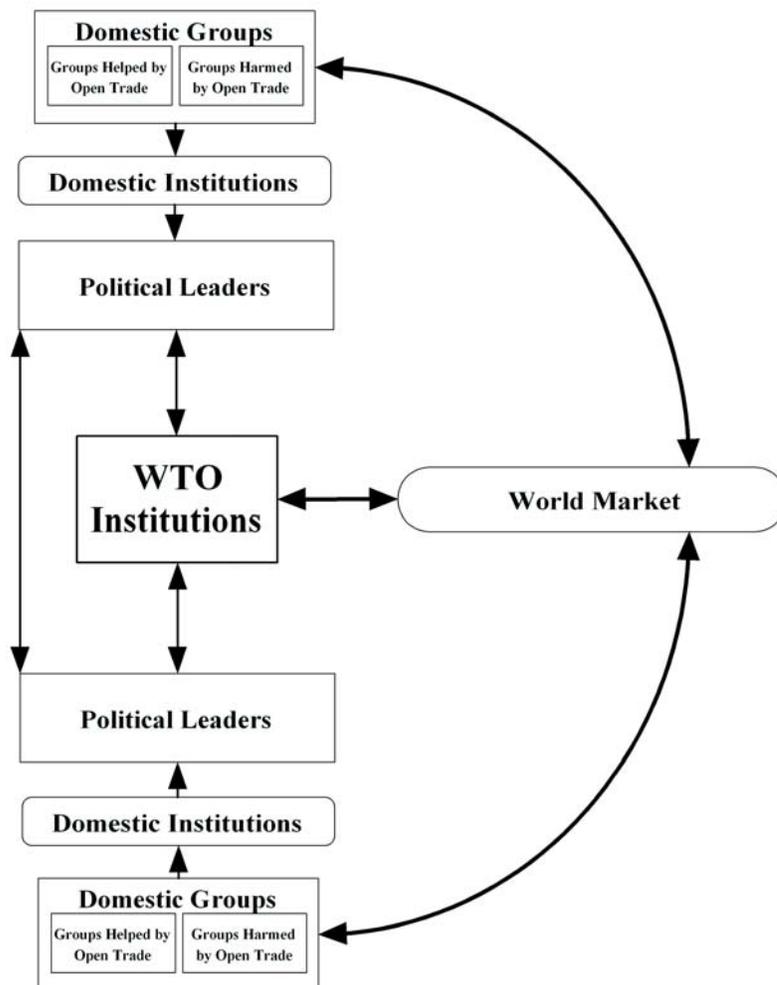


Figure 2.2: Domestic Pressure on Leaders With International Institutions



CHAPTER 3: DISPUTE RESOLUTION PROCESSES AND DISPUTE DATA

The section that follows discusses the dispute settlement procedures under the GATT and WTO as well as providing an overview of the data on disputes used in this study. The two organizations share a common role in enforcing the rules of the international trade system, but the rules for resolving disputes over alleged violations of the rules are very different between the two organizations.²⁰ The first section discusses the nature of the dispute settlement process at present in the international trade regime in general terms. In the second section, the details of each organization's dispute settlement mechanisms are explained in more detail. The final section provides an overview of the data used in this dissertation including a discussion of data collection and problems presented by the GATT/WTO system for traditional methods of operationalizing data involving disputes. This section also deals with the more controversial decisions made in the process of data collection, most specifically the decisions related to the European Union.

3.1 The Evolution of Rules Under GATT and WTO

In an era where anti-globalization protesters decry the WTO as an all powerful destroyer of all that is good in the world and neo-liberal economists laud it as the great hope for the world economy, it is important to remember that the WTO has strict limits on its actions. The GATT/WTO system has two essential functions in the world trade system created following World War Two. The regime serves as a forum for negotiations

²⁰ As discussed later in this section, the degree to which the institutional change from GATT to WTO is a subject of debate in the literature. (Reinhardt, 2002; Hudec, 1999; World Trade Organization, 2003) The argument of this study agrees with the bulk of the literature produced by the WTO: that the

regarding the rules of the system and as a body that manages the rules agreed upon during these negotiations. These functions are essentially separate in practice, although they are obviously related.

International trade negotiations have proceeded in a series of "Trade Rounds" that have served as the main mechanism for the broadening of the rules of the trade regime over time. It is within these rounds that the member states engage in negotiations regarding what the rules of the trade system will be. These rounds are the bargaining stage of the process and have a significant role in the design of the institutions of the GATT and WTO. This process is subject to the whole range of coordination problems inherent in international bargaining and in many ways have come to represent the most contentious area in which the system functions.

The GATT and WTO negotiating rounds depend on a rule of consensus in decision making. In theory any single member state may block the adoption of new rules. In practice the process of decision making in the negotiating rounds has come to be dominated by blocks of countries with similar interests. These blocks are the principle negotiators and most decisions are the result of negotiations between the principle members of these blocks. In a system that depends on consensus, this has been an effective means for moving the negotiating part of the process forward, although it is not clear whether the consensus model of decision making can overcome many of the present hurdles faced in the present Doha Round of negotiations.

Over time, trade negotiations in the GATT/WTO framework have successfully

DSU represents a major advance in the formal process of dispute resolution, but for reasons that are

expanded the purview of the trade regime to cover many areas not foreseen at the time of its founding. The organization created to aid in the reduction of tariff rates in the interim period until the ratification of the ITO treaty proved successful in addressing a range of challenges from tariff reduction to non-tariff barriers, trade in services, and international intellectual property protections.

Out of these negotiations has emerged a body of international trade rules that has grown more comprehensive and complex with time. As it has grown in complexity it has come to increasingly resemble the domestic legal codes of states. The legal code that has emerged from this process has been administered by the GATT and WTO dispute settlement bodies.

The broad rule-making function of the GATT/WTO system is, in practice, separate from its day to day function as enforcer of the rules of the system. The WTO, like its predecessor the GATT is designed to administer a very complex system of trade rules, not simply to promote trade openness. While the long-term goal is to move towards a free and open trading system, the practical function of the WTO on a day-to-day basis is to administer the system that emerges from the negotiating rounds. The system that the WTO coordinates represents a complex system of agreed upon rules that govern the international trade regime. The WTO oversees a veritable alphabet soup of trade agreements that create rules for a broad array of policies from simple tariff rates to the protection of intellectual property rights.²¹

somewhat different than those given by the WTO

²¹ The WTO rules represent a collection of international agreements that were consolidated under the WTO Treaty in 1994. While the rules are considered to be part of the WTO system, they are often referred to by their specific titles in WTO literature and in the relevant policy literature. Two examples of

The GATT and WTO systems were created to manage this set of rules. While the original rules of the GATT system were relatively narrow by today's standards, they represented a major break from historical practice. Prior to the creation of the GATT there had been no systematic attempt to organize a set of institutions to manage the rules of world trade. In this regard, the creation of the GATT was revolutionary. In making the major shift from largely bilateral or regional trade negotiations to a multilateral trade system, the members of the GATT were moving into new territory. To handle the potential disagreements over just how these new rules were to be interpreted, the GATT included a system for resolving disputes over interpretation of the rules. The dispute settlement system was also intended as a check to ensure the compliance of all members with the terms of the GATT. The inclusion of a formal (albeit weak) dispute settlement mechanism was an important part of managing the new system of rules being put in place.

From an enforcement perspective the central flaw of the GATT system is that it placed an absolute priority on consensus. As a result, the dispute settlement mechanism privileged collective agreement over rule enforcement. In order to gain a ruling in favor of the initiator of a dispute, the GATT rules required a "positive consensus" in favor of the initiating party. In practice, this meant that the targeted state could block unfavorable rulings by refusing to accept the decision by the technocrats on the dispute panel. Under the GATT the targeted state had to accept that it had violated the rules in order for the

extensions of the basic GATT rules are the General Agreement on Trade in Services (GATS) and Trade-Related Intellectual Property Rights (TRIPS). Further information is available from the WTO Analytical Index at http://www.wto.org/english/res_e/booksp_e/analytic_index_e/analytic_index_e.htm

process to proceed.

The WTO sought to solve the problems created by the need for positive consensus by replacing this rule with one of “negative consensus.” To block the acceptance of a panel report, the WTO rules require consensus against the panel’s report. This removes the possibility that the targeted state alone could block the adoption of the panel report.

Over time, the scope of international trade rules has grown widely, but it remains the case that the GATT and WTO are institutions created to manage an agreed upon set of rules and to provide a forum for ongoing negotiations. It is important to keep in mind that the dispute settlement procedures of the GATT and WTO are based on this principle of enforcing an agreed upon system of rules. The dispute settlement system does not promote an agenda outside of that already agreed to by all of the regimes' members.

3.1.1 Disputes under that GATT System

The GATT was not intended to be a long-term solution to the problem of coordinating international trade. The GATT was intended to be a stopgap measure that would begin the process of trade liberalization in preparation for the creation of the International Trade Organization (ITO).²² As a temporary solution, the GATT was left with very little in the way of permanent institutions. In spite of the relative lack of formal institutions, the GATT did contain one critical feature that allowed it to enforce its rules: a formal dispute resolution process.

The provision of a dispute settlement mechanism was an important step forward

²² The Havana Charter, which was to have created the ITO was signed by 50 nations in Havana in 1948. The failure of the US Senate to ratify the Charter led to the collapse of the negotiations for the creation of the ITO. This left the GATT as the only body through which to coordinate international trade policy until the creation of the WTO in 1994.

in the procedural settlement of disputes over trade rules. It was the first attempt to manage compliance with an international trade regime through a formal system. The mechanism provided for the collective settlement of disputes over the terms of GATT agreement. National policies were subjected to international scrutiny through an established set of procedures agreed upon by all of the contracting parties.²³ In the early period of the GATT, the rules of the trading system dealt almost exclusively with tariff rates and traditional forms of restrictions on trade. Over time, through the successive series of trade rounds, the GATT gained a wider purview. As the rules of the GATT regime expanded, so did the range of national policies that were eligible for action under the dispute settlement system. In spite of its long-term success, the loose nature of the GATT organization left some serious deficiencies in the dispute settlement mechanism.

The GATT dispute resolution process is relatively simple. (See Figure 3.1) Any contracting party may make a formal complaint regarding alleged violations of the terms of the GATT by any other contracting party. Notification generally came in the form of an official note of the desire for consultations to the defending party and the GATT Council. The complainant and defendant are required to engage in a period of consultations before the dispute may be brought to the Council.²⁴ If the period of consultations is not successful at resolving the dispute, the complainant may elect to bring the dispute to the Council by requesting that the Council form a Panel to examine

²³ The term "contracting party" is used to refer to GATT members in the actual treaty and in most legal documentation. In a legal sense, the GATT is not a conventional IGO treaty. It is a contract between states that establishes terms of behavior to which all of the signatories agree. The GATT agreement also allows for the membership of non-state actors. The term "contracting party" thus allows the inclusion of all potential members, state and non-state.

the issue and make a ruling to adjudicate the dispute. The decision to form a Panel requires the unanimous vote of the Council. A Panel consists of a group of contracting party representatives. The Panel may include one member from each contracting party (in this form the Panel essentially is the GATT Council acting as the Panel) or a smaller group of contracting party representatives (in this case selected by the Council for the purpose of serving as the Panel in question.)

If empanelled, the Panel would hear the arguments of both sides regarding the relative merits of the case. After hearing the case, the Panel would render its decision in the form of an official Panel Report. The Panel Report constitutes the formal interpretation of the relevant GATT rules, and would be binding on the parties if adopted by the Council. It also is expected to contain details specifying what actions the defendant must take in order to come into compliance with the GATT rules. While the Panel itself may consist of a sub-group of the contracting parties, approval of the Panel's Report (the legal decision regarding the dispute) requires a unanimous vote of the Council in order to be adopted. As the defendant and complainant are both members of the Council, both parties to the dispute have an effective veto over the process both at the Panel stage and at the ruling stage. If the Panel ruling is adopted, it is binding on both parties and, if the Panel ruled in favor of the complainant, the defending state would be required to change its policies. If the defending state refused to change its policies, it would be subject to sanctions by the entire GATT membership. The decision to impose sanctions, however, required a unanimous vote of the Council.

²⁴ The GATT Council consists of one representative from each of the contracting parties, including

The GATT process is thus a fairly weak dispute settlement mechanism. Either party to the dispute may scupper the process at any stage. While there is formally a procedure by which violators of the regime may be sanctioned, there is effectively no enforcement mechanism in place to ensure compliance with the dispute resolution system. The target of any punitive sanctions may veto their implementation. The process is also very inefficient in that each stage of the process allows for significant delays on the part of either party. No limits are placed on the amount of time that the parties may carry on their consultations. Further there are no effective limits on the amount of time a Panel may take to hear its cases. The need for unanimity in order to proceed allows the process to be delayed not just by the disputants, but by almost any member who wishes to slow the process whether or not that member was party to the dispute.

The GATT system, for all its inefficiencies, worked reasonably well for the years in which it operated. In spite of the fact that the process was essentially a "court without a bailiff" GATT members used the system nearly 300 times during the GATT period (Reinhardt, 2001). In spite of its relative success during the GATT period, the inefficiencies of the GATT dispute settlement procedures led to widespread calls for reform of the process. The GATT system had worked well during the early years of the GATT regime when the range of issues was narrow and the body of existing legal precedent was small. Over time, however, successive rounds brought more and more issues under the jurisdiction of the GATT. This expansion of the jurisdiction of the GATT led to a growth in the potential areas for dispute. These new areas were, however more

the complainant and defendant.

problematic in their application. Members learned to use the delaying aspects of the system to prolong both the consultations and the panel process. Further, implementation of negative rulings also became increasingly delayed as no effective means existed of directly sanctioning slow compliers short of sanctions by the full Council. The combination of these effects began to show the limits of the GATT system in the face of increasingly contentious questions over the application of trade rules. As the GATT system's weaknesses became more apparent, calls for reform entered into the negotiations taking place during the major rounds.

During the Uruguay Round of negotiations leading to the creation of the WTO, the question of dispute settlement was a major issue for the contracting parties. The central argument for reform was that the GATT system no longer sufficed for resolving disputes in the present area of responsibility, much less the greatly expanded range of issues to be included in the WTO agreement. The trade regime could not function without a clear system for dispute settlement, but major reforms were needed to keep the system effective. The central problem of the GATT system was that universal support was needed for a ruling. The process depended on all member states agreeing at all stages, including the disputants. With the growing complexity of the issues and the extant body of trade law, an impartial, professional body was needed with the responsibility of making decisions regarding the interpretation of world trade law. In addition, a new system of enforcement was needed. The essentially moral pressure of the GATT system was not enough to force policy change in what were increasingly sensitive policy areas. A new mechanism of enforcement was needed. Further, a new modality of

enforcement was also needed as wholesale sanctioning of guilty members did not, in many cases, fit the limited nature of the violations. Extensive debate undertaken at the Uruguay Round addressed these fundamental failings of the GATT system. The end result of these debates was a major institutional change in the nature of the dispute settlement process.

3.1.2 Disputes under the WTO System

In 1994, the members of the GATT adopted the Agreement Establishing the World Trade Organization (AEWTO). This is the formal document that enacted the shift from the GATT system of trade rules to those of the WTO. In many areas, the degree of transition was minimal. Much of the AEWTO simply consolidated a series of agreements that had been negotiated under the GATT system. The AEWTO brought many of these agreements together in a single agreement. The dispute settlement mechanism of the GATT was one area in which the transition was exceptionally significant. Annex 2 of the AEWTO contains the Dispute Settlement Understanding (DSU). The DSU created a new system for resolving disputes between WTO members that was designed to remedy the principle failings of the GATT system. In doing so, it ushered in a new set of institutions at the international level designed to resolve disputes over WTO rules.

The Dispute Settlement Body (DSB) is the organ with primary responsibility for the dispute settlement process. As in the GATT process, the entire WTO General Council acts as the DSB. Representatives from all WTO members hold seats on the Council. Thus it is ultimately the Council that is responsible for the management of the dispute settlement process. While this outwardly resembles the GATT system, there are

important procedural changes that limit the power of the disputants to affect the outcome under the DSU.

As with disputes under the GATT, disputes at the WTO are about rule breaking within the regime. A contracting party or group of parties may initiate a dispute if they perceive a policy on the part of another party violates the rules of the WTO system. The initiation of a dispute is a relatively simple process of delivering formal notification to the Dispute Settlement Body and the targeted party of a "request for consultation". Once this process has begun, the DSU provides a carefully structured framework in which the dispute is to be resolved. Figure 3.2 provides a visual summary of the dispute process.

The ability of members to extend disputes without end was seen as a major failing of the GATT system and the DSU contained specific remedies for this problem. Table 3.1 details the temporal limits on the various stages of the process defined in the DSU. The inclusion of set time limits in the process was intended to limit the ability of disputants to draw out the process indefinitely. One of the most significant concerns for the WTO process was that it should be more efficient than the process under the GATT system. The inclusion of strict time limits places restrictions on how long any disputant may draw out the process.

The disputing parties are required to engage in consultations (as under the GATT) prior to the escalation of the dispute to the Panel stage. The WTO limit for the consultation period is 60 days. At any time during this period, the parties may resolve their dispute amicably. The General Secretary of the WTO may be asked by either side to mediate if the consultations appear to be failing. At the end of the consultation period,

the complainant may make a formal request to the DSB that a Panel be formed. Up to this point the process has been very similar to that used under the GATT. From this point forward, the process changes substantially. If the complainant requests a panel the defendant has only one chance to delay its creation. Upon the request of the complainant, the DSB has forty-five days to appoint a panel to hear the complainant's case. The defendant may delay the formation of a panel for one WTO meeting cycle (typically 6 months) but after this, no delays are open to the defendant. The DSB can only block the formation of a panel if there is a consensus against the panel within the DSB. In the absence of a consensus against a panel, the DSB selects a panel of between three and five (depending on the complexity of the case) experts to hear the case (World Trade Organization, 2003; Davey, 2002).

The composition of the Panel is also critically different from the GATT system. Under the GATT, contracting party representatives served as the panelists. While they could (and often did) consult experts, the formal responsibility for making the formal, legal judgments lay with the individual state representatives. The WTO system created a permanent pool of panelists whose sole function is the adjudication of disputes.²⁵ The panelists are appointed by the Council and form a pool of experts from whom the composition of specific panels is drawn. The shift away from the use of state representatives as panelists is an important step in the creation of an impartial mechanism

²⁵ A permanent pool of experts has been created to serve on WTO panels. They are selected based on their understanding of international trade law and their respect in the international trade community. The pool of experts provides the list of names from which the DSB will draw the individuals for any specific panel. Members of the pool of experts may not represent any government. They are required to act as independent agents. See (World Trade Organization, 2003; Davey, 2002) for the panel experts and (Steger, 2002) for the Appellate Body.

for adjudication.

The Panel has six months to reach its decision. The DSU defines a clear progression of stages the Panel must follow during this period. Each side of the dispute is given a chance to present its case, first in writing and later in person in the presence of the Panel members. In a departure from GATT practice, the Panel may also hear the positions of third parties to the case if they have expressed an interest.²⁶ Following the "first hearing" at which the cases are presented each party may present a written rebuttal of the arguments made at the hearing. The Panel is empowered to seek the guidance of experts in the field if the matter under consideration requires it.²⁷ This may take the form of ad hoc consultations or it may take the form of an expert review group under the direction of the Panel.

A first report is circulated to the disputing parties for comment. This report contains the findings of fact in the case, but does not contain the final decision of the panel. The parties are given two weeks to comment on the interim report in written statements to the Panel. The Panel then completes and interim report containing all elements of the final report and circulates this to the disputants. The disputing parties have one week to request a review of the report. The review process consists of further meetings with the disputing parties, but may take no longer than two weeks from the date

²⁶ This has led many parties, both members and non-members to file the equivalent of *amicus curiae* briefs with the various Panel's established under the WTO. The Appellate Body has ruled that such briefs may only be filed by member states, but that briefs written by NGO's, MNC's, or other entities may be included as part of the filings of parties to the dispute. This has created an avenue for non-member participation in the WTO dispute process the implications of which are not clear.(Steger, 2002)

²⁷ The specifics of this provision are somewhat vague, as are the required qualifications of the "experts". This provision appears to be an acceptance of the fact that the complexity of some issues

the request for review is received by the Panel.

Following this process, the Panel releases its final report to both parties and to the DSB. The disputants are given the Report two to three weeks before it is provided to the DSB. The final Panel Report contains the official finding of the Panel. If the Panel ruled in favor of the complainant, the Report will also include the required remedies for the defendant to remove the policy in question. The Report will become a Ruling 60 days after the date the Report is submitted to the DSB unless a consensus of the DSB decides to reject the Report.

Either disputant (or both) may appeal the Ruling and request that an Appeals panel review the terms of the ruling. The Appellate Body consists of seven permanent officers. These officers are appointed by the DSB and serve four-year terms. From the seven officers, a panel of three persons is chosen to serve as the Appellate Panel for the dispute. The Appellate Panel has sixty to ninety days to review the Panel Report. The Appellate Panel may make accept the Report as written, modify the terms of the Report, or reject the Report outright. The Appellate Panel provides its decision to the DSB. The Appellate Report becomes the official Appellate Ruling thirty days after the receipt of the Appellate Report by the DSB unless a consensus exists within the DSB to reject the Appellate Report.

Once the Appellate Report becomes official, the defending state must comply with the terms of the ruling. The defendant has thirty days to formally accept the ruling (essentially to promise to change the offending policy). Following the acceptance of the

covered under the DSU require a technical legal expertise that may not be present in the members of the

ruling, the defendant is expected to change the policy immediately. If this is not possible, the defendant must make the change in "a reasonable period of time." (World Trade Organization, 2003) If the defendant takes no action within the reasonable period, the complainant may request talks on compensation. If these talks do not achieve an acceptable settlement within twenty days, the complainant may make a request to the DSB for the right to impose retaliatory sanctions on the defendant. The DSB has thirty days to authorize the retaliatory sanctions. Only a consensus against sanctions may block their imposition. Assuming no resolution takes place, the complainant may introduce retaliatory sanctions at any time following the authorization by the DSB.

As indicated in the timetable shown in Table 3.1, the theoretical maximum duration of this process is about eighteen months. In practice, however, the process can take much longer if the disputants use every avenue offered in the dispute process to delay the outcome.

The WTO process reflects a significantly greater commitment to firm and impartial procedures in the dispute settlement process. It also represents a major increase in the "legalization" of the process as a whole. The GATT process emphasized discussion and negotiation between the parties within the process. It was the only way to allow the process to function in the absence of an enforcement mechanism or professional adjudicators and given the ability of either side to bring the process to an end in the Council (Reinhardt, 2001; Busch, 2000; Busch, 2003; Chang, 2001). The WTO process places a strong emphasis on adjudication within a framework of accepted rules

(Reinhardt, 2002). While the WTO retains a commitment to mutual negotiations through the retention of the consultation stage, the later stages of the process reflect a move towards a more purely rules-based method of dispute resolution (Davey, 2002).

Another significant change in the WTO system is that the decisions resulting from the process are enforceable. The rules provide for specific means to punish states that refuse to change their policies in order to comply with WTO rulings. While this is a major step forward in the shift of authority away from the contracting parties and towards a global administrative body, the enforcement mechanism is not without its flaws. The means of enforcement is retaliatory sanction by the complainant parties. While this is an improvement from the GATT conditions where no sanctions were likely to occur, it represents a fairly weak mechanism of enforcement. Retaliatory trade sanctions have only a limited applicability, and they depend on the ability of the complainant state to be able to gain enough from the retaliatory sanctions to overcome the economic costs to its own economy of the sanctions. Thus the system of enforcement remains weak in spite of its marked improvement over the GATT system.

The WTO DSM marks two significant changes in the nature of the dispute settlement procedures of the global trade regime. It makes significant progress towards a system of international enforcement based on the rule of law. The transparent procedures, rules-based decisions, and independent, professional adjudicators are significant elements necessary for the creation of an international legal structure that functions along the lines of domestic legal institutions in states where the rule of law determines legal outcomes.

3.1.3 Institutional Change and the Dispute Process

The institutional changes from the GATT to the WTO are an important component of this study. While the WTO describes the new dispute settlement mechanism as being a radical shift from the past (World Trade Organization, 2003) several authors who have examined the changes in institutional design have argued that the design changes are trivial in their substantive impact. These authors argue that the shift towards a more legally oriented system does not represent a fundamental change as the enforcement mechanism ultimately still lies on the ability of the initiating member(s) to impose sanctions on the defending state. If the initiator(s) lack the power or will to do so, the system is essentially without teeth, just as the GATT system was (Hudec, 1999; Reinhardt, 2002).

The argument that the institutional changes are insignificant ignores an important element in the impact of the institutional changes: the relationship between the institutional change at the international level and the normative beliefs of the political leaders in the member states. While Reinhardt, Busch, and Hudec understate the degree to which the system is without enforcement, they are correct in noting that the enforcement power of the WTO is essentially the power and willingness of the initiator(s) to impose costly sanctions on the target. If the initiator lacks the will or the capability to impose sanctions, the WTO process is just as toothless as its predecessor in an institutional sense.

Where the WTO changes are greatly significant is that the process has shifted from one almost entirely based on negotiation between the disputants to one that is firmly

based in procedure. The procedural nature of the WTO DSU fits clearly in the accepted method of resolving disputes to which democratic leaders are committed. The resolution of conflicts of interest via clear, rules based procedures is an essential characteristic of the rule of law in democratic states. Commitment to this type of procedure on the part of democratic leaders and their citizens is an important element that makes the procedure of dispute settlement at the international level acceptable to democratic political leaders. The emphasis placed on the institutions by previous authors has neglected the interaction between domestic and international institutions and the impact that the norms of domestic leaders has on their international political decisions.

3.2 The Disputes Used in This Text

The disputes used in this dissertation cover all of the disputes that take place under the GATT and WTO systems from the years 1948 to 2000. The section that follows provides an overview of the disputes that are used in this text. This section begins by discussing the basic criteria used to collect the data on disputes and providing a set of operating definitions.

3.2.1 Operational Definitions: What makes a dispute?

Reinhardt and Bush (2002) provide a summary of the complex issues surrounding how disputes should be defined in research on international trade law. They identify three essential questions relating to operational definitions of trade disputes:

What defines a dispute?

How does the study handle disputes with multiple complainants?

How does the study handle repeated disputes over the same issue area?

The question of what defines a dispute seems obvious, but it represents an important

decision regarding the nature of the cases under consideration. Obviously not every disagreement over international trade escalates into a formal dispute under the GATT or WTO. Many trade rows take place on a bilateral basis, with many more never becoming serious enough to warrant the effort required for a GATT or WTO dispute. It is also important to clearly delineate what constitutes a trade dispute as the term “dispute” raises potential confusion. The term dispute is commonly used in the study of international conflict to refer to conflicts involving violent means of dispute settlement. Trade disputes are just the opposite. They reflect a rejection of violent means and a commitment to procedure.

3.2.1a What is a dispute?

This study considers a dispute to be any case in which a contracting party formally requested consultations under either the GATT or WTO rules. This limits the cases under consideration only to those that become part of the formal process of dispute resolution in the respective trade institution. This analysis excludes requests for review of such subjects as safeguards or anti-dumping cases unless these escalate into disputes within the dispute settlement mechanisms of the respective organization.²⁸

The inclusion of only disputes formally undertaken within the dispute settlement mechanisms of the GATT and WTO provides a minimum level of severity for the conflicts covered in this study. For a dispute to merit the cost (diplomatic as well as

²⁸ Both the GATT and WTO have provisions for safeguards measures and anti-dumping measures. Members may engage in requests for review under these procedures which do not come under the purview of the dispute settlement systems of either body. As the procedures for these requests are very different from those of the dispute settlement mechanisms, the inclusion of these requests would be theoretically problematic. The cost and consequence of safeguards and anti-dumping reviews are much lower than those cases that trigger the dispute settlement mechanism.

economic) of the use of the formal procedure it must represent a significant conflict of interest between the disputants. This minimum level of severity provides a theoretical floor for the disputes under study. The requirement of a "request for consultations" also eliminates purely rhetorical disputes that arise during the deliberations of the General Council as well as those raised in the Trade Rounds. In short, by requiring the initiation of a formal dispute this project deals only with the most severe types of trade disputes.

3.2.1b How does this study handle multiple complainants?

The issue of multiple complainants is an important one. A significant number of disputes under the GATT and WTO involve multiple complainants. This makes the choice of how to handle these cases important. The two basic options for handling multiple complainants are 1) to consider the dispute as a single unit, with multiple complainants as variables within the dispute observation and 2) to treat each country pairing as a separate observation.

The WTO records use the dispute as the unit of observation. Disputes are referenced with a WTO Dispute number and all complainants are included as characteristics of the dispute. Hudec's groundbreaking data collection efforts (Hudec, 1993) also used the dispute as the unit of observation. This approach, however, is problematic for the study of domestic political characteristics on trade disputes. It also presents problems for calculating the impact of economic variables as they related to the parties within the dispute.

This study treats disputes with multiple complainants as separate disputes between each complainant and the target. The overall data structure used for most of the

empirical testing in this study is dyadic in nature. To accommodate multiple complainants, the data used here treats each complainant - defendant pair as a separate dispute between the two states in the dyad. This allows the inclusion of state-level variables for both parties in the analysis. It also follows the convention of most recent empirical work on GATT and WTO disputes (Reinhardt, 2000; Sherman, 2001). Reinhardt and Busch also point out that the dyadic approach is preferable as it allows for the inclusion of multiple complainants who file at different times in the same dispute (Reinhardt, 2002).

3.2.1c How does this study handle multiple filings?

Multiple filings on a single issue are an interesting case. The most commonly cited case of this type is the "Banana War" between the United States and the EC. In this case there were four separate filings related to the EC's protection scheme for bananas. In part, this was the result of the transition from the GATT regime to the WTO system. The WTO rules offered a more favorable venue for the US case, and disputes were filed at the WTO that mirrored previous disputes at the GATT. While this case is interesting, it is relatively rare²⁹. Multiple filings on the same issue frequently reflect a failure of a previous attempt at resolution. In these cases, the concern of the complainant is not satisfied by the outcome of the previous process, and further action is required.

This study treats multiple filings as separate disputes in line with the bulk of the

²⁹ There is some evidence that the proportion of these cases is rising as a result of the WTO system. The enforcement capability of the WTO has led to questions of whether or not the actions undertaken by losing defendants to comply with WTO decisions are sufficient to meet the requirements of the Panel ruling. In some cases, the remedy put in place to comply with a previous ruling is, in turn, subject to a dispute. At the time of writing, these disputes remain a small portion of the total, but it is possible that these will become more significant over time as the number of WTO rulings on contentious issues rises.

literature on trade disputes (Reinhardt, 2002). To understand the impact of domestic political systems on trade dispute behavior, the decision to initiate the dispute is the key event. The issue area covered under the dispute is not of importance. The decision to initiate a subsequent dispute is not a serious theoretical issue for this study. Given this, the convention in the literature is adhered to.

3.2.2 The Disputes: Descriptive Statistics

The data on GATT and WTO disputes as described below includes all disputes arising under the GATT and WTO regimes for the years 1948-2000. The dispute dataset contains all cases in which a party made a formal request for consultations to the relevant dispute settlement mechanism. This yields a dataset of 298 GATT disputes and 600 WTO disputes initiated prior to Dec 31, 2000. The institutional changes from the GATT to the WTO have resulted in different information being collected regarding the escalation of disputes. The GATT dispute process only formally escalated to a panel stage. The WTO process allows multiple levels of dispute escalation. The data on the respective disputes includes all relevant escalation data for the dispute process under which the dispute was conducted. The summary statistics discussed below consider the EU to be a single entity for the purposes of counting the disputes.

The dataset containing the GATT and WTO disputes was derived by combining existing data on GATT disputes with original data collected on the disputes before the WTO. The GATT data is taken from Eric Reinhardt's dissertation data (Reinhardt, 1996). Dr. Reinhardt's data is in turn based on Robert Hudec's data on GATT disputes (Hudec, 1993). The GATT data comprises 298 separate dispute incidents under the GATT regime.

The WTO data was collected using the "State of Play" dispute summaries published annually by the WTO. These provide summary information (including relevant dates) for all disputes filed under the WTO regime. This data was compiled for all disputes listed in the data file. Disputes involving multiple complainants are coded with an original complainant or group of complainants being the member that filed first. All subsequent members who file in a dispute are coded with a dummy variable to indicate that they are "joiners" in the dispute. A dummy is also included to track all disputes with multiple complainants. Dummy variables are included to account for each stage of the escalation process, along with the relevant dates for each level of escalation.

The resulting dataset of WTO disputes encompasses 600 disputes between WTO members. The most striking element is the large number of disputes relative to the number filed under GATT. In only a fraction of the time, the WTO has doubled the number of disputes under the GATT.

3.2.2a Disputes Over Time

The most striking trend observed in the dispute data is an increase in disputes over time. The number of trade disputes filed has greatly increased as time has passed. Even looking only at the GATT period, the number of disputes was rising, albeit not consistently, over time. Figure 3.3 shows the trend in GATT and WTO disputes over time as well as the increase in membership of the trade regime and the overall rise in total world trade. While the membership trend rises fairly consistently over the period of the GATT with two major exceptional periods, the number of disputes does not follow the same trend. The two surges in GATT/WTO membership occur during the period of

decolonization (1958-68) and immediately following the fall of the USSR (1992-1996). The period of decolonization was a time of rising numbers of states in the system as a whole. While the 1990's also represented a shift from the GATT to the WTO, the rise in the number of member states fits closely with the end of the Cold War and the third wave of democratization.

Bush and Reinhardt (2002) follow Hudec (1999) and claim that the rise in the number of disputes filed at the GATT and WTO over time is largely a function of the increase in membership of the trade regime. This argument, supported by a figure similar to Figure 3.3 below, suggests that the dispute propensity has remained largely the same across institutional change and that the driving force for increased dispute propensity has been a concomitant rise in membership and in international trade (Bush and Reinhardt, 2002, p464). Figure 3.3 duplicates the figure used by Bush and Reinhardt, but includes the total world trade volume in the same chart. All three values rise over time, but they do not follow the clear relationship argued for by Busch and Reinhardt. The GATT/WTO membership numbers display two periods in which membership has rapid growth. These roughly coincide with two major system-level events that increase the number of potential members. The first is decolonization of the late 1950's and the 1960's. This era sees a significant growth in GATT membership, with the GATT nearly doubling in membership between 1960 and 1970. The second period is the post-Cold War period in the 1990's.

Contrary to the predictions of the argument that membership growth drives dispute growth, the period of membership growth did not experience a corresponding

growth in the number of disputes filed with the GATT. The average number of disputes per year actually falls during the 1960's. During the 1950's the GATT averaged 4.8 disputes per year. During the 1960's, the decade with the highest percentage growth in membership, the average number of disputes was the lowest of any decade in the GATT's history at 2.1 disputes per year. This raises serious questions as to the validity of the argument that membership growth drives the increase in the number of disputes.

To resolve the different interpretations of the trends shown in Figure 3.3, a simple regression model was estimated using the total number of GATT/WTO disputes in a given year, the total number of members in the GATT/WTO system, and the total volume of world trade for the given years. To account for the potential that it is not the total number of members, but the proportion of the members that are democratic, a variable including the proportion of member states that are democratic is also included.³⁰ The results are displayed in Table 3.2. The regression results confirm the argument that the growth in the number of member states is not a sufficient explanation for the rise in the number of trade disputes over time. All the models estimated use the number of disputes in a given year as the dependent variable. Member states and total world trade (in hundreds of billions of constant dollars) are used as independent variables in all models. In the most basic model, only these components are included. The result of Model 1 is that trade is positively signed and significant, indicating that rising world trade gives rise to greater numbers of disputes. The membership variable is not significant and is negatively signed. This would suggest that the simple explanation that rising

membership leads to rising dispute initiations is not sufficient.

Model 2 still leaves out institutional change, but includes the variable for the proportion of member states that are democratic. In this model the number of member states is similarly not significant. This model does demonstrate that the percentage of member states does have an impact on the number of disputes in the given year.³¹ In this model, both trade and the percentage of democratic members significantly influence the number of disputes per year.

Models 3 and 4 are the full models including institutional variables. These include the full range of institutional changes that took place under the GATT/WTO regime. The GATT system had one institutional innovation that affected the way disputes were handled under the GATT system. This was a fairly minor change in the nature of the dispute process, but it is included here to account for the possibility that even minor institutional change may have an influence. In these models (Model 4 drops the percentage of democratic states variable as it ceases to be significant in these models) the only variable of significance is the WTO institutions. This variable is significant and positively signed as expected in the theory set forth in this work.

This very simple test shows that there is more to the rise in dispute propensity than just the rise in the number of member states. Neither membership growth, nor the growth in overall world trade is sufficient to explain the rise in the number of trade disputes. It also shows that even in this simple model, the institutional changes from GATT to WTO

³⁰ Democratic is taken to mean the states that score 7 or higher on the Polity measure. This variable is the total number of democratic states as a percentage of the total number of states.

³¹ The very large coefficient for the percentage variable is due to the scale of the variable relative to the others.

were significant.³²

As discussed earlier, the reliance of previous research on the institutional structure of the dispute settlement mechanism to explain behavior has led to some problematic assumptions regarding trends in the dispute process. The rise in the number of disputes following the implementation of the DSU suggests that the shift to a rules-based system of dispute resolution significantly increased the number of disputes filed within the system.

3.2.2b Dispute Escalation

Table 3.3 contains brief summaries of the characteristics of the dispute data. When looking at the dispute characteristics we observe a number of interesting characteristics of disputes across both the GATT and WTO dispute settlement systems. The most striking is the very small number of disputes that reach the panel stage. Previous authors (Reinhardt, 2000, 2001; Busch, 2000) have shown that only a relatively small proportion of dispute escalate beyond the consultation stage of the dispute. The WTO disputes show that a similar pattern exists when states seek to escalate to the higher levels of the dispute process. While the escalation information of WTO disputes is somewhat limited by the right censoring of some of the disputes, the basic trend of declining escalation appears to be consistent. Looking only at disputes that have reached a conclusion, the likelihood of escalation decreases significantly at each subsequent stage of the process. At each stage of the process there is a significant decline in the number of states seeking to escalate the dispute.

³² This institutional effect will be further explored in Chapter 4.

The reluctance to escalate disputes has been explored in the GATT context by Busch (2000). Busch analyzed the impact of institutional design and regime type on the tendency of states to empanel disputes. Busch's results suggest that democratic dyads were more capable of reaching a resolution in the consultation stage than were mixed or non-democratic dyads. His findings also showed that the institutional shift (in this case the 1989 "Improvements") did not seriously impact the probability of a dispute reaching the panel stage (Busch, 2000). While the rarity with which disputes are empaneled is not the subject of much systematic study, the commitment of the GATT and WTO systems to consultative solutions to trade problems places pressure on states to resolve their disputes early.

3.2.2c Multilateral Disputes

Multilateral disputes provide a potentially serious methodological issue for this project. Many disputes under the GATT/WTO system are not simply bilateral disputes. Groups of states may elect to initiate a dispute collectively. Frequently smaller states will also bandwagon onto disputes initiated by larger, more powerful states. The practical upshot of this is that the majority of disputes at the GATT/WTO are multilateral in nature.

As previously discussed, the dominant solution in the literature is to treat the disputes as individual events with each complainant state paired with the defendant. In these cases, there will be multiple initiations against a single opponent, but each of these will be captured in separate dyads in which the initiator and target are paired for that year. This solution allows the inclusion of country-level data in the analysis of the dispute.

Embedded in the question of multilateral disputes is an even more serious set of

questions relating to the European Union's role at the WTO.³³ The EU acts as a single contracting party consisting of all its member states. In essence this is a unique case in which an IGO acts as a state representative in another IGO. The implications of this are discussed below.

3.2.2c.1 Implications for the European Communities at the GATT/WTO

Traditional analysis of domestic institutions in the context of the democratic peace has been done by examining domestic level variation and its impact on the behavior of states outside of the framework of international institutions (Dixon, 1994 ; Dixon, 1998; Maoz, 1993; O'neal, 1999). These approaches focus on the nature of the domestic political system. Insofar as regional institutions are considered, they generally are included in terms of shared membership (Mansfield, 2003). While recent research has begun to address the impact of domestic considerations within states as mediated through international organizations, this literature is still relatively new and has not yet reached a consensus (Mansfield, 2001). There is virtually no research relating to conflict resolution in which a regional organization is an intermediary actor in disputes within a larger structure.

Research on the domestic side of trade policy formation has dealt primarily with the mechanisms by which national economic interests channel their economic power into political power and thus into decision-making (Hiscox, 2002; Rogowski, 1989; Stolper, 1941). This body of research has dealt primarily with policy at the domestic level. This

³³ The official name for the European Union and its predecessors under the GATT/WTO system is the "European Communities". The term European Union and European Communities are used here interchangeably.

has also been heavily biased towards explanations based on the relative power of interest groups to the detriment of explanations based on the institutional design of domestic governing institutions. The limited work on the role of institutions in economic policy formation has demonstrated that variations in the institutional design of domestic governing institutions have an impact on the nature of policy decision making (Alesina, 1995). These studies have been limited primarily to democratic states, and they have focused on how the design of institutions changes the incentives for political leaders to use economic policy manipulation for political gain.

This presents an interesting theoretical puzzle for the study of international trade disputes. How does the intermediary level of regional organizations alter the behavior of states in the larger global trade regime? The central question to consider is how the addition of the regional level of institutions will affect the transfer of political influence in the member states to behavior at the international level. This additional level of institutions provides a buffer between national decisions and international behavior. It also adds an avenue of access for interests at the regional level.

While a simple solution would be to consider the EU to be the same in quality as a federal system at the domestic level, this is theoretically problematic. The EU lacks sovereignty under international law, and thus cannot act with the power that has accrued to states in the international system. It also places the EU in an odd position in international law in that it is treated differently in different contexts. The WTO treats the EU as an independent entity with both rights and obligations that follow the rules of the WTO regime. The EU is considered to be an independent customs territory and treated

as such. EU member states' obligations under the WTO are collective in nature. In the WTO, the EU is the unified voice of all its members. In this sense, it is similar to nations using a federal system to divide power between a central authority and other governing entities within the states. An analogy would be the United States and its federal system. At the WTO, the United States government acts on behalf of all fifty constituent states as the single voice of the nation. The major flaw in this analogy is that the constituent states of the United States are not considered to be sovereign entities with international identity independent from their central authority. At the WTO, the EU member states are represented individually and enjoy membership benefits and responsibilities as single states.

This issue of dual representation also includes the issue of subsidiarity, the proper allocation of authority within political systems. The EU is empowered to act in the collective interest, but it is also prevented from acting outside of limited issue-areas assigned to it by treaty. This issue was adjudicated as part of EU law in 1994 when the European Court of Justice issued a ruling clearly defining the areas of competence for the EU and the member states (Bello and Schmertz, 1995). This ruling affirmed that the EU Commission could negotiate treaties on behalf of member states in areas in which the EU Treaties clearly assigned the authority over the relevant issues to the EU. In areas in which the competence was not given to the EU, the authority to negotiate commitments was left to the member states. In areas in which competence could not be clearly assigned, the Court laid out a doctrine of shared competence in which the Union and the member states would act collectively, with the Union and members negotiating side by

side in these cases. This ruling has significance for the current analysis because Article 133 of the Rome Treaty clearly allocates the power to negotiate external trade issues to the Community. Thus the internal law of the EU leaves to the EU Commission the exclusive power to act in matters of external trade, which includes representation of the member states at the EU.

The entity that has come to be known as the European Union began with the European Coal and Steel Community (ECSC) in 1951. The ECSC was an attempt by six nations (Belgium, France, Germany, Italy, Luxembourg, and the Netherlands) to coordinate their post-war economic reconstruction via collective management of key industries. This early attempt at economic integration was successful and further integration followed in 1957 with the Treaty of Rome. This is the most significant event in the history of the EC for the purposes of its relations with the GATT/WTO system.

In creating the EEC, the Treaty of Rome laid the groundwork for the integration of the original six members of the EC. In the Treaty of Rome, there were a range of provisions designed to eliminate trade barriers within the EC and to promote the creation of a common market. One of these provisions was Article 113. Article 113 of the Treaty of Rome authorized the EEC (specifically the European Commission) to negotiate on behalf of the member states in international treaties relating to "external trade policy".³⁴

³⁴ Specifically Article 113 authorized the Commission to negotiate on all matter related to a common commercial policy, subject to a final decision by the European Council. In practice, the Commission has relied on a special committee (authorized in paragraph 3) to handle the day to day relations with the GATT and WTO, as well as other groups to which the EC is bound by international agreement. In a later revision to the Rome Treaty, the article number was changed to 133 (although the text was left alone). The committee created to deal with external trade issues is referred to as the "133 Committee". The 133 Committee reports to the Commission and the Commission reports to the Council. Ultimately the Council makes the final decisions relating to external trade policy.

In practice, this gave the EEC the power to represent the member states at international trade talks. It also made the EEC the designated representative of the member states to the GATT trade rounds. In 1957, the EEC was granted the status of a "contracting party" within the GATT. This effectively made the EEC a member of the GATT in its own right. This status has continued through several institutional changes within the EC and the transition to the WTO framework.

This process is made somewhat ambiguous by the inclusion in the original Rome Treaty of a transitional period that ran through 1969. It is only after the expiry of the transitional period that the EC takes on the full representation of its member states. Prior to 1970, the member states negotiated common arrangements and continued to represent themselves at the same time as the EEC was also engaged in bilateral negotiations on behalf of the Community as a whole.³⁵ To complicate matters further, the vague language of Article 113 left the details of the Commission's role vague. Prior to 1978 member states disagreed on the scope of representation provided under Article 113. In 1978, the European Court of Justice adopted a broad interpretation of Article 113, expanding the range of policies covered by the Article (European Union, 2003). The powers granted under Article 113 (renumbered to Article 133 in a Treaty revision) were further clarified in 1994. The Court of Justice placed specific limits on the powers of the Commission to negotiate in new areas such as intellectual property. Issue areas that were not covered under Article 113 were subject to "joint competence" and were subject to participation by both the Commission and the member states (Hippler Bello, 1995). Joint competence

muddied the waters of responsibility as the new WTO agreement had included provisions found by the Court to be the subject of joint competence.

In spite of the complicated legal structures created in the EC, and the somewhat confused jurisdiction arising from the rulings of the Court, in practice the EC has maintained its position as the sole representative of its member at the GATT and WTO since 1970. The EC was empowered to negotiate on external trade policy to ensure that the policies of the EC reflected the interests of the EC as a whole and not the interests of particular member states and it has largely followed this dictum.

The specific procedure for the implementation of this power gave the final decision over the outcome of negotiations to the European Council. The Council has acted by qualified majority vote since the Commission took over the central role in external trade policy in 1970. In practice this means that the Council requires a qualified majority to engage in trade conflict on behalf of the EC as a whole (European Union, 2003).

The nature of the membership rules of the GATT and WTO has meant that, while the EC acts as the representative of its members, the individual member states have also remained as members of the GATT and WTO (World Trade Organization, 2003). In negotiations, this has meant that the EC states have a solid block of states within the negotiations acting as a single unit. In the dispute settlement mechanism, this has less impact. The EC is considered a single entity and acts as such. Disputes are directed towards the EC and not its constituent member states. Similarly, in initiation of disputes

³⁵

While the EEC did not gain full power to negotiate on behalf of all member states until 1970, it

it is the EC that participates, not the member states as a group.

In the context of this study, the treatment of the EC becomes a significant issue for the reasons outlined earlier. How should the EC be treated in theoretical and empirical studies? Essentially three options are available:

- Treat multilateral disputes by EC members as a collective action different in kind from those disputes involving members not sharing an RTA.
- Include both the EC (as a separate entity) and its members in the data, considering the EC to be a member in its own right, separate from its component states.
- Treat multilateral disputes by EC member in the same manner as multilateral disputes by non-EC members. (ie: each state of the EC is paired with the other state in the dyad.)

The choice here is not trivial. All of the three options have potential problems. The first option allows collective action through the EC to be separated from collective action by other means. The integration of the EC in the area of common external trade policy is unique at the WTO. Considering the EC as a single state for the purposes of analyzing disputes after 1970 (the end of the transition period) accounts for this unique position in the GATT/WTO system.

To include both the EC and its constituent members in the analysis is a tempting alternative. Collective actions could be attributed to the EC, while individual actions could be attributed to the individual states. This solution allows for the separate accounting of collective action within and outside of EC.

The last solution is problematic. The EC provides a clearly defined layer of governance between the individual member states and the GATT/WTO system. The EC is specifically designed to function as a single entity in international trade negotiations.

did take part in the Kennedy Round of trade negotiations (1963-1967) in its own right.

The decision to engage in a trade dispute originates at the EC level. To treat disputes by EC members as simple multilateral disputes is to ignore a significant level of decision-making authority. It also will artificially inflate the number of disputants. Not all disputes involving the EC involve issues of importance to all members. In a typical multilateral dispute, disinterested parties simply would not join the dispute. In the case of the EC, even states not directly affected by the issue would be forced to join the dispute.

For the purposes of this study, the first option is taken. All disputes involving the EC are treated as disputes in which the EC is a single contracting party. All data for the EC is aggregated into characteristics for the EC as a whole. For variables relating to democracy and political institutions, the weakest link principle is used unless otherwise specified. The lowest score of any member state will be used as the score for the EC as a whole. This reflects the fact that any single member state retains the power to block the initiation of disputes at the GATT/WTO if they choose to exercise that right.

3.3 Applying the Data

The data surveyed in the preceding sections is the foundation of the data sets used to estimate the models that appear in the subsequent chapters. Each chapter will contain details on how the data is applied and the specific information relating to the models that appear in each of the following chapters. This data will be used to test a series of hypotheses regarding the impact of domestic institutions on trade dispute propensity.

The dispute data is combined with data from a variety of other sources. The data measuring democracy is from the Polity Dataset. Version IV of the Polity dataset is used in all models in which democracy is a factor. Unless otherwise specified, the commonly

used democracy scale is used in all models. This is the democracy – autocracy measure commonly used in research on the impact of democratic institutions. There are alternative measures that could have been used here, but the Polity data gives the broadest range and is inclusive of the entire time period under observation.

Economic data is a necessary part of any analysis of trade. All of the models that appear in this dissertation use Kristian Gleditsch's Expanded Trade and GDP Data as the source of economic data.

The resulting data set used as the core of this dissertation contains 291,034 directed dyad years covering all GATT and WTO members from the year 1948 to the year 2000. The temporal domain is bounded on the left by the creation of the GATT regime in 1948 and is bounded on the right by the availability of trade and economic data ending in the year 2000. Summary statistics for the main dataset are found in Table 3.4. Unless stated otherwise all of the models that appear in the following chapters are based on the dataset described here.

Table 3.1: Formal Time Constraints on WTO Disputes

Stage of Dispute	Formal Limits on Duration
Consultations, mediation, etc	60 days
Panel set up and panelists appointed	45 days
Final panel report to parties	6 months
Final panel report to WTO members	3 weeks
Dispute Settlement Body adopts report (if no appeal)	60 days
Appeals report	60-90 days
Dispute Settlement Body adopts appeals report	30 days
Theoretical Maximum Dispute Duration	15 months

Source: World Trade Organization (http://www.wto.org/english/thewto_e/whatis_e/tif_e/disp1_e.htm)

Table 3.2: Trade Dispute Frequency and Institutional Change

	Model 1	Model 2	Model 3	Model 4
Number of Member States	-.305 (.169)	.268 (.307)	-.246 (.215)	-.074 (.114)
Total World Trade (hundreds of billions of dollars)	.823*** (.134)	.486* (.200)	.155 (.167)	.135 (.165)
Percent Democratic Members	n/a	97.230* (44.158)	-34.268 (36.314)	n/a
GATT Improvements Dummy	n/a	n/a	8.588 (8.731)	4.700 (7.68)
WTO Dummy	n/a	n/a	83.509*** (15.987)	74.384*** (12.717)
Constant	10.940 (9.097)	-64.327 (35.290)	33.308 (28.102)	7.356 (5.774)
r^2	.623	.657	.860	.857
N	53	53	53	53

* significant at .05 level ** significant at .01 level *** significant at .001 level

Results are regression coefficients with standard errors in parentheses

Table 3.3: Dispute Characteristics Under GATT and WTO

	Total Disputes	Multilateral Disputes	Disputes Empanelled	Disputes Appealed	Disputes Sent to Arbitration
GATT	298	140 (47%)	173 (58%)	N/A	N/A
WTO	600	479 (80%)	120 (20%)	59 (10%)	10 (2%)
Total	898	619 (69%)	293 (33%)	N/A	N/A

Table 3.4 Summary Statistics for Main Variables

	Obs	Mean	Std. Dev.	Min	Max
Dichotomous Dispute	291034	.0020101	.0447888	0	1
Initiator democracy	275423	1.776831	7.474252	-10	10
Initiator Durability	283688	21.59587	29.78989	0	191
Target Democracy	275421	1.776764	7.474239	-10	10
Target Durability	283686	21.59537	29.78886	0	191
WTO Dummy	291034	.2705801	.4442603	0	1
Initiator Total Trade	289283	39908.73	225615.3	0	2.81e+07
Target Total Trade	289283	39908.74	225615.3	0	2.81e+07
Initiator Dyadic Trade Percentage	289264	.0093745	.0437753	0	1
Target Dyadic Trade Percentage	289264	.0093744	.0437753	0	1

Figure 3.1: GATT Dispute Settlement Process

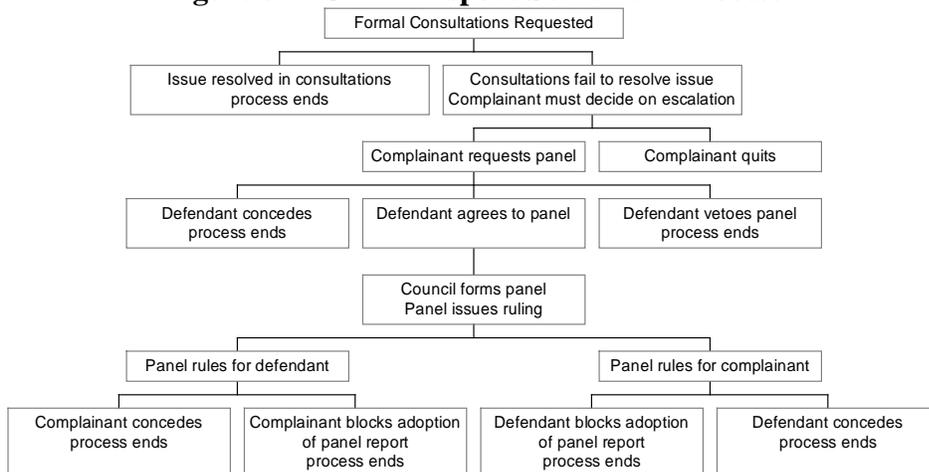


Figure 3.2: WTO Dispute Settlement Process



Figure 3.3: Trade Disputes, Membership, and Global Trade

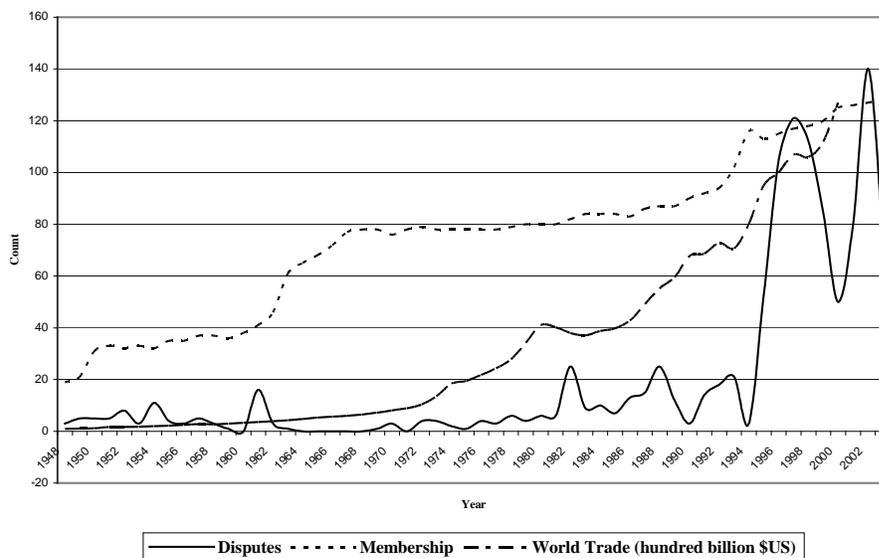
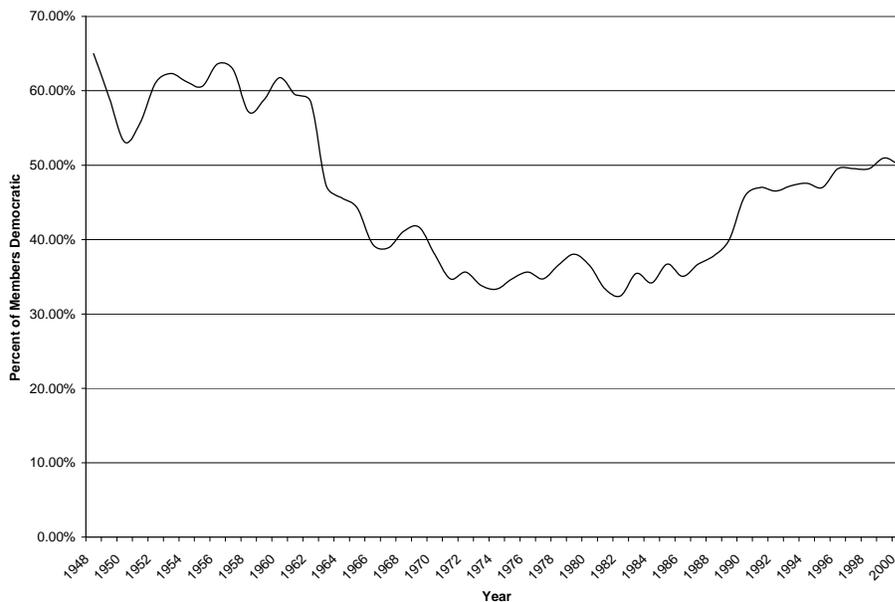


Figure 3.4: Democratic GATT/WTO Membership



CHAPTER 4: INTERNATIONAL INSTITUTIONAL CHANGE AND DEMOCRATIC LEADERS

Democratic political leaders have a tough time of it. The previous two chapters have discussed the complex policy environment in which leaders must operate and the degree to which international institutions can place conflicting pressures on political leaders. In a world of complex interdependence, political leaders will be faced with a constantly churning set of domestic interests that will use the political institutions available at the domestic level to put wide ranging, often conflicting pressure on their political leaders. To manage complex interdependence and promote cooperation, political leaders bind themselves to international organizations. These organizations in turn place institutional pressure on political leaders to abide by the commitments they have made to these organizations. This results in constant pressures on political leaders that must be balanced in order to ensure political survival. Chapter Two discussed in detail how these pressures come to bear on political leaders in the context of two-level institutional pressure under complex interdependence. This chapter applies this logic specifically to how the changes in the dispute settlement mechanisms at the international level affect leaders differently depending on the degree to which domestic institutions subject them to pressure from diverse domestic interest groups.

This chapter will argue that the international system puts both direct and indirect pressures on political leaders. These pressures primarily manifest themselves in policy decisions by political leaders. The institutional environment at the international level also plays a key role. When the international institutional environment changes, political

leaders take note and adjust their responses to domestic institutional pressures. The more democratic the institutions in a state, the more the leadership will be affected by changes to their international environment.

This chapter tests the impact of international institutional change on the decision making of domestic political leaders. The analysis demonstrates that the manner in which the international institutional change affects the decisions of political leaders is conditioned on the type of domestic political institutions in which the leader must operate. In short, the more democratic the domestic institutions, the greater the impact of international institutional changes.

4.1 Trade Disputes and the Change in Global Institutions

In practice, trade disputes are largely the purview of democratic states (Sherman, 2002). The more democratic a state's political institutions, the more open its leaders to pressures to push the limits of the rules of the trade. This means that the more democratic a state is, the more likely it is to engage in behavior (cheating or selective interpretation of grey areas) that makes it a potential target of trade disputes. Further, the more democratic the political institutions of the state, the more likely that its leaders will be pressed for enforcement of the trade regime's rules in response to other state's actions (Reinhardt, 2001 and Sherman, 2001).

As discussed in Chapter Two, political leaders make decisions regarding international trade policies in the context of an international environment that is characterized by complex interdependence. This interdependent international

environment makes the decisions of political leaders subject to indirect pressures from the international environment through its impact on their domestic support base. The international environment also communicates their actions to other political leaders who are making similar decisions in the same connected web of relationships. In the absence of any international institutions, this interrelationship will inevitably lead to conflicts of interest between the actors in the various states and this has historically led to the breakdown of the international trade system.³⁶

To solve the problem of breakdown in the international trade system, the GATT system was created after the Second World War. International institutions can potentially solve coordination and cooperation problems for political leaders through the binding limits on the actions leaders may elect to pursue. The problem is that these limitations may also create the conditions in which compliance with the international institutions leads to the loss of domestic support and thus the loss of power for political leaders. The loss of power being anathema to political leaders, international institutions that seek survival for the longer term must include mechanisms that allow flexible application of the rules in times of domestic crisis for the member states.

The GATT system, largely by accident, incorporated several key mechanisms that allowed for just the sort of flexibility required to ensure long-term compliance with the goals of the regime while allowing short-term defections in the interest of political survival. The flexibility of the system allowed political leaders to pursue short-term political survival policies that may contradict the rules of the regime. The regime

³⁶ For more detail see the discussion of the collapse of the world trade system in 1900-1914 and in

included a dispute settlement mechanism that allowed member states to force compliance on rule-breakers (albeit only very weakly) and to resolve disputes over interpretation of the rules of the regime. This mechanism of enforcement was key as it allowed a period of time in which states could violate the regime, but also permitted eventual enforcement of the rules through a formal process.

The GATT DSM was thus an institutional mechanism that allowed states to act flexibly in the interest of survival, while preserving the overall survival of the regime. The central problem, however was that the extremely weak enforcement provisions made it a highly risky undertaking to bring a potential rule-breaker to book under the GATT DSM.³⁷ The DSM of the GATT was thus clearly flawed and its weaknesses were increasingly apparent as time passed.

The solution to the problems of the GATT was a fundamental reform of the DSM under the WTO. The WTO DSM significantly changed the institutional design, and thus the incentive structure of dispute settlement under the WTO. The key element in the WTO DSM is that it eliminated many of the obstacles to effective enforcement of the rules of the regime. The institutional blocks that allowed the defendant to prevent unfavorable rulings from entering into effect were removed. Further, the pool of potential panelists was changed to draw from a specified pool of experts on international trade law.³⁸

The net effect of the WTO DSM is to greatly reduce the uncertainty of the two

the 1930's that appears in Chapter Two.

³⁷ See the discussions of GATT enforcement in Chapters Two and Three.

³⁸ Details of these changes are discussed in Chapters Two and Three.

key elements of the outcome of the process: gaining a favorable ruling and enforcement of the ruling when it is handed down. These two elements are key to the calculations of decision makers when considering whether or not to initiate disputes. The likelihood that a dispute will result in an enforceable favorable ruling is a key element of the decision to engage in the initiation of a trade dispute. Greater certainty of the outcome and its enforcement significantly lowers the uncertainty costs associated with the initiation of a dispute.

The change to the WTO DSM implies important changes in the international institutional environment in which political leaders find themselves. The key here is that political leaders must make their decisions in the context of both domestic and international institutions, but these decisions in turn affect the decisions of other political leaders. The interconnectedness of decision-making in the context of complex interdependence makes domestic political survival decisions increasingly likely to have ripple effects across other states, potentially leading to political pressure on those states' leaders to act in response.

As the global economy becomes more integrated, this process by which domestic policy decisions increasingly generate international pressure is key to understanding the dispute process. Figures 2.1 and 2.2 in Chapter Two illustrate the interconnected nature of these relationships. The inclusion of international institutions (as shown in Figure 2.2) demonstrates that the pressures generated by these complex interconnections arising from the ripple effects of policy will be channeled through the institutions at the international level in some cases. Political leaders in states affected by policy in other states may elect

to use the international regime as a means of gaining a desired policy outcome if the institutions of the regime allow it. The key, however, is that the institutions are just one of the possible policy choices available to potential initiators.

It is important here to take a step back and look at the process by which trade disputes come about. As discussed more fully in Chapter Two, the traditional concept of the dispute has begun with the decision to initiate a trade dispute by the potential initiator. To begin with the initiation decision is to ignore an important step in the process: the decision to act in such a way as to create the opportunity for an initiation to take place.

The politically powerful actors within a state are subject to international market pressure and are suffering a relative loss to international competition. These groups seek redress through their domestic political institutions. They pressure their political leaders to engage in policies that will protect them from international competition. This pressure can come in a range of forms, but will generally require policies that have a measurable economic effect, thus requiring political leaders to engage in policies that are likely to generate ripple effects that impact other states similarly enmeshed in the global economy. While policy adaptations of this sort need not generate ripples of sufficient size to create harmful effects in other states, the larger the state's economy and the more democratic its institutions, the greater the likelihood that the leadership will be forced, for reasons of political survival, to undertake policies that will have ripple effects of sufficient size to disrupt the economies of other states in the system.

The policy responses of political leaders in this context can range widely. These responses will also cover a wide spectrum of responses that will test the rules of the trade

regime to varying degrees. The trade regime allows for limited, short term responses to legitimate system shocks, but it does not allow widespread, or sustained protections against the marketplace in areas covered under the regime. A key element of uncertainty in this process is just how the rules of the trade regime apply in real world cases. There are thousands of pages of treaty text and annexes, as well as past precedent that determine the likely outcome of a trade dispute. Within these pages are many loopholes and flexibility mechanisms. The result is that there is a “fog of law” that surrounds trade policy. While there are some areas in which clear precedent exists, these are very rare relative to the full body of law under the WTO.

This distinction is important for a range of reasons as discussed in Chapter Two. First: States need not cheat outright in order to be targeted with trade disputes. In fact, outright cheating may be the worst possible response as it is the behavior most likely to generate a response. Outright cheating threatens the trade regime as a whole and is much more likely to be subject to a dispute as states will have a high likelihood of success in enforcement action. A much wiser strategy is to avoid outright cheating and elect to find a grey-area in the rules. The grey-area allows political cover (a claim that the decision is legal) and makes the success of potential challenges less certain. Thus states seeking policies to prop up supporters harmed by competition are much better served by seeking loopholes in the rules rather than by outright cheating.

Most research on the trade regime that has looked at disputes has characterized the behavior leading to the disputes as cheating or as defection from the rules of the regime (Reinhardt 2001; Sherman 2001,2002). The fog of law approach makes the

decisions that lead to disputes much more like the bargaining and payoff calculations defined by Rosendorff (2005). While Rosendorff also uses the language of defection and rule violation, his logic is equally applicable to the case of selective interpretation of the rules of the system. The use of the DSM as a means of purchasing domestic political survival through “paying fines” in the form of sanctions on a state's trade allows a state to purchase domestic political survival by accepting a financial loss to offset the damage the survival policy inflicts on other states.

The second impact of the fog of law is the importance it plays in the survival of the regime. Koremenos (2005) discusses key elements of flexibility in international institutions as a key mechanism of survival. The fog of law performs a similar function under the WTO to the flexibility mechanisms discussed by Koremenos. The rules of the system are clear and carefully spelled out, but they are general. How they apply in each case is subject to the interpretation of the DSM. This allows states to test multiple interpretations of the rules of the regime within the DSM. The incentive to apply these tests, however comes only in the face of a domestic political situation that requires adjustment by one state that affects the key political groups in another state. In such cases, State A and State B can seek a clear and impartial decision under the WTO as to whose interpretation is correct.

These actions are not defection from the regime and are less likely than outright cheating to threaten the long-term survival of the regime itself. In other words, the fog of law allows an additional level of flexibility within the institutions of the regime that political leaders can use for temporary solutions to domestic problems. This also

provides a clear, formal channel for such disputes to follow as they are inherently disputes over the interpretation of an agreed upon set of rules. This process also makes the nature of the dispute settlement institutions an important element in calculations of trade policy. The nature of the dispute settlement institutions frames the incentives they provide to political leaders and thus affects their behavior. Changes to these institutions can then have important effects on behavior.

This means that potential target states have a range of potential options short of outright cheating that allow them to make adjustments to domestic institutional survival pressure while at least arguably maintaining commitment to the rules of the regime.

For potential target states this has important implications. In conditions of complex interdependence, the creative destruction of the market will be placing constant pressure on political leaders to react. The decision to respond to these market pressures will be almost entirely the result of domestic pressure caused by the international marketplace channeled through the domestic political institutions. The pressure on political leaders to engage in policies likely to spark a response from fellow member states is generated by the global economy and domestic institutions. It is relatively free of influence from the international institutions. The international institutions channel potential disputes over the rules within a particular institutional context, but the domestic political survival pressure is what drives the formation of policy.

This in turn affects the international institutional pressures on political leaders when they make decisions related to domestic survival at the expense of commitment to international institutions. The pressure for protection is consistent over time given the

nature of the global economy. The pressure is channeled through domestic political institutions and pressed on political leaders regardless of the international institutional context. In such cases, a wide range of policy options present themselves, many of which will have ripple effects throughout the international economy and thus make the state the potential target of policy action by other states. Pressure to survive trumps international commitments in these cases, and the only question is the degree to which the policy pressure will result in a policy that violates the rules of the trade regime. The conflict management institutions play only a trivial role in this calculation. This suggests that changes in the conflict management institutions at the international level will have little or no effect on the behavior of political leaders when they are considering whether to survive politically or remain committed to the international regime. Political leaders will seek survival and brave the consequences that may come in being targeted for a trade dispute.³⁹

For those harmed by the policies of another state, considerations are different. Sectors harmed by the policies of other states will press their home governments for redress. This process is nearly identical to the process by which states being harmed by free trade will press for protection, but the decisions are influenced to a much greater degree by the international institutional context of the enforcement options available. When faced with harmful policies by another country, domestic political leaders have a

³⁹ It should be noted that trade disputes are relatively rare occurrences, but that this can vary greatly by the country pairing. The overall likelihood of a dispute taking place in a given dyad year is 0.12% under the GATT and 0.41% under the WTO when all member states are considered. While this is a very rare event, this is the mean level. For exceptionally contentious dyads such as the US/EU dyads under the WTO, the probability of a dispute in a given year is above 90%. This implies that leaders' calculations will be complicated to say the least.

wide selection of potential policy tools at their disposal. Some of these tools are themselves potential violations of the trade regime, but the tool kit also includes the option of rule enforcement through the institutions of the regime. Sectors that benefit from free trade will use their access to political leaders to press for the enforcement of trade rules that are in their favor as one potential policy outcome.

The dilemma faced by political leaders in this case is complex. Leaders face pressure to provide redress for their supporters in the face of cheating, but the policy tools for the provision of such redress are not limited to the dispute settlement process. Policy leaders can opt to provide subsidies, tax credits, or other forms of taxpayer financed payments to the harmed industries. This is, however, costly and creates an additional problem of where that money should come from given budget constraints. While the use of the dispute settlement mechanism is often less costly in purely monetary terms if success is guaranteed, success is often uncertain. The process can be long and the final outcome less than complete removal of the offending policy. Thus political leaders must calculate which policy choices are best for retaining the support of their key constituents.

Critical to this calculation is the uncertainty of the dispute settlement process. Just how likely is a policy change by the offender to be the result of the dispute? This is a complicated question, but one that is significantly affected by the rules of the trade regime under which the dispute is undertaken. It is in this calculation that the question of the international institution is most critical. The GATT system had very weak enforcement of its decisions, with all of the enforcement potential deriving from the willingness of the losing state to act out of its commitment to the norms of the regime and

not out of any institutional enforcement power. The WTO institutional context is very different. In this case there is a clear mechanism for enforcement of rulings as well as time limits on the process to prevent delays.⁴⁰ Due to the improved enforcement capacity at the WTO, the likelihood of being able to force a change in the offending policy is greatly increased.

For democratic political leaders the shift in institutions is important. The inclusion of enforcement lowers the degree of risk in the selection of the trade dispute option. Better enforcement implies a greater likelihood that a policy change will be implemented. It also allows for financial compensation if the change is not implemented. For potential initiators then, the change in international institutions has a significant effect on the policy process through the reduction of the uncertainty costs of initiating a dispute.⁴¹ This makes the WTO system more attractive than its GATT predecessor to policy leaders. The shift in the DSM towards a process that more clearly resembles the domestic legal practice in democratic states also makes the process more likely to be acceptable as an alternative to direct payments for political supporters.

Policy pressure thus makes democratic states more likely to engage in behavior that makes them likely targets for a dispute. This pressure applies in a manner that is independent of the international institutional framework. The more democratic a state,

⁴⁰ See Chapters 2 and 3 for the full discussion of this process and the changes from the GATT to the WTO in terms of dispute settlement.

⁴¹ While not specifically discussed here, the change in the WTO also included time limits. While these potentially lower the cost of the dispute by reducing the time required to get implementation, the overall increase in the legalization of the process also increases costs as it requires greater expertise to make the formal arguments required under the WTO DSM. The increase in the cost of the legal process will largely offset the gains from the shorter periods of the disputes. Further, as many disputes end in the

the more likely it is to initiate a dispute within the DSM of the trade regime. The decision to initiate is affected by the international institutions as the relative uncertainty cost of enforcement is dependent on the nature of the DSM. This has the potential to make many democratic states appear hypocritical in their policy choices. On the one hand, they choose to target violators of the trade regime for disputes designed to enforce the rules of the regime. On the other hand, the same country will seek to implement protectionist policies in order to favor members of the ruling coalition. The larger the economy of the democratic state, the wider these pressures will be and the greater the number of disputes in which the state will become embroiled, both as an initiator and as the target of disputes. When combined with the long duration of these disputes once initiated, it is reasonable that large democratic states should be simultaneously engaged in multiple disputes both as the initiator and as the target. Depending on the sectors of the economy involved states might even be arguing contradictory positions simultaneously in different contexts.

At the end of this discussion then we are left with a very simple argument. Political leaders pay attention to changes in international institutions, but in the decision making process that leads to disputes, it is the potential initiator that is most clearly affected by these institutions. The ability of the international institution to enforce its rules plays an important part in the decision to seek redress within its enforcement body.

This argument implies three hypotheses:

- ***Hypothesis 4.1:*** The number of disputes overall will increase with the change

consultation stage with some form of compromise, the cost of WTO disputes in these cases is likely to be comparable to those of the GATT as they are procedurally similar in the consultation stage.

from GATT to WTO institutions.

- **Hypothesis 4.2:** As the institutions of a potential initiator become more democratic the marginal effect of the change from GATT to WTO institutions will increase.
- **Hypothesis 4.3:** There will be no statistically significant marginal effect of the change from GATT to WTO institutions for potential target states.

The remainder of this chapter discusses a series of tests of these hypotheses and the results of these tests.

4.2 Data and Method

To test the hypotheses articulated above, this chapter employs a logit analysis of the presence or absence of a dispute between two GATT/WTO member states in a given year. The dataset used in the models discussed here consists of directed dyads for all GATT/WTO member states for each year from the founding of GATT to 2000.⁴² The dataset includes all possible initiator – target pairings for each year.⁴³ The resulting dataset contains 260,804 observations covering the years 1948 to 2000.

The directed dyad approach is used here to allow the testing of directional hypotheses regarding the dispute process. To evaluate the separate processes of initiation and targeting it is necessary to include the direction of the actions of the states in the dataset.

The data for the disputes themselves is derived from the dataset discussed in Chapter Three. The dataset includes all disputes between GATT and WTO member states

⁴² The year 2000 is the cut off as it is the latest year for which data is available at the time of this analysis.

⁴³ The dataset does not include “I vs I” dyads, namely those in which a state is paired with itself. These are eliminated for the obvious reason that the no state is likely to file a dispute with itself.

under their respective dispute settlement mechanisms. These disputes represent the total population of disputes under the rules of the trade regime since its founding.

The central question of this chapter, and this dissertation as a whole, is how the institutional characteristics of the international regime affect the behavior of its members. To account for this in the models discussed here, a dummy variable for the WTO dispute settlement institutions is concluded. This is coded a one (1) for all years in which the WTO DSM is in place and a zero (0) for all years in which the GATT DSM is in place. As demonstrated in Chapter Three, the change to the WTO DSM had a significant and positive effect on the probability of a dispute taking place overall.

The democracy variable is the scaled democracy score from the Polity dataset (Marshall, 2000). The standard operationalization is used, subtracting autocracy from democracy to generate a scale from -10 to 10. This is included for both the initiator and the target in each dyad.

As this chapter deals with how the change discussed in Chapter Three relates to democracy, an interaction term is included in the models presented here to account for the interaction of institutional change and democracy. This interaction term is generated for both the initiator and the target in the dyad. A variety of control variables are included to account for factors that are known to affect the likelihood of a dispute from previous work and from theory. Unless otherwise specified all economic data is taken from Kristian Gleditsch's Expanded Trade and GDP dataset (Gleditsch, 2002 #423). This dataset was selected for its breadth of coverage among the GATT and WTO membership and for its temporal domain extending until 2000.

The two most important economic indicators in determining the potential for a dispute are trade and GDP. States that have no trade, or whose trade is insignificant to the economy as a whole are less likely to experience disputes. This is operationalized here in the conventional manner. This is to create two measures: overall trade and trade dependence. Overall trade is operationalized here as the sum of imports and exports of the state in question. This is generated for both the initiator and the target state and included in the model for both states. As theory and convention suggest that the impact of a unit of trade will decrease as the value of trade rises, a log measure of trade is used in these models. Trade dependence is operationalized here in the form of trade as a percentage of GDP. This demonstrates the degree to which the state's economy is dependent on international trade and thus the degree to which trade issues are likely to play a major role in domestic politics. GDP is operationalized in the conventional way. As the impact of a unit change in GDP declines as the value rises, a log measure of GDP is used in keeping with convention.

It should be noted here that this specification of trade has been chosen as it most clearly models the domestic political process involving the decision to initiate a trade dispute. As political leaders face decisions related to the need to retain domestic political support, it is the trade dependence of the initiating state that is likely to fuel this pressure. The overall dependence (rather than the dyadic dependence) will be the most important determinant as to whether significant pressure will emerge to engage in trade disputes. High trade dependence will lead to a greater role for trade in domestic politics and thus increase the pressure for policy action by political leaders from groups involved in trade.

While overall trade volume matters (and is thus included), it is trade dependence that will most strongly affect the salience of the issue to domestic political leaders.

Given pressure to act to enforce trade rules, domestic political leaders will seek the most likely targets. The larger the volume of trade overall in a target state, the greater the likelihood that policies will be in place to protect particular companies and sectors. While trade diversity will also be important in this regard (greater number of industries = greater number of policies likely to be violations of the regime) data on this is not readily available for a wide range of countries.

Thus this model includes the two basic characteristics for both the initiator and the target state. These are operationalized in a manner consistent with the theory that what drives the decision to initiate and the target selection are two different characteristics of trade for the states in the dyad.

It is likely that long periods of “peace” in the trade regime will decrease the likelihood of trade conflict in the future. A long history of trade peace between states suggests that they will likely avoid disputes in the future. This variable is calculated as the number of years since the last dispute between the states in the dyad or since the dyad came into being. In cases where no dispute has ever taken place, this variable is equal to the number of years that the dyad has existed in the dataset.⁴⁴

As the variable of interest is binary in nature (dispute/no dispute) a series of logit models for time-series cross sectional data are estimated. These models are all logit

⁴⁴ The number of “peace years” was calculated using Beck, Katz, and Tucker's BTSCS plug-in for STATA. While designed for use in the study of militarized conflict, the method of computation is the same in this context.

models with panel corrected standard errors. The coefficients expressed in the tables that follow are all logit coefficients. Due to the use of interaction terms, substantive interpretation of these coefficients is difficult (Braumoeller 2005; Brambor, et al. 2005). Figures have been generated to display the conditional effects of the key variables to provide clarity of interpretation.

4.3 Results

The results of the logit models estimated for this chapter are shown in Table 4.1. The first two models (Models One and Two) estimate what is essentially a replication of earlier studies of trade dispute behavior. Earlier studies using only GATT data demonstrated that democracy increases the likelihood of experiencing a dispute within the dyad (Reinhardt 2001; Sherman 2001). These models confirm that this result is consistent with the results observed when the WTO disputes are included.

Models One and Two also offer support for Hypothesis 4.1 that the change to the WTO institutions had a statistically significant and positive effect on the likelihood of a dispute taking place in any given dyad in a given year. Model Two is the full model, including controls, and it provides results consistent with the previous work on trade disputes and in support of Hypothesis 4.1. Control variables behave as expected and the WTO dummy is positive and significant.

Models Three and Four test the interactive relationships theorized to exist in this chapter and constituting Hypotheses 4.2 and 4.3. The general results are summarized in Table 4.1, but interpretation of these results are complicated by the use of the two

interaction terms in the model. Simple interpretation of the results in Table 4.1 can be misleading and such interpretations are a common flaw of much of the literature that uses interaction terms (Braumoeller 2005; Brambor, et al. 2005). The conditional values of the z-score and the marginal effects for the key variables of interest were calculated to test Hypotheses 4.2 and 4.3. These results were calculated from the results of Model Four, the full model with controls.

The conditional z-scores of the WTO DSM on dispute propensity conditioned on democracy are displayed in Figure 4.1. This figure demonstrates that the conditional effect of the WTO DSM is not statistically significant for the potential target at any level of democracy. This implies strong support for Hypothesis 4.3, that there is no significant relationship between the international institutional change and the propensity to engage in behavior leading to a state being targeted. The marginal z-score for the initiator is statistically significant, but only at levels of democracy above zero on the Polity scale. This offers support for Hypothesis 4.2, that the WTO DSM does have a significant and positive effect on dispute propensity for initiators, but that states must at least have shifted from the autocratic half of the Polity scale (-10 to 0) to the democratic half of the scale (0 to 10). Potential initiators must have met a minimum level of democracy for the WTO DSM to matter.

The conditional marginal effects of the WTO DSM at varying levels of democracy are displayed, as are 95% confidence intervals, in Figure 4.2.⁴⁵ The conditional marginal effect rises as the Polity democracy score rises. When looking at

the values of democracy above zero on the Polity scale, this relationship is consistent across the range of values on democracy for which it is statistically significant. This is further confirmation of Hypothesis 4.2. The statistically significant levels of initiator democracy see a rising marginal effect as the democracy score rises.

The substantive impact of these results is difficult to interpret from the marginal effect figures or the logit coefficients expressed in Table 4.1. For this reason, the predicted probability of a dispute under the GATT and WTO is displayed in Figure 4.3. This figure displays the mean predicted probability of a dispute in a given dyad at various levels of initiator democracy. This figure indicates that the relative difference between the two institutions is negligible until after initiator democracy rises to above zero. There is no significant spike in the predicted probability until five on the democracy scale.

Overall these results provide strong support for the three hypotheses stated earlier. The WTO DSM increases the likelihood of a dispute overall. The impact of the WTO DSM impact potential initiating states to a greater degree as their Polity democracy scores rise. Target states did not see a significant impact of the WTO DSM at any level of democracy. The predicted probability of a dispute rose significantly, but only when the scores of initiator democracy were in the statistically significant range.

4.4 Conclusions

Political leaders take into account the international institutions in which they make policy decisions. This does not affect political leaders in the same way in all cases,

⁴⁵ The equivalent marginal effects for the target are not displayed as they are not statistically

however. The need to pursue political survival means that leaders will respond to changes in the needs of their key political supporters at the domestic level without significant consideration of the international institutions. For political leaders that are pressured to enforce international rules, the impact of this pressure is only a significant factor for states that are sufficiently democratic to require large support bases in order for leaders to gain and retain power. Further, the larger the support base, the greater the effect of the lowered costs attendant in the institutional changes from the GATT to the WTO.

Political leaders are thus sophisticated in how they make choices regarding the rules of international institutions. Political leaders will engage in behavior to ensure political survival based primarily on domestic political considerations. International institutional enforcement requires a calculation of the incentives created by the international institutions, thus making institutional design a key element of this calculation. When institutions change to reduce the uncertainty costs associated with using the dispute settlement institutions of the regime this will increase the degree to which states seeking enforcement action will avail themselves of the process. When you lower the cost of trade disputes, you get more disputes. The rising number of disputes observed extends from the larger number of states that find the reduced cost of the dispute acceptable. It also indicates that the rise in the number of disputes under the WTO is primarily the result of calculations within the initiating states. The target states seek the fog of law roughly at the same level as under the GATT.

significant at any level of target democracy.

This chapter implies that international institutional design can significantly affect how political leaders evaluate participation in international institutions. Effective enforcement increases compliance actions by aggrieved members. But the impact of institutional change is not universal. The domestic institutional environment faced by political leaders significantly affects how international institutions impact political leaders. Future examinations of the operation of international institutions must consider how these changing incentives will affect the political leaders of the member states given their domestic institutional contexts.

Table 4.1: Institutional Interaction and Dispute Propensity

	Model 1	Model 2	Model 3	Model 4
Initiator Democracy	.196*** (.022)	.124*** (.018)	.155*** (.022)	.098*** (.019)
Target Democracy	.272*** (.027)	.133*** (.019)	.269*** (.035)	.167*** (.033)
WTO Dummy	.948*** (.114)	.953*** (.123)	-.043 (.527)	.859 (.483)
Initiator Democracy / WTO Interaction	n/a	n/a	.115** (.039)	.079* (.038)
Target Democracy / WTO Interaction	n/a	n/a	.006 (.045)	-.063 (.039)
Initiator GDP (log measure)	n/a	.595*** (.058)	n/a	.603*** (.058)
Target GDP (log measure)	n/a	.374*** (.064)	n/a	.376*** (.064)
Initiator Total Trade (log measure)	n/a	-.094 (.070)	n/a	-.109 (.070)
Initiator Dyadic Trade Percentage	n/a	2.934*** (.404)	n/a	2.917*** (.400)
Target Total Trade (log measure)	n/a	.214** (.076)	n/a	.219** (.076)
Target Dyadic Trade Percentage	n/a	1.009 (.531)	n/a	1.041* (.527)
Years without dispute	n/a	-.235*** (.054)	n/a	-.234*** (.054)
Constant	-8.799*** (.281)	-13.591*** (.667)	-8.445*** (.342)	-13.655*** (.712)
X ²	364.23***	2010.39***	467.28***	2013.73***
Log Likelihood	-3277.888	-2047.351	-3269.253	-2042.012
N	260,804	259,957	260,804	259,957
* significant at .05 level ** significant at .01 level *** significant at .001 level Results are logistic regression coefficients with panel corrected standard errors in parentheses, coefficients for splines are not reported in the interest of parsimony				

Figure 4.1: z-scores of the WTO DSM on Democracy

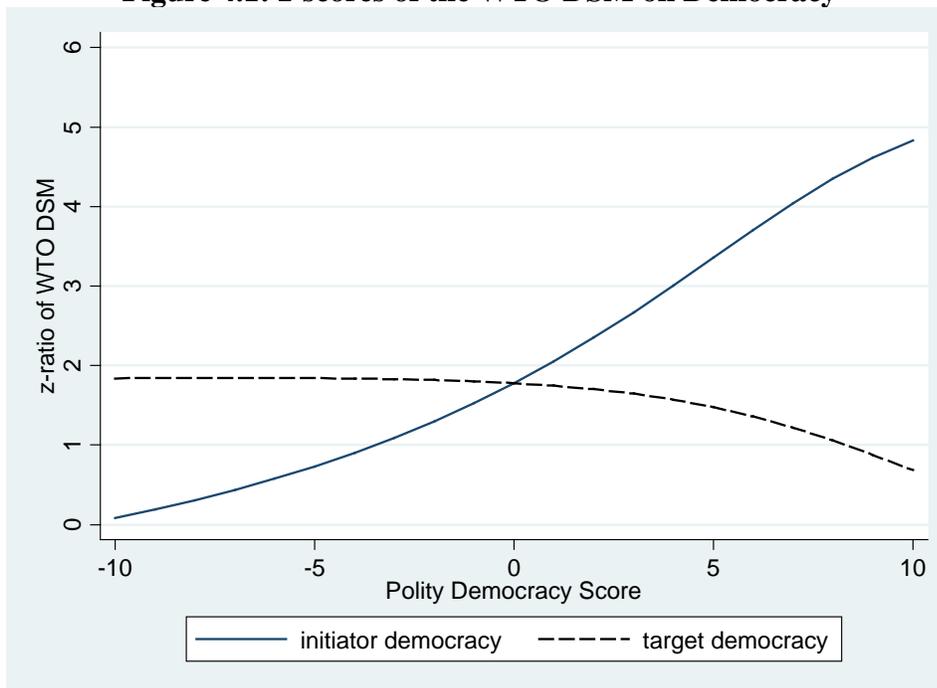


Figure 4.2: Marginal Effect of WTO DSM

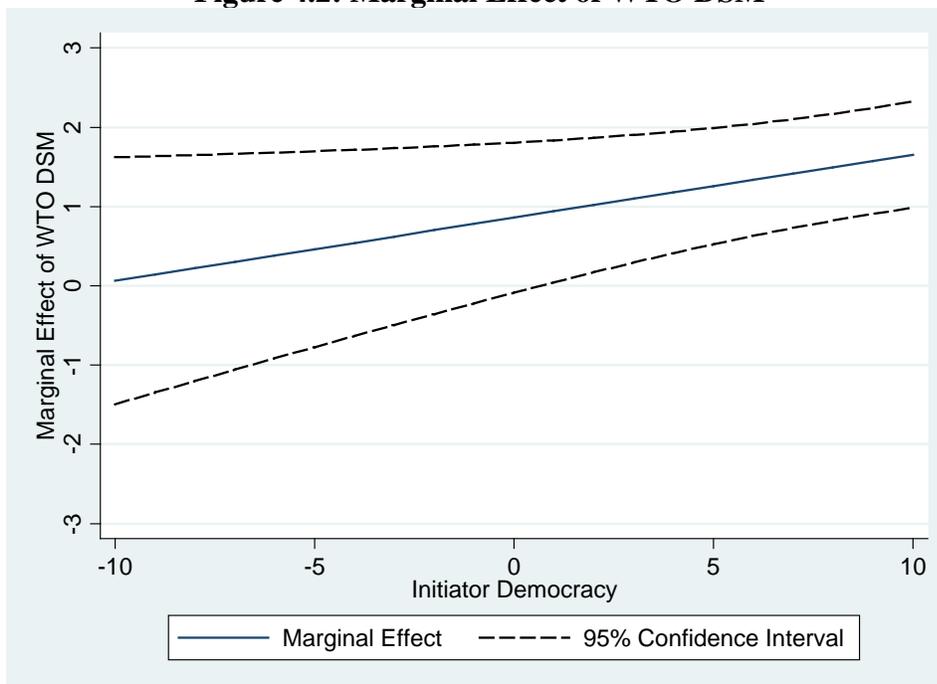
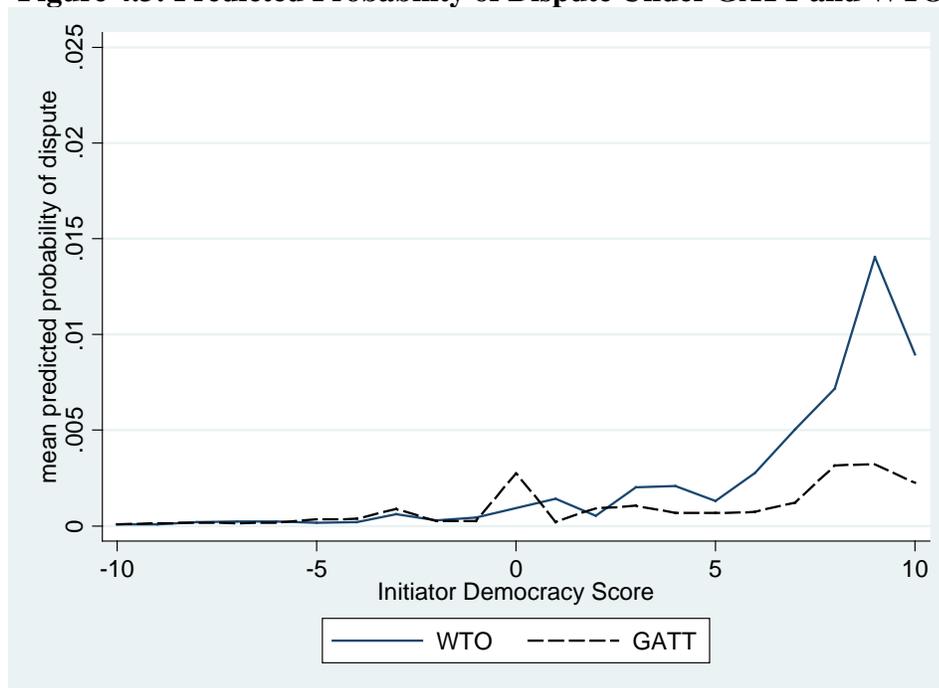


Figure 4.3: Predicted Probability of Dispute Under GATT and WTO

CHAPTER 5: INSTITUTIONAL DURABILITY, UNCERTAINTY, AND PICKING BATTLES

Uncertainty vexes political leaders. In conditions of uncertainty, it is difficult to predict the best policy choices in given situations. The greater the uncertainty, the more difficult it is for political leaders to accurately select the policies that will ensure their survival as leaders. In the contemporary world of complex interdependence, contradictory institutional pressures, and an unceasing churning of the global market, political leaders find themselves faced with constant uncertainty in key areas and they seek to adapt their policy decisions to meet the challenges presented by uncertainty. The previous chapter demonstrated that the reduction in uncertainty caused by a change in the Dispute Settlement Mechanisms of the trade regime led to a clear increase in recourse to the trade regime by the leaders of states that have more democratic institutions. Further, the more democratic the institutions of a state, the stronger the effect of the changed DSM on political leaders within that state's institutions. In short, international institutional changes that reduce the level of uncertainty regarding the outcome of a dispute affect how political leaders make decisions within this international institutional context.

This chapter examines the role of institutionally generated uncertainty at the domestic level by examining the role of institutional stability in the reduction of uncertainty. Institutional change brings with it the potential for confusion and uncertainty for political leaders and their supporters. When institutions change, the incentives created by the new institutions represent a change from those created by the previous

institutions. While the incentives created by institutions are known by the actors operating within them, they are known only with uncertainty. As time passes and institutions remain in place, this uncertainty is gradually reduced through repeated interactions between the actors. The longer institutions endure unchanged, the lower the degree of uncertainty for the actors regarding the incentives for the other actors within the institutional framework.

This logic suggests that uncertainty is reduced as institutions endure. This process at the domestic level suggests that the behavior of political leaders in an atmosphere of uncertainty will be affected by the endurance of the institutions at the domestic level. The sections that follow build upon this logic, explaining a theory of domestic institutional endurance and its effect on political leaders when evaluating potential disputes at the GATT and WTO. This chapter argues that the reduced uncertainty that comes with the endurance of political institutions does affect the behavior of political leaders, and that this effect increases as the openness of the political system increases.

5.1 Changing Institutions

Previous research on the relationship between domestic government type and international behavior has focused on the direct relationship between the institutions of government and the behavior of states. This research has generally assumed that the type of government directly impacts state behavior in a variety of ways (Maoz 1994, Dixon 1994, Bueno de Mesquita, et al. 2002, and others). What is much rarer is a test to

determine the role that the endurance of a given set of institutions plays in the process of how domestic institutions come to affect international behavior.

When institutions change, the incentives created by these institutions also changes. While the incentive structure changes in the moment of institutional change, the understanding of the changes on the part of the actors within the institutions is subject to uncertainty about precisely how the incentive structure has changed for different actors in the process. Actors within changing institutions do not instantly become aware of the incentives for other actors created by the new institutions with absolute certainty. No group can be sure of how the other groups preferences have changed given the new institutions. Only by testing the waters and gauging the reactions of other actors can the actors in the process come to know with confidence how other actors will behave.

In the early period following a change in institutions actors seek to devise the best strategies to achieve their goals within the new institutional context. The actors will test their fellows within the new institutions and gauge their reactions under different circumstances. With each challenge, the actors learn more about how other actors respond in the new institutional context. Over time, this process results in the actors gaining a working knowledge of the best strategies to achieve their ends, gradually stabilizing until the next institutional change or another change in circumstances leads to a change in the incentive structure. At this point the process begins anew.

This implies that actors take time to learn how the institutions in which they are operating work in practice for all the various players. Once institutions change, or new institutions are created, there will be a period of declining uncertainty as the actors learn

from each others' responses. During this period, the actors in the political process will engage in policy decision making designed to secure their interests. Political leaders will seek to build and/or maintain the support necessary to gain and retain power. Potential and actual supporters will seek concessions from political leaders in return for political support. In short, the key players will seek to act to see that their interests are looked after.

In the context of trade disputes, what matters is not simply the institutions of the domestic political system, but the interaction of the incentives at the domestic level and the international level. Political leaders are subject to the institutional pressures of their domestic political systems, but also the international institutional environment in which they are acting. International institutions provide context, and in some cases rules of conduct which political leaders must consider in making their decisions. Thus, in the institutional context for political leaders is one that blends domestic and international pressures.

5.2 Institutional Learning and Trade Disputes

The learning model discussed above is particularly useful in understanding the process by which political leaders become involved in trade disputes under the GATT and WTO. The GATT/WTO system provides a clearly defined mechanism for the adjudication of disputes regarding international trade rules as discussed in previous chapters. These international rules changed during the GATT/WTO transition, changing the international institutional incentives that leaders face from the dispute adjudication

mechanism within the trade regime. The domestic institutions of member states also change within this period. This context allows the testing of how domestic institutional change affects international behavior within a changing international institutional context. Previous research by Eric Reinhard (2001), Richard Sherman (2001), as well as the analysis set forth in Chapter 4 have demonstrated that as states become more democratic, they become more likely to engage in disputes under the rules of the trade regime. While the authors differ as to the implications for conflict propensity to be taken from these results, there is general agreement that as states become more democratic, they are more open to domestic political pressure and are thus more likely to engage in disputes in support of their political supporters. Chapters 3 and 4 demonstrate that the international institutional change also matters in determining the behavior of political leaders and that the marginal effect rises as democracy rises.

Trade disputes thus represent an example of political leaders and those groups seeking public policy actions must adapt as the changing nature of domestic and international political institutions change the incentives faced by the actors involved. As they adapt to the changing institutional circumstances, there will be a period of institutional learning as the political leadership and its support base seeks to find the best strategy for achieving their respective goals. To see clearly how trade policy exemplifies the learning process, a brief review of the process by which states make their foreign trade policies is in order.⁴⁶

All political leaders in all states must make important, and often difficult

⁴⁶ For a more complete discussion, please see Chapters Two and Three.

decisions regarding international trade. The degree to which states embrace integration in the global market varies, as does the degree to which this embracing of the market is moderated by other forms of government policy (welfare states, retraining, etc.). These difficult decisions are made by all political leaders based on the fairly straightforward, and widely assumed goal of retaining their position of power and authority.⁴⁷ All political leaders will balance the need for protection of domestic interests and the need to embrace markets to the degree that they believe will maximize the likelihood of their continued political survival.

What it takes to achieve political survival, however, varies a great deal between governments. The more authoritarian a state, the smaller the group of key supporters required to gain and retain power. The more democratic a state, the larger the number of supporters required to gain and retain power. This has an important implication for the available policy tools that political leaders may use. Bueno De Mesquita, et al. (2003) argue that political leaders are increasingly forced to use public policy tools as the size of the support group rises. Small groups of supporters may be secured with private payments from the political leaders budget and still leave substantial sums for use the the leadership. As the number of supporters required to gain and retain power increases, these private payments become too expensive, rapidly depleting the budget of the leadership. To gain the support of large numbers of key groups, the only effective option is the use of public policy. In effect, this implies that the more democratic the political institutions of a state, the more likely are its leaders to turn to public policy tools as th

⁴⁷ See Chapter Two for a more complete discussion

primary means of gaining the necessary support base. The more democratic the institutions of the state, the larger the number of political supporters required for political survival, and the greater the temptation to use public policy for political ends (Bueno De Mesquita, et al. 2003).

In most of the work on the role of factors of production and capital mobility in trade policy pressure, democratic states are the focus of discussion (Hiscox 2002). Work in other areas of economic policy demonstrates that political leaders in democratic states actively attempt to manipulate macroeconomic policy as a tool for electoral victory (Alesina, et al. 1999). Prior work has also demonstrated that proportional representation systems with a tendency towards coalition governments lead to a larger intervention by the government than do majoritarian systems. This manifests in the economy in the form of a larger government share of GDP being extracted for state purposes (Persson and Tabellini 2003). Across a range of economic policy areas, political leaders intervene in order to ensure their political survival. The evidence further suggests (albeit sketchily so far) that the broader the required representation of the people, the greater the economic intervention by political leaders in the wider economy as a means of gaining political support.⁴⁸

Political leaders are thus more inclined to respond to the will of their supporters using public policy tools as states become more democratic. This public policy action

⁴⁸ It should be noted that this intervention is in the area of macroeconomic manipulation rather than direct intervention in the marketplace. It can very clearly be argued that government intervention by autocratic states is also very strong, but directed at limiting the freedom of the market to act to protect government power. This would intuitively seem to be of a different quality than the intervention of democracies, but it should not be excluded from consideration that the propensity for government

frequently takes the form of economic policy manipulation. In using the economy, political leaders will select the forms of intervention that best suit their political supporters at the lowest cost to themselves. Trade policy fits neatly into this type of policy action.⁴⁹ Political leaders can calculate the cost of trade policy to various groups and make judgments regarding how particular groups will be impacted by changes to the wider policy changes. Most particularly, trade policy offers a range of options in which narrow benefits can be tied to widely distributed costs.

It is important to note here that the political survival calculation is a political one, not a purely economic one. While the costs to groups may be in monetary terms, as are the potential costs of alternative policies, the political cost is what is critical. All political leaders face the problem of a scarcity of resources. They must pick and choose the optimal mix of policies to support the entire winning coalition within their budget constraints. This means that even very small groups may be worthy of trade disputes if their political power is great enough or if they are the “swing” group. In fact it is plausible that the cost of disputes for some countries (particularly those with large legal staffs in their Trade Ministries) may be very low compared to other policies. What is key then is how the decision to engage in a dispute fits into the larger policy context, not the specific dollar value of the industries involved.⁵⁰

In addition to the mix of political and economic criteria comes a practical question: Even if we win our dispute and the policy is declared illegal, what is the

intervention is a U-shaped curve with the drive to intervene strongest at the extremes. While this is potentially interesting, there is not room to consider it here.

⁴⁹ For a more complete discussion, see Chapter 2.

likelihood that the other side will comply? This is a key point in understanding two things: 1) why disputes increased in number with the implementation of the WTO dispute system and 2) why potential initiating states feel these institutional effects more so than do the potential target states.

For a political leader to decide to make a favorable interpretation of the trade rules is a very inexpensive way to gain and retain support. The costs are primarily borne by consumers in the home states and consumers and competitors in other states. The benefits are directly felt by political supporters. The most direct costs are the possible costs of defending against a dispute by harmed parties. The probability of this taking place is very low as disputes are infrequent relative to the number of member states.

For a political leader to decide to initiate a dispute, they must have some confidence that a favorable ruling can be achieved and that the ruling will be enforced. If there is no enforcement, then the offending policy remains in place continuing to cause harm, and the political leadership has spent its resources on a fool's errand. Thus the probability of enforcement is important to the potential initiator in a way that it is not to the potential target. This means that the contributing factors to their respective decisions will be different.

To illustrate the point, an example is useful. In 2002, American President George W. Bush imposed tariffs on imported steel to offset “dumping” by foreign steel companies. While it was clear to most observers that the problems with American steel companies were largely ones of an inability to compete effectively due to aging plants

⁵⁰ This point is critical in explaining why some trade disputes appear to involve trivial industries.

and the weight of pension liabilities, a case could be made that dumping was taking place within the rules of the WTO. The US government elected to try and make that case. The beneficiaries were large steel companies in the US and steel workers. These industries were concentrated in key battleground states (notably Pennsylvania) for the 2004 presidential election. It also sent a clear message to the region regarding Republican candidates in the 2002 congressional election.

While steel workers and steel companies were clear beneficiaries, those companies who used steel as an input in their production chains and the general consumer suffered under this interpretation of dumping rules. The cost of steel rose and this was passed on to steel users as lower profits and on to consumers as higher prices.⁵¹ These groups were not concentrated geographically or electorally. Lacking the coherence necessary to lobby the government in a unified way in which electoral college votes were clearly at stake, these groups could not effectively threaten to transfer support to potential rivals in the way that the steel industry was able to.

In the end, the interpretation of dumping rules by the US was challenged in the WTO Dispute Settlement Body by a coalition of states whose steel industries had suffered from the US tariffs. In 2003 the WTO ruled that the US interpretation of dumping rules was incorrect and that the countervailing duties were thus illegal under the rules of the trade regime. The US removed the steel tariffs in December of 2003 in compliance with the WTO ruling.

The US steel tariff case illustrates the calculations of political leaders in seeking

The political value of the industry may be disproportionate to the economic value.

to use international trade law to benefit domestic groups. For the political leadership in the US, the steel tariffs placed a small burden on a widely distributed range of domestic producers and consumers in the form of higher unit costs for steel. The benefits of the steel tariffs were, however, concentrated in politically key geographic regions and among politically key groups within these regions. A provision in WTO law existed that could arguably apply to the case. The US did not need to win the case at the WTO as the tariffs were in place and the political benefits would be felt at least in the 2002 election and the eventual repeal came late enough that the US political leadership could at least claim that it did all that it “legally” could. Further, the nearly two years in which the steel tariffs were in place provided breathing room in which the steel industry was able to consolidate itself and overcome some of its structural problems. Even though the US lost the case in the WTO, the outcome was a political win for the Republican party in the elections of 2002 and 2004.

The Steel Tariffs case thus demonstrates that even a lost case at the WTO can have a positive impact for potential target states. The public policy decision that led to the dispute and the eventual defeat and forced withdrawal of the policy was politically successful. This is a clear example of a member state's leaders undertaking a temporary defection from the system when the system conflicts with political survival (Rosendorff 2005), and eventually being forced to remove the offending policy. The removal came late enough that the survival objective was successful.

What is key here is that the decision to engage in behavior that leads a state to be

⁵¹ Both groups lost as only part of the rise in the cost of inputs could be passed on to the end users.

targeted in a trade dispute can often be very inexpensive compared to other policy alternatives. The pressure on leaders for protection by groups harmed by the market is continuous over time. Such pressure is always there. Protection is generally easily targeted to particular groups and the costs of such a policy are often low in an economic sense. The political costs are similarly low as the burden of such policies is borne mainly by competitors in other states that do not have a direct role in the leader's survival. The cost borne within the state is likely to be widely distributed and thus politically safe. In short, taking actions that make a state a likely target have clear political benefits and are often very cheap relative to other forms of policy. As the payoffs for these policies are nearly instantaneous (politically) they are relatively immune to the effects of institutional change. You need not worry if the institutions will survive or if there is uncertainty about the future if you get the clear benefit today.

The decision to initiate a trade dispute is very different. Political leaders are acting to enforce compliance with the trade regime in order to benefit their political supporters. The payoff for such a policy is contingent on the success of the effort. To get a payoff from a dispute, the dispute must be won and the offending policy in the other state changed. This takes time, which requires confidence in the survival of the political institutions, at least for long enough that the outcome of the dispute will have an effect.

A significant risk to political leaders following a change in institutions is the risk that the institutions may change again and that such changes may effect the ability of political leaders to retain power. The instability that is concomitant with changes in governing institutions raises the uncertainty in the minds of political leaders that the

system will survive. If the system that ensures the eventual return to power after an election loss is at risk of change or failure, political leaders' commitment to political survival must become focused on short term strategies. The longer a political system survives, the greater the confidence among political leaders that it will continue to do so. This confidence in the system leads political leaders to make increasingly long-term decisions to gain the support of key groups. As WTO dispute can take years to adjudicate and get results, a long-term perspective is necessary in order to make such disputes a viable policy option.

A further element in this process is that the political leaders can become increasingly confident in their calculations of the incentives of the other actors in the political process. As the regime consolidates over time, the uncertainty of political leaders and their supporters regarding the incentives of their fellow actors in the process is reduced. Both leaders and members of the winning coalition become increasingly confident in the existing institutions and their beliefs about the incentives of their fellow actors in the process.

For potential initiators, then, the endurance of the institutions of the regime will matter in their decisions to engage in trade disputes. The longer a set of institutions survives, the lower the uncertainty about the future. Political leaders can be confident that the regime will continue to exist in its current form, allowing longer-term decision-making. The political leadership and its supporters will also have had time to interact and reduce the uncertainty of incentives within the institutions.

As institutions endure, the lowered uncertainty lowers the effective cost of

initiating a dispute. This lowering of the uncertainty costs makes disputes more likely for states of greater endurance. This effect will also be affected by the degree to which a given state is open to pressures to engage in trade policy action. The broader the support base required, the more likely to engage in trade policy actions such as trade disputes.⁵² The longer a given set of institutions endures, the greater the likelihood that political leaders will engage in long-term policies. The greater the institutional endurance, the lower the uncertainty costs of trade disputes. Taken together, these imply that regime endurance should have a greater marginal effect at higher levels of democracy.

The preceding argument implies the following hypotheses:

- ***Hypothesis 5.1:*** As the durability of the institutions of a state increases, the probability of initiating a dispute will rise for potential initiators.
- ***Hypothesis 5.2:*** Institutional durability will have no significant effect for potential targets.
- ***Hypothesis 5.3:*** For potential initiators, the marginal effect of regime durability will increase as the level of democracy rises
- ***Hypothesis 5.4:*** For potential targets, the marginal effect of regime durability will not be significantly affected by democracy

5.3 Data and Method

This chapter estimates a series of six logit models to test the above hypotheses. These models are all standard logit models using panel-corrected standard errors to correct for temporal dependence (Beck and Katz, 1995; Beck, Katz, and Tucker, 1998). All of the models in this chapter follow this method.

The dataset used to test the above hypotheses is the same as that described in detail in Chapter Three and Chapter Four. The dataset consists of all of the member

⁵²

See Chapter Four

states of the GATT and WTO for the period from 1947 – 2000. The directed dyad year structure pairs all possible initiators with all possible targets for the period under consideration for the reasons discussed in Chapter Four. The operationalization of trade disputes, democracy, and the control variables follows the form discussed in detail in Chapter Four.

The durability of the regime is calculated using the Polity Dataset's durability variable for the given state in a given year. This variable is a count of the number of years since the last three point change in the Polity Democracy Scale has taken place in three or fewer years. The Polity durability variable thus gives the number of years since the last significant institutional change within the given state. As the first years following a transition are likely to have the largest impact on reducing uncertainty in the minds of leaders and other actors, the natural log of durability is included in the models.

To test the interaction effect of democracy and durability on the initiator and target states, a series of interaction terms are constructed. These interaction terms are included in the model and are the product of the included democracy and durability scores.

To account for the effect of the changed dispute settlement institutions described in Chapter Four, this model also includes a dummy variable for the WTO dispute settlement mechanisms.

5.4 Results

The results of the logit models estimated in this chapter provide significant

support for the four hypotheses stated above. In particular, the results demonstrate that durability is statistically significant only in the initiating state, and even then only when the initiating state scores highly on the Polity scale. The marginal effect of durability increases as the democracy of the initiator increases. Target durability is never a significant factor in the models, nor is there a statistically significant interactive effect of target durability and democracy.

The results for the six logit models estimated in this chapter are shown in tables 5.1 to 5.3. These tables begin with simple models of durability in Models one and two. Models three and four include the interaction term. Models five and six include the key control variables discussed in Chapter Four.

Without the inclusion of the interaction term or the controls we see that an initial model of just the effect of democracy and durability indicates that both democracy and durability are statistically significant and positive in BOTH the target and the initiator. The inclusion of the WTO dummy in model two yields a statistically significant and positive result for that variable as well. While in these models the results suggest that both initiators and targets are affected by durability, these models are incomplete given the discussion of the preceding sections.

Models three and four include the interaction terms in the analysis. In these models we see some changes. Importantly, without the inclusion of controls the interaction terms of both the initiator and target are significant and positive, indicating that the marginal effect of durability rises as democracy rises. For reasons of brevity, a

detailed breakdown of the interaction effects is not provided for these models.⁵³

Models five and six are the models of most concern here, and the most important in this discussion. These models include all of the important control variables discussed in Chapter Four. The inclusion of these controls is very important as these play a significant role in the dispute process under consideration. Table 5.3 includes the results for Models five and six. Model five includes durability, but excludes the interaction terms. Of most significance in Model five is the result for target durability. With the inclusion of the full range of controls, the target durability score has ceased to be statistically significant. This suggests that even without the interaction effect of democracy on durability included in the model, the target state's durability is not a significant factor in the decision to engage in trade disputes.

Model six is the full model and thus the one of most interest to us. Model six demonstrates that the control variables perform as expected. The results in the table also indicate that the interactive effect of initiator democracy and durability has the predicted significant and positive relationship. The results for our key variables of interest, democracy and durability are difficult to interpret from the results in the table. For this reason, additional results are displayed in Figures 5.1 to 5.4 to provide a more accurate interpretation of the results of Model 6.

Figure 5.1 displays a graph of the conditional z-score of democracy conditioned on durability. We see that in this graph, target democracy is statistically significant at all

⁵³ The details of the interaction effects, such as the conditional z-scores and marginal effects are not included as these models are still incomplete. The space required to examine these effects was not worth the additional attention of the reader (at least in the mind of the author) as the full models with controls do provide such details in the discussion of their results.

levels of target durability. Initiator democracy is statistically significant at most levels of durability, although at very low levels of durability, initiator democracy is not statistically significant. These results indicate that democracy remains consistently significant across all levels of durability for the target state and at most levels for the initiator.

Figure 5.2 displays the conditional z-scores of durability conditioned on democracy. The results here are more interesting. The conditional z-score for target durability is never statistically significant at any level of target democracy. This confirms the prediction in hypotheses 5.2 and 5.4. Target durability is not statistically significant. The significance of target durability is not conditional on varying levels of democracy. These results lend strong support to the prediction that durability is not a significant factor in the decision of leaders to engage in behavior likely to lead to being targeted in a dispute.

Figure 5.2 also displays the conditional z-scores of durability conditioned on democracy for the initiating states. In this case, the z-score indicates that the effect of durability on the likelihood of a dispute is conditioned on the level of democracy in the potential initiator. The z-score increases as democracy increases, becoming statistically significant at five on the polity scale. This offers limited support for hypothesis 5.1 and strong support for hypothesis 5.3 in that the impact of initiator durability is statistically significant, but this statistical significance is conditioned on the Polity democracy score of the state in question. The relationship is only statistically significant at scores above five on the Polity scale. This implies that durability matters, but only for states in which the institutions are relatively highly democratic.

Figure 5.3 displays the conditional marginal effect for the durability of the initiator at various levels of democracy, including 95% confidence intervals. The line trends upwards indicating that the marginal effect increases as democracy increases. At the levels of democracy where the relationship is statistically significant (five and above) the results are a rising marginal effect as democracy rises. This provides strong support for hypothesis 5.3 as it demonstrates that the marginal effect of durability rises as democracy rises.

The substantive impact of this is shown in Figure 5.4. This figure displays the predicted probability of a dispute for states based on their relative levels of durability. States are divided into their position relative to the quartiles of initiator durability. All states in the bottom quartile are listed as the “lower quartile” group on the figure. States whose durability places them in the interquartile range are listed as such in the figure. Likewise states in the upper quartile are listed as such in the figure.⁵⁴ For most of the range of democracy, the predicted probability of a dispute remains relatively close for the three groups. When the conditional relationship between democracy and durability becomes statistically significant at five on the Polity scale, the groups separate, with the lower quartile group having the lowest predicted probability of a dispute and the highest quartile group having the highest.

Overall, these results strongly support the four hypotheses stated earlier.

Durability matters for highly democratic initiators, but not for less democratic ones. The

⁵⁴ Quartiles are used here due to the extreme skewness of the distribution of durability scores. There is a very long right handed tail to the distribution and the use of mean and standard deviation is problematic due to the very large number of outliers. The use of quartiles was a more useful form of categorization.

effect of durability is conditioned on the domestic institutions of the state. In targets, durability is not a significant factor in determining dispute prevalence and this is consistent across all levels of democracy.

5.5 Conclusions

The institutional environment in which leaders operate has complex effects on how they make policy decisions. The durability of the institutions reduces uncertainty in the minds of political leaders as to the potential outcomes of disputes. The more durable the institutions, the greater the likelihood of a dispute, but not in all cases. It is only in states that possess highly democratic institutions that this effect is significant. When states do not require large bases of support to gain and retain power, the impact of regime durability is not significant. For target states, the temptation to choose political survival over commitments to international institutions is a constant force that must be considered by political leaders. This pressure is independent of the durability of the institutions. The durability of institutions does not significantly effect the propensity to be targeted.

This implies that the institutional relationship at the domestic level is complex. Democracy matters, but the characteristics of those democratic institutions matter also, but not in all cases. The results presented in this chapter demonstrate that the institutional incentives presented at the domestic level significantly effect policy outcomes. In states in which political leaders must seek large winning coalitions, they will choose policy options that maximize survival within their budget constraints. When the costs are relatively high, leaders will seek other policy options. When these costs are lowered by

the reduction in uncertainty, political leaders make more frequent recourse to the dispute settlement mechanisms available to them within international institutions.

While Chapter four demonstrated that the international institutional change affected the behavior of political leaders, this chapter demonstrates that domestic characteristics beyond simply the size of the support base required to retain the leadership can also affect the behavior of political leaders. In the complex calculations of political survival, it is the mix of institutional characteristics that determine the behavior of political leaders and their eventual policy outcomes.

Table 5.1: Basic Models of Durability

	Model 1	Model 2
Initiator Democracy	.139*** (.011)	.136*** (.012)
Target Democracy	.178*** (.012)	.178*** (.013)
Initiator Democratic Durability (log measure)	.546*** (.085)	.588*** (.087)
Target Democratic Durability (log measure)	.583*** (.081)	.625*** (.082)
WTO Dummy	n/a	1.114*** (.111)
Constant	-10.401***	-11.174***
X ²	588.31***	739.77***
Log Likelihood	-3115.68	-3035.58
N	260,804	260,804

* significant at .05 level ** significant at .01 level *** significant at .001 level

Results are logistic regression coefficients with panel corrected standard errors in parentheses. Cubic splines are computed, but not shown in the interest of parsimonious tables.

Table 5.2: Basic Interaction Models

	Model 3	Model 4
Initiator Democracy	-.004 (.027)	-.030 (.028)
Target Democracy	.103** (.038)	.084* (.040)
Initiator Democratic Durability (log measure)	.059 (.095)	.035 (.099)
Target Democratic Durability (log measure)	.336** (.114)	.321** (.122)
Initiator Democracy / Durability Interaction	.058*** (.010)	.066*** (.011)
Target Democracy / Durability Interaction	.028* (.014)	.035* (.015)
WTO Dummy	n/a	1.157*** (.110)
Constant	-8.681***	-9.144***
X ²	645.59	856.16
Log Likelihood	-3094.66	-3009.42
N	260,804	260,804

* significant at .05 level ** significant at .01 level *** significant at .001 level

Results are logistic regression coefficients with panel corrected standard errors in parentheses. Cubic splines are computed, but not shown in the interest of parsimony.

Table 5.3: Full Models With Controls

	Model 5	Model 6
Initiator Democracy	.107*** (.016)	-.021 (.026)
Target Democracy	.124*** (.018)	.080* (.033)
Initiator Democratic Durability (log measure)	.225*** (.060)	-.196* (.095)
Target Democratic Durability (log measure)	.061 (.050)	-.075 (.010)
Initiator Democracy / Durability Interaction	n/a	.054*** (.010)
Target Democracy / Durability Interaction	n/a	.017 (.013)
WTO Dummy	1.044*** (.128)	1.097*** (.126)
Initiator GDP (log measure)	.645*** (.060)	.668*** (.061)
Target GDP (log measure)	.386*** (.064)	.393*** (.064)
Initiator Total Trade (log measure)	-.175* (.074)	-.204** (.074)
Initiator Dyadic Trade Percentage	2.799*** (.479)	2.699*** (.471)
Target Total Trade (log measure)	.205** (.078)	.207** (.077)
Target Dyadic Trade Percentage	.480 (.530)	.166 (.545)
Years without dispute	-.229*** (.054)	-.225***
Constant	-13.695***	-12.422***
X ²	1903.79***	1939.56***
Log Likelihood	-2034.40	-2020.59
N	259, 957	259, 957

* significant at .05 level ** significant at .01 level *** significant at .001 level

Results are logistic regression coefficients with panel corrected standard errors in parentheses. Cubic splines are computed, but not shown in the interest of parsimony.

Figure 5.1: z-score of Democracy Conditioned on Durability

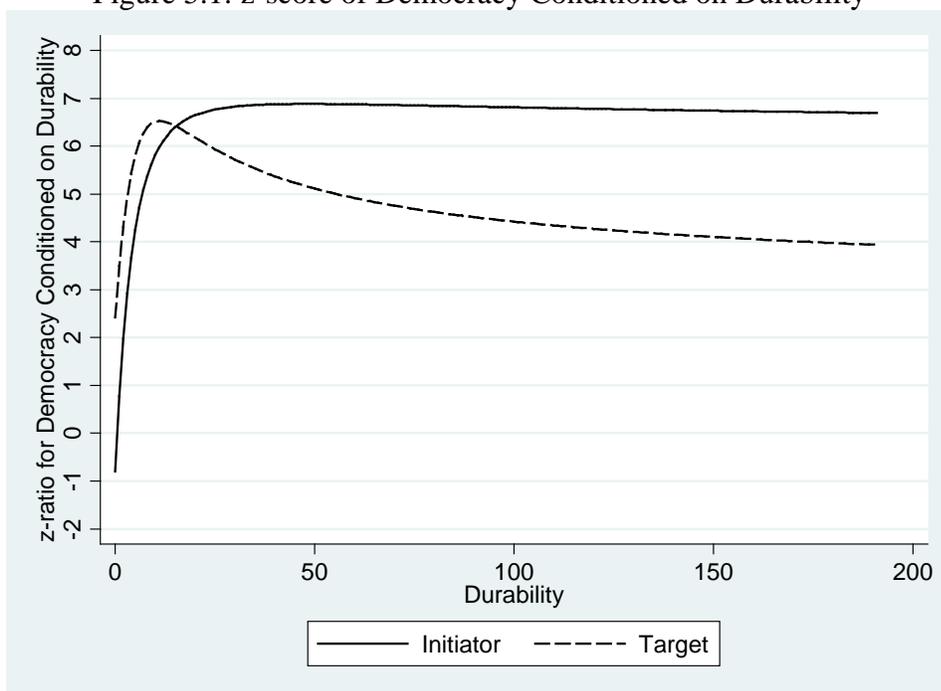


Figure 5.2: z-score of Durability Conditioned on Democracy

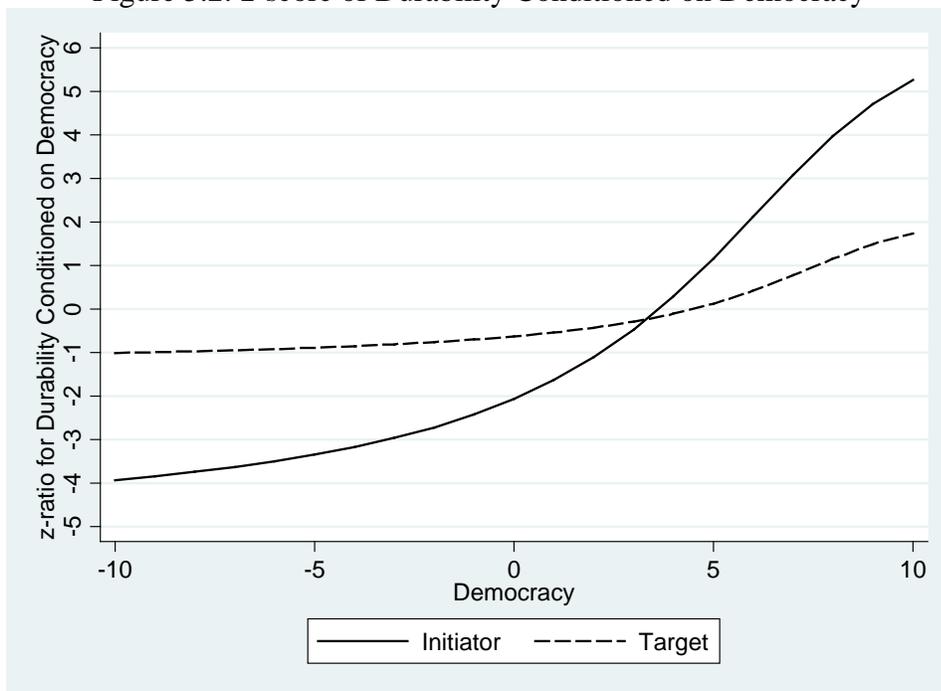


Figure 5.3: Marginal Effect of Durability Conditioned on Democracy

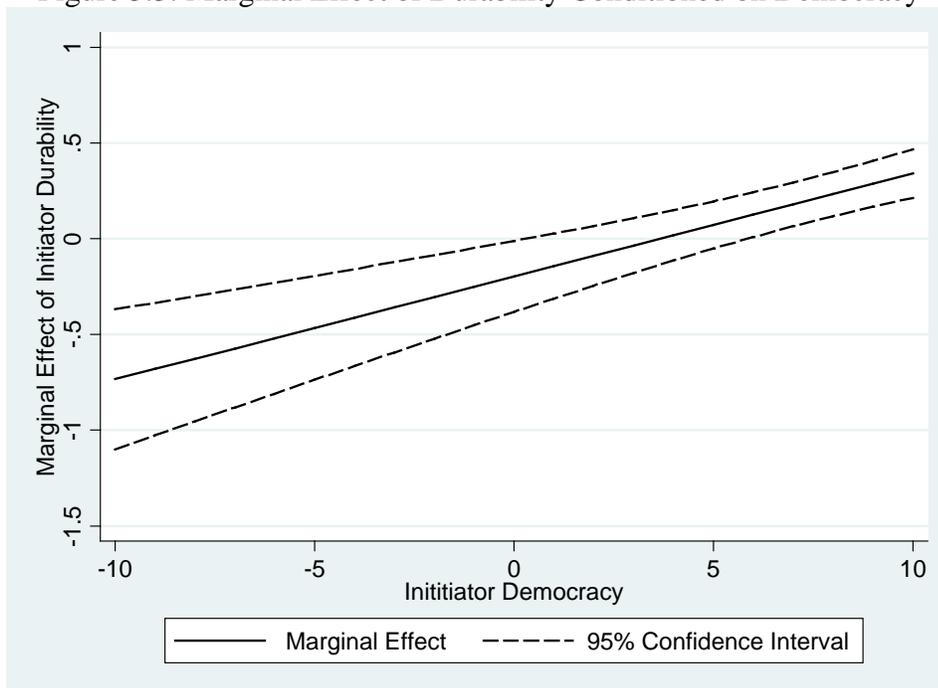
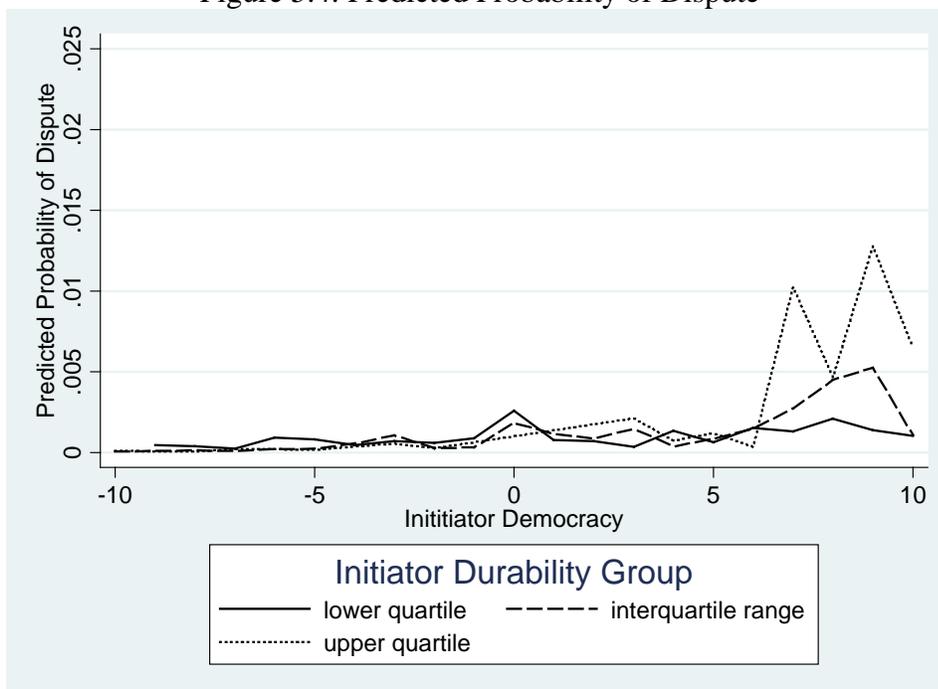


Figure 5.4: Predicted Probability of Dispute



CHAPTER 6: ROBUSTNESS CHECKS AND MODELING ISSUES

A central issue of concern in any statistically based analysis is proper specification of how to operationalize complex real-world observations into testable data (King, Keohane, Verba 1994; Goertz 2006). In many areas of political science research scholars can fall back on a long tradition in the literature on the operationalization of key concepts and events in their statistical designs.⁵⁵ In the study of trade disputes, no such consensus exists. This presents potentially important questions about how the choice of model specification may affect the results. This is of particular importance given that the few published works focusing on trade disputes in this form (Reinhardt 2001, 2002; Sherman 2002) do not use a common method of operationalizing several of the key elements of the dispute process.

This chapter seeks to allay the concerns regarding problems of specification and robustness that might otherwise arise given the lack of clear consensus in the literature on how to deal with these questions. This chapter seeks to test alternative specifications of several of the major concepts embedded in the empirical tests in chapters four and five. This chapter will focus on several of the key problems of specification raised in chapter three, specify alternative methods of specification, and test these alternative specifications to determine what, if any, differences these specifications make in the analysis of the key hypotheses in chapters four and five.

This chapter will address several key concerns. The first three concerns relate to

⁵⁵ Militarized interstates disputes, third party interventions, wars, gravity models for trade, to name a scant few of many areas in which there is an accepted set of tools for operationalization of key concepts. While the author grants that there are often flaws to these conventions, the basic point to follow is not affected by this issue.

the inclusion of all GATT/WTO member states in the analysis. It can be argued that only states that actually trade with each other can experience trade disputes. The analysis that appears in chapters four and five includes all GATT/WTO member states, including those that do not actually trade with each other. Models are estimated in this chapter that exclude states between which there is no trade. The second and third concerns are related to the fact that the United States and the European Union experience a significant number of disputes both as initiators and as targets. Given the large number of disputes between these two members, it is possible that the results are being driven by these two entities. A model is estimated that drops all dyads containing the US and EU. A second model is estimated that drops only the dyads in which the US and EU dispute with each other, but allowing disputes (as initiators and as targets) with other states.

The question of how to operationalize the EU is a major one. The EU is like no other member of the GATT/WTO system. It is not a nation state or a customs area within a larger state. It is the aggregate representation of a group of nation states that act collectively. While the process of decision making in the EU mirrors that of large federal states like the US or Germany, it is not entirely the same creature. As such, it is possible that aggregating the EU is not the proper way to operationalize its disputes. Neither Reinhardt (2001) or Sherman (2001) operationalize the EU this way. An alternative specification would be to include the EU member states as individual members and consider their disputes to be multilateral disputes both as the initiators and as the targets. Models are estimated that include the EU as separate member states engaged in multilateral disputes.

Lastly, there is a key question as to whether the dispute is the proper dependent variable at all. The existence of the consultation stage of the process may suggest that a dispute is merely an extension of bilateral negotiations between the parties. It is a signal of seriousness, but not the key moment in the process. The key moment in the process is the recourse to the impartial adjudicator that takes place at the panel stage. To test how this affects the results, models are estimated using the empaneling of the dispute as the dependent variable rather than the request for consultations.

This chapter demonstrates that the key findings related to the impact of two-level institutional interaction is robust across a wide range of alternative models of the data. While the results are not exactly the same across all alternative specifications, the core results discussed in chapters four and five: that the incentives provided by institutions at the international level interact with those at the domestic level in predictable ways to affect decision-makers' behavior is consistently demonstrated by these models. The findings in the previous chapters are quite robust across alternative specifications and alternative models.

6.1 Alternative Decisions

This chapter takes five decisions made in the process of designing the empirical models in the previous chapters and test the impact of alternative decisions. The existing literature on trade disputes and the analysis of institutions in the process is small and there is not yet any consensus as to the appropriate ways of turning these processes into statistical models. What follows is a discussion of several of these areas and how the

alternative models tested in this chapter incorporate these concerns. Table 6.1 summarizes the different alternative models used in this analysis. They are more fully explained in the following sections.

6.1.1 Trading States

In order for states to have trade disputes, they need to trade with each other. At first glance, this would seem to be an obvious element of any analysis of trade disputes. If there is no trade, there can be no disputes, and thus the dyads in which there is no trade are dyads in which a dispute is impossible. This is a very reasonable argument, but one that is problematic in the face of complex interdependence as we observe it today.

The theory of trade disputes that is fully outlined in chapter 2 of this project discusses the key role that interest groups play in pressing political leaders for action. These interest groups are politically important in the states that is being pressed for action. While in most cases these interest groups will have domestic operations tied to the global market and that are affected by decisions by other states, this is not necessarily the case. It is possible for a multinational corporation headquartered in country A to have operations in country B that are affected by the decisions of country C. Country A need have no trade relations at all with country C in this case for the MNC to experience negative effects of country C's policies and lobby country A's political leadership for assistance. This may be especially true of country B is small and lacks the resources to engage in trade disputes as a means of policy. A similar situation has, in fact, occurred. The United States does not export bananas to Europe. American companies operating in

Latin American do. The banana war, one of the longest and most difficult trade disputes to date, was largely fought between the US and the EU. It was the interest of the American MNC's that drove the US to press the dispute even though the trade in question was between Latin American and Central American states and not at all between the US and the EU (Josling, 2003).

It is thus possible for trade disputes to exist between states that do not actually trade with each other at all. Dyads in which no trade takes place represent approximately 30% of the total dyads of the GATT/WTO membership since the founding of the trade regime. While it is possible for disputes to exist where there is no trade, no such disputes exist in practice. Even the Banana War did not represent a case where NO trade existed between the parties. No trade related to the subject of the dispute existed, but trade between the US and the EU is extensive overall. Thus, while the theoretical potential for trade-free trade disputes exists, we have yet to see one happen in reality.

This raises an important question. Should such trade-free dyads be excluded from the analysis of the dispute process? If no such dispute has ever taken place and the mechanisms for enforcement in the absence of direct harm to the parties would mean essentially no enforcement of the dispute even if successful, aren't we just including dyads that over represent a zero outcome?⁵⁶

This argument has some credibility and is worth exploring in the context of a chapter like this one, examining robustness. A model to test the key hypotheses of

⁵⁶ While the GATT/WTO system does not have clear rules on “standing” to initiate a dispute, the enforcement mechanism of the WTO is built on retaliatory sanctions as a punishment for harmed states. The amount of these sanctions is based on the harm done to the country's economy. In the absence of trade

chapters four and five is thus estimated using only the states that have trade relations. This model drops all non-trading dyads from the analysis. As mentioned above, this results in a roughly 30% drop in the number of dyads. This model is referred to in the subsequent sections as the “Trading States” model.

6.1.2 The US and EU Bias

At every conference where previous work contributing to this project has been presented, the issue of the US and EU has been raised. It comes in the form of “The US and the EU are the largest economies in the world. They have the most trade with each other and the rest of the world. They also have far and away the most mutual disputes. Aren't your results just an artifact of the US and EU?” There is some validity to this as these two entities dominate the dispute process in a variety of ways due to their economic strength, their wide-ranging trade relationships, and the fact that both have teams of lawyers whose jobs are to engage in trade disputes, largely with each other.

It is possible then, that the large number of US and EU disputes are warping the statistical results. To account for this, two models are estimated that address the problem of the US and EU weighting the results. The first model (hereafter called the “US and EU Removed” model) drops all dyads in which the US and EU appear. This results in the complete removal of the US and EU from the models. While this decision has problems of its own, it eliminates the chance that the US or EU or the combination of the two could be skewing the results.

such calculations would be difficult at best, and inevitably zero at worst. If retaliatory sanctions of no

A second model addressing the US and EU is a model that drops the US vs. EU dyads, but leaves the US and EU dyads in which they are paired with all other states. In other words, India vs. US remains in the model, as does US vs. India. The key here is that the US and EU can still play a role, but the large number of mutual US vs. EU dyads are removed. This is a compromise model designed to retain the the two states in part so as not to entirely remove the two largest trading economies from the analysis. This model is referred to as the “US vs. EU Removed” model.

6.1.3 That Pesky EU

The EU is a problem. It is a contracting party to the GATT and WTO. It is the sole representative party for its member states in trade matters, including GATT and WTO disputes. The problem is that the EU is not a state. It is an intergovernmental organization. At the same time, it reflects an integration of policies that has no equivalent in any large organization in the world. This is a problem for statistical analysis. The solution to this problem used in chapters four and five is to aggregate the EU and treat it as a single entity for reasons fully explained in chapter three.

At the same time, previous research has kept the EU disaggregated and included disputes involving it as multilateral disputes involving all member states (Reinhardt 2001). This is an important research design decision with potentially important results in the statistical models. In this chapter on robustness checks, a model is included that specifies the EU member states as separate entities. Their disputes are coded as

value are the best enforcement hoped for, the cost of the dispute may never be worth the trouble.

multilateral disputes between all EU members and the other state in the dyad. This includes both initiations by the EU and the targeting of the EU by other states. The result is an increase in the number of disputes under the coding rules that include all parties to the dispute.⁵⁷ The nature of the existing data does not allow for the disaggregation of the EU states with any more precision than this as the data includes only the code “European Communities” for dyads in which the EU is a participant.⁵⁸

The models estimated using the EU states as separate entities are referred to as “Disaggregated EU” models. These models follow the baseline analysis that appears in chapters four and five, but with the EU member states considered as separate states engaged in multilateral disputes.⁵⁹

6.1.4 What's a Dispute?

While there is agreement in most of the literature on trade disputes at the GATT and WTO that the original coding rules set by Hudec (1993) are the standard for such research, there is an alternative specification that is suggested by interpreting signaling arguments related to trade disputes. The consultation stage of the dispute process is essentially a continuation of bilateral (or multilateral if the dispute involves multiple

⁵⁷ See Chapter 3

⁵⁸ It is also likely that in many cases, the nature of the dispute would make it unclear as to who they key parties to the dispute were. As an example in the banana war it was primarily the offending regime had existed in individual member states, while other member states had been open to trade from all banana producers. It was the extension of the restricted regime to all EU states under the Single European Act that created the conditions for the Banana War. In this case it is unclear who the offending states within the EU would be if one were to try and separate the Banana War to include only the relevant EU states. In short, it may not be possible under present conditions to determine conclusively which individual member states were involved in any EU related trade dispute.

parties) negotiations between parties. The parties have presumably already been engaged in negotiations prior to the formal request for consultations as leaders should at least try the low cost bargaining process before resorting the higher cost GATT/WTO process. Thus, at least theoretically, it can be argued that the consultation stage is an extension of existing negotiations. What it represents is a signal of resolve to the other party rather than a desire to become engaged in a costly legal process. Only half of the requests for consultations result in the formation of a panel, so the consultation stage is often as far as disputes ever go.

In addition, the impartial dispute settlement portion of the process does not begin until the panel stage. The consultation stage is simply the formal requirement that the two sides of the dispute discuss the process. Thus there are both cost based and norms based reasons that it may be better to use the panel as the indicator of the dispute. To test whether the use of the panel as the dependent variable changes the results of the analysis, two models are estimated and presented using the panel as the dependent variable in the analysis in place of the request for consultations. In the “panel” models, a dispute is coded as “1” if a panel is requested and “0” if a panel is not requested.

6.2 The WTO DSM

Chapter four tests the impact of the change from the GATT to the WTO on the decisions of political leaders. The findings discussed in chapter four demonstrate that the

⁵⁹ All of the alternative models were estimated for the disaggregated EU states. These results are not presented here for reasons of parsimony as the overall pattern is the same as that observed in the baseline models. The trend across robustness checks is the same for both operationalizations of the EU.

institutional change to from the GATT to the WTO has a increasing marginal effect as the level of institutional democracy rises. The effect of the WTO institutional change was statistically significant for states that score higher than zero on the Polity scale and that the marginal effect rises as states scores on Polity rise as well. This finding is robust across all of the alternative models.

Table 6.2 provides the basic statistical results for the various model specifications. The models are relatively consistent at first glance. Democracy of both the initiator and targets are statistically significant and positive. The WTO dummy variable is reported as statistically insignificant across all the models. While the initiator / WTO interaction is statistically significant and positive in most models, in the US and EU removed models, the interaction term is not significant. Similarly the target interaction term is not significant in any of the models. As discussed in previous chapters, however, the inclusion of the interaction terms requires that we look at much more than just the basic table in order to understand the results.⁶⁰

To examine the statistical significance of the results across the models it is necessary to look at the conditional z-scores of the WTO DSM across varying levels of democracy. Figures 6.1.1 to 6.1.5 display the conditional z-scores for the five models that appear in Table 6.2. When looking at the conditional z-scores across the models we observe that there is a consistent relationship across all five of the models. In all five models the conditional z-scores fall below the level required for statistical significance across the entire range of target democracy. This demonstrates that the effect of the WTO

DSM is not statistically significant at nearly any level of target democracy in nearly any model.⁶¹

The z-scores for the WTO DSM across the range of initiator democracy shows a consistent relationship across all five models. The z-score rises as Polity rises, becoming statistically significant at zero on the Polity scale in most models.⁶² This supports the findings presented in chapter 4 that the change to the WTO DSM was significant for initiating states at higher levels of democracy. The support for the hypothesis that initiating states are more likely to be affected by the change to more robust dispute settlement institutions is consistent across all five models.

Similar to the results for the z-scores, the marginal effects of initiator democracy are consistent across all five models. The conditional marginal effects for the five models are displayed in figures 6.2.1 to 6.2.5. Across all five models, the marginal effect of democracy rose as the initiating state's Polity score rose. The slope of the rise was relatively consistent across models. The disaggregated EU model showed a negative marginal effect at low levels of initiator democracy, but only for Polity scores for which the corresponding z-scores were not statistically significant. As with the results relating to the z-scores, we see strong support for the results in chapter four across these alternative models.

Given the results for the z-scores and the marginal effects, it is not surprising to see that the predicted probabilities across these alternative specifications show similar

⁶⁰ The discussion of interaction terms in chapters four and five highlights the importance of “looking beyond the table”. (Brambor, et al. 2006)

⁶¹ In the US and EU removed model the z-score is statistically significant at low levels of democracy, but ceases to be statistically significant at 0 on the Polity scale.

support for the results in chapter four. Across all five models, the predicted probability of a dispute under the WTO regime is much greater than that for the GATT regime and the gap widens the higher the Polity score of the state.⁶³ This broadly demonstrates the robustness of the findings of chapter four across these alternative specifications.

6.3 Durability

Chapter five tests the impact of the durability of the political institutions on the impact of democracy in predicting GATT and WTO disputes. The findings show that for initiating states, the longer a particular set of institutions is in place, the more likely the political leaders are to initiate trade disputes and that this effect is stronger the higher a state scores on the Polity scale. Chapter five further demonstrates that while democracy remains significant across all levels of durability for target states, durability is not significant at any level of target democracy. In short, durability and democracy are mutually reinforcing for initiators, but not for targets.

Table 6.3 gives the basic statistical results for the replication models for chapter five. These results are consistent with the pattern observed in the robustness check models for chapter four with two exceptions. In the EU disaggregated model the target state durability / democracy interaction is statistically significant and positive. In the US and EU removed model, the initiator durability / democracy interaction is statistically

⁶² In the disaggregated EU model, the z-score crosses the significance threshold at 4.

⁶³ While the results are broadly the same, the disaggregated EU model shows a slightly different shape in the curve as Polity rises and it does not share the fall-off from scores of 9 to 10 that is observed in the other models.

insignificant at all but the highest levels of initiator democracy.⁶⁴ While there is more variation here than in the results for chapter 4, the models generally reproduce the results observed in chapter 5.

Figures 6.4.1 to 6.4.5 display the z-scores for democracy at various levels of durability. Across all of these models, target democracy is statistically significant across all levels of durability. Initiator democracy is statistically significant across most of the range of durability, although across all models initiator democracy is not significant at the very bottom end of the range of durability. These models demonstrate that the statistical significance of democracy is consistent across durability.

Durability shows more variation in the results than does democracy. Figures 6.5.1 to 6.5.5 display the z-scores for durability conditioned on democracy. The results for initiator democracy are consistent across the models. The z-score is below the threshold of statistical significance at low and moderate scores on the Polity scale. As the Polity score rises, the z-score passes the significance threshold at five in most models.⁶⁵ Initiator durability has a statistically significant impact only at high levels of democracy across all models. Target durability is more complicated. In the baseline model, trading states model, and the US vs. EU removed models the results are consistent with target durability never reaching the threshold for significance at any level of democracy. In the US and EU removed model, the z-score for target durability does not ever cross the threshold of significance, but the curve is downward sloping as the Polity score rises,

⁶⁴ The z-score does not become statistically significant until 9 on the Polity scale.

⁶⁵ As previously mentioned, the z-score becomes significant only at 9 on the US and EU removed model.

unlike the first three models mentioned. The disaggregated EU model has a similar downward slope, but in this model, target durability is statistically significant at all levels of democracy, dropping close to, but not falling below the threshold at ten on the Polity scale.

In the marginal effects of initiator durability at various levels of democracy we see consistent results. In each of the five models we see the marginal effect of durability rising as the Polity democracy score rises. The models are consistent with the results in chapter 5. As we found target durability to be statistically significant across all levels of democracy, Figure 6.6.6 displays the marginal effect of target durability on democracy. The result is a declining marginal effect of durability as democracy rises.

As in chapter five, the predicted probabilities are complicated by the skewed distribution of the data. The predicted probabilities displayed in Figure 6.7.1 to 6.7.6 follow the same format as was used in chapter five. The results are displayed for the upper and lower quartiles of dyads and for the dyads in the interquartile range. These figures demonstrate that the resulting predicted probabilities, while showing slight differences in the curves are generally consistent with the results of chapter five that the predicted probability of a dispute is greater for dyads in higher durability quartiles than in the lower quartiles.

The results of these models are broadly consistent with the results of chapter five, although there are some key differences. The major difference is the result for the disaggregated EU model that shows a statistically significant and negative conditional effect of durability on democracy for target states. This implies that the effect of

durability is different in this model than in the others. While this is most likely the result of the over-representation of highly democratic states resulting from the inflation of the number of disputes through the disaggregation of the EU, this is nonetheless an interesting finding in this model. It deserves exploration in future work.

6.4 Panels as the Dependent Variable

The final group of models examined in this series of checks on robustness somewhat different from the rest in that the basic dependent variable in these models differs from that found in the earlier models. These models use the escalation of dispute from the consultations stage to the panel stage as their dependent variable. Models using the panel as the dependent variable were estimated for the full baseline models in chapter four and five.⁶⁶

Table 6.4 summarizes the results of the panel models. The results using empaneled disputes as the dependent variable are similar to those in the equivalent baseline model. The key difference here is that the interaction term for the target state is statistically significant in the basic table. At first glance this raises questions regarding the basic logic of chapter four when the panel is used as the dependent variable. This question is resolved when looking at the more detailed results. Figures 6.8.1 to 6.8.3 display the results for the panel model of the analysis in chapter 4. Figure 6.8.1 displays the z-scores of the WTO DSM conditioned on the democracy scores of the initiator and

⁶⁶ Models with the panel as the dependent variable were also estimated using the disaggregated EU method. The results varied in the same manner as those for the consultation stage. As the variation between the models was of the same form for the consultation stage and the panel stage operationalizations, the disaggregated EU models are not presented here.

target states. The conditional z-scores for the WTO DSM conditioned on target democracy displayed in this figure never cross the threshold of statistical significance. At no point on the Polity democracy scale is the WTO DSM significant. This indicates that the summary table's results are misleading.

The z-score of the WTO DSM conditioned on initiator democracy follows a curve similar to that observed in the consultation stage models, but with the z-score becoming statistically significant at a higher level of initiator democracy. In the baseline model the z-score crosses the threshold at zero on the Polity scale.⁶⁷ In the panel model, the z-score crosses this threshold at five on the Polity scale. Thus in the panel model we observe a shift in the point at which the influence of the WTO DSM becomes significant, but the basic trend of the curve remains the same.

A similar effect takes place in the conditional marginal effects of the panel model. Figure 6.8.2 displays the results for the marginal effect of the WTO DSM conditioned on levels of initiator democracy. While the curve begins in the negative range at low levels of democracy in the panel model, at the levels of democracy that are statistically significant the marginal effect is positive. The overall trend for the marginal effect is that it rises as the Polity democracy score rises. This is consistent with the trend observed in the marginal effect of the consultation stage model.

The results for predicted probability for the panel models follows a trend similar to those for the z-scores and marginal effects. The predicted probability of a panel, while smaller than that for a dispute, follows the same trend. Figure 6.8.3 displays the

⁶⁷ See Figure 6.1.1

predicted probability of a panel being formed at various levels of initiator democracy for both the GATT and WTO DSM's. The result is essentially the same as that in the consultations stage models.⁶⁸

The results of the models replicating the analysis from chapter four with the panel as the dependent variable thus demonstrate that the analysis from the baseline model of chapter four are confirmed when using the panel stage rather than the consultation stage as the dependent variable. While the change to the WTO DSM is only statistically significant at high levels of democracy, the effect is the same as that observed in the consultations models.

The results for the analysis of chapter five largely follow the same pattern as those for the analysis in chapter four. Table 6.4 summarizes the results for the chapter five model. These overall results are the same as those in the baseline model. The initiator durability measure is significant and negative.⁶⁹ The Interaction term for initiator democracy / durability is significant and positive. The WTO dummy variable is significant and positive. Figure 6.8.4 displays the z-score for the democracy scores of the initiator and target conditioned on durability. The z-score of democracy conditioned on durability is significant across the entire range for target states and for all but the lowest durability scores for initiating states. This is wholly consistent with the z-scores in the baseline model.⁷⁰

Figure 6.8.5 displays the z-scores for durability conditioned on democracy for

⁶⁸ The scale of the Figures 6.8.3 and its consultation stage counterpart, Figure 6.3.1 are the same for ease of comparison across tables.

⁶⁹ As noted elsewhere, this reflects the marginal effect of the initiator durability score at the point where democracy is zero. See Figure 6.8.6 for the marginal effects.

both initiators and for targets. The results are very similar to those in the baseline model.⁷¹ The z-score of target durability is not significant at any level of target democracy as in the consultation stage model. The z-score for the initiating state crosses the statistical significance threshold only at seven on the polity scale. This compares to a crossing of the threshold at six in the consultation stage model. The results are consistent across the two specifications of the dependent variable.

As in the z-scores, the marginal effects are nearly identical to those observed in the consultation stage models. Figure 6.8.6 displays the conditional marginal effect of durability at various levels of democracy. The predicted probability of a dispute follows the patterns of the other results for the panel models. Figure 6.8.7 displays the predicted probability of a panel for the quartile groups of initiator durability. These follow a pattern that closely resembles that for the consultations stage models.

On the whole, the substitution of the panel stage for the consultation stage in determining the existence of a dispute made little practical difference in the outcome of the analysis. The results were consistent across both specification of a dispute. This lends further support for the basic results. It also suggests that while the panel is an escalation of the dispute, it is subject to the same basic institutional pressures as the decision to request consultations.

6.5 Robustness

Overall, the findings in this study are robust across a range of competing

⁷⁰ See Figure 6.4.1

alternatives. Different decisions regarding the population of cases to examine have only a minor impact on the statistical results in most cases. The major shifts in the results come in the case of decisions regarding the EU. Even in these cases, the underlying problem devolves to one of theory. There is no way of determining in a concrete way whether the aggregated or disaggregated EU models are superior to the other. Both survive the standard tests for model viability and both produce substantially similar results regarding the hypotheses contained in this study.

In resolving the issue of the EU, this author returns to the basic theory of this work. Institutional incentives at multiple levels affect the decision-making process of political leaders. Within the GATT/WTO system, it is the contracting parties that make the decision to engage in or not engage in an initiation of a dispute. It is the contracting parties that are targeted in a dispute. Under these rules, the EU is the contracting party that is responsible for the resolution of the issues related to all of its member states. It is the EU that initiates a dispute, the EU that is targeted in a dispute. It is the internal, institutional process of the EU that provides the incentives for political leaders to make decisions regarding trade disputes and it is the EU as a whole that should be the focus of institutional scholars in analyses that seek to understand the role of institutions on behavior.

From a methodological standpoint, the choice is likewise clear. The inclusion of all the member states of the EU as jointly engaged in a multilateral dispute inflates the number of states involved in disputes as well as greatly increasing the number of disputes

⁷¹ See Figure 6.5.2

engaged in by advanced industrial democracies. This will create biases in the analysis that can affect the results. Given the choice of potentially over representing advanced democracies or under representing them, this author opts for the later. Over representation creates more problematic biases in the data and creates more uncertainty regarding the validity of results. If democracy is under represented, but still shows itself to have a significant role, we can be more confident in the results.

On the whole, the alternative models and specifications in this chapter have shown that the two core institutional effects on political leaders are robust across various alternative specifications. The role of institutions in shaping the decision making of political leaders in trade disputes is consistent across a range of alternatives. This suggests that we can be confident in the role that institutional interactions play in shaping the decision logic of political leaders. Perhaps most importantly, at least to the author, is the confidence that this imparts in the key findings in chapters four and five.

Table 6.1: Summary of Replication Models

Model	Summary
Baseline Model	The models as they appear in their respective chapters (4 or 5). These results are the same as those that appear in the chapter in question.
Trading States	These models are estimated only for the dyads in which trade exists between the states in the dyad.
US and EU Removed	All dyads containing the US and EU are removed. The remaining dyads represent all the remaining members in directed dyads.
US vs. EU Removed	Only the dyads of US vs. EU are removed. The US vs. all member states other than the EU and vice versa are included.
EU States Separate	These models treat the EU member states as separate states engaged in a multilateral dispute against the adversary either as joint initiators or as joint targets.

Table 6.2: Replication Models for Joint Effects of WTO DSM and Democracy

	Baseline (Ch. 4)	Trading States	US and EU Removed	US vs. EU Removed	EU States Separate
Initiator Democracy	.098*** (.019)	.098*** (.019)	.128*** (.035)	.100*** (.019)	.084*** (.010)
Target Democracy	.167*** (.033)	.164*** (.032)	.154** (.041)	.169*** (.033)	.196*** (.024)
WTO Dummy	.859 (.483)	.895 (.483)	1.380 (.049)	.877 (.483)	.339 (.305)
Initiator Democracy / WTO Interaction	.079* (.038)	.077* (.037)	.053 (.064)	.075* (.037)	.063*** (.017)
Target Democracy / WTO Interaction	-.063 (.039)	-.063 (.038)	-.078 (.049)	-.066 (.039)	-.045 (.030)
Constant	-13.655 (.712)	-13.412 (.716)	-14.017 (.983)	-13.699 (.709)	-17.031 (.492)
X ²	2013.7***	1920.0***	660.1***	1987.7***	3176.3***
Log Likelihood	-2042.012	-2036.074	-882.682	-2002.167	-5247.466
N	259,957	184,573	248,095	259,895	306,496
<p>* significant at .05 level ** significant at .01 level *** significant at .001 level Results are logistic regression coefficients with panel corrected standard errors in parentheses, coefficients for splines are not reported in the interest of parsimony. The control variables are omitted from this table as they are consistent across models and are not the key elements of interest. They detailed results are available upon request.</p>					

Table 6.3: Replication Models for Joint Effects of Democracy and Durability

	Baseline (Ch. 5)	Trading States	US and EU Removed	US vs. EU Removed	EU States Separate
Initiator Democracy	-.021 (.026)	-.022 (.026)	.014 (.042)	-.024 (.026)	-.055*** (.013)
Target Democracy	.080* (.033)	.077* (.033)	.119* (.048)	.082* (.033)	.274*** (.047)
Initiator Durability (log measure)	-.196* (.095)	-.197* (.094)	-.235 (.152)	-.197* (.095)	-.371*** (.052)
Target Durability (log measure)	-.075 (.010)	-.078 (.119)	-.144 (.157)	-.075 (.119)	.477*** (.124)
Initiator Democracy / Durability Interaction	.054*** (.010)	.053*** (.010)	.052** (.018)	.055*** (.010)	.069*** (.005)
Target Democracy / Durability Interaction	.017 (.013)	.017 (.012)	.0007 (.018)	.016 (.013)	-.039** (.014)
WTO Dummy	1.097*** (.126)	1.107*** (.126)	1.304*** (.187)	1.053*** (.122)	.552*** (.073)
Constant	-12.422 (.674)	-12.178 (.679)	-12.708 (.903)	-12.459 (.669)	-16.422 (.580)
X ²	1939.5***	1840.1***	681.41***	2075.4***	3293.8***
Log Likelihood	-2020.59	-2014.864	-876.960	-1979.611	-4798.12
N	259,957	184,573	248,095	259,895	271,401
<p>* significant at .05 level ** significant at .01 level *** significant at .001 level Results are logistic regression coefficients with panel corrected standard errors in parentheses, coefficients for splines are not reported in the interest of parsimony. The control variables are omitted from this table as they are consistent across models and are not the key elements of interest. They detailed results are available upon request.</p>					

Table 6.4: Replication Models Using Empanelled Disputes

	Chapter 4	Chapter 5
Initiator Democracy	.132*** (.028)	-.002 (.034)
Target Democracy	.190*** (.048)	.100 (.054)
Initiator Durability (log measure)	n/a	-.330*** (.103)
Target Durability (log measure)	n/a	.050 (.201)
Initiator Democracy / Durability Interaction	n/a	.067*** (.012)
Target Democracy / Durability Interaction	n/a	.004 (.021)
WTO Dummy	.106 (.863)	.606*** (.163)
Initiator Democracy / WTO Interaction	.171* (.073)	n/a
Target Democracy / WTO Interaction	-.125* (.057)	n/a
Constant	-15.125*** (.908)	-13.743*** (.897)
X ²	908.34***	1023.06***
Log Likelihood	-1205.35	-1198.76
N	259,957	259,957
<p>* significant at .05 level ** significant at .01 level *** significant at .001 level Results are logistic regression coefficients with panel corrected standard errors in parentheses, coefficients for splines are not reported in the interest of parsimony. The control variables are omitted from this table as they are consistent across models and are not the key elements of interest. They detailed results are available upon request.</p>		

Figure 6.1.1: z-score of WTO DSM at Various Levels of Democracy
(Baseline Model)

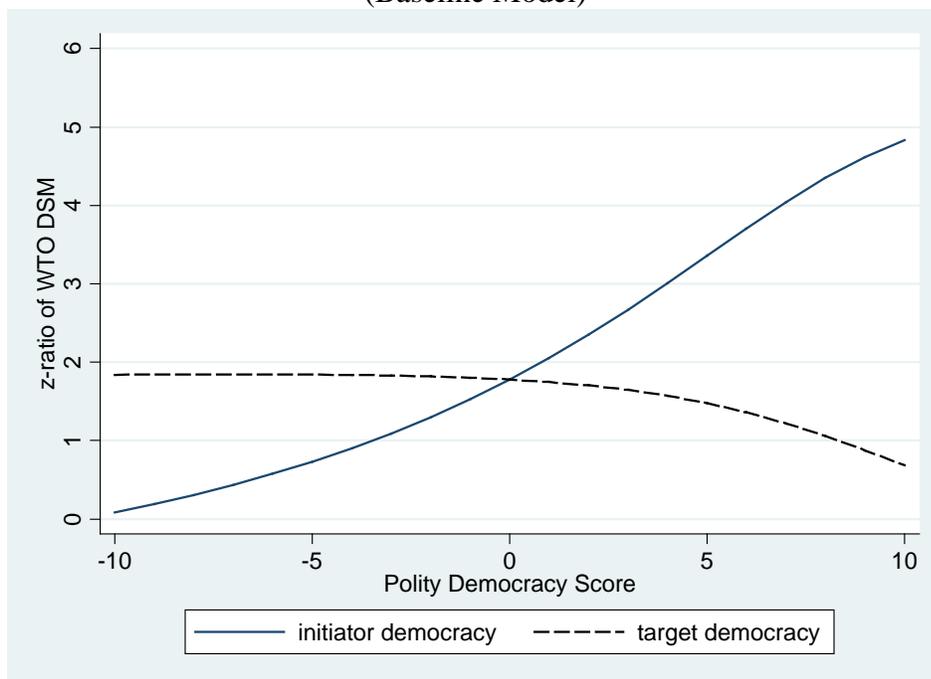


Figure 6.1.2: z-score of WTO DSM at Various Levels of Democracy
(Trading States Model)

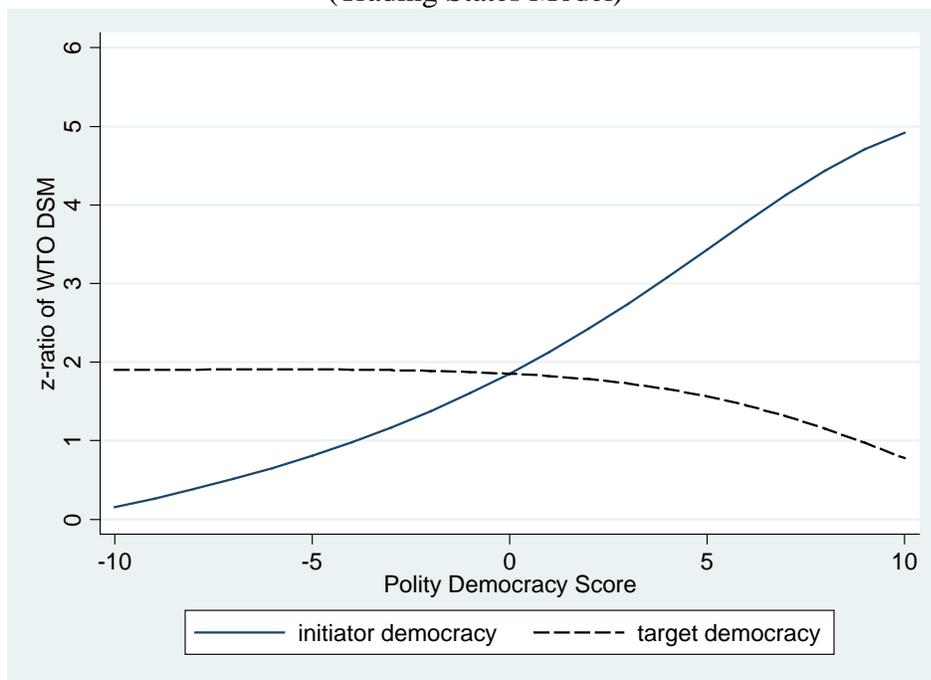


Figure 6.1.3: z-score of WTO DSM at Various Levels of Democracy
(US and EU Removed Model)

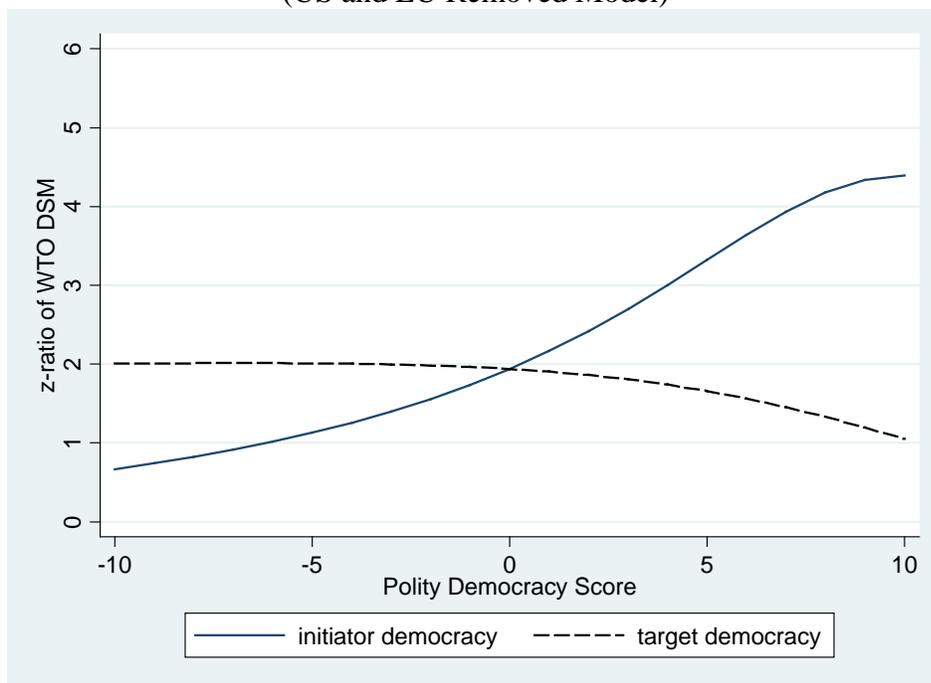


Figure 6.1.4: z-score of WTO DSM at Various Levels of Democracy
(US vs. EU Removed Model)

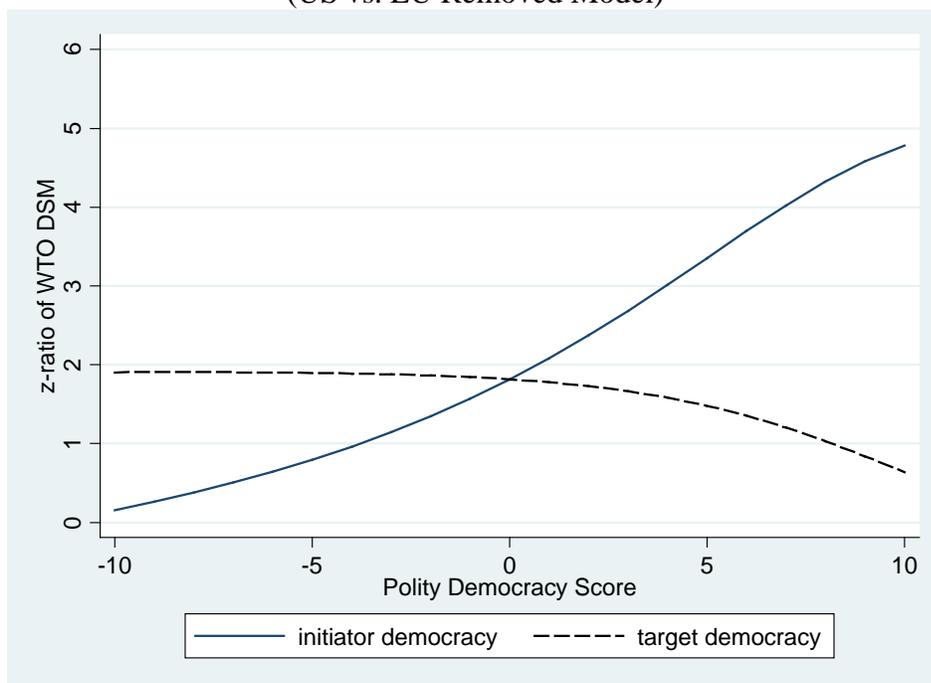


Figure 6.1.5: z-ratio of WTO DSM at Various Levels of Democracy
(Disaggregated EU Model)

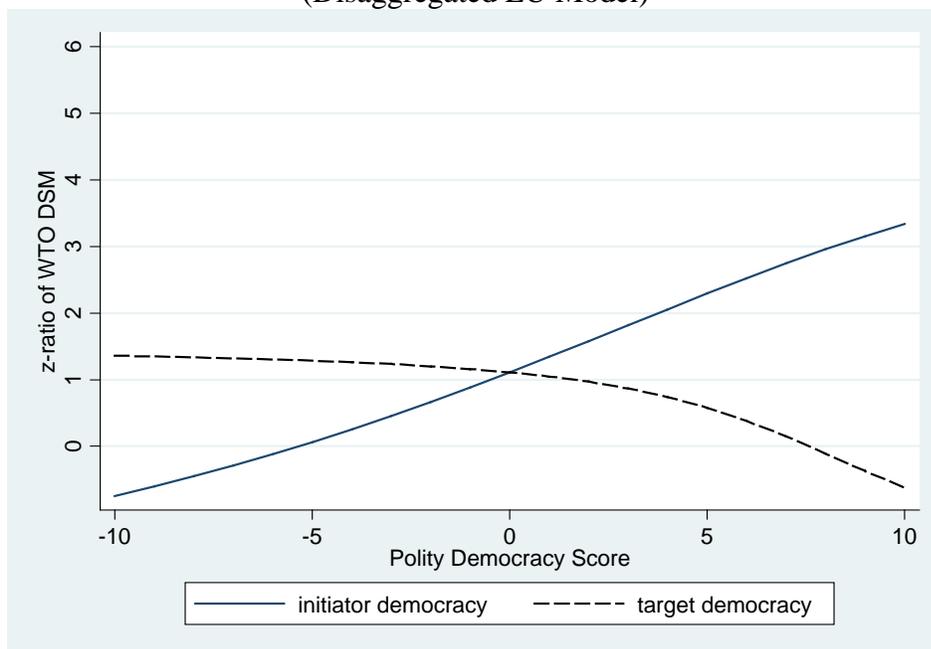


Figure 6.2.1: Marginal Effect of WTO DSM at Various Levels of Democracy
(Baseline Model)

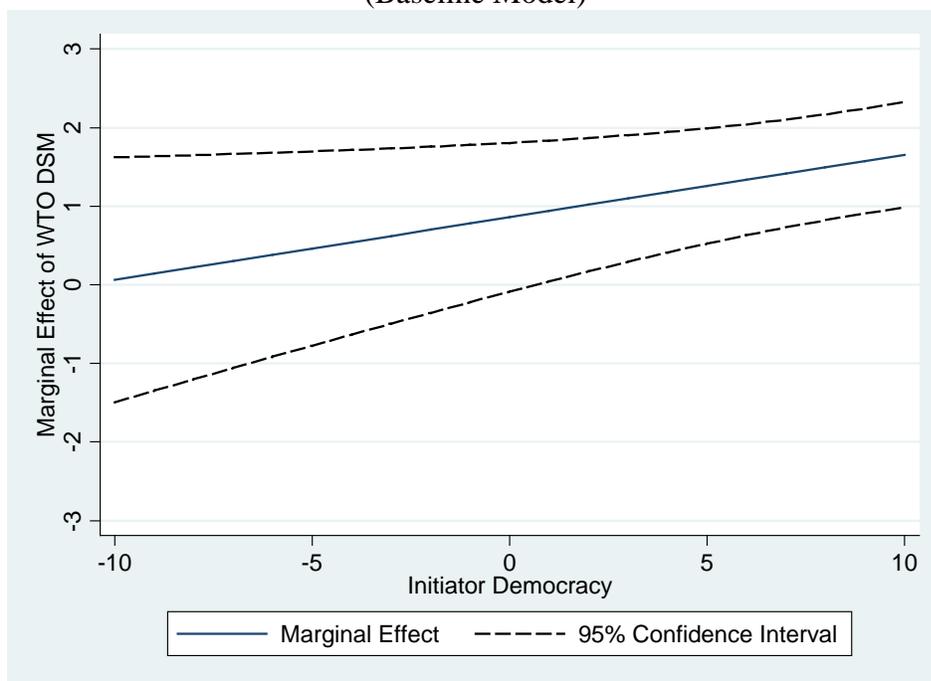


Figure 6.2.2: Marginal Effect of WTO DSM at Various Levels of Democracy
(Trading States Model)

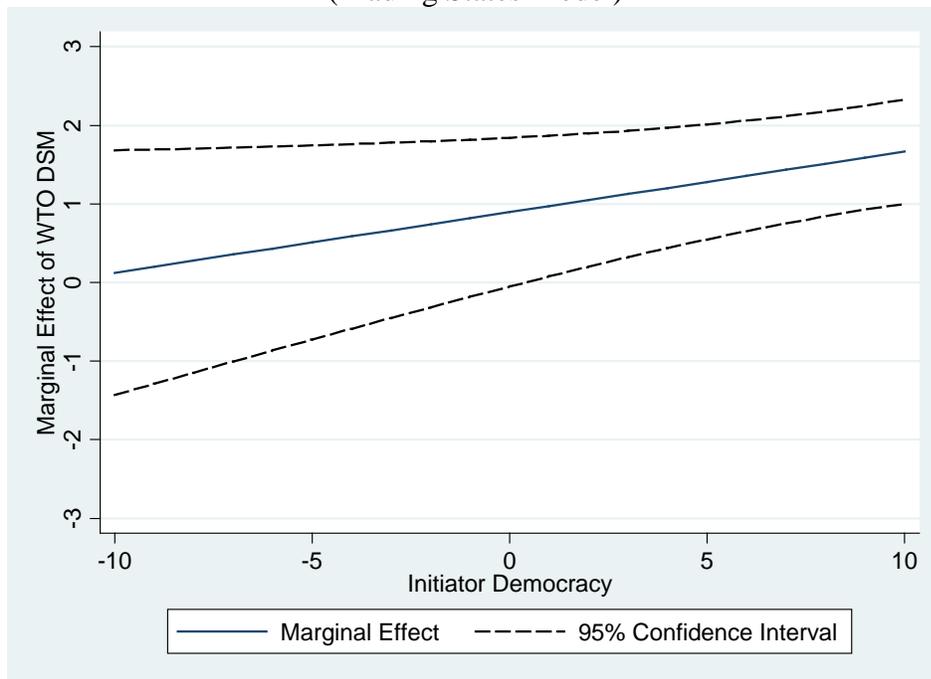


Figure 6.2.3: Marginal Effect of WTO DSM at Various Levels of Democracy
(US and EU Removed Model)

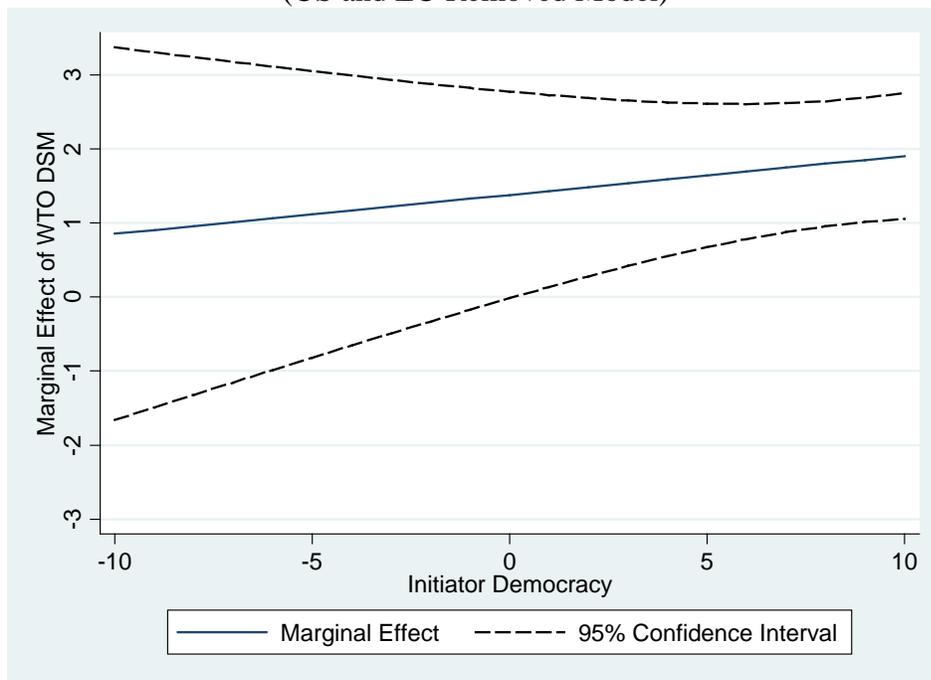


Figure 6.2.4: Marginal Effect of WTO DSM at Various Levels of Democracy
(US vs. EU Removed Model)

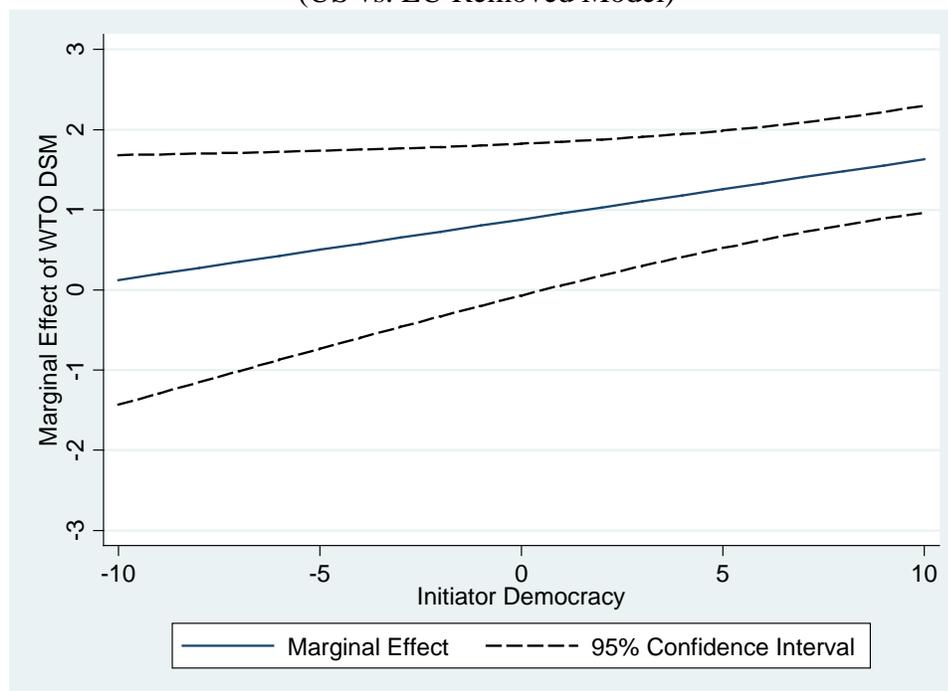


Figure 6.2.5: Marginal Effect of WTO DSM at Various Levels of Democracy
(Disaggregated EU Model)

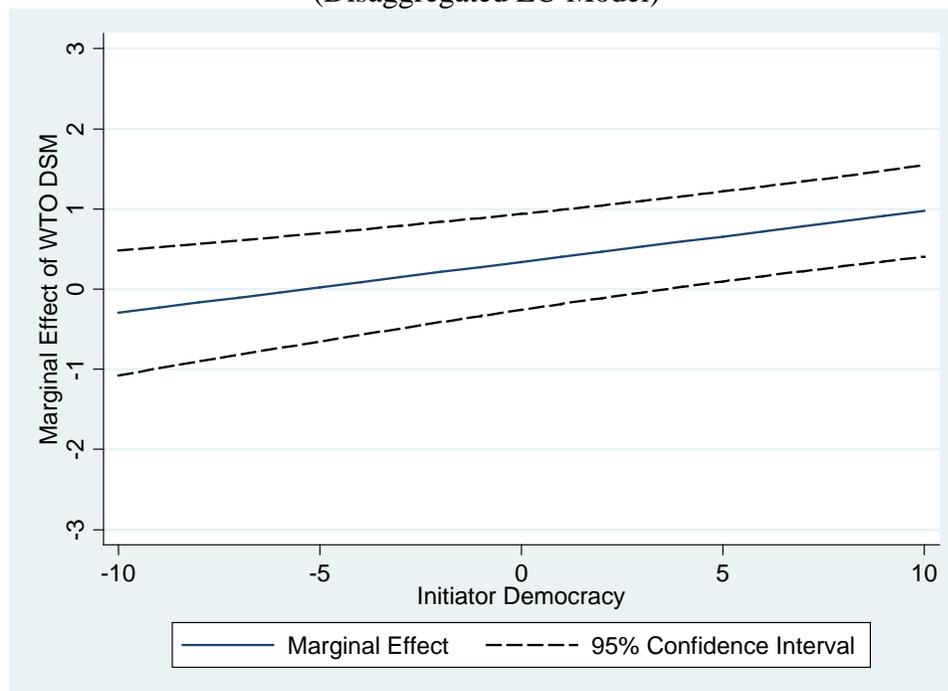


Figure 6.3.1: Predicted Probability of Dispute at Various Levels of Democracy (Baseline Model)

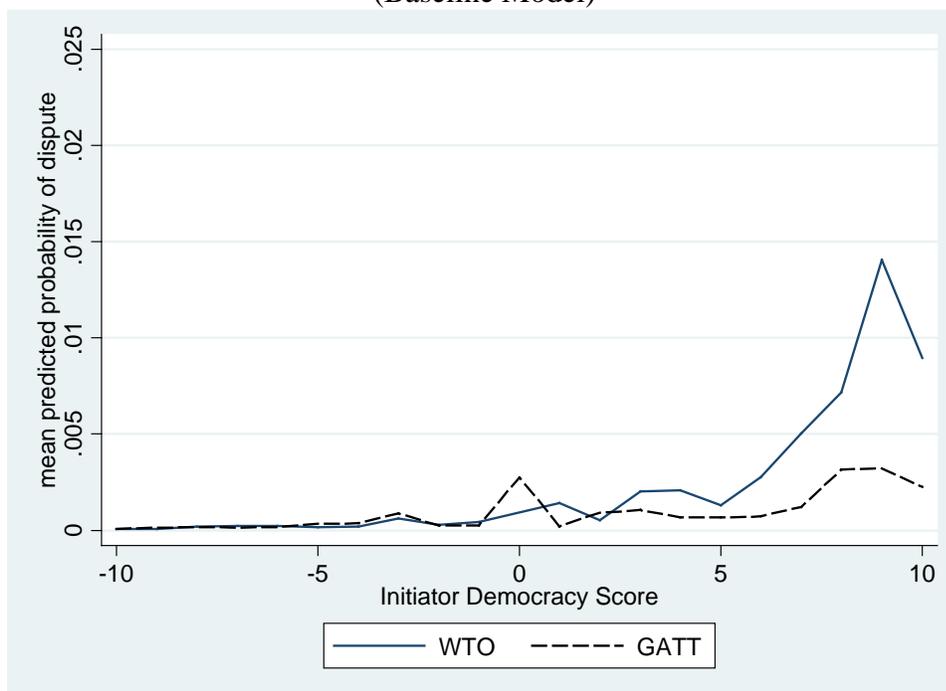


Figure 6.3.2: Predicted Probability of Dispute at Various Levels of Democracy (Trading States Model)

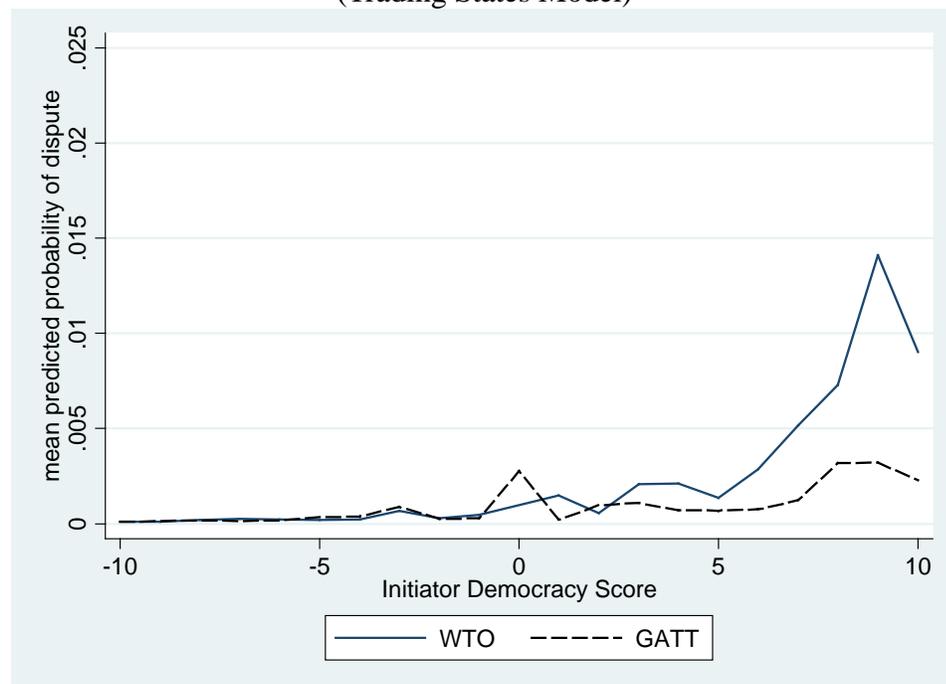


Figure 6.3.3: Predicted Probability of Dispute at Various Levels of Democracy (US and EU Removed Model)

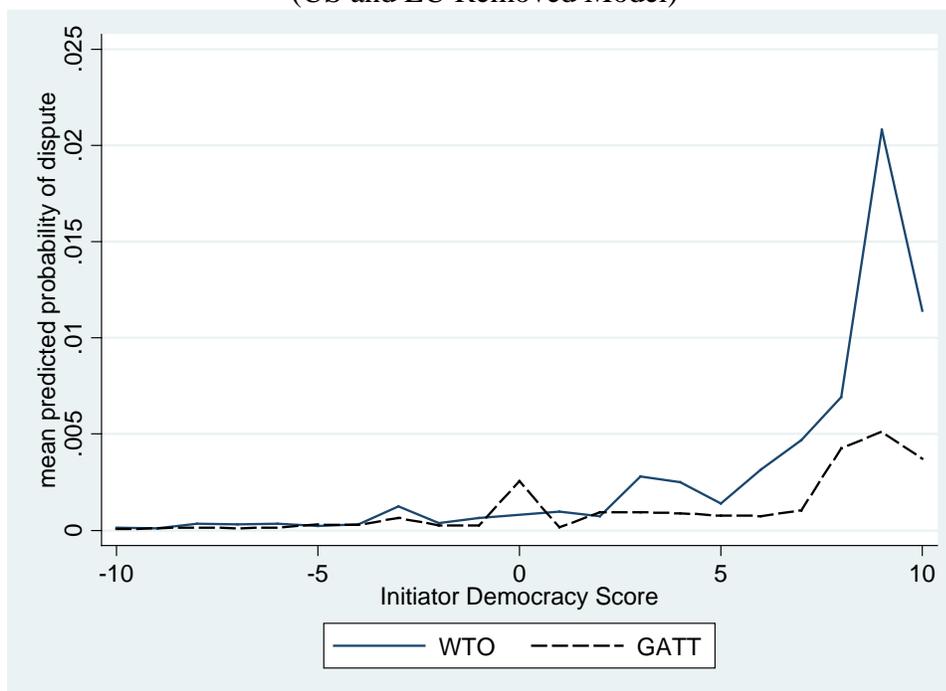


Figure 6.3.4: Predicted Probability of Dispute at Various Levels of Democracy (US vs. EU Removed Model)

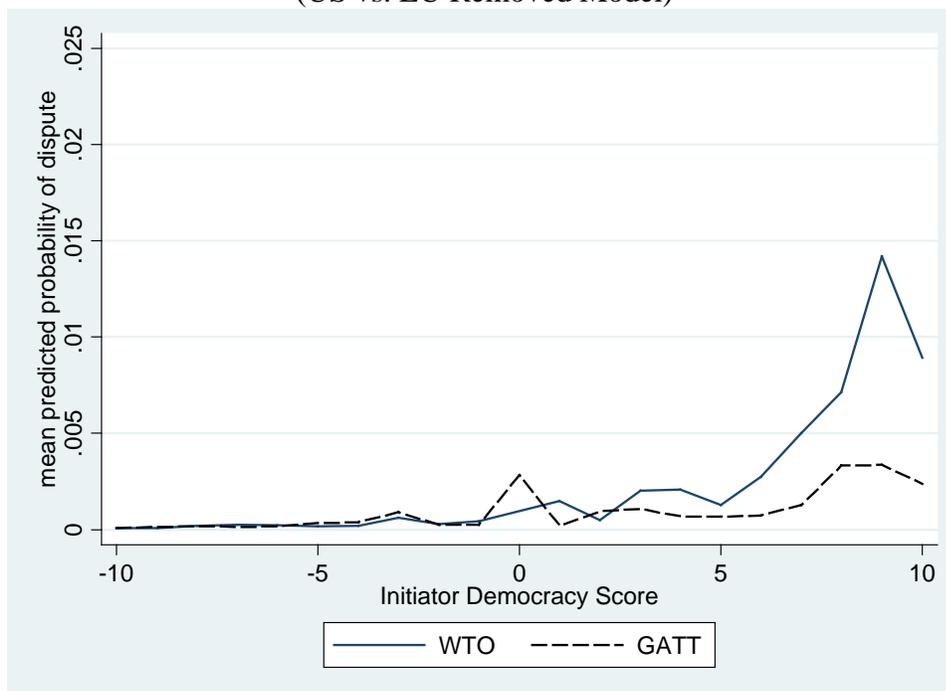


Figure 6.3.5: Predicted Probability of Dispute at Various Levels of Democracy (Disaggregated EU Model)

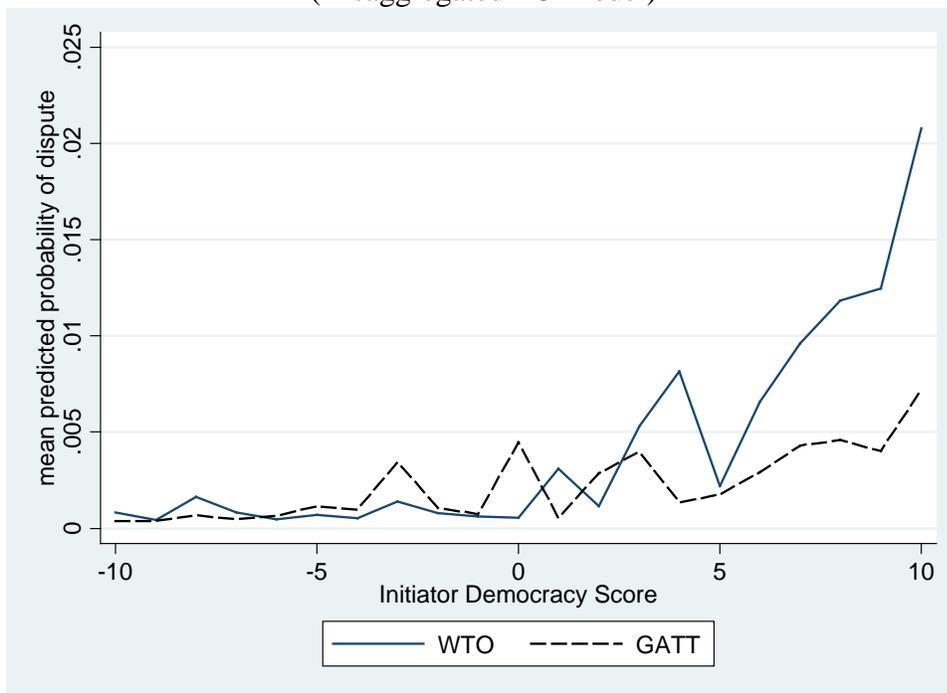


Figure 6.4.1: z-score of Democracy at Various Levels of Durability (Baseline Model)

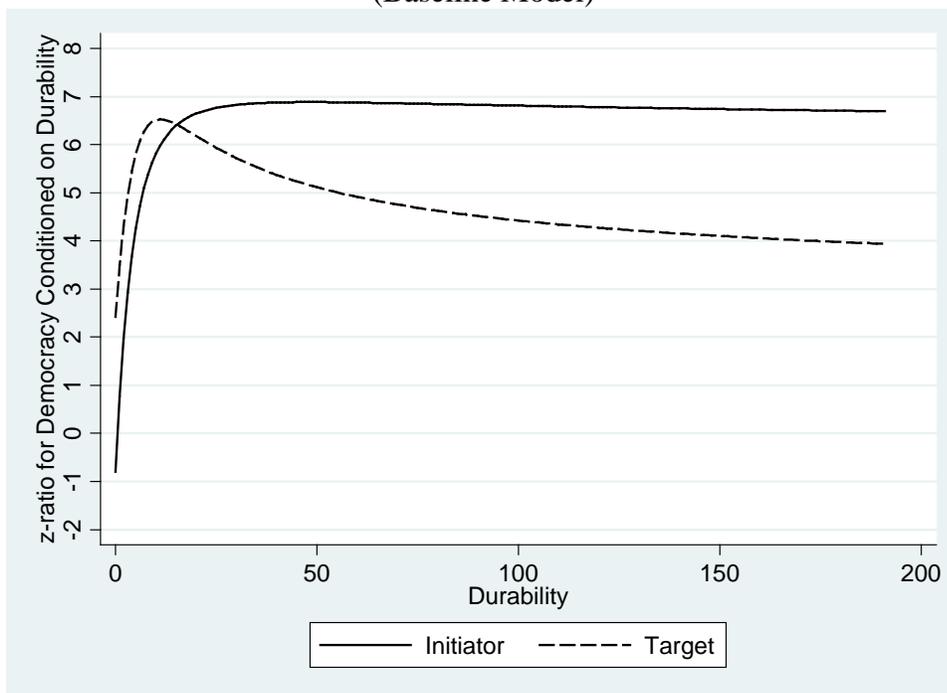


Figure 6.4.2: z-score of Democracy at Various Levels of Durability
(Trading States Model)

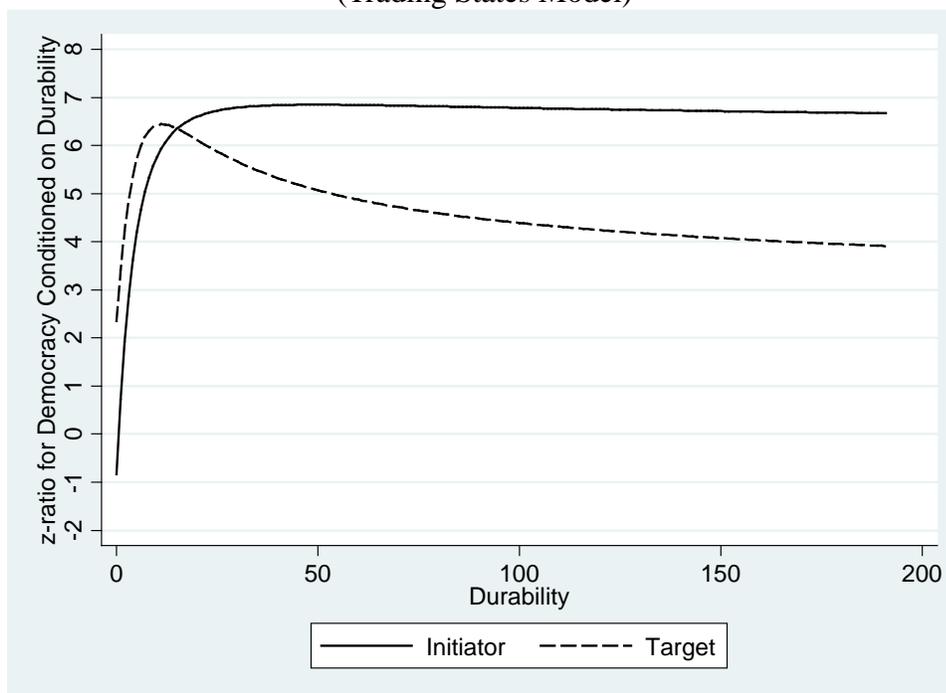


Figure 6.4.3: z-score of Democracy at Various Levels of Durability
(US and EU Removed Model)

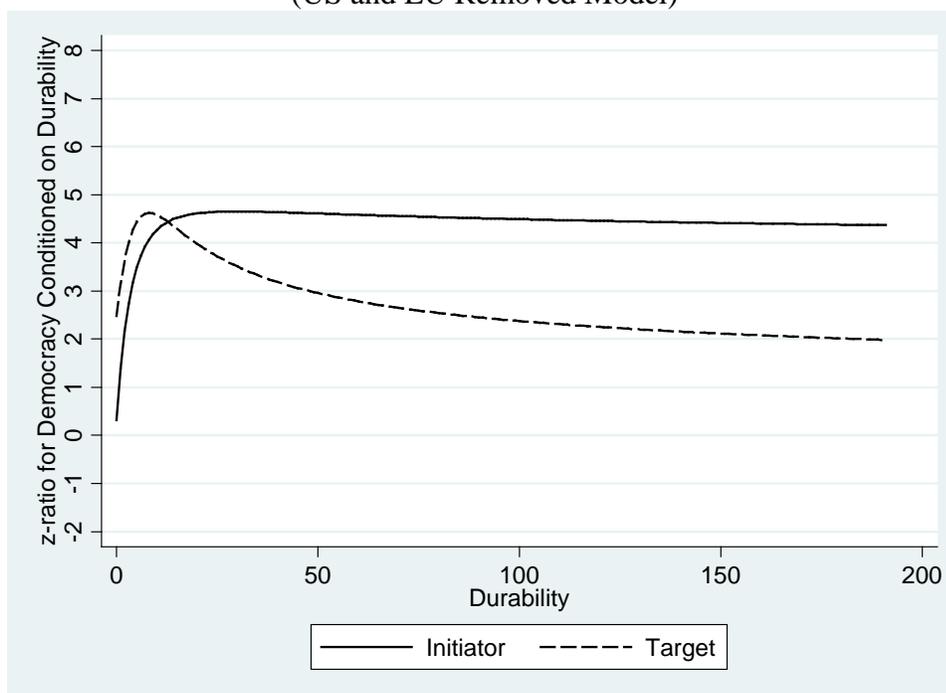


Figure 6.4.4: z-score of Democracy at Various Levels of Durability
(US vs. EU Removed Model)

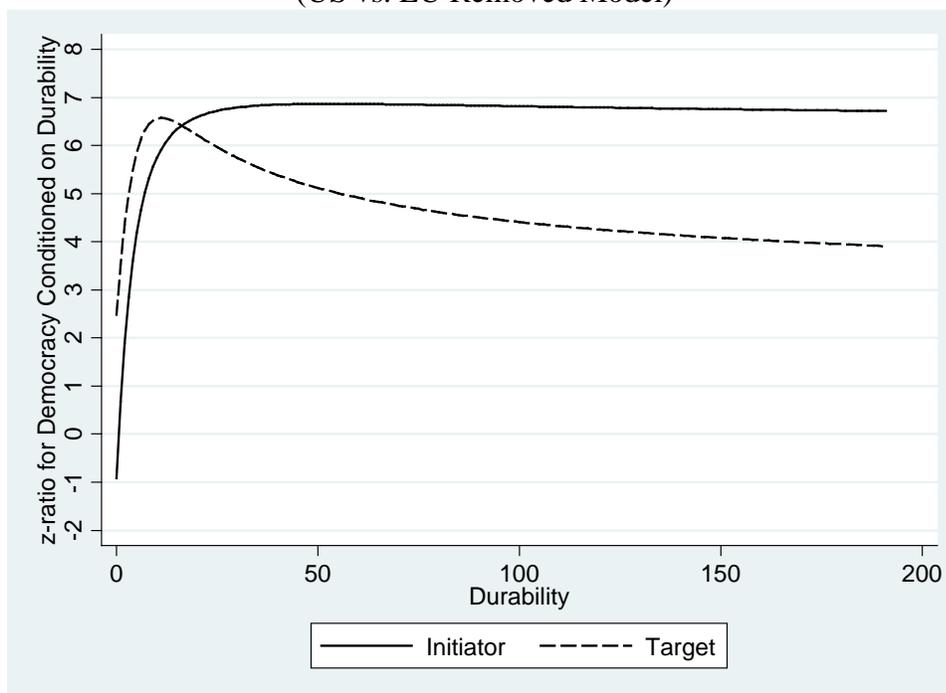


Figure 6.4.5: z-score of Democracy at Various Levels of Durability
(Disaggregated EU Model)

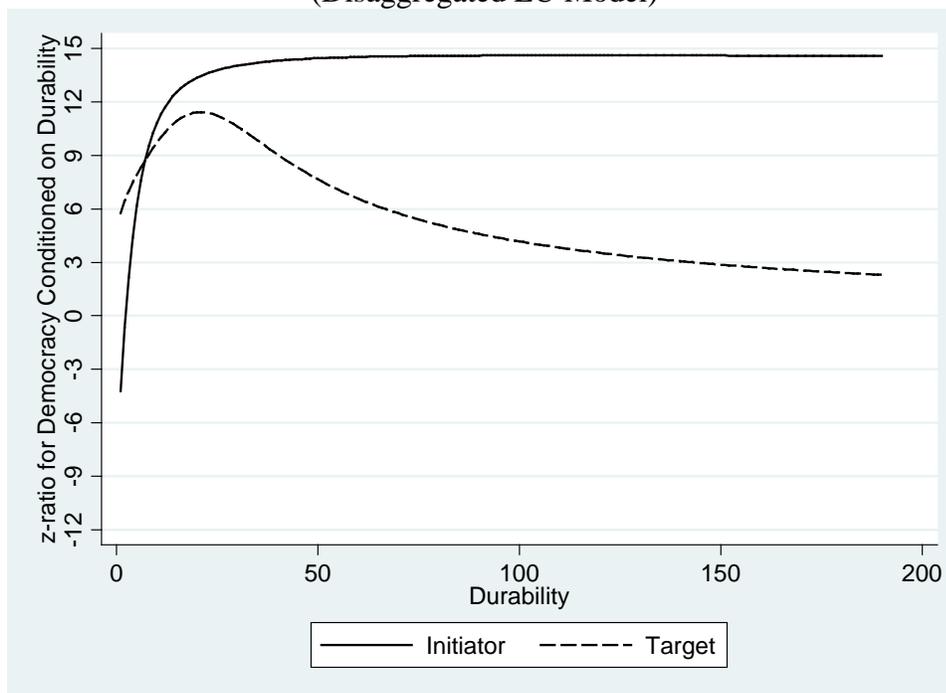


Figure 6.5.1: z-score of Durability at Various Levels of Democracy
(Baseline Model)

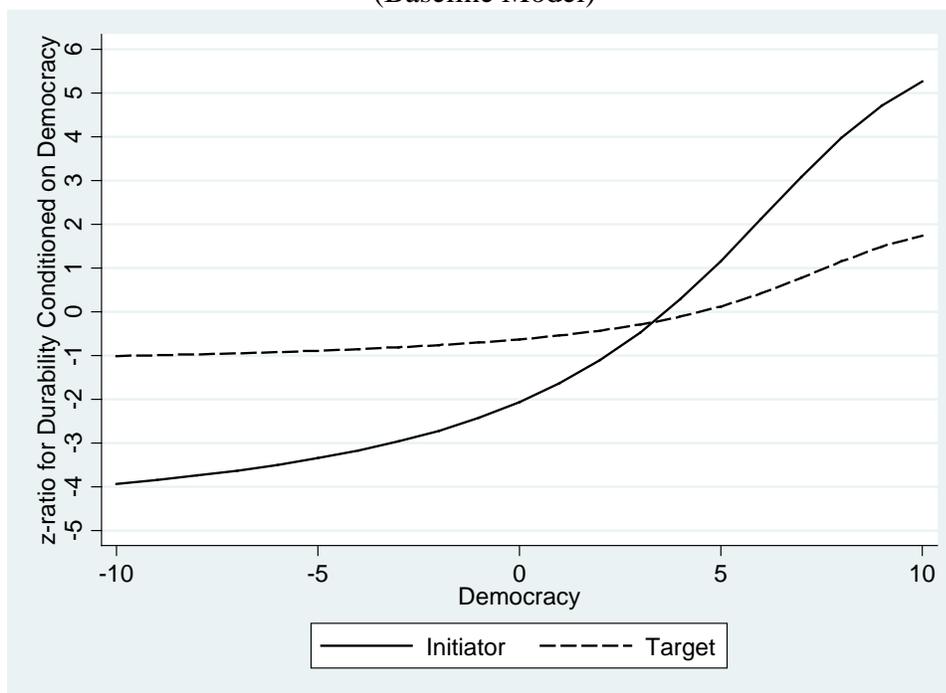


Figure 6.5.2: z-score of Durability at Various Levels of Democracy
(Trading States Model)

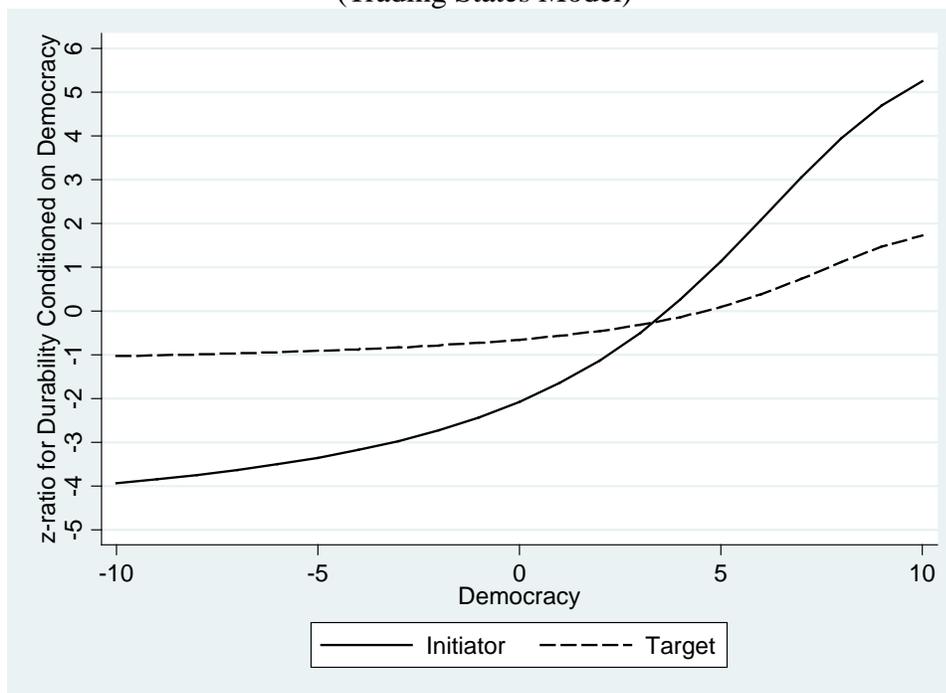


Figure 6.5.3: z-score of Durability at Various Levels of Democracy
(US and EU Removed Model)

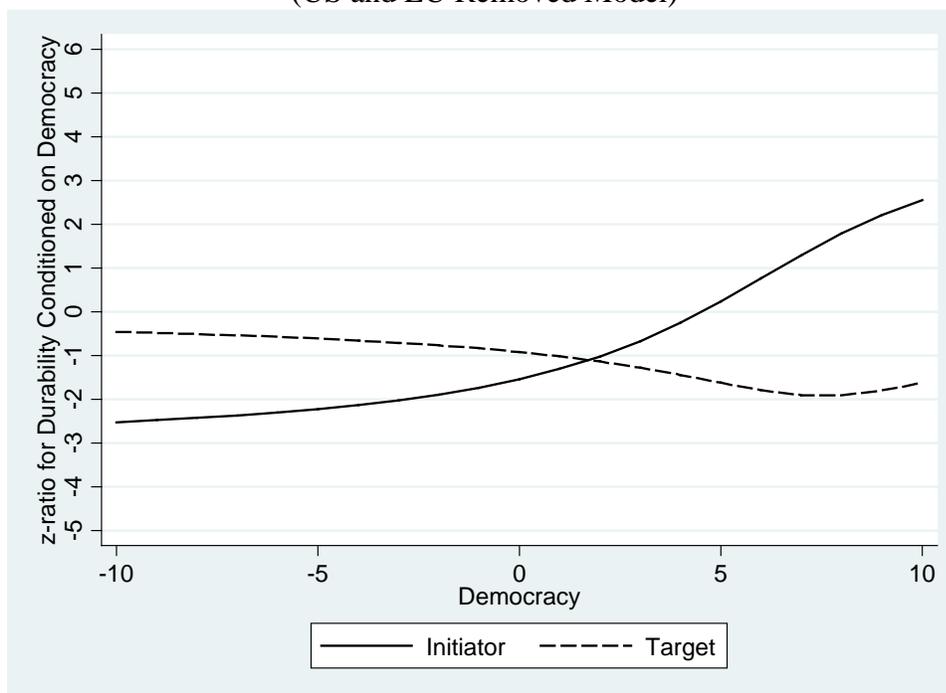


Figure 6.5.4: z-score of Durability at Various Levels of Democracy
(US vs. EU Removed Model)

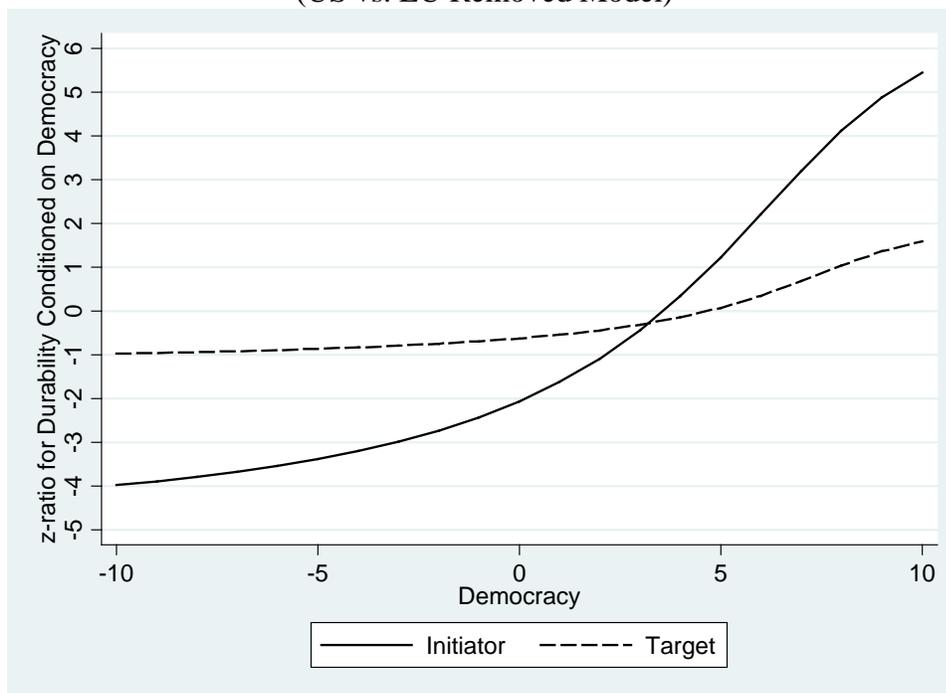


Figure 6.5.5: z-score of Durability at Various Levels of Democracy
(Disaggregated EU Model)

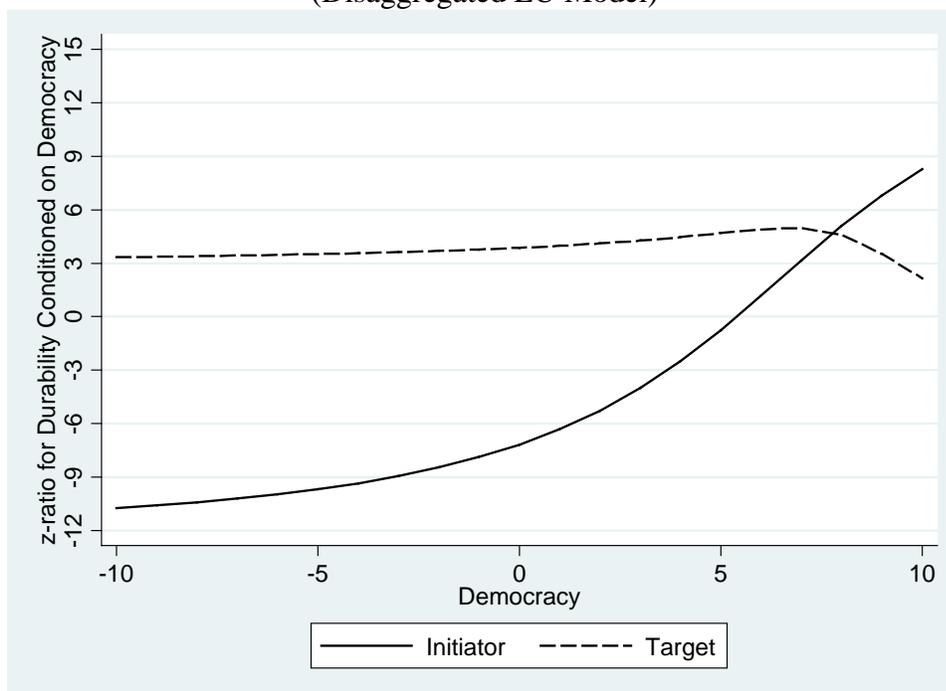


Figure 6.6.1: Marginal Effect of Durability at Various Levels of Democracy
(Baseline Model)

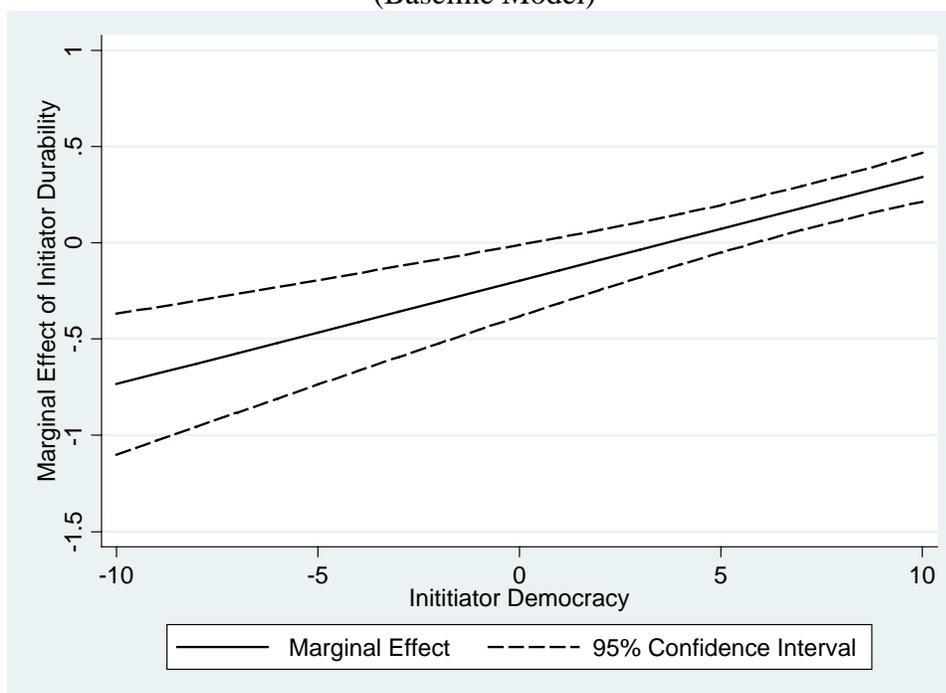


Figure 6.6.2: Marginal Effect of Durability at Various Levels of Democracy
(Trading States Model)

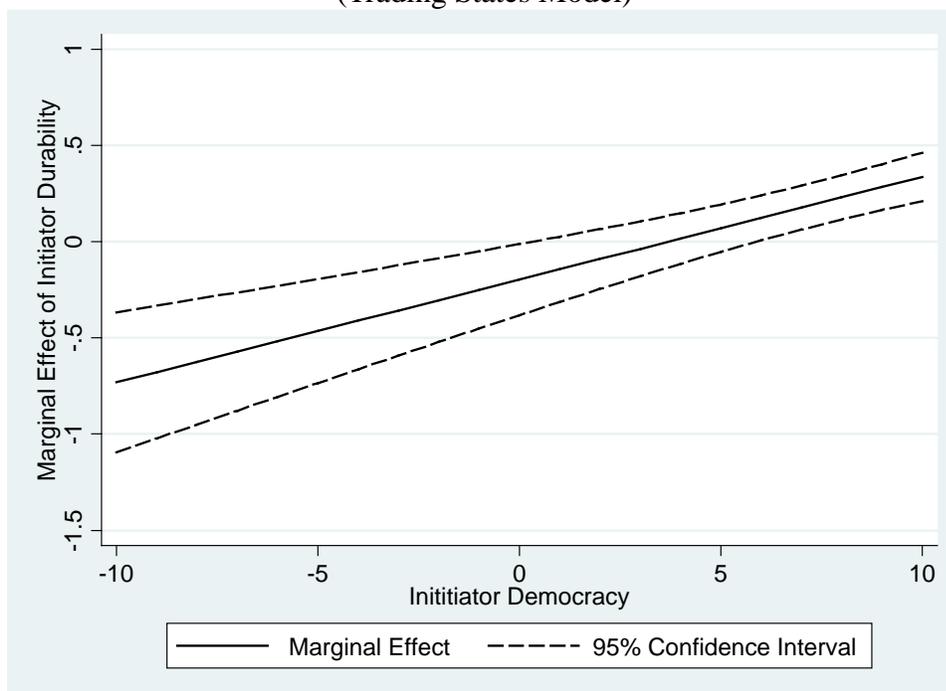


Figure 6.6.3: Marginal Effect of Durability at Various Levels of Democracy
(US and EU Removed Model)

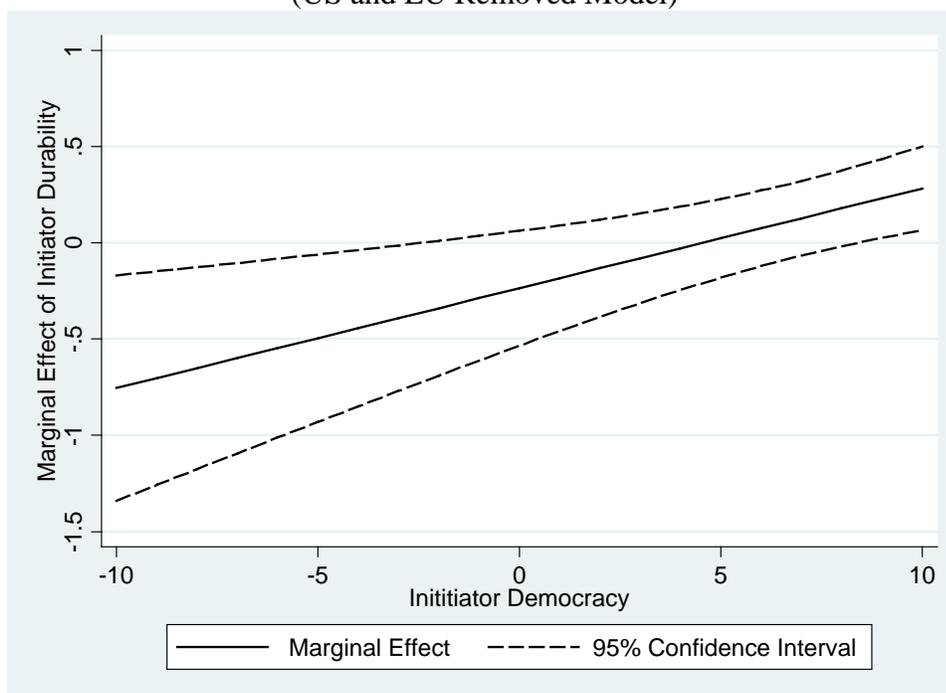


Figure 6.6.4: Marginal Effect of Durability at Various Levels of Democracy (US vs. EU Removed Model)

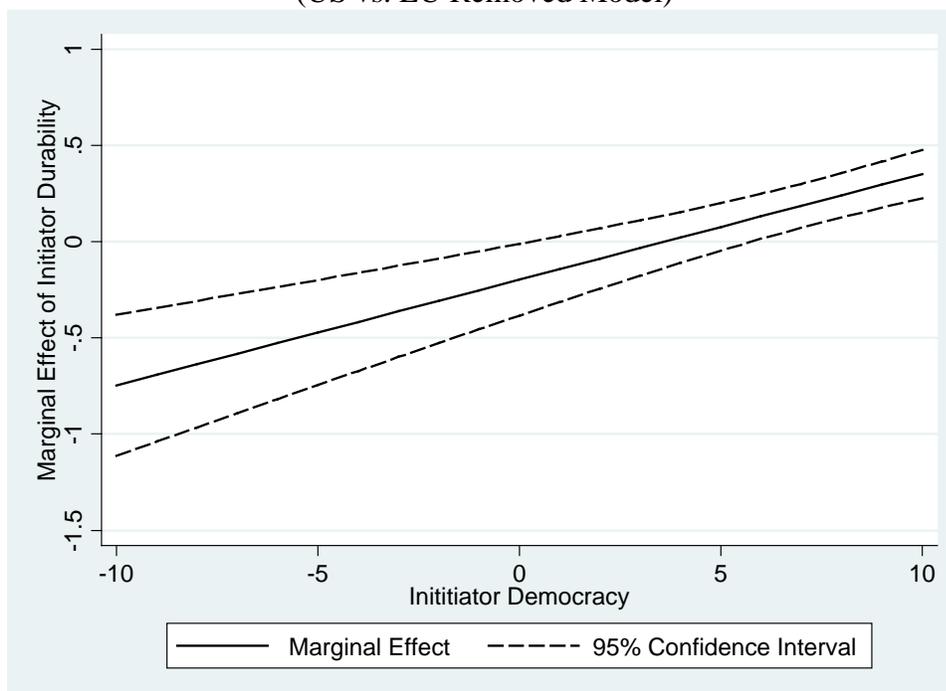


Figure 6.6.5: Marginal Effect of Initiator Durability at Various Levels of Democracy (Disaggregated EU Model)

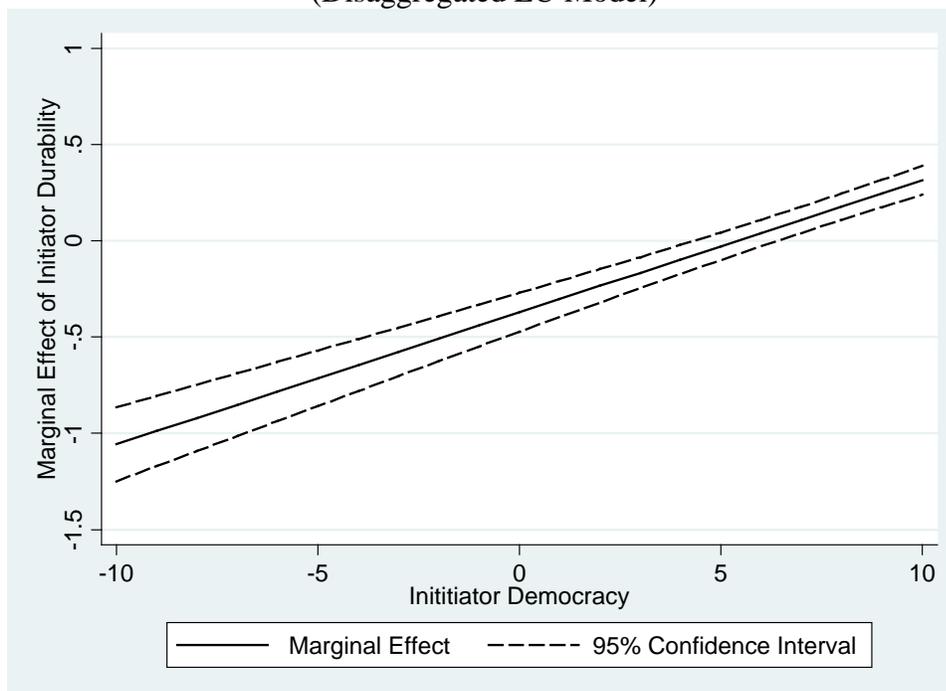


Figure 6.6.6: Marginal Effect of Target Durability at Various Levels of Democracy
(Disaggregated EU Model)

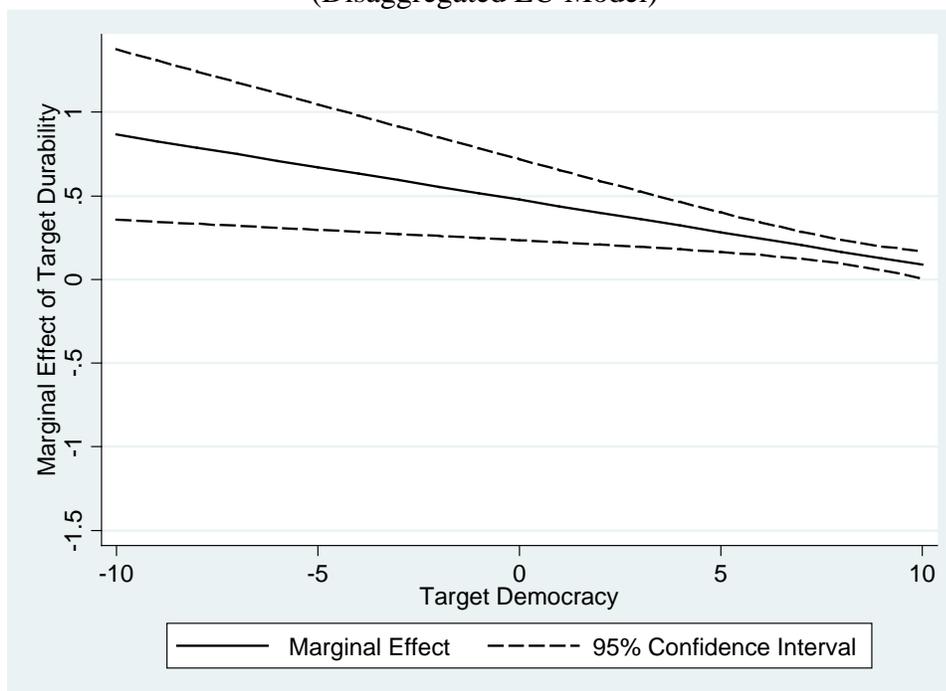


Figure 6.7.1: Predicted Probability of Dispute at Various Levels of Democracy
(Baseline Model)

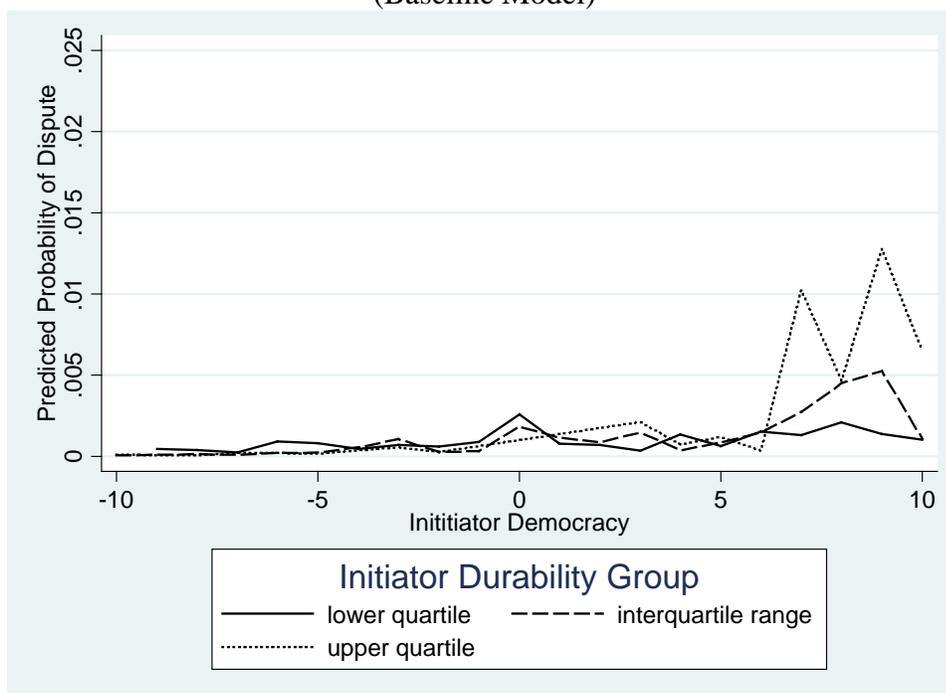


Figure 6.7.2: Predicted Probability of Dispute at Various Levels of Democracy
(Trading States Model)

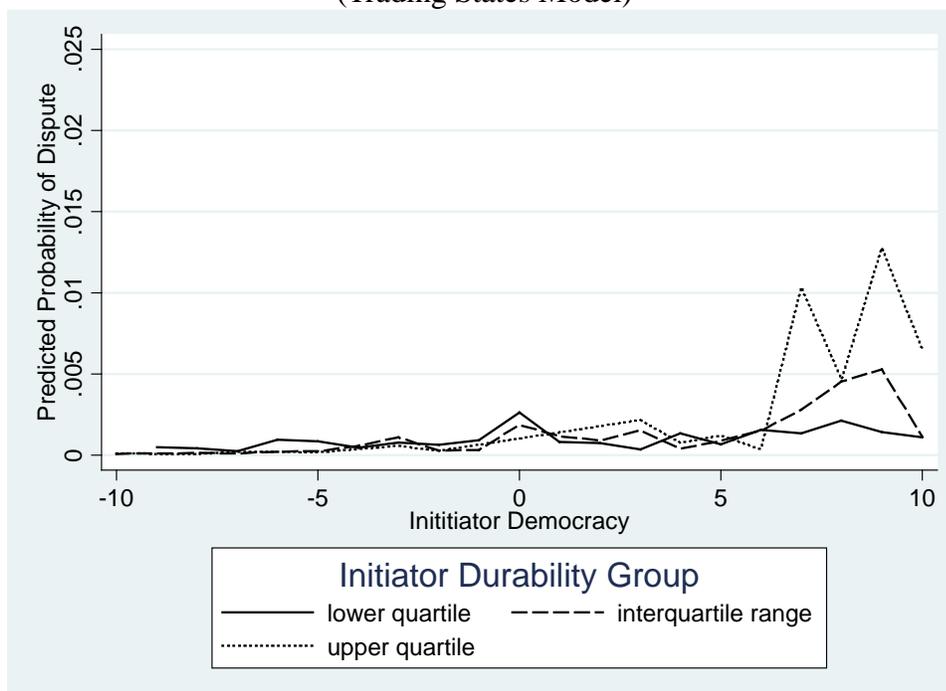


Figure 6.7.3: Predicted Probability of Dispute at Various Levels of Democracy
(US and EU Removed Model)

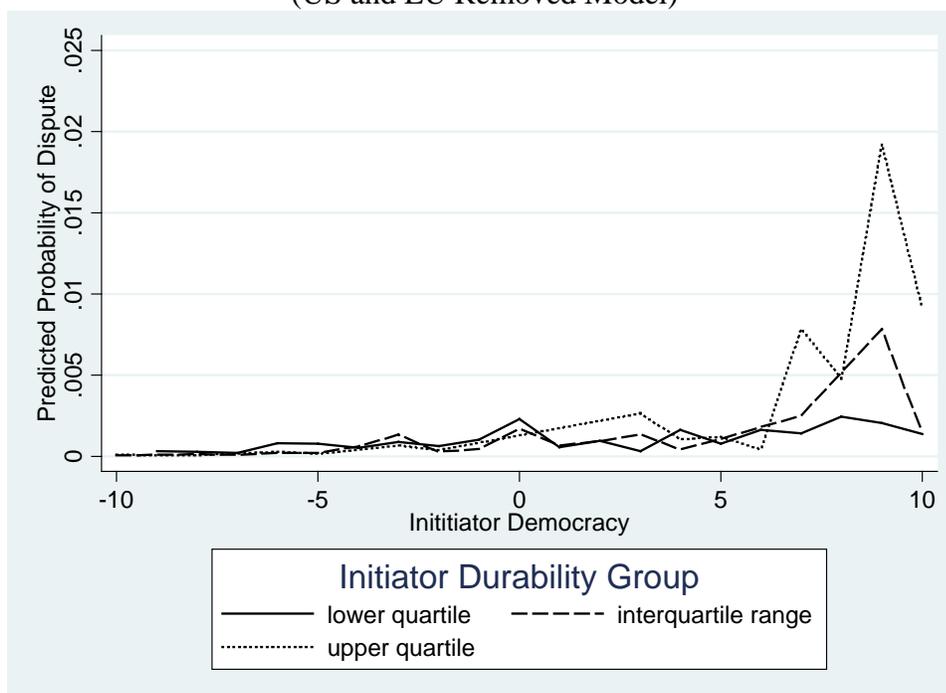


Figure 6.7.4: Predicted Probability of Dispute at Various Levels of Democracy (US vs. EU Removed Model)

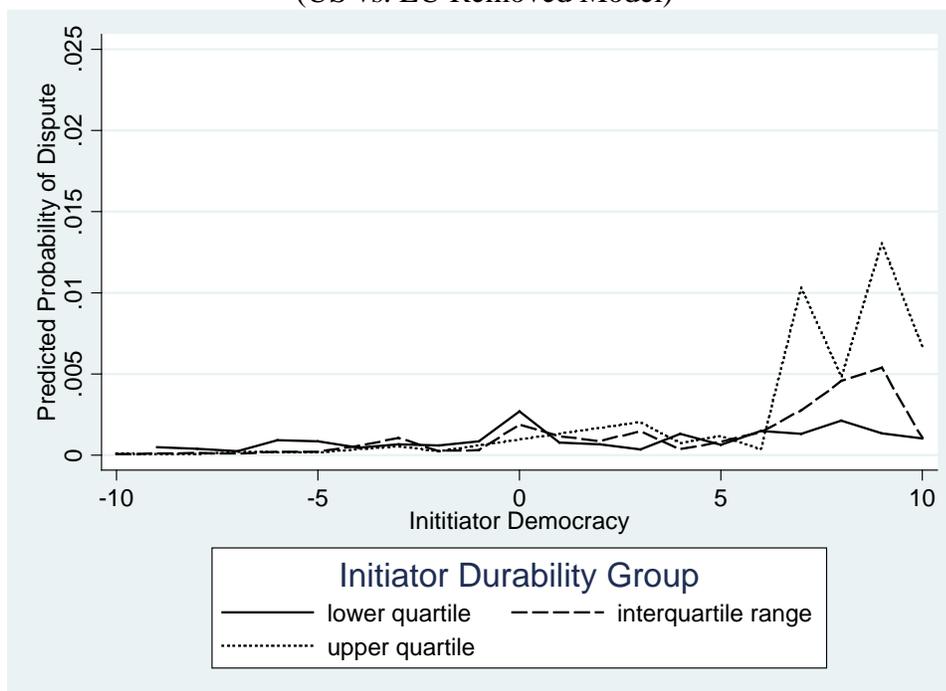


Figure 6.7.5: Predicted Probability of Dispute at Various Levels of Initiator Democracy (Disaggregated EU Model)

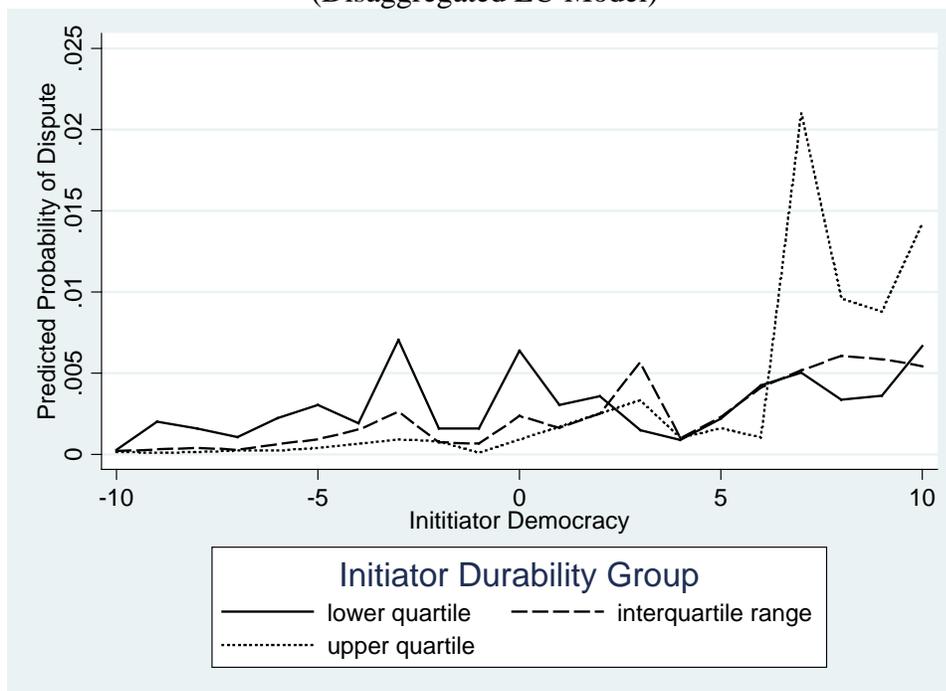


Figure 6.7.6: Predicted Probability of Dispute at Various Levels of Target Democracy (Disaggregated EU Model)

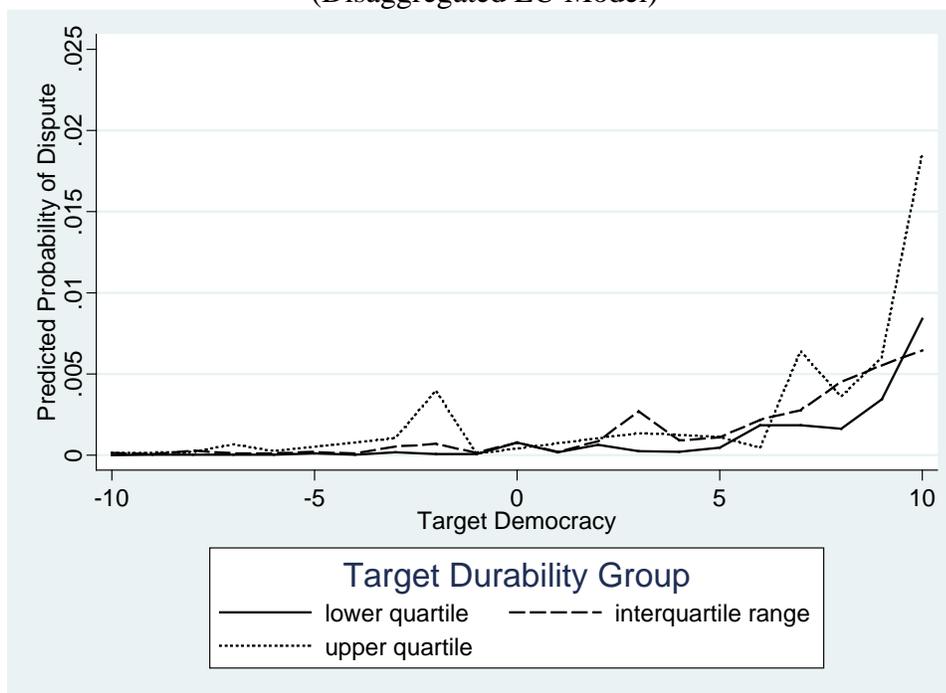


Figure 6.8.1: z-score of WTO DSM at Various Levels of Democracy (Panel Model)

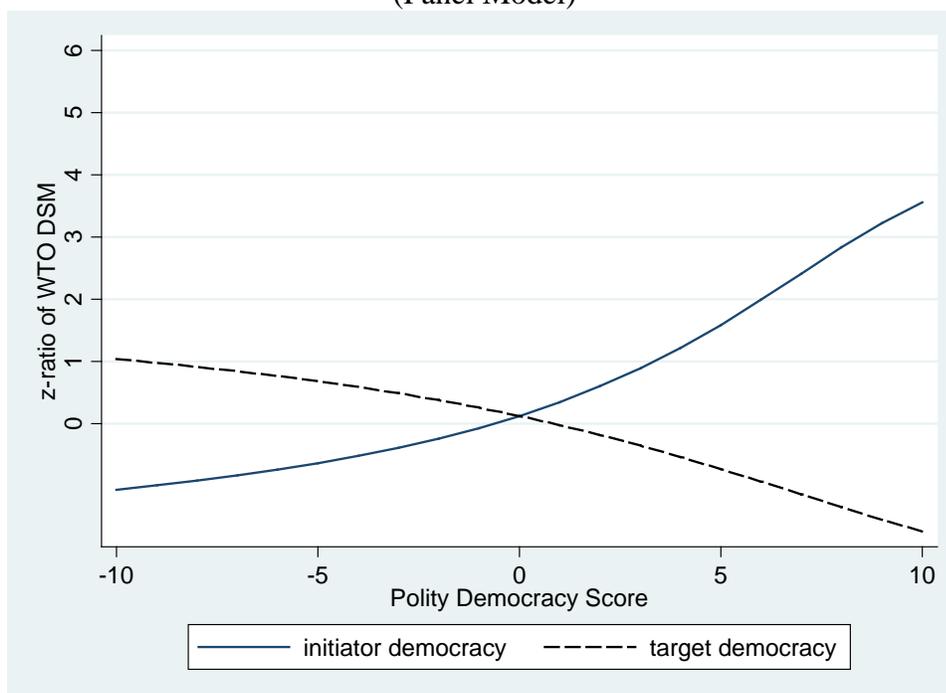


Figure 6.8.2: Marginal Effect of WTO DSM at Various Levels of Democracy
(Panel Model)

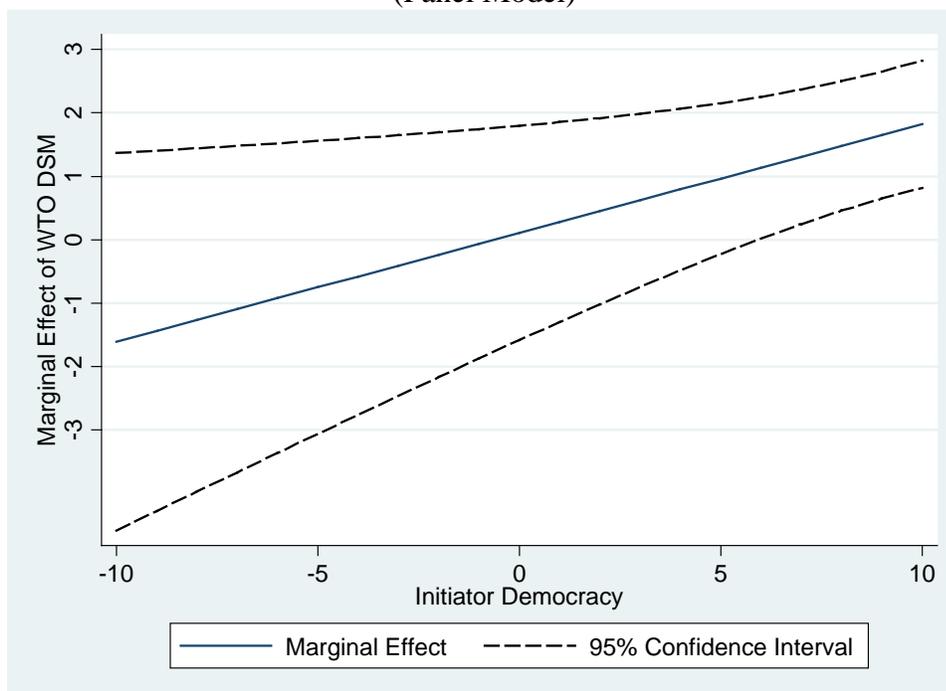


Figure 6.8.3: Predicted Probability of Panel at Various Levels of Democracy
(Panel Model)

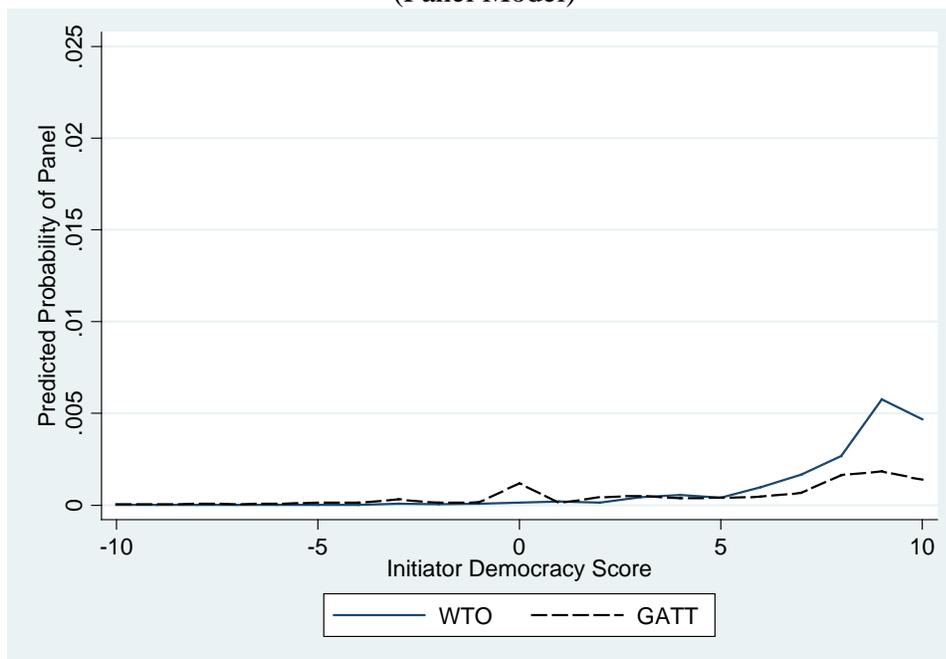


Figure 6.8.4: z-score of Democracy at Various Levels of Durability
(Panel Model)

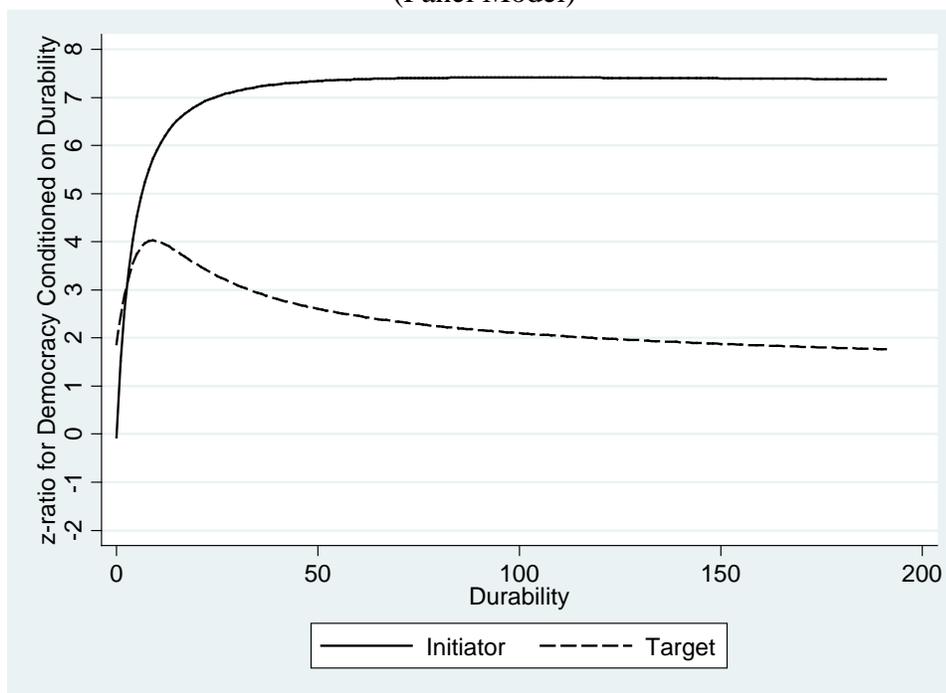


Figure 6.8.5: z-score of Durability at Various Levels of Democracy
(Panel Model)

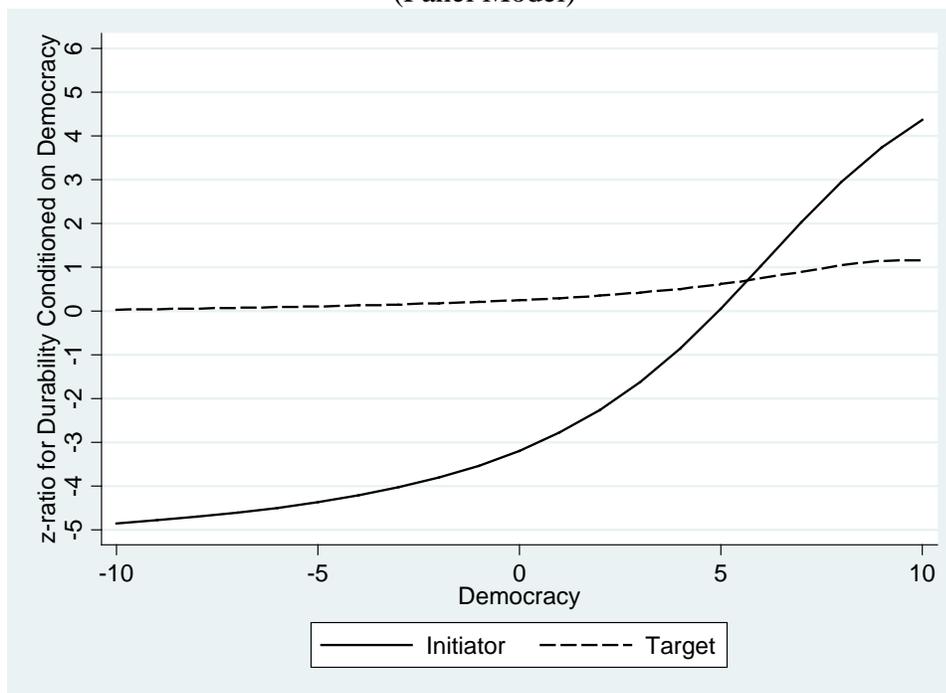


Figure 6.8.6: Marginal Effect of Durability at Various Levels of Democracy
(Panel Model)

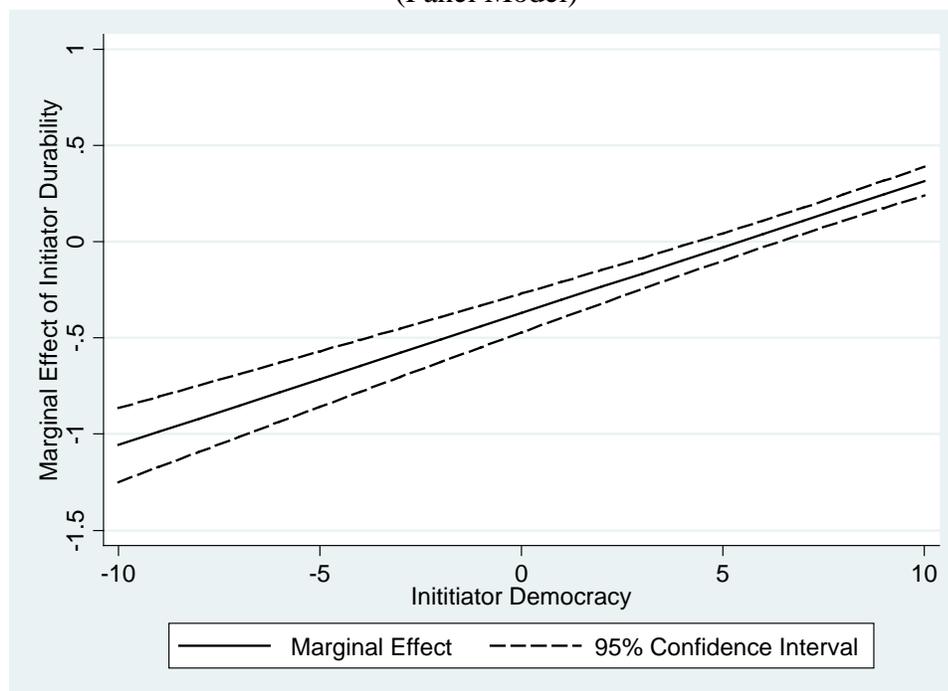
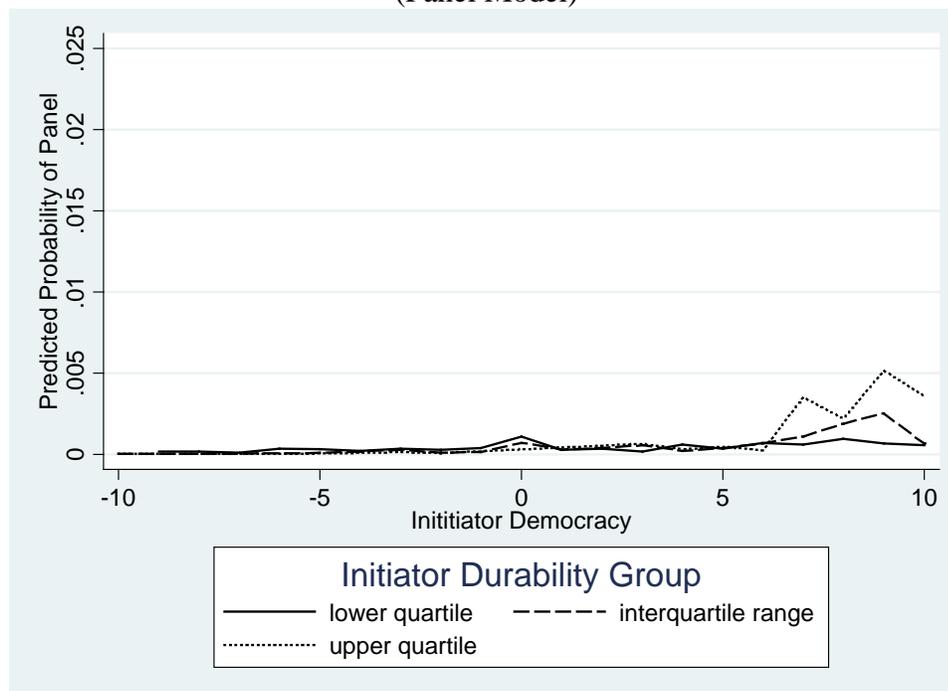


Figure 6.8.7: Predicted Probability of Panel at Various Levels of Democracy
(Panel Model)



CHAPTER 7: CONCLUSIONS AND PARTING THOUGHTS

Political leaders are often caught in difficult positions. They know that international cooperation can bring benefits both to themselves and their citizenry over the long term. The problem is that the long term rarely is the term in which they must make decisions about policy. The short-term determinants of domestic political survival often work against sustained international cooperation. Political leaders must make their international calculations, particularly in the design of international commitments in an odd mix of certainty and uncertainty. They can be certain that the world will change in the future and that the incentives of the international environment and their domestic environment will change. The problem is that they cannot know with anything vaguely resembling certainty just how these changes will come about. The decisions of political leaders are thus characterized by uncertainty about the future.

International institutions that have any hope of surviving account for the uncertainty of the future by the inclusion of flexibility mechanisms that allow states to adapt as times and domestic political needs change. Where flexibility is not included by design, states with an interest in maintaining the regime will seek informal flexibility within the institutional context in which they find themselves. Design elements play a key role in structuring the incentives of political leaders. These incentives play a key role in the actions of political leaders in the context of the institutions in which they find themselves operating.

The design of the GATT/WTO regime is highly flexible, although this was largely an unintended consequence of its origin as a temporary mechanism. Over time, though,

this flexibility has served the regime well as it has allowed it to adapt to changing circumstances. Too much flexibility can be counter-productive and lead to the erosion of the core rules of the regime. The GATT/WTO regime guards against this by including the dispute settlement mechanism as a means for member states to enforce the rules of the regime. In practice, the GATT/WTO regime thus possesses the means for member states to act flexibly in times of domestic political necessity by violating the rules of the trade regime, and at the same time allows states harmed by these actions to force eventual compliance with the rules.

It is in this area that the key institutional design change at the international level took place when the GATT gave way to the WTO. The GATT system had included a mechanism for adjudication of disputes, but had lacked significant enforcement power. The WTO DSM included a more robust enforcement mechanism and a shift to more impartial adjudicators, allowing greater certainty of outcome in the process. This shift made a key change in the incentives for political leaders considering whether or not to engage in disputes. The lower effective costs of the dispute made disputes more attractive to potential initiating states.

This change in institutional incentives was not felt by all states in the same way. Domestic institutions play a key role in how international incentives were translated into policy by political leaders. Domestic institutions structure political survival incentives for political leaders. Leaders do not survive in international institutional contexts. They must survive within the context of the domestic institutions through which they gain and retain power. These domestic level institutions thus have a powerful role to play in

determining how the international incentives faced by leaders will be translated into policy.

Chapter Two discussed this in great detail. Political leaders in all states must cultivate a base of support sufficient to gain and retain power. The more autocratic the state, the smaller this support base can be. The more democratic the state, the larger the support base must be. This has important implications in trade policy. The larger the support base, the more likely that it will contain groups that are harmed by the creative destruction of the international marketplace. These groups will use their power within the domestic political institutions to press for protection from these market pressures. This places pressure on political leaders to undertake policy decisions that will promote protection and violate the rules of the trade regime. In this manner, the more democratic the domestic institutions of the state, the more likely it is that the political leadership will engage in actions that will make the state a likely target in enforcement action.

This process is the result of international market pressure and domestic political institutions and is thus relatively immune to the pressures of the international institutional context. This implies that the actions that lead political leaders to make their states likely targets of trade disputes are not affected by international institutional change. This process of implementing protection will generate responses by other states leaders through a similar process of political pressure from key support groups, but in the case of the potential initiator of a trade dispute, the international institution matters greatly.

The more democratic a state, the more likely that the leadership's broad base of support will contain a group harmed by protectionist policies in other states. In this case,

the group in question will seek redress and the political leaders face a choice as to how to supply this redress. In this calculation, relative cost is an important part of the evaluation of policies. With a limited budget, the cost of a trade dispute is a key element of the decision whether or not the dispute will be worth the expense. A major part of this calculation is the likelihood that the dispute will result in a favorable ruling that can be enforced. Under the GATT, these were significantly larger questions than under the WTO. The GATT lacked effective time limits on cases as well as allowing the defendant to block unfavorable rulings. Both of these significantly raised the uncertainty of victory in GATT disputes. The WTO reforms reduced this uncertainty and the attendant costs of the disputes. This made the initiation of a dispute relatively less expensive compared to other policy choices, increasing the likelihood that states would initiate disputes.

But this effect is not universal. Chapter Four demonstrated that the domestic institutions of the member state affected the impact of the WTO changes. The impact of the change to the WTO was felt only on states that were sufficiently democratic. This demonstrated that the international institutions' impact was conditional on the domestic political institutions of the member states. Further, Chapter Four demonstrated that the change from GATT to WTO did not have a significant impact for any potential target state. In short, the impact of international institutional design is conditional on the domestic institutions of the member states.

Chapter Five extended this argument to include the element of domestic institutional change. As domestic institutions change, their impact varies with the endurance of the institutions. The behavior of leaders was affected by the relative

endurance of their domestic institutions. As with international institutional change, this impact was not universal. The impact of institutional durability was felt only in states that were sufficiently democratic. The analysis in Chapter Five demonstrated that political leaders in highly democratic states are affected by the relative endurance of their domestic institutions in deciding whether or not to initiate trade disputes. As in the analysis of international institutions, the decisions by political leaders that lead to a state being targeted in disputes were not affected by domestic institutional change.

Chapter Six demonstrated that this work is generally robust across alternative specifications of the models and the data.

This project has thus added several important innovations to the ongoing research on institutional design and its impact on international cooperation. Foremost, this project demonstrates that institutional relationships are complex and function at multiple levels. In evaluating the impact of international institutions, the domestic institutions of the member states must also be considered. Different institutions at the domestic level produce different incentives for political leaders. These incentives affect the behavior of these leaders in key ways, most notably in their recourse to elements of flexibility designed into international institutions. How these international institutions will work in practice requires an understanding of how the incentives they generate interact with those generated at the domestic level.

This work also suggests that elements of the international institution that are generally considered fixed, in this case the rules of the regime, can act as mechanisms for institutional flexibility. The rules of the GATT/WTO regime are complex enough that

they are difficult to apply in particular cases with clarity. The resulting fog of law allows the member states to engage in protectionist actions that are potentially violations of the rules of the regime while still claiming to be compliant. The presence of an impartial adjudication mechanism allows states to then clarify these claims in contest with the claims of other member states. In short, the channeling of disputes over interpretation into the institutions of the regime has made the complex rules of the regime a mechanism for institutional flexibility. Long-run compliance is bought through short-run defection.

This work also suggests that the design of the dispute settlement mechanism matters greatly. The increased effectiveness of the WTO DSM had an immediate and significant impact on the recourse to it as a means of resolving disputes. The improvement in the mechanism led to increased use. While the context of the trade regime is a special case and may not be applicable across all institutions, this is an empirical question that can be answered elsewhere.

These elements lead the author to mixed feelings about the implications of this work. This suggests that democracy may be a two edged sword for the global economy. While the free and open societies that are part and parcel of highly democratic countries are a generally considered a good thing, and indeed have produced high standards of living, long life expectancy, and generally made people fat and relatively happy, the seeds of future problems may be germinating in our democratic institutions. Democratic institutions are likely to see growing pressure from groups disaffected by the pressures of globalization. While globalization has generally been economically beneficial, the distribution of benefits has not been even. The beginnings of a shift of jobs away from

the high cost advanced industrial societies and towards the developing world has been underway for some time. Improvements in developing world education and the contemporaneous decline in education in the advanced industrial world means that over the next generation, more jobs will continue to shift out of the developed world to the developing world.

In this context, the political leaders of the advanced industrial states will be increasingly faced with pressure to push the limits of the trade regime. The incentives to cheat will only grow. If democracy continues its post Cold War spread, this would also mean that a growing number of states will be subject to these temptations to cheat. While the GATT/WTO regime has weathered past storms well and succeeded beyond all expectations at managing the world trade system, the example of 1900-1939 lurks in the shadows. The globalized world of 1900, bound together by a system of world trade and finance as integrated as the world of the year 2000 collapsed into four decades of war and economic crisis. It collapsed because the domestic interests of states trumped their collective interest in cooperation.

The GATT/WTO regime was created to prevent such a collapse. It has worked wonders thus far, but the Doha Round of trade negotiations bodes ill for the future. The negotiations are at an extended impasse and there is no end to this in sight. The larger issues of cooperation continue to win out in the day to day operation of the WTO, not as yet reflecting the stalemate at the negotiating table. In spite of this, it remains an open question if the flexibility provided by the DSM can resolve the key issues of the WTO if the flexibility mechanism of periodic renegotiation stalls.

This work demonstrates that we must consider the domestic institutions of WTO members when we think of how the WTO institutions will function in practice. In their current form, the WTO institutions serve the interests of the members well. If the domestic pressure to break from the regime continues to grow in many of its democratic members, the employees of the WTO DSM can expect a busy future.

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