

The Choice of Institutions for Trade Disputes

Christina L. Davis

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In trade policy, the parallel process of creating regional trade associations, participating in the multilateral trade system, and concluding bilateral arrangements has resulted in overlapping jurisdictions. This forms an example of a “regime complex” as defined by Raustiala and Victor (2004, 279): “an array of partially overlapping and nonhierarchical institutions governing a particular issue-area.” Each institutional forum has different features regarding the level of legalization and the number of issues and actors. Yet many trade issues could conceivably come up in any of these negotiation fora. Indeed, the ability to choose among competing jurisdictions and use exit as a form of leverage represents a common feature in this style of governance (Hooghe and Marks, 2003). Lobby groups and governments on both sides of a trade negotiation try to choose the set of rules that will favor their preferred outcome.

The selection process within the trade regime complex filters the most difficult trade disputes into WTO trade rounds or dispute adjudication, while easier trade problems are resolved in bilateral and regional venues. Export industries push their governments to address foreign trade barriers. Yet WTO rules that restrict use of coercive tactics outside of the WTO reduce the cost for respondent governments to stand firm against concessions at the bilateral level. This makes disputes with highly mobilized interest groups on both sides the most likely to end up in the WTO.

The challenge presented by overlapping institutions is the potential for disaggregating interest group pressure and reputations. Whereas large package deals that encourage broad interest group coalitions are often necessary to support liberalization of sensitive issues, some interest groups can exit from the tedious WTO negotiations and have their interests met by other means. Cherry picking easier gains in other fora, however, may narrow lobbying for liberalization in the multilateral negotiations. The possibility of segmented reputations across multiple fora also reduces the reputation penalties for noncompliance.

In this memo I will discuss in section 1 the variation in institutional forms found within the trade regime complex. Section 2 focuses on the selection dynamic that governments face when addressing potential trade disputes. Section 3 proposes three hypotheses about how governments choose a forum, with particular focus on which issues will be raised in adjudication. Section 4 discusses how overlapping institutions could influence negotiation outcomes and compliance by changing the aggregation of interest group pressure and reputation effects.

1 Institutional Design

There is wide variation in institutional form among the institutions that govern trade relations. Distributional stakes and enforcement problems explain some of the variation in centralization, flexibility, and membership of institutions (Martin, 1992; Koremenos, Lipson and Snidal, 2001). In collaboration problems such as those presented by trade liberalization among a large number of countries, there is an incentive for a state to allow others to liberalize while it continues to protect its sensitive industries. Under these circumstances, cooperation may require an institution with a formal organization and extensive monitoring to help enforce compliance.

Two kinds of negotiation fora are nested within the GATT/WTO regime, with relatively more flexibility for government control during trade rounds and higher levels of delegation for adjudication under Dispute Settlement Proceedings (DSP). During the trade rounds that engage in rule-making, states retain veto power through the consensus decision process. Thereafter, dispute settlement procedures provide the monitoring capacity to enforce commitments. The U.S. commitment to support GATT at its creation in 1947 was necessary to reassure smaller states that the United States would continue to support free trade. Later, frustration over the growing trade deficit led the United States to accuse other countries of unfair trade policies, and a period of increased U.S. unilateralism in turn led other states to again doubt the U.S. commitment to free trade. Facing a risk that all would turn away from cooperation with the rules, the U.S. supported the strengthening of the organization as a way to signal its continued preference for free trade (Goldstein and Gowa, 2002). The establishment of the WTO added a secretariat and strengthened the enforcement capacity of the dispute settlement process while prohibiting unilateral sanctions. These changes both facilitated trade negotiations among an increasing membership and renewed confidence in the rules enforcement system.

In contrast with the legalistic nature of the GATT/WTO trade system, Asia-Pacific Economic Cooperation (APEC) brings much lower levels of delegation and centralization with higher flexibility. APEC relies on advisory committees and consultation in an informal negotiation process. Commitments are not binding and have tended to be imprecise in form. Kahler (2000, 562) explains the particular form of Asia-Pacific Economic Cooperation (APEC) as a strategic choice by developing country members that would only consent to an informal institution because they feared that Japan and the United States would dominate agenda-setting and enforcement. Indeed, when designing APEC, members chose not to include a legalistic forum for dispute settlement.

Bilateral negotiations may occur at the informal level of diplomatic talks that produce a letter of understanding, or as a negotiation to produce specific commitments in a bilateral trade agreement that is ratified as a treaty. Regional trade institutions run the full range in levels of formality and delegation with some including formal dispute settlement procedures (Smith, 2000).

The creation of multiple fora for trade disputes reflects variation in the cooperation dilemma even within the area of trade policy. In addition to functional pressures, as Raustiala and Victor

(2004) argue, there is also path dependence in the evolution of the regime complex. One notable example is the use of prior agreements as a template in subsequent agreements in a different fora. This can work in both directions between the bilateral and multilateral level. For example, the United States first negotiated intellectual property right provisions in bilateral agreements, and then pushed for their insertion in the WTO (Helfer, 2004, 20). For other trade measures, the terms negotiated in the WTO agreements are often copied verbatim into bilateral agreements.¹

2 Institutional Selection

The long negotiations that establish an institution prevent frequent renegotiation. Transaction costs, concern about creating conflict with existing institutions, and status quo inertia all favor using or modifying existing institutions rather than creating new ones (Aggarwal, 1998). As Jupille and Snidal (2005, 16) argue, states face a problem of *institutional selection* that calls for “choice of one institution from a fixed but plural menu of extant alternatives.” In this selection decision states will respond to the cooperation problem and evaluate the transaction costs of existing institutions. The characteristics of the issue will shape preferences over institutional constraints. In addition, at the selection stage governments face domestic political pressures and diplomatic restraints that would be more diffuse in a general discussion about institutional creation.² There is less uncertainty about such demands given that the immediate issue at stake is known. Consequently, decisions about the institutional forum for a given dispute reflect specific goals of the state and interest groups in strategic interaction with the respondent state.

Trade disputes between states present a wide range of choices that allow for selective use of an international institution. Table 1 provides examples of the available options. Typically trade officials are not making a decision of whether to adjudicate or do nothing, but rather whether to file a complaint and/or raise the issue in a different venue. There is strong equivalence between dispute resolution systems under the WTO and NAFTA with many trade topics covered by both (Jackson, 1997, 135). Such potential for overlapping jurisdiction raises the possibility of *forum shopping* similar to the practice in a public law context of choosing among court jurisdictions. Even trade fora that differ substantially in their institutional form may be used to address similar trade policy issues.

In many trade disputes, a complaint about a particular trade barrier could be raised in multiple possible negotiation fora. An overview of several important U.S.-Japan trade negotiations illustrates this point. U.S. complaints about Japan’s quantitative restrictions on agricultural imports were addressed in the Tokyo Round, bilateral talks in the early 1980s, a GATT dispute panel in 1987, and in the Uruguay Round. Japan’s restrictions on forestry products were ad-

¹See Davis (2006) for example of the TBT agreement text used in the U.S.-Vietnam bilateral trade agreement.

²During institutional design, uncertainty about protectionist interest group pressure motivates the establishment of escape clauses (Rosendorff and Milner, 2001).

Types	WTO	Other Fora
Consultation	WTO committees	bilateral talks, OECD, summit
Comprehensive negotiation	Trade Round	APEC, EU, FTA
Adjudication	WTO dispute settlement	NAFTA dispute settlement

Table 1: Negotiation Fora for Trade Disputes

ressed in comprehensive U.S.-Japan bilateral negotiations, which produced the Market-Oriented Sector-Selective (MOSS) trade agreement in 1986, the Uruguay Round, and later arose as a central issue in the APEC talks on Early Voluntary Sectoral Liberalization during the 1998 Kuala Lumpur Ministerial meeting. Some trade topics involve the negotiation of an agreement in a new area and are not suitable for an adjudication forum. Nevertheless, this still leaves the option of bilateral, regional, or multilateral talks. For example, in the 1980s and 1990s, Japan and the United States concluded bilateral arrangements on semiconductors. Later semiconductor trade was subsumed within a sectoral agreement negotiated in a multilateral context. The Information Technology Agreement concluded at the WTO Singapore Ministerial in 1996 eliminated tariffs on semiconductors, telecommunications, software, and computer-related products. Alternatively, such an agreement could have been negotiated as an issue on the agenda of a trade round. Indeed, telecommunication issues were also part of the Uruguay Round service negotiations and commitments for basic service provisions were added in a 1997 Telecom Accord, which represented a sectoral agreement among a subset of 69 WTO members. As a final example, the United States has chosen to pursue investment agreements primarily on a bilateral basis, while Japan lacks bilateral agreements and urges that a strengthened multilateral framework on investment should be adopted as part of the Doha Round.

Many issues are raised in multiple fora simultaneously or sequentially. Indeed, the WTO procedures explicitly encourage bilateral settlement and/or resolution through discussion of trade problems in WTO committees. Even after a complaint is filed, WTO procedures call for a formal process of bilateral consultations in Geneva before entering the panel stage of adjudication. Thus an issue such as the EU policy on bananas had been the subject of the Uruguay Round and bilateral consultations before the United States along with Latin American countries filed complaints and entered the formal consultations of the dispute process that eventually led to a panel ruling and settlement.³ In another example, the problems of regulating the steel industry have been addressed simultaneously in several fora: after a surge of steel imports in 1998, the United States engaged in bilateral negotiations with exporters such as Japan, Korea, and Russia; a steel subsidies agreement is being negotiated under the auspices of an OECD Steel Committee; the Doha Round negotiation

³See Meunier and Alter (2004) for a discussion about how this case raised overlapping institutional commitments for EU members as they weighed the Lome convention and WTO agreement implications for the EU banana import regime.

group on WTO rules will clarify subsidies and anti-dumping rules that affect the steel sector as part of a broad agreement; and, several WTO dispute panels have ruled on steel anti-dumping and subsidies policies.

Indeed, pressure from one negotiation forum may encourage settlement in another forum on the same or related issues. In the case of the steel negotiations, the victory by the EU and other complainants in a WTO panel against U.S. safeguard tariffs protecting its steel industry was cited as adding more momentum to the OECD talks.⁴ The United States has also tried to use bilateral and regional FTA agreements as a means to apply pressure on nations to do more in trade rounds – during the Uruguay Round, U.S. engagement in NAFTA, several key GATT panels, and threats of bilateral retaliation on specific issues all pressured other states to become more serious about making the compromises necessary for a Uruguay Round agreement. Similarly, following the impasse at the Cancun meeting of the Doha Round, the United States increased efforts to achieve a Free Trade Area of the Americas both as an alternative forum for trade liberalization and as a means to pressure states to be more compromising in future Doha Round talks. When these regional talks themselves also stalled with disagreements between the United States and Brazil, the U.S. Trade Representative Zoellick said he would exert pressure on Brazil through negotiating bilateral trade deals with other Latin American states.⁵ A review of the scholarly literature, however, shows mixed evidence about whether liberalization through bilateral and regional free trade agreements promotes multilateral liberalization (Mansfield and Milner, 1999, 595).

While it is not uncommon for an issue to be addressed in multiple fora, few are addressed in all possible fora – some selection is made. Trade authorities have limited resources to engage in negotiations on all fronts for all issues. A kind of triage is necessary to direct specific trade disputes to the most appropriate negotiation forum.

3 Towards an Explanation of Forum Choice

Since its establishment in 1995, the dispute settlement system of the WTO has been used for litigation of over three hundred trade disputes. The complaints filed for adjudication, however, represent a small fraction of the total number of policies in violation of WTO agreements. Individual government reports on foreign trade barriers show extensive lists of unfair trade barriers, most of which are not being raised in adjudication. What determines why one trade barrier is raised in a formal complaint for adjudication while others are negotiated in different venues or simply monitored without any action?

⁴ *The Financial Times*, 6 December 2003.

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3.1 Interest group politics

An important factor for the choice of negotiation forum is domestic political pressure. The study of trade policy has long centered on how underlying economic interests and the influence of lobby groups on policy shape preferences for free trade or protection. Yet interest group lobbying is not restricted to the simple dichotomy of favoring free trade or protection. There is close coordination between interest groups and trade officials regarding strategies for any particular negotiation. Public-private partnership is especially important in the highly technical area of WTO adjudication (Shaffer, 2003). Interest groups help to identify specific trade problems and urge governmental action, lobby for selection of a particular institutional forum, and use their resources to support the chosen negotiation strategy.⁶

Discussing issues in a non-binding forum could be chosen by a government that wants to deflect weak domestic groups. Helfer (2004) suggests that developing country governments may have raised intellectual property rights issues about traditional knowledge in soft law fora as a way to respond to pressure without creating any obligation to take national action. Interest groups with substantial resources in terms of size and organization, however, are unlikely to be satisfied by a government simply talking about their problem. For governments facing demands from strong industries for relief from a trade barrier, the public nature of filing a legal complaint visibly demonstrates to domestic audiences that the government is engaging in aggressive export promotion.

On the side demanding liberalization, interest group preferences over choice of fora reflect an underlying concern to get the best outcome for their specific problem for the lowest transaction costs. These groups will favor the negotiation structure that focuses attention on their own trade problem. A smaller number of issues and actors reduces the risk that problems in other areas of the negotiation will delay or weaken the agreement on their topic. Informal settlement at the consultation level is appealing because it may require the least time and effort lobbying. Yet in the face of delay tactics by the trade partner and fear of noncompliance, fixed time periods and formal rules of adjudication offer advantages. Although adjudication is costly, a positive legal ruling provides greater leverage to bring a complete change in the policy and deter future use of such trade barriers by all trade partners. I expect that interest groups on the initiating side will prefer consultations and/or adjudication over comprehensive negotiations.

Some industries may be more reluctant to take their problem to the WTO. Dynamic industries with rapid product turnover may find WTO negotiations or adjudication too slow to be worth investing resources (Davis and Shirato, 2006). Industries with a regional comparative advantage but not a global advantage favor regional agreements that allow them to exclude third parties

⁶USTR officials recently instructed companies seeking help from the USTR to resolve trade disputes with foreign countries that companies are expected to commit resources by providing a detailed rationale for their complaint, hiring lawyers and economists to conduct relevant analyses, and lobbying agencies and politicians to support the USTR strategy (*Inside U.S. Trade*, 3 February 2006).

(Chase, 2003). Similarly, within the choice set of adjudication fora, illiberal industries fearful of setting a global precedent will favor regional over WTO adjudication (Busch, 2005).

The tendency for respondent governments to refuse concessions at the bilateral level limits the cases that can be successfully negotiated bilaterally to those without strong opposition. The WTO rules against unilateral sanctions have raised the costs of coercive bilateral negotiations. For example, the U.S. attempt to threaten sanctions against Japan for its refusal in bilateral talks to make concessions on auto market access led to Japan filing a WTO suit against the United States and brought a quick settlement in which the United States backed down on its major demands. In contrast, it is difficult for the respondent to keep sensitive issues off the table in a comprehensive trade round. During the early agenda-setting stage of trade rounds, consensus rules produce law-based bargaining that increases participation by adding issues and using vague language to prevent any group from feeling threatened (Steinberg, 2002). It is even harder for the respondent to veto adjudication. WTO rules of automaticity eliminated the GATT practice of allowing a state to block a panel against its policies. As a result, disputes with strong resistance to liberalization are the most likely to end up in WTO negotiations.

The resulting pattern is clear. The main venue for US-EU trade disputes over trade problems is the WTO, while they each pursue bilateral trade agreements with smaller states where the trade structure and exceptions in the agreement reduce domestic adjustment costs. Agricultural topics with entrenched opposition are mainly negotiated in the Doha Round while information technology where there was little organized opposition was dealt with in a sectoral agreement in the WTO among members willing to sign up.

Interest group hypothesis: Trade disputes involving a conflict between strong interest groups on both sides are more likely to be raised in WTO adjudication.

Diplomatic restraint

There is a strong push for export promotion because it creates a private good for the industry that gains market access and improves general welfare through the increase of free trade. It may also produce a negative externality for bilateral political relations. In particular, filing a WTO complaint generates tension because it accuses the trade partner of violating its commitments and demands the unilateral removal of a trade barrier protecting a domestic industry. The WTO dispute process can create negative public perceptions as a result of exaggerated rhetoric from both sides (Alter, 2003). The availability of alternative soft law fora in the trade regime complex highlights the perception that resort to hard law is an *aggressive* action.

International politics affects not only trade levels, but also management of trade disputes. The long-running liberal realist debate about interdependence and cooperation highlights two points: trade promotes mutual gains that can build common interests among the beneficiaries of trade, and trade generates clash of interest due to domestic opposition from those harmed by trade and

international concern about relative gains. States must manage this dilemma and avoid the risk that a trade fight will lead to a security fight. Just as states recognize that markets react to their diplomatic moves (Gartzke and Li, 2003), they also consider how economic policies could influence diplomatic relations. Therefore they strategically select their trade disputes. The calculation for institutional selection may include evaluation of the impact on bilateral relations.

Allies that have close political relations may be more willing to risk small damage to political relations from a trade dispute. Since there is less fear of security problems between democracies, and democratic governments are accustomed to viewing adjudication as a legitimate means of dispute resolution, states will also have less concern about the negative externality for bilateral relations when dealing with a democratic state. Therefore, even when accounting for the expectation of higher trade flows between allies and democracies (Gowa, 1994; Mansfield, Milner and Rosendorff, 2002), these states will have more trade disputes because a trade dispute between allies or democracies is less likely to increase the risk of security problems. States that have sensitive political relations on the other hand may fear that negative repercussions from a trade dispute will spillover to increase the risk of security conflict sometime in the future. For example, the United States and Japan are far more likely to initiate WTO complaints against each other as allies than they would initiate a dispute against China.⁷

Diplomatic restraint hypothesis: States will be less tolerant of trade barriers by allies and democracies, and more likely to file a legal complaint against them. States will be more likely to ignore the trade barriers of states with less friendly relations.

Efficiency

The null hypothesis is that states choose the forum according to the legal status and market value of the trade measure at stake. While the previous hypotheses emphasize political and diplomatic factors that influence the cost benefit calculation for a dispute, a more narrow focus would dictate simply weighing the transaction costs of settling the dispute in a particular forum against the likely gains from ending the trade barrier. Adjudication is a costly process that takes anywhere from two months to four years and requires extensive legal resources. High value markets are more likely to present sufficient benefits to justify the cost of litigation. Moreover, in adjudication there is no certainty of gaining victory in the ruling or compliance from a victory. Some issues, such as anti-dumping measures, have led to consistently strong positive rulings and have transparent implementation. Other issues such as those related to domestic standards have fewer case precedents and are more likely to encounter problems to evaluate implementation.

Efficiency hypothesis: Only strong legal cases of high market value will be adjudicated.

⁷One could also conjecture that states anticipate democracies or allies are more likely to comply with a ruling. Empirically, all of the major compliance failures in the WTO dispute settlement have been by democratic states, with many involving the United States, Europe, and Canada. Nevertheless, a selection process could screen out noncompliance by other states.

4 Unraveling Packages and Segmented Reputations

The cumulative effect of selection choices among overlapping institutions in the trade regime complex may have detrimental effects for the multilateral regime. The key question is the possible shift in aggregation of interest group behavior and reputational penalties.

As discussed above, interest group pressure pushes some of the most difficult issues into the multilateral forum (WTO trade round or DSP) where it is more difficult to veto placing an issue on the agenda. Easier issues where there is less resistance for a given product or with a specific country are more likely to be settled in the other fora that can be more efficient. As Hooghe and Marks (2003, 240) suggest, governance with multiple jurisdictions (“Type II Governance” as opposed to federal style “Type I Governance”) facilitates entry and exit among competing fora. When a multilateral forum appears to represent a slow and costly bargaining process (trade rounds last five to eight years while dispute settlement cases last anywhere from one month to four years), shifting negotiating attention to regional or bilateral agreements represents the rational exit strategy for any issue that does not face a veto actor in the respondent state.

Such competition could encourage a market for production of a public good (Hooghe and Marks, 2003, 240). Indeed, a clear example is the U.S. strategy to push forward with NAFTA negotiations when the Uruguay Round appeared to be foundering in deadlock. This has often been cited as one factor to push the Europeans and Japan to be more serious about making concessions to reach an agreement in the Uruguay Round.

But it is also possible that use of the exit strategy will unravel the package deals and grand coalitions that are necessary to achieve broad liberalization in trade rounds. Those industries that find their trade interests satisfied by the bilateral, regional, or sectoral agreements will no longer have any reason to lobby for the multilateral process. Rather than having a large cross-sector deal in the multilateral round that allows every state to find a balance of costs and benefits, some industries will be left with few benefits to gain from a multilateral agreement that they have not already gained through bilateral or regional agreements. This could reduce the ability of states to construct a domestic coalition in support of the multilateral agreement.

In addition, the presence of multiple jurisdictions with free exit has important implications for the reputational mechanism that maintains compliance. Keohane (1984) shows that international institutions help states with short term incentives to defect achieve long term gains from cooperation by engaging them in repeated cooperation over time with linkages across issues. A central point is that institutions encourage states to maintain a good reputation through compliance in order to achieve broader gains within the institutional setting. In a formal model of trade cooperation, Maggi (1999) shows that the DSP sustains cooperation by providing information to third parties about violations. He argues this mechanism generates a broader reputational effect than in the absence of the institution where there would be no such third party reputational effect (Maggi, 1999). These theories suggest the importance of reputational mechanism to maintain

compliance within a regime, but are silent on effects across regimes. Downs and Jones (2004) have argued that states have multiple reputations and a violation of one agreement may not impact the reputation of the state in another regime. They point to the frequent pattern in which states have varying compliance records and reputations in different areas. By offering “limited liability”, the segmentation of reputation reduces reputation penalties for any given violation relative to the assumption that state’s have a single reputation from violations.

The question here is whether the trade regime complex is sufficiently dense to support a single reputation shared across overlapping institutions. If states have a single reputation in the regime complex, each forum could borrow leverage from the larger stakes of the regime complex for greater enforcement power. For example, if a Canadian violation of NAFTA agreement not only influences its reputation with its NAFTA partners but also WTO members, NAFTA would gain stronger pressures for compliance. But if there are segmented reputations within the trade regime complex (e.g. the violation of NAFTA has no effect on Canada’s WTO reputation), then overlapping institutions could weaken reputational penalties by providing exit options. Through forum shopping, states could escape a bad reputation in one venue and pursue opportunities for agreements in another forum where they would not suffer any reputation penalty.

Evaluation of the impact of overlapping institutions on outcomes and compliance requires comparison of similar cases settled in different institutional fora over time. One would want to examine whether an increase in liberalization of a particular industry achieved in one forum is followed by less lobbying from that industry for subsequent cases in other fora. The segmentation of reputations could be observed in differential compliance records across institutions in the regime complex for comparable disputes, whereas similar compliance levels would be indicative that states hold a single reputation.

5 Concluding remarks

As research moves away from studying a single institution in isolation to comparison of a set of nested and overlapping institutions, it is important to give more attention to how states decide which issues will be addressed in a particular forum. The hypotheses suggested here are incomplete – government institutions, bargaining power, and ideas along with other factors not mentioned are also likely to influence institutional selection.

This memo suggests a two stage research agenda to model institutional selection choices and policy outcomes. One point is the need to examine the full set of potential trade disputes. I am currently completing a dataset on the trade complaints of the U.S., EU, and Japan with their major trade partners and plan to investigate some of the issues raised in this memo and in the discussion at this conference for my current research project.

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