

1. INTRODUCTION

The rise of China and other members of the BRICS and a series of crucial events such as the Asian financial crisis of 1997 and the global crisis of 2008 have transformed the global economic landscape. The changing dynamics of the global trade system have posed serious challenges for interests of large economies such as US and EU who have played a central role in the rule-based multilateral trading system since the end of World War II.

Despite these challenges and reforms, international institutions have long sustained the liberal international economic order since 1944. The World Trade Organization (WTO) and its predecessor -The General Agreement on Tariffs and Trade (GATT)- have been the central institutional pillars of the Bretton Woods system. In recent years, however, the mood about the WTO and its dispute settlement system has shifted dramatically. The US President Trump has clearly expressed his distaste for the WTO which he widely criticized as unfair to US interests. By blocking judicial appointments to the WTO's Appellate Body, not only did he paralyze the 25-year-old system of resolving disputes, he also put at risk the foundation of the global trading system and economic order. As noted by Cecilia Malmström, the EU Commissioner for Trade, "The appellate body function of the WTO dispute settlement system is moving towards a cliff's edge. Without this core function of the WTO, the world would lose a system that has ensured stability in global trade for decades."¹

It seems clear that the Trump administration wants the world economic order revert to the glory days under the GATT where the largest economies wielded power to change the behavior of others. As we know, however, the old system has been replaced for that reason. It is more important than ever that we look at economic relations between hostile economic

¹"WTO reform: EU proposes way forward on the functioning of the Appellate Body," <https://trade.ec.europa.eu/doclib/press/index.cfm?id=1945>. Accessed June 15, 2020.

partners, changing dynamics of the global economy, and discontent among states at the institutional changes. In my dissertation, I address pressing concerns over the institutional design of dispute settlement, its consequences of power disparity, and the future of the multi-lateral trading system more broadly. In doing so, I focus on two salient trends in international trade systems over the last two decades: the legalization of international institutions and the proliferation of regional trade agreements (RTAs).

In recent decades, world politics has become increasingly legalized² through the creation of international courts or court-like institutions across issue areas (e.g. trade and investment, peace and security, health and human rights, and the environment). One of the major changes of the WTO from its predecessor was the transition to a strongly legalized dispute resolution system. The WTO provides more precise, elaborated, and binding rules and timelines than the GATT. Countries can no longer wield a veto in the new system and hence, small and poor countries are able to bring more disputes against more powerful countries. The introduction of the permanent Appellate Body composed of highly-qualified lawyers contributes to the rule of law in the trading system. By restricting the use of escape clauses and safeguards, the WTO also constrains opportunistic behavior by members.³

The WTO's dispute settlement mechanism is widely recognized as one of the most legalistic institutions. Extant literature has analyzed the role of the WTO's dispute settlement system (e.g. Chaudoin, Kucik, and Pelc, 2016; Rosendorff, 2005; Sattler, Spilker, and Bernauer, 2014). Despite the criticisms of increased legalization of international institutions (e.g. Goldstein and Martin, 2000; Kim, 2008) many studies of international adjudication show the effectiveness of the WTO's newly upgraded dispute resolution system (e.g. Davis, 2012; Rosendorff, 2005).

²Legalization refers to a set of institutional characteristics with three dimensions: obligation for compliance through binding rules, precise and highly elaborated rules, and delegation to international arbitration (Abbott et al., 2000).

³See, for example, Goldstein and Martin 2000.

In the following two chapters, I ask: Does the WTO's legalized dispute settlement mechanism provide a more level playing field for small and weak countries than the GATT? Building on Rubinstein's alternating-offer bargaining model,⁴ Chapter 2 examines how the legalized dispute settlement mechanism benefits less powerful states in trade disputes with their more powerful counterparts. My game theoretic analysis demonstrates that weak complainants are more likely to benefit from the WTO than the GATT due to structural advantages of the WTO's dispute settlement mechanism granted to complainants. Nevertheless, fair adjudication which supports specific and firm rules of the dispute resolution system is necessary for weak complainants to insulate themselves from power politics. These results suggest that the sheer existence of legalized international arbitration alone is not an effective means of empowering weak members.

In Chapter 3, I test the empirical implications of the key theoretical and substantive findings of my game-theoretic work. I argue in the affirmative: the enhanced legal features of the WTO's dispute settlement mechanism provides bargaining leverage for small and poor countries so that they have fared better than under the GATT. Using original data on disputes at the GATT and the WTO from 1980 until 2018 and post-dispute trade flows for each GATT/WTO dispute initiated between 1989 and 2015, my statistical analysis illuminates the patterns of disputes over international trade regimes and the distributional effects of institutional design of dispute settlement mechanisms, and further the effects on the "rigidity and stability" of the multilateral trading system. Empirical evidence supports my arguments that the more legalized system of dispute settlement provides a more level playing field for small and poor countries by providing bargaining leverage for them to gain more from disputes with their more powerful counterparts.

Along with the rise of global economic interdependence, regional trade agreements have become increasingly common in the international trading system since the end of World

⁴See Rubinstein 1982.

War II. The number of RTAs has increased rapidly during the past two decades. In particular, it doubled to reach more than 400 RTAs in force from 2000 to 2016. Most nations are now involved in one or more RTAs; even nations without any RTAs are not completely outside the range of RTAs. As Bhagwati and Krueger (1995) have put it, we now live in a world like a “spaghetti bowl” where every nation is connected with different types of RTAs in a very complex way.

Although there is a great variation, almost all RTAs have systems of dispute resolution. Yet, the WTO has been used much more frequently than RTA for dispute resolution (Chase et al., 2013). The empirical irregularity of disuse of RTA dispute settlement mechanisms (DSMs) leads to the next puzzle: Why do countries agree to build dispute settlement systems in regional trade agreements but do not resort to such systems to resolve their disputes? Seeking answers to the puzzle, I compare the institutional designs of dispute settlement between the WTO and RTAs in Chapter 4.

Rosendorff (2005) shows that legalization of the WTO helps to enhance systemic stability by bringing flexibility into the strategies of member countries. I extend Rosendorff’s model of the WTO’s dispute settlement mechanism to demonstrate that regional trade agreements increase power disparities more than the WTO by providing greater flexibility in using dispute resolution strategies to powerful countries.

The model predicts that an RTA’s dispute settlement mechanism will increase the flexibility gap between the poor and the rich. RTA arbitration grants more room for powerful countries to manipulate the international trading system when it comes to disputes. Less powerful countries are less likely to have flexibility in RTA arbitration than they would have under WTO arbitration. As a result, less powerful countries are more likely to insulate themselves from power politics in the WTO than RTAs. This implies that the frequent use of WTO adjudication results from the systemic superiority of the WTO compared to RTA adjudication.

This result also implies that the increased disparity in strategic flexibility will lead to increases in per period probability of breakdown and, consequently, reduce the stability of the trading system. An RTA's dispute settlement mechanism generates a trade-off in gains between large and small countries, rather than the trade-off between "rigidity and stability" as in the WTO. And the significant loss sustained by weak countries incurs the cost of stability of the regional trading system.

The conclusion chapter reviews the theory about the role and the distributional consequences of the institutional design of dispute settlement across international trade regimes. It highlights the key findings of this dissertation and contributions in the literature.