

# Measuring the Cost of Privacy: A Look at the Distributional Effects of Private Bargaining \*

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## Abstract

Transparency is one of the most contested aspects of international organizations. While observers frequently call for greater oversight of policymaking, evidence suggests that settlement between states is more likely when negotiations are conducted behind closed doors. The WTO's legal body provides a useful illustration of these competing perspectives. As in many courts, WTO dispute settlement is designed explicitly to facilitate settlement through *private* consultations. However, we argue that the privacy of negotiations creates opportunities for states to strike deals that disadvantage others. Looking at product-level trade flows from all disputes between 1995 and 2011, we find that private (early) settlements lead to discriminatory trade outcomes—complainant countries gain disproportionately more than the rest of the membership. When the facts of a case are made known through a ruling, these disproportional gains disappear entirely. We also find that third party participation—previously criticized for making settlement less likely—significantly reduces disparities in post-dispute trade. We draw parallels to domestic law and conclude with a set of policy prescriptions.

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# 1 Introduction

How much transparency should there be in global governance? While public opinion is quick to call for greater openness in international institutions, political scientists remain ambivalent. Recent findings show that when bargaining is conducted in public view, negotiators are vulnerable to influence by powerful domestic interests. Domestic pressure creates incentives to adopt more aggressive stances, which significantly reduces the prospects for compromise between parties (Stasavage, 2004*a,b*; Fox, 2007; Busch and Reinhardt, 2006; Kahler, 2004). As a result, bargaining may be more productive when conducted behind closed doors, shielded from the view of hard-line interests. This purported relationship between privacy and effectiveness is the rationale behind, e.g. committees in domestic legislatures that confer *in camera*. It is also why countries frequently conduct diplomacy and international bargaining in private.

There is a danger, however, to taking these claims too far and losing sight of privacy's costs. Although privacy insulates negotiators from certain political pressures, it also means that actors affected by "closed door" deals are left disenfranchised. This is why deliberations that take place in international institutions are sometimes seen as "remote, secretive, unintelligible, and unaccountable",<sup>1</sup> and have become a frequent target of criticism, especially among democratic audiences.

Importantly, the debate over transparency is not just about what states allow their domestic constituencies to see. It also relates to what states reveal to each other. For example, one of the key factors behind the trend toward regionalism in global trade governance is the idea that like-minded states can reach more ambitious deals without other parties in the room. Yet, here too, the same tension arises. States might be better able to strike deals when insulated from international audiences, but these deals may come at a cost—namely, the interests of other countries.

While considerable theoretical progress has been made in the debate over transparency, empirical work lags behind. This is not surprising: the nature of private negotiations makes them a difficult object of study. If affected actors cannot scrutinize these deals, how might scholars do better? We confront this empirical challenge by looking to an institutional setting in which privacy plays an important, observable role: the World Trade Organization. The WTO's legal body, praised as the "cornerstone of the trade regime," features a fortuitous design that pits both sides of the transparency argument against one another. As a result, although it remains difficult to ascertain the impact of privacy in any one case, it is possible to assess the average distributional

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<sup>1</sup>From Schmitter (2003, 83)'s characterization of Europeans' fears over the interference of the European Union in their daily lives.

effects of privacy across the WTO.

The rules of the trade regime enshrine the principle that privacy promotes agreement. The WTO's Dispute Settlement Understanding (DSU) is explicitly designed to promote out-of-court settlement, requiring that states consult with one another before a panel is convened. Crucially, that mandatory consultative process, and its results, remain private: the exact terms of "early settlements" are rarely revealed to the membership. The DSU's institutional design is a testament to the belief that some measure of opacity facilitates settlement. For this reason, the WTO serves as an apt illustration of our argument.

We argue that the true cost of privacy has been unaccounted for by the WTO's designers. In particular, privacy creates a space in which states can strike *discriminatory deals*. A discriminatory agreement is one where participants accrue disproportionate benefits, that is, where trade benefits from settlement are not distributed equitably across WTO members with a stake in the matter. The private nature of consultations generates opportunities for such deals even as one of the WTO's core principles prohibits precisely this kind of discrimination. We show that even with explicit rules proscribing discrimination, privacy skews deals in favor of the parties in the room. This is because privacy itself makes credible oversight of these agreements difficult. The benefits of privacy are no less real; it does render reaching agreements more likely. However, these benefits must be weighed against the price paid in terms of the uneven distributional effects of the agreements struck.

Recognizing the possible risks associated with transparency, the WTO introduced "third party" status, which allows non-litigants to enter the room from the very beginning of a dispute, including the otherwise private consultative process that precedes litigation. A number of scholars have seized upon this reform as an opportunity to explore one side of the transparency debate. Davey and Porges (1998) warn that third parties make settlement more difficult and Busch and Reinhardt (2006) bolster this claim. The odds of settlement drop by more than half, on average, when a dispute features third parties. Their explanation is that the presence of third parties induces litigants to look tough, setting a precedent for future disputes. The result is that third parties reduce the likelihood of compromise.

We do not dispute these claims. We argue, rather, that the presence of third parties can also be used to examine the other, less empirically validated, side of the transparency debate. We expect that when third parties are in the room, litigants grow more likely to reach solutions that are beneficial to the broader membership: third parties act as unwitting enforcers. Conversely, when there are no third parties in the room at all, litigants will take advantage of low transparency,

striking deals tailored to their own interests.

The findings provide support for our expectations. We present systematic evidence of the average effects of privacy in WTO disputes. We examine what happens to trade flows of disputed products in the wake of disputes, and identify how trade flows relate to the level of privacy under which the settlement was reached. Considering all WTO disputes since 1995 addressing merchandise trade, we find strong evidence of disparities in trade flows resulting from early settlements—i.e., agreements reached in private. Under the privacy afforded by consultations, complainants benefit significantly more than the rest of the WTO membership. Crucially, this is not purely a result of complainants having more to gain. Even when taking into account the precise nature of disputes, including whether they are about bilateral issues, there are larger differences in the trade benefits accrued by complainants relative to the members. As such, our findings should be cause for concern to observers who view the privacy of consultations as welfare-enhancing. This article provides what is to our knowledge the first evidence for the existence of discriminatory settlements at the WTO.

Yet, our findings also bring good news. We show that by their sheer presence, third parties significantly reduce the disparities in payoffs. Moreover, this unwitting enforcement effect holds when we account for the existing literature’s claim that third parties make settlement less likely. Even after correcting for this selection bias, third parties play an important role in deterring discrimination. Taken together, the evidence suggests that third parties free-ride on the complainant, and the rest of the membership free-rides on third parties. Settlements *can* be thought of as a public good, but only when they are conducted in a sufficiently open manner.

Our results demonstrate that transparency has countervailing consequences within international institutions. The distribution of trade benefits from WTO membership are shaped by the privacy of the dispute settlement process. Even in an institution built on the principles of reciprocity and non-discrimination, states appear to take advantage of the opportunities that privacy creates to strike deals that violate these norms.

We close with a set of policy prescriptions. The WTO is aware of the risk privacy poses: WTO training modules speak of “the danger that the parties to a dispute might be tempted to settle on terms that are detrimental to a third Member not involved in the dispute” (WTO, 2004). Yet its institutional design makes enforcement difficult. As we show, the problem lies not principally in the privacy of the negotiations themselves, but in the opacity of the outcome of those negotiations. We compare the lack of oversight of these negotiations outcomes with the other Bretton Woods institutions, which have recently implemented oversight mechanisms in response to similar concerns,

and with another issue-area at the domestic level: antitrust legislation. We use these other settings to describe how an oversight mechanism might function in the trade regime, and argue that it would come at comparatively little cost to the effectiveness of negotiations.

## 2 Argument

Much like students taking an exam, policymakers are expected to act differently simply by virtue of knowing they are being observed. The fact that their positions are part of the public record ought to create incentives to better represent constituents' interests. This is why transparency is often presented as an end in itself: as soon as deliberations take place in plain view, they are expected to yield different outcomes. Negotiators must internalize the preferences of their constituents, and take those interests into account in the positions they take and in the concessions they make.

Transparency is most meaningful when mechanisms to rein in the political actors at issue are themselves highly effective. This requirement is met both in principal-agent relationships, as with policymakers negotiating a trade deal on the part of domestic constituents, and in institutional settings where other states have formal means of recourse if they view their interests have been negatively affected. In such settings, transparency is above all a tool of deterrence. It deters undesirable behavior on the part of negotiators, from the point of view of observers.

Questions about the effects of transparency on representation (and policy outcomes) are relevant at all levels of governance. Yet, they have special resonance in the context of international institutions, where it is often claimed there exists a democratic deficit. The fact that international institutional designs are faulted for lacking democratic legitimacy is, of course, not happenstance. There is a widespread belief among policymakers that transparent negotiations at the international level bear less fruit. There are at least two reasons for this. First, open negotiations may create disincentives for the parties to compromise. Accountable governments risk public sanction for appearing to back down during negotiations. Domestic audiences are often assumed to have hard-line preferences and, as a result, may place pressure on negotiators to adopt more aggressive, less cooperative postures. If so, then negotiators have incentives to look tough to appease the domestic constituency at the expense of compromise. Second, bargaining in public could simply become intractable as greater numbers of parties (with diverse preferences) are allowed to influence the outcome.<sup>2</sup> In sum, when parties can meet behind closed doors, shielded from public view,

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<sup>2</sup>In the memorable words of the American diplomat Harlan Cleveland, the question is, "how do you get everyone into the action and still get action?" in: Keohane and Nye (2001).

compromise is more likely.

Thus, transparency implies an important trade-off. On the one hand, observers want knowledge of, and access to, the policy making process. On the other hand, privacy insulates negotiators from external pressures, increasing the likelihood of settlement. How can one determine which outcome is welfare-enhancing?

Given the nature of private settlements, it is hard to measure this trade-off with precision. However, one setting that provides a fitting laboratory in which to observe the distributional consequences of privacy is the WTO, an institution that has been at the center of the debate over internal transparency. The WTO and its DSU provide a useful illustration of the argument. Unlike many other institutional settings, we can directly observe the outcome of private negotiations: trade flows between members. This is akin to estimating the content of private settlements in civil suits by monitoring all parties' bank accounts.

And unlike other domains, countries' incentives are straightforward: complainants, and other countries with exports at stake, seek greater market access. Defendants, for their part, would rather limit such market access to protect politically powerful domestic interests—otherwise there would be no dispute. For these reasons, this paper attempts to measure the cost of privacy by looking to the WTO and asking: who gains more, and who gains less in the wake of disputes?

## **2.1 Encouraging Settlement Over Rulings Through Privacy**

The WTO's legal system is designed to facilitate settlement. As in other domestic and international legal settings, countries would rather avoid the condemnation of an unfavorable verdict. From the standpoint of domestic politics, these verdicts constitute the "fire alarm" that alerts constituents to their governments' violations of the very obligations they committed to (McCubbins and Schwartz, 1984; Sevilla, 1997; Chaudoin, 2011). These recognized violations constitute political opportunities on which domestic opposition may capitalize (Kono, 2006): if voters act on such signals at the polls, these violations decrease state leaders' odds of retaining power (Mansfield, Milner and Rosendorff, 2002). Similarly, countries rather avoid being seen as breaking the rules in front of other member-states. A settlement avoids such an authoritative condemnation of a country's behavior.

Even absent any reputational consequences that result from an unfavorable panel ruling, one motive for settling is to avoid high litigation costs. For this reason, all else equal, a country should be willing to concede more if the case does not go to trial (Gilligan, Johns and Rosendorff, 2010). In sum, governments are keenly aware of the cost of adverse WTO rulings, and behave strategically

to avoid them.

This incentive to avoid condemnation of unfavorable verdicts helps explain the high rate of early settlement: 63 percent of disputes never make it to a panel ruling. Of these, about half end with a “mutual agreed solution”; the remainder are dropped by the complainant. This is not happenstance: this preference for settlement over litigation is built into the institution’s design. The DSU explicitly mentions in Article 3.4 that any rulings or recommendations “shall be aimed at achieving a satisfactory settlement of the matter.”

The means by which the DSU encourages settlement highlights its recognition of members’ domestic politics. Given that trade protection likely emerges as a result of successful petitioning by domestic industries, the WTO’s institutional design not only imposes a period of mandatory bargaining in advance of litigation, but it actively protects the privacy of this bargaining phase. Indeed, while the institution has progressively increased its level of transparency in recent decades, the privacy of consultations has been jealously guarded (with the notable exception of third parties, which we examine closely below). The privacy of consultations is geared towards allowing litigants to settle their differences without the intrusion of the domestic groups with interests at stake. It keeps governments from having to posture for the sake of its industries. It also allows governments to present the outcome of negotiations in a favorable light to domestic audiences once they come home. Taking these considerations together, the incentive to settle—which allows defendants to save face, avoid the condemnation of a negative ruling, and arrive at a private agreement while it is still possible—grows as the process of dispute settlement inches closer to a ruling.

This also helps explain why scholars such as Busch and Reinhardt (2001) claim that the odds of observing full concessions falls once a verdict is handed down, even if the complainant wins the verdict. Once a verdict is handed down, defendants have little left to lose, since they have already been branded as violators. As a result, they are more likely to dig in their heels and delay compliance as long as possible. Accordingly, the success of dispute settlement rests on its ability to drive (early) settlement between litigants.

## **2.2 The Impact of Privacy on the Content of Settlements**

### **2.2.1 Settlements as Public Goods**

The WTO’s central principle, most-favored nation (MFN), states that any concession granted to one member shall be granted to all members. Yet the negotiations underlying the institution remain, in many respects, an aggregation of bilateral deals (Bagwell and Staiger, 2004). During WTO

accessions, working party members negotiate on a bilateral basis with the entrant, and the sum of these bilateral deals constitutes the accession package. Similarly, throughout the GATT, especially, multilateral negotiations consisted of bilateral deals that were then extended to other members through MFN. More relevant to our argument, dispute settlement is usually a bilateral process, since in most cases a single complainant challenges the policy of the respondent country. Yet dispute settlement features the equivalent obligation to extend all concessions obtained bilaterally to all members. This obligation is contained in DSU Article 3.5, which outlines that any solutions arrived at during dispute settlement must be consistent with the agreement, meaning that the settlements reached between litigants cannot be discriminatory. In other words, a defendant cannot legally lift barriers on a given product for the complainant, without also lifting barriers on that product for all other members. The rules thus intend for all members to gain from settlements.

The implication is that non-participants can free-ride on bilateral negotiations, including those conducted during a dispute (Bown, 2009, 2005). Anecdotal evidence tells us as much. Consider a complaint filed by the U.S. against Japan over import restrictions on apples. As a result of this challenge, New Zealand—which also exports apples to Japan—stands to benefit in equal measure. As Phil Alison, the chairman of Pipfruit New Zealand Growers, rejoiced, “[t]he Americans will now sit down to negotiate a protocol with the Japanese and we will hope to piggy-back on that”.<sup>3</sup> The fact that the case was filed by the US may well mean that the U.S., as a country, cares more about this issue than New Zealand, either because it exports more apples to Japan in absolute terms, or because it is a more politically salient issue at home. Yet Pipfruit New Zealand Growers, as well as all other apple exporters to Japan, stand to gain as much as American exporters. This is the public goods promise of dispute settlement.

Yet, the multilateral and the bilateral facet of the WTO sometimes enter into conflict. Early settlement represents such a setting. We argue that the means by which the institution promotes early settlement—and thus the odds of liberalization, given how full concessions are more likely prior to a ruling than subsequent to one, regardless of the ruling outcome—also make dispute settlement more prone to discriminatory settlements. In other words, there exists an implicit clash between the way in which the institution seeks to increase the size of the pie and the means by which it would ensure the equitable distribution of this pie. This familiar clash between effectiveness and equity is the one we examine in this article. We demonstrate that owing to its institutional design, the WTO is tilted more towards bilateralism than conventional wisdom would lead us to believe.

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<sup>3</sup>“Apple Growers Reject WTO Ruling”. Sydney Morning Herald. November 27, 2003. Available at: <http://www.smh.com.au/articles/2003/11/27/1069825915658.html>.

## 2.2.2 Settlements as Private Benefits

Opportunistic, or “discriminatory” settlements, which are struck between litigants at the expense of the greater membership, can take on many forms. Precisely because of the institutional design features that promote settlement through privacy, we lack accounts of early settlements struck in consultations. Indeed, it is a corollary of our argument that if there were readily available data on these, there would be far less reason to fear discriminatory outcomes in the first place. As we describe below, many of the same concerns operate in domestic law.

We can, however, point to settlements reached in public view, after a dispute has run its course, where others have protested that a settlement amounted to discrimination. When the US and EC recently reached an agreement in one of the WTO’s oldest disputes, *EC—Hormones*, other countries warned that the settlement reached could be discriminatory in a way that went against the EC’s obligations under DSU Article 3.5. Indeed, the settlement could be taken to define “high quality beef”, on which a larger quota was offered, as “only that of the type exported by the US”.<sup>4</sup> As a representative from Uruguay, an important beef exporter, put it: “There was no justification for maintaining that this specific type of beef, which received preferential treatment, was different from other high quality beef. This constituted discriminatory treatment in favour of a certain origin. [...] Uruguay and all other suppliers would be up against a competitor with a single and exclusive zero tariff preference.”<sup>5</sup> The representative of Uruguay went on to read Article 3.5 of the DSU in its entirety, stressing that any settlement reached in the case could not be struck at the expense of third countries. In another dispute brought by Korea against Japanese restrictions on seaweed imports, *Japan—Quotas on Laver*, Japan agreed to effectively allocate its quota of dried and seasoned laver imports exclusively to Korea.<sup>6</sup>

Our point is that these types of objections are never voiced in reaction to mutually agreed solutions reached prior to a panel ruling, since there is most often no information available about these early settlements. Some of these agreements, as noted above, are never even formally notified to the institution.<sup>7</sup> Settlements in disputes that led to verdicts and appeals and compliance panels,

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<sup>4</sup>WTO document WT/DSB/M/270.

<sup>5</sup>Statement by the Representative of Uruguay, Minutes of Meeting Held in the Centre William Rappard on 19 June 2009, WTO document WT/DSB/M/270, para 68.

<sup>6</sup> The settlement read: “An annual import quota will be allocated exclusively for Korean Laver Products.” WT/DS323/5. See Alschner (2012). Observers were quick to denounce this agreement as discriminating against other members to the benefit of the parties in the room.(Nakagawa, 2007) In explaining why such deals could be reached, legal scholars pointed both to the lack of full transparency, and to the high bar for legal recourse against perceived discrimination: “as the content of the mutually satisfactory solution is not disclosed, there is a small chance for an interested third Member to detect it and take action against it under the WTO DSM.”(Nakagawa, 2007, 858)

<sup>7</sup>See WTO document WT/DSB/M/15.

by comparison, largely take place in public view. This wide informational disparity between cases that settle early and those that reach a ruling may be difficult to conceive of. After all, the WTO, as other international institutions, has as one of its core missions the distribution of information about its members' trade policies. To illustrate the difference that the ruling makes for the amount of public information available about a case, we compare the length of all mutually agreed solutions reached before and after a ruling. This is a crude measure, yet it remains a telling one for the purpose of illustration.

Indeed, most cases that reach a verdict end with the defendant publicly complying with the WTO judges' recommendations. Yet countries may also go on negotiating even after a ruling, and reach some compromise solution in view of the ruling's content. Our premise is that when such settlements are reached past the ruling stage, they have largely lost their private nature. Rulings have publicized the facts of the case, and converged the membership's expectations over what would constitute a satisfactory outcome—hence the incentive to settle early. To demonstrate this, we collect all 91 notifications of a mutually agreed solution: of these, 32 were concluded after the ruling, and 59 were concluded without a ruling having been reached. These settlements, of course, do not include concluded deals that were not notified, such as the entirely private deal concluded between Malaysia and Singapore in 1996, where the dispute was dropped by Singapore before ever reaching a verdict. Only later was it made clear that a bilateral arrangement had been reached, a lack of transparency that the DSB Chairman himself complained about.<sup>8</sup> The difference in the detail provided in pre-ruling vs. post-ruling deals is made apparent in Figure 1. The average length of a mutually agreed solution is 9 pages when reached prior to a ruling, and 28 pages when reached after a ruling. This difference is highly statistically significant. These documents all have the same legal status, and are constrained by the same legal requirements for openness. Yet when deals are reached prior to a ruling, and the entirety of a case has taken place in a closed room, countries are less likely to provide detailed information about the content of their settlement. Some notifications of early settlements amount to one sentence: “On behalf of our authorities we would like to inform you that Hungary and Croatia did find a mutually satisfactory solution to this case in 2003.”<sup>9</sup> In such cases, members outside the room have no chance to scrutinize the content of the bilateral

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<sup>8</sup> “[The Chairman] recalled that in July 1995, following Singapore’s withdrawal of its request for consultations with Malaysia, the Chairman of the DSB had stated that: ‘it was important that at this stage when DSB practices were being established that Members considered the need to register formally not only the initiation of disputes but also the settlement and resolution thereof’. *This precedent had not been followed.*” (emphasis added) Visibly, the precedent has fared no better since this dispute. Dispute Settlement Body, Minutes of Meeting Held in the Centre William Rappard on 24 April 1996. WTO Doc WT/DSB/M/15.

<sup>9</sup> WTO Document WT/DS297/2. See Alschner (2012)

deal.

In sum, cases like *EC—Hormones* and *Japan—Quotas on Laver*, where one can identify discrimination because a deal is reached after a panel has clarified the facts of the case and has found in favor of one party, are likely to be only the tip of the iceberg. While the publicity inherent in a ruling, which converges members’ expectations about what a settlement should look like, will act as a deterrent to discrimination, no such deterrent exists for cases that settle in private, since challenges of discrimination become downright improbable (Nakagawa, 2007). Knowing what we know about countries’ incentives, discrimination is thus likely to be concentrated in early settlement reached in private.

### 2.3 Domestic Parallels

The debate over the transparency of deliberations provides an especially fruitful opportunity to try and bridge the traditional divide between the study of domestic and international institutions (Staton and Moore, 2011), and give added weight to the argument. Indeed, it is in the domestic realm that the tradeoff between equity provided by greater transparency, and effectiveness that hinges on privacy, has been studied most closely. And it has generated identical concerns, despite the common perception that the domestic sphere is more transparent and less afflicted with a ‘democratic deficit’ (Moravcsik, 2004). And while these studies lack the benefit of the rich data available for the international trade regime, domestic legal observers have long warned that the option of settling behind closed doors “works in favor of ‘private peace’ and in opposition to ‘public justice’” (Menkel-Meadow, 1994). In a noted critique, the philosopher David Luban claimed that settlements in domestic law lead to an “erosion of the public realm” (Luban, 1994). A number of salient cases have recently substantiated these concerns.

The recurrent concern of judges has been that confidential settlements allow private interests to trump public interests. In a recent case between the U.S. Securities and Exchange Commission (SEC) and an American bank, a federal judge refused to approve the settlement over fears that its private content, which failed to unearth and publicize the facts of the case, was “neither fair, nor reasonable, nor adequate, *nor in the public interest.*”<sup>10</sup> In an opinion that delves to the core of the tradeoff explored in this article, Judge Rakoff ruled that while “the policy of accepting settlements without any admissions serves various narrow interests of the parties”, “the parties’ successful resolution of their competing interests cannot be automatically equated with the public

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<sup>10</sup>Emphasis added. United States District Court Southern District of New York. Judge J. S. Rafoff, U.S.D.J. Case 1:11-cv-07387-JSR. Document 33, 11/28/11. p. 8.

interest.”<sup>11</sup> Much like in early settlements at the WTO, the risk of settlements favoring the parties at the expense of those outside of the room flows from an informational gap: “the court, and the public, need some knowledge of what the underlying facts are: for otherwise, the court becomes a mere handmaiden to a settlement privately negotiated on the basis of unknown facts.”<sup>12</sup>

U.S. antitrust law has recognized the same challenge: the Tunney Act of 1973 requires a judge to confirm that any settlement between a firm and the Justice Department is “in the public interest”.<sup>13</sup> Here too, the risk that settlements may not be in the public interest arises from their confidential nature. Even in the domestic realm, then, informational gaps are thought to have distributional consequences. Yet by contrast, the WTO has no opportunity for judicial oversight of private early settlements, a missing institutional feature we come back to in our conclusion. Little wonder, then, that WTO observers have expressed concerns that “settlements may be struck at the expense of third parties or may remain unknown to the larger public” (Alschner, 2012). The purpose of this article is to measure this likelihood, and quantify the cost of privacy in international trade settlements.

## 2.4 Knowing Discrimination When We See It

In general, we can expect that discriminatory settlements will not consist of erecting extra barriers against countries outside of the room, but rather taking down barriers in a selective fashion, in a manner that disproportionately benefits the complainant country. This could include explicit discrimination, such as redefining a product into multiple categories and offering concessions, either through tariff abatement or quota enlargement, only on the category concerning the complainant’s exports.<sup>14</sup> Or it could involve allowing in a given crop from the complainant’s market, while maintaining a ban on other similar crops, as the recent practice of examining GMO products on a case-by-case basis suggests may increasingly happen.<sup>15</sup> Finally, it could entail more subtle discrimination, where settlements reached address the specific concerns of the complainant,

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<sup>11</sup>ibid

<sup>12</sup>ibid

<sup>13</sup>Antitrust Procedures and Penalties Act: Hearings on S.782 and S.1088 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 93d Cong., 1st Sess. 1, 1973.

<sup>14</sup>GATT-era example, as the US threatened to unilaterally challenge Japanese barriers on beef imports, Japan reached a settlement in 1979, by recategorizing beef into two distinct products, where grain-fed beef—which the US exported—now fell under the rubric of “hotel grade” beef, and would be considered as distinct from grass-fed beef—which Australia exported (Davis, 2003, 153). Japan then granted concessions for grain-fed beef, but not grass-fed beef, privileging the US to the detriment of Australia. See fn 6 for a more recent case where Japan offered an exclusive quota to Korea on Laver.

<sup>15</sup>“Canada-EU Make Peace on Biotech Dispute”, <http://ictsd.org/i/news/tni/54805/>. Last accessed: May 17th, 2012.

such as by modifying a quality or safety standard to play to the particular strengths of a complainant's producers, while applying that standard in a formally MFN-compliant fashion. For our purposes, discriminatory settlements can thus be defined as any arrangement between litigants that customizes the concessions to the benefit of the complainant, and to the relative detriment of non-litigant parties.

Importantly, this is *not* to say that we expect all disputes to favor the complainant and non-litigants equally. Some legal issues are inherently multilateral, as with disputes over subsidies, which when removed, should favor all competitors equally. Other issues are inherently bilateral, as with disputes challenging antidumping duties, which are targeted at a given country. Similarly, trade in some products is inherently bilateral, as in the case of large civil aircraft, where only two firms make up the world market. It follows that in all such inherently bilateral disputes, any concessions by the defendant are likely to favor the complainant more than other countries in absolute terms, since the complainant was more concerned by the initial barriers than other countries. And yet, this need not entail that a discriminatory settlement has taken place.

The strength of our research design is that it explicitly accounts for this possibility. As we describe below, we are interested in variation *within* disputes: we examine the impact of privacy vs. transparency on trade outcomes, based on the stage a dispute reaches. For this reason, the only way in which the occurrence of antidumping disputes (or duopoly disputes) would bias our findings is if these disputes were also more likely to settle in private, prior to a ruling being reached. We account for this possibility separately in our analysis, where we further discuss the implications of "inherently bilateral" disputes on our results.

The institution has always had trouble policing voluntary agreements between countries. In some cases, it has relented, as with its acceptance of preferential trade agreements, the greatest exception to the WTO's founding principle of nondiscrimination. In other cases, it has been more dogged, as with the proscription against voluntary export restraints, negotiated in the Uruguay Round. Yet even here, there are growing signs that the rules may be falling short (Lee, 2002), and that members are reaching agreements reminiscent of voluntary export restraints, in spite of the proscription against grey-area measures in the Agreement on Safeguards. As Lee (2002, 163) puts it, "the difficulty in preventing grey-area measures is that no country has interest to challenge those measures where they are implemented as the result of mutual assent." The policing of mutually satisfactory solutions, reached in advance of a verdict, faces a similar problem. Few countries have an interest in challenging the inconsistency of deals struck during early settlement, especially that

the particulars of these deals most often remain private.<sup>16</sup> If the WTO’s institutional design favors increasing the size of the pie at the expense of its fair distribution, this should be observable in the distributional consequences of disputes on individual countries’ trade flows. This reasoning leads us to the following hypothesis. If private consultations are conducive to discriminatory settlements, then:

*H1:* The complainant will capture a greater portion of the gains if an early settlement is reached than if a ruling is handed down, even if the complainant wins that ruling.

## **2.5 The Effect of Third Parties on the Distributional Consequences of Early Settlements**

The designers of the WTO were manifestly aware of the possibility of clashes between bilateralism and multilateralism. In Bagwell and Staiger’s telling, it is precisely to prevent “bilateral opportunism” that the WTO elevates the principles of reciprocity and nondiscrimination, and allows for nonviolation complaints (Bagwell and Staiger, 2004). Yet Bagwell and Staiger (2004) themselves recognize that these rules form only a “first line of defense” against bilateral opportunism. Indeed, this line of defense may be insufficient to prevent the violation of the regime’s core principles. Specifically, we argue that such rules are likely to fall short when the institution protects the privacy of negotiation outcomes with a view to facilitating settlement in the shadow of the law.

One feature of dispute settlement that may have a countervailing impact is the presence of third parties. Third parties are member-states, other than the litigants, who can be present during a dispute as early as the period of consultations, if they claim an interest in the trade at stake, or in the systemic implications of the dispute. Third party status has recently received much attention from the literature. On the one hand, we know third parties gain from participation in terms of trade flows (Bown, 2005; Bechtel and Sattler, 2011), and we know third party status allows developing countries to acquire legal capacity (Busch, Reinhardt and Shaffer, 2009). On the other hand, and in keeping with the tradeoff identified above, it has also led to backlash from observers who claim that third parties decrease the likelihood of settlement, and thus increase the risk of litigation (Davey and Porges, 1998; Busch and Reinhardt, 2006). This scholarship has demonstrated empirically that the presence of third parties has a highly significant impact on the outcome of negotiations. Either because they introduce new issues into the negotiations, or because they lead litigants to take more intransigent positions as a means of investing in their reputation

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<sup>16</sup>Nakagawa (2007)

as tough negotiators in view of subsequent disputes with the third party countries, third parties decrease the odds of settlement: as few as five third parties appear to render a mutually agreeable solution all but impossible (Busch and Reinhardt, 2006).

We do not contest these findings; indeed, our analysis replicates them. Yet we argue that existing work leaves out an important part of the story—namely, the effect that third parties have on the distributional consequences of early settlements. Put differently, we believe the early settlements that occur in the presence of third parties will lead to more evenly distributed market access being granted by the defendant. To be clear, we do not claim that third parties are in the room in order to prevent bilateral opportunism. Third parties may join for a number of reasons, all of them based on self-interest. As mentioned above, countries have been shown to join disputes as a means of learning, and building legal capacity (Busch, Reinhardt and Shaffer, 2009). This is often the reason given for China’s fervent participation in all disputes it could join after its entry into the organization. Third parties may also want to join a dispute in order to urge the panel to be circumspect in its handling of important, sensitive issues where a ruling may have important implications for future WTO jurisprudence. Most commonly, however, countries join as third parties as a means of ensuring that their interests are represented in legal decisions that affect them directly, be it because they trade in the product at issue, or because the legal measure being examined concerns them (Bown, 2004). The enforcement function of third parties, in this way, is a by-product of their presence in the room, rather than the reason for it. If third parties play an unwitting enforcement function by warding off discriminatory settlements, in a way that the existence of rules by itself cannot, then the membership as a whole will benefit from their presence, despite the effect they may be having on the odds of any deal being reached in the first place. In sum, the branding of third parties as spoilers of may have been premature.

Yet, the effect of third parties we hypothesize should only be seen under certain circumstances. Given our theory, any enforcement effect will be limited to instances where, in the absence of third parties, discriminatory settlements would be difficult to police. As per *H1* above, this scenario is most likely during consultations. As we have emphasized, the private nature of consultations implies a higher likelihood of inequitable settlements. Conversely, once a ruling is reached, and recommendations for compliance are made public, all members observe the outcome of the panel (or appellate) decision, and there is a convergence of expectations over what would constitute compliance. That is precisely why defendants are most likely to concede fully if a settlement is reached prior to a ruling. Recall that defendants wish to avoid the normative costs associated with

being branded a violator. Once a verdict is handed down, and blame is assigned, the contours of any subsequent deal are made known to political actors outside the negotiations, and it becomes more difficult for litigants to save face in front of their domestic industries. As Keohane and Nye (2001, 17) put it, “consummating deals may often require a certain degree of obfuscation of the tradeoffs being made.” For these reasons, in cases where the rulings have reduced informational asymmetries, third parties should have less of a role to play. Conversely, it is in disputes that end in consultations that third parties are likely to play an important role in preventing discrimination. Third parties shine a light on otherwise private consultations, reducing the potential for discrimination by illuminating the terms of any settlement.

Taken together, this logic leads to our second hypothesis. If third parties play an unwitting enforcement function, then:

*H2:* Third parties’ presence should increase the gains of the rest of the WTO membership, but only for disputes that conclude before a ruling.

### 3 Research Design

We now test the validity of our hypotheses. Our analysis relies on a new database of WTO dispute histories and product level trade flows. We collected detailed information on the key events and outcomes of each dispute in the WTO era from DS1 through DS420. We also assembled product level trade data for every dispute that names a specific good.<sup>17</sup> The data amount to what we believe is the fullest available record of trade relations between members in disputed goods.

Our unit of observation is dispute-partner-year, where “partner” refers to all complainants, third parties, and non-participants that trade with the defendant in a given good. For reasons described below, we only include disputes for which there exists a complete record of trade data. This yields a sample of 242 disputes, (involving a total of 260 complainants, 650 third parties, and 6800 non-participants).

#### *Dependent Variable*

We are interested in answering two broad questions. First, is there evidence to suggest that complainants are able to exploit private settlements by obtaining disproportionately more market access? Second, what role do third parties, as eyes in the room, play in preventing this discrimination—i.e.,

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<sup>17</sup>Not every case involves a specific product; some are better classified as “non-merchandise” disputes, which concern broader domestic rules and practices—e.g. DS402 on the use of “zeroing” in US anti-dumping determinations.

enforcing multilateralism? To address these issues we analyze post-dispute trade flows between respondents and partner countries.<sup>18</sup> Specifically, we observe the volume of imports into respondents from each WTO member for the 5-year period after a dispute ends. We assume that, if the dispute settlement procedure is working effectively, it should help dismantle discriminatory entry barriers. Consequently, imports into respondent markets from partner countries ought to increase on average. Examining import levels is thus the appropriate means of identifying *de facto* discrimination. We are careful, however, to control for the possibility that countries who conduct more trade have more to gain from dispute settlement. By comparing the gains of the complainant relative to the remainder of the membership across different levels of privacy, we are able to distinguish the impact of privacy from the strength of the bilateral trade relationship prior to the dispute.

To construct our measure we start with bilateral import data for every product named in disputes that cite specific goods, using data from the United Nations' Comtrade, which we access through the World Integrated Trade Solution (WITS), hosted by the World Bank. Imports are initially recorded at the classification level referenced in the complaint (either 2-, 4-, or 6-digit Harmonized System codes). We then collapse the imports data by dispute-partner-year, summing the product-specific data into one yearly indicator of imports *only* in disputes products.

We cast our analysis at the dispute level (rather than the product level) for two reasons. First, we have no *a priori* theoretical reason to expect that products are affected differently *within* the same dispute. Second, disputes vary widely in the number of products they name. Across the sample, the mean number of products is 5, while the median is only 2. A plurality of disputes name a single product (141 cases), while others name as many as 13 (DS220) or even 31 (DS253) goods. In a product level context, cases that cite more goods would be weighted disproportionately heavily in the sample. As a result, we rely on the dispute level analysis where dependent variable,  $Disputed\ Imports_{i,j,t}$ , is a sum of each respondent  $i$ 's imports from partner  $j$  in year  $t$ . We log this variable to correct for the highly skewed nature of the distribution.

In constructing our measure, we only include product lines for which a complete record of trade data is available for 5 years after the dispute ends. It is important to omit products with missing values because their disappearance (and reappearance) in the sample will create artificial drops (or jumps) in trade flows over time.<sup>19</sup> The end of the dispute is defined as the year that the last

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<sup>18</sup>An alternative strategy would be to look at the market concessions states grant at the end of dispute, and assess how discriminatory these concessions are. However, reliable data on trade policy changes is scant, especially following settlements prior to a ruling. More importantly, there is always a gap between announced policy changes and reality. Our approach effectively accounts for this gap: we are interested in the *de facto* market access states are able to secure from respondents.

<sup>19</sup>We omit respondent-partner dyads with zero trade between them. We do not have a prediction about whether

official action was notified to the WTO. Cases that appear to be in “limbo”—for example, where they have stalled for many years at one stage of the process, such as a dispute launched in 1995 by the U.S. against Korea on Agricultural products, and that yielded neither a panel nor a settlement since<sup>20</sup>—are omitted. Thus, the 5-year span of trade flows we analyze begins the year after a mutually agreed solution or ruling is notified. This window provides a sufficient historical record to observe changing patterns in imports levels through time.<sup>21</sup>

### *Independent Variables*

The analysis relies on two main independent variables. In Models 1 and 2, we explore the prevalence of discriminatory settlements. According to H1, we expect that complainants enjoy a comparatively larger boost in post-dispute market access (relative to non-participants) if complainants are striking discriminatory deals with respondent countries. We construct a variable *Complainant<sub>d</sub>* that is coded “1” if the partner country is a complainant in dispute *d*, and “0” otherwise. If discriminatory settlements occur, then we expect a positive, significant coefficient for *Complainant<sub>d</sub>*, indicating that complainants receive a significantly greater boost in imports than the reference category—third parties and non-participants.

In the second set of tests we explore the role that third parties play in preventing discrimination. Our theory predicts that third parties reduce the degree to which early settlements result in an asymmetric distributions of trade benefits. In Model 3 we include a simple count of the number of *Third Parties<sub>d</sub>* in each dispute *d*. In additional tests, we utilize alternative forms of this variable, including a dichotomous indicator of any third party participation (*Third Party Dummy<sub>d</sub>* in Model 4). This tells us whether just one third party in the room is sufficient to observe an enforcement effect. We also use a logged count (*Third Parties Logged<sub>d</sub>* in Model 5), as a means of accounting for the potential of a non-linear relationship between third party participation and the distribution of payoffs. Finally, we weight the count of third parties by the average amount of trade the third parties do with the respondent in a disputed product (*Third Party Weighted<sub>d</sub>*). The logic this allows us to evaluate is that third parties may only play an enforcement role when they have high(er) levels of material interest in the dispute.

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dispute settlement (of any type) generates new trade relationships between states that previously conducted zero trade.

<sup>20</sup>Korea—*Measures Concerning the Testing and Inspection of Agricultural Products*, WT DS3, and DS41

<sup>21</sup>Using this cut-off point, as opposed to not truncating the sample, creates a more conservative test. Including observations further into the future would increase the likelihood that we find an upward trend in post-dispute trade flows. However, it has implications for the size of our sample; it effectively limits our sample of disputes ranges from DS1 to DS396.

### *Control Variables*

Each model includes a set of controls designed to account for the features of disputes or countries that affect import levels. First, we include the market size of both the respondent and partner country. Market size is measured as the logged value of GDP in constant year 2000 US dollars. These variables—*Respondent GDP* $_{i,t}$  and *Partner GDP* $_{j,t}$ —capture whether the size of a market shapes trade flows. Larger markets are likely to conduct more trade in a given good. Moreover, given terms of trade effects, larger markets may be better able to secure deeper concessions during disputes because they can more credibly threaten retaliation. The data are taken from the World Bank’s *World Development Indicators*.

We also include a measure of whether the countries in each respondent-partner pair are democracies. Using a dichotomous indicator of democracy we generate *Democratic Pair* $_{i,j,t}$ , which is coded “1” if both the respondent and partner are democracies. We might expect that democracies are less likely to enter into discriminatory settlements if they are compelled by domestic audiences to behave in a more transparent manner. Conversely, democratic pairs of countries may be *more* likely to strike discriminatory deals given their vulnerability to domestic interests. We remain agnostic about the direction of the relationship. We utilize Cheibub, Gandhi, and Vreeland’s (2009) coding of democracy for this measure.

Finally, it is necessary to control for features of each bilateral trade relationship more broadly. Most importantly, we control for the previous level of product-specific imports between each respondent-partner pair. Previous imports inevitably influence imports in year  $t$ . Including a one-year lag of the dependent variable helps account for temporal correlation in import level. Additionally, the total volume of imports received from each partner will partly determine the depth of import penetration in any given product. We construct a measure of the logged total imports (for all products), from each partner *Total Imports* $_{i,j,t}$ . This additional measure is important because it allows us to control for whether existing stake in the disputed product is driving the asymmetry in post-dispute trade.

## **4 Analysis and Results**

In this section we present the results of our analysis. We offer a sequence of tests designed to first identify the existence of discriminatory settlements, and then to explore whether third parties participation deters this discrimination. To preview our main findings, Models 1 and 2 show that the

distributional gains from early settlement are spread unevenly across the WTO membership (*H1*). Complainants fare much better under early settlement than do third parties and non-participants, whereas they do *no better* once a ruling has been handed down, and the benefit of privacy is forgone. In Models 4-7, we show that third parties decrease the likelihood of early settlement—a result consistent with existing literature—and that third parties reduce asymmetries in the payoffs between complainants and the membership at large (*H2*).

*Models 1-3: How Prevalent is Discrimination Under Privacy vs. Publicity?*

There is a widespread belief that the dispute settlement mechanism works precisely because it allows states to settle their grievances through private consultations. However, the lack of transparency during consultations may lead to deals that benefit only those countries privy to negotiations—i.e., complainants. We present a series of fixed effects regressions designed to identify the distribution of benefits in these settlements, which we then compare to the distribution of benefits under publicity, once a ruling has been handed down. Disparities between the payoffs received by complainants and the broader WTO membership suggest that the concessions secured in the consultative process are not spread evenly across the membership. Since, as pointed out above, we cannot observe discrimination directly, these results reveal only indirect evidence. However, for reasons we discuss further below, they provide a strong basis for rethinking the benefits of early settlement.

Our models include fixed effects to account for the possibility that unobserved features of each dispute shape their distributional consequences.<sup>22</sup> We cluster the standard errors by dispute number. Following the example set by Busch and Reinhardt (2006), we combine dispute numbers where multiple complaints challenge the same issue. Therefore, when eight countries challenge U.S. steel safeguards in 2002, we count this a single dispute, since all eight disputes were filed at the same time and yielded a single panel ruling. Our initial tests utilize the following baseline model:

$$\begin{aligned} Disputed\ Imports_{i,j,t} = & \beta_0 + \beta_1 Complainant_d + \beta_2 Respondent\ GDP_{i,t} + \beta_3 Partner \\ & GDP_{j,t} + \beta_4 Democratic\ Pair_{i,j,t} + \beta_5 Disputed\ Imports_{i,j,t-1} \\ & + \beta_6 Total\ Imports_{i,j,t} + \alpha_d + \mu_{i,j,t} \end{aligned}$$

where  $\alpha_d$  is dispute-specific fixed effect and  $\eta_{i,j,t}$  represents the error term.

Next, we perform the same regression exercise on three samples: (i) all WTO disputes in Model

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<sup>22</sup>The results are largely consistent when using random effects. However, a Hausman test confirms that fixed effects are more appropriate in our setting ( $\chi^2 = 50.85, p < 0.000$ ).

- 1; (ii) Disputes that concluded with an early settlement, before a panel ruling, in Model 2; and
- (iii) Disputes that reached a panel ruling, in Model 3.

### *All WTO Disputes, Including Early Settlements and Rulings*

Model 1 estimates the average payoff that complainants get from participating in disputes of any outcome (Model 1 in Table 1). The model provides a good overall fit to the data. The R-squared is 0.50 and the F statistic is 711.99 ( $p < 0.000$ ). The controls for import trends and total penetration are strong predictors of post-dispute levels. As expected, both are strongly and positively associated with imports. These controls are important, as they allow us to guard against the possibility that evidence of discrimination may simply derive from the fact that complainants trade more with respondents, all things equal.

Turning to our explanatory variable, the coefficient on  $Complainant_d$  is significant and positive. The estimates suggest that on average, complainants reap a greater benefit from engaging in dispute settlement than other WTO members (third parties and non-participants). Figure 2 displays the substantive effects. Post-dispute imports flows are predicted to be 15.11 [14.88, 15.33] in logged dollars for complainants, as opposed to 14.88 [14.87, 14.89] for nonparticipants.<sup>23</sup> This difference amounts to a difference of \$750,000, or an increase of 26% in annual imports (a change from \$3.64 to \$2.90 million).

Model 1 relies on a sample of all dispute outcomes, and may not, by itself, appear surprising: after all, complainants may have more to gain from dispute settlement; the fact that they do better than others, on average, may be expected. However, our prediction is that discrimination is most likely to occur during early settlements ( $H1$ ).<sup>24</sup> The details of concessions granted in early settlements are hidden from view, whereas formal rulings, which establish expectations about what compliance would entail, are available for public scrutiny. Thus, we expect the disparity between the payoffs received by complainants and the rest of the membership is greatest under early settlements, where low levels of transparency create opportunity for discrimination.

### *Disputes That Ended in Early Settlement*

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<sup>23</sup>All substantive effects are reported in logged dollars and include the 95% confidence interval in brackets.

<sup>24</sup>To be clear, early settlements are defined as disputes where a mutually agreed solution is officially notified to the WTO by both parties. The latter condition is important, as there is sometimes disagreement over whether a solution is truly mutually agreeable, as in *EC-Bananas III*, when the European Communities notified an understanding with the US and Ecuador as a mutually satisfactory solution within the meaning of Article 3.6 of the DSU, but both Ecuador and the United States disagreed, and asked that the dispute not be taken off the Dispute Settlement Body (DSB) agenda.

Model 2 confirms this expectation. (Column 2 in Table 1). Complainants enjoy a clear benefit in cases that settle early (corresponding to 30.4% of our sample) when compared to the benefit obtained by the rest of the membership. The effect for this advantage is statistically significant at the 0.05 level, and it is substantively large: complainants enjoy 68% larger volume of post-dispute imports than the rest of WTO members. Complainants receive 14.71 [14.36, 15.05] compared to the 14.19 [14.18, 14.21] received by non-participants (Figure 2), or an annual difference between \$2.44 and \$1.45 million dollars.<sup>25</sup> While complainants seem to be doing relatively well across all cases, they seem to be doing especially better than others in early settlements.

### *Disputes That Reached a Ruling*

Model 3 confirms the effect of privacy on outcomes, by showing what happens in its absence. When litigation begins, and the stakes of the dispute are publicized for all to see, complainants no longer do better than others. Thus, when we re-estimate the same model as above on disputes that do not settle early (which corresponds to 69.6% of cases in our sample), we find that complainants do not in *any way* do better than third parties or nonparticipants (Column 3 in Table 1). In other words, the significant disparity between those benefits accrued to complainants and non-participants is concentrated *entirely* in disputes that end in early settlement.<sup>26</sup>

These estimates suggest that, on average, early settlements favor the complainant disproportionately more than cases that result in a panel ruling. The trade benefits of these disputes are distributed asymmetrically across the WTO membership. Overall, complainants do significantly better than other trade partners, be they third parties or non-participants, but *only* if the dispute is concluded in private. Under publicity, everyone benefits just the same. As a result, it appears that the feature of the DSU most commonly believed to facilitate settlement—private consultations—leads to trade outcomes fundamentally at odds with another core feature of the regime: non-discrimination.

### *Alternative Explanations*

Is there an alternative explanation for our results? We anticipate the following challenge: since states select themselves into the role of complainant based on their material stake in the disputed issue, one might argue that we should expect complainants to “win” more from settlements. If

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<sup>25</sup>Note that the confidence interval is wider around the prediction for complainants because there are far fewer complainants in the sample than non-participants.

<sup>26</sup>Note that this is not a test of whether members benefit from going to rulings. It is a test of whether complainants do *better* than non-participants after rulings are handed down.

complainants simply have more to gain, or if the nature of the disputed policy is inherently bilateral, then observing larger gains for complainants need not imply discrimination.

Yet the mere existence of “inherently bilateral” disputes—i.e. cases such as antidumping disputes that affect the complainant more than the remainder of the membership—is in itself insufficient to undermine our results. For these disputes to affect our results it is *necessary* that they be distributed non-randomly across different dispute outcomes. This is precisely the strength of our research design, which examines within-dispute variation. It exploits the difference in privacy between consultations and litigation, by comparing the distribution of gains between disputes that concluded prior to a ruling, and those that ended only after a ruling had been made public. To conclude that the greater gains to complainants associated with early settlement are due to the inherent bilateralism of certain disputes, anti-dumping disputes, to take one example, would need to have a higher likelihood of settling early.

We examine this premise and find no support for it. We look at the distribution of the ten most commonly cited agreements in disputes across outcomes, as shown in Table 2. The table does not support the claim that disputes involving inherently bilateral measures are more likely to settle early. If anything, anti-dumping cases, which form the most likely category of “inherently bilateral” disputes, appear somewhat *less* likely to settle early. As a result, there is no reason to believe that the evidence from Models 1-3 is driven by the fact that complainants simply “have more to gain” from dispute participation. We evaluate this relationship more directly in robustness tests below and find that there is no systematic relationship between the disputed issue and either likelihood of early settlement or the distribution of payoffs.

Another critique may be that non-participants may still “win” under early settlement, even if they win less than complainants. In other words, non-participants could be getting a “smaller piece of a larger pie”, and thus still have a preference for early settlement. We examine this possibility and find it to be false. The average value of annual trade from non-participants into respondents’ markets after an early settlement is \$1.67 million. After a case goes to panel, it is nearly double that, at \$2.95 million. Non-participants thus stand to gain significantly more when cases go to court. This is further evidenced by the aggregate gains once disputes have ended. The average *aggregate* trade from non-participants into respondents’ markets over the five years following a ruling is \$1.18 *billion*. After early settlements, this average is only \$690 million. Again, non-participants get nearly twice as much following panel rulings as they do following early settlements. These numbers suggest that, under early settlements, non-participants are not simply getting a smaller piece of a

larger pie; they are demonstrably losing from bilateral opportunism.

Finally, if it were true that complainants naturally win more because they have “more to gain,” this would not explain differences in the results between early settlements and disputes with rulings. Instead, it would imply that complainants benefit significantly more from disputes *of all types*. However, we fail to find a similar disparity when looking at cases that went to rulings. For all of these reasons, we conclude that our evidence points to the existence of discriminatory settlements that result directly from the private nature of early settlements.

#### *Models 4-7: Do Third Parties Prevent Discrimination?*

We have found that the privacy of early settlement appears to be at odds with the equitable treatment of trade partners as envisaged under trade rules. However, our theory leads us to expect that third party participation may help reduce discriminatory outcomes. We now test the proposition that the third parties play an enforcement function, and that their presence is associated with more equitable trade concessions (*H2*).

Exploring the role played by third parties requires a different estimation approach. Dispute outcomes are assigned non-randomly. Existing literature shows that third party participation affects the likelihood that disputes go to the panel/ruling stage. Failing to correct for this selection process would bias our estimates of third parties’ effects on payoffs. Therefore, we estimate a series of Heckman selection models that allow us to isolate the effects that third parties have on both (1) the likelihood of early settlement; and (2) post-dispute import levels. As above, we cluster the standard errors by our combined dispute identifier. The selection equation is specified as follows:

$$\begin{aligned}
 \text{Early Set.} &= \beta_0 + \beta_1 \text{Third Parties}_d + \beta_2 \text{Respondent GDP}_t + \beta_3 \text{Partner GDP}_t \\
 &+ \beta_4 \text{Democratic Pair}_{i,j,t} + \beta_5 \text{Disputed Imports}_{i,j,t-1} + \beta_6 \text{Total} \\
 &\text{Imports}_{i,j,t} + \beta_7 \text{Claims Number}_d + \mu_{i,j,t}
 \end{aligned}$$

Note that we add a variable in the selection stage for the number of individual legal claims made by the complainants, which is usually seen as evidence of a weak-case, and a legal “trash-can strategy”. This measure, *Claims Number<sub>d</sub>*, is a count of the WTO articles cited in the dispute. This addition is required to ensure that our system of equations is identified appropriately.<sup>27</sup> This

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<sup>27</sup>We also ran models using two alternatives. The first was an indicator of “great power” participation. Participation by the largest members may have an important effect on the likelihood that a dispute settles early. The second measure was the percentage of the complainants’ previous disputes that went to panel. It may be the case that certain complainants are systematically more likely to pursue their claims and are therefore less likely to settle

variable performs well across all the models ( $p < 0.050$ ). It bears no relation to our second stage dependent variable, while showing the predicted relationship with the likelihood of early settlement. The outcome equation assumes a structure similar to Model 1:

$$\begin{aligned} \textit{Disputed Imports}_{i,j,t} = & \beta_0 + \beta_1 \textit{Third Parties}_d + \beta_2 \textit{Respondent GDP}_t + \beta_3 \textit{Partner} \\ & \textit{GDP}_t + \beta_4 \textit{Democratic Pair}_{i,j,t} + \beta_5 \textit{Disputed Imports}_{i,j,t-1} \\ & + \beta_6 \textit{Total Imports}_{i,j,t} + \mu_{i,j,t} \end{aligned}$$

Model 4 presents the results when using a count of third parties as the explanatory variable (Table 3). First, notice that the  $\chi^2$  statistic is 58.12 ( $\chi^2 < 0.000$ ), suggesting that the selection and outcome equations are not independent, and that the Heckman correction is required. Also, the sample size is far greater for these selection models than it was for Models 1, 2, and 3. Recall that these models are looking at the post-dispute trade flows of non-participants and therefore the  $N$  is much larger than the models focusing only on imports from complainants.

Looking at the selection equation, we see that third parties significantly decrease the likelihood of early settlement. This finding is consistent with what we know about how third parties extend the lifespan of disputes. Importantly, however, the previous work on third party participation led to the conclusion that third parties may prevent mutually beneficial settlements. The findings above allow us to qualify this view of third parties, suggesting that third party participation is not strictly inefficient. Third parties prevent the types of settlements that disadvantage the WTO membership at large.

The outcome equation illustrates the effects that third parties have on the payoffs received by non-participants. The results show that third parties have a significant, positive impact on post-dispute import levels for the membership ( $p < 0.050$ ). Figure 3 illustrates the substantive interpretation of the estimates (the figure reports the predictions in logged values for ease of interpretation). The predicted import flows from non-participants over the interquartile range of *Third Parties*—values from 0 to 6—result in a shift in imports from 16.91 [15.74, 18.07] to 18.22 [16.23, 20.20], or a rise from \$22.1 to \$81.8 million.

The estimates suggest that third party participation has an unambiguously positive effect on the trade consequences of early settlements for non-participants. The WTO membership enjoys significantly greater benefits from early settlement when third parties participate. More generally,

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early. In both cases, the substantive interpretation of the results remains constant.

this evidence shows that respondents and complainants strike much less discriminatory deals when third parties are in the room. Any market access granted to complainants is extended to the entire membership when third parties are allowed to observe the terms of deals being reached.

Model 4 relies on a simple count of the number of third parties involved. Model 5 tests whether any third party participation is sufficient to prevent discrimination (Table 4). Rather than using *Third Parties<sub>d</sub>* we use a dichotomous indicator *Third Party Dummy<sub>d</sub>*. The results show an even stronger relationship ( $p < 0.000$ ). Having just one third party involved increases the post-dispute payoffs to non-participants from 16.63 [15.52, 17.74] to 17.89 [16.08, 19.70].

Model 6 employs a slightly different coding. In this specification, we rely on the logged count of third parties. However, a large number of disputes—nearly thirty percent—have no third parties. We therefore generate *Third Parties Logged<sub>d</sub>* using the following formula:

$$Third\ Parties\ Logged_d = \text{Log}(Third\ Parties_d + 1)$$

In our sample, there are only 5 disputes with more than 15 third parties. The mean number is 3.2 and median is 1. Only a few disputes, like DS265 and DS266, over EU sugar subsidies, include 20 or more third parties. To correct for the skewed nature of the simple count variable we rerun the model with the logged count (Model 6 in Table 4). As with the two other constructions of the DV, the results show that third parties contribute significantly to the post-dispute trade relationships that non-participants have with respondent states.

Finally, we also looked at a trade-weighted count of third parties. The enforcement effect of third party participation may be conditioned by their average material stake in the disputed issue. Model 7 (Table 4) employs a trade-weighted count and the results are consistent with the other specifications. The effect of third parties is not conditioned by the strength of their interest in the dispute when measured as trade in the disputed products. This finding, together with the fact that a simple dichotomous indicator of any third party presence is equally significant, suggests that discriminatory deals are successfully deterred by extra eyes in the room, regardless of their number or particular interests.

Models 4-7 thus demonstrate two important effects of third party participation. First, as mentioned, the findings echo previous work on the relationship between third parties and early settlement. The presence of these “observers” significantly reduces the likelihood that states reach an out-of-court settlement. Second, we find strong evidence that, when early settlements does occur, the WTO membership benefits significantly from third party participation. One caveat is

warranted in this respect. We do not observe the partisanship of third parties during early settlement. The stance these parties take in the dispute (pro-complainant, pro-defendant, or mixed) only becomes clear once cases go to panel, and third parties have the opportunity to submit opinions to the panel. Under mutually agreed solutions, by comparison, it is not immediately obvious which side of a dispute each party supports. Yet our story does not turn on whom third parties support. It requires only that their presence in the room prevent litigants from reaching deals that are customized to the exclusive interests of the complainant, at the expense of the greater membership.

### *Robustness Checks*

We explore the durability of our results by conducting a number of additional tests.<sup>28</sup> First, it is possible that discriminatory settlements are more likely when great powers—defined here as the EU and US—are involved in the dispute. These states, which are involved in a huge number of WTO disputes, may use their legal expertise and/or their credible threat of retaliation in order to secure more favorable outcomes. We re-estimate Model 2 with a restricted sample that omits great power complainants entirely; the results remain consistent.

The US and EU may also be better able, for the same reasons, to prevent discriminatory settlements when they exercise their third party rights. Indeed, these members are not just frequent complainants, they also participate regularly as third parties. The US has been a third party on 93 occasions; the EU, 114. We re-estimate Model 4 by eliminating those disputes where either the US or EU is a third party. This change does not affect the baseline estimates. As a result of these two tests, we can say with some confidence that neither discrimination nor its policing is restricted to major powers.

A related, but distinct, issue is whether third parties' material interest in the dispute has an effect on the role they play. One can imagine that third parties are more efficacious as their material interest in the dispute increases (indeed, a high stake in the disputed product is an important predictor of third party participation in the first place). To take this into account, we modify the explanatory variable by interacting the number of third parties by their average volume of imports into the respondent market. This interaction is insignificant in both stages of the selection model. Third parties' material interest in the case does not influence the likelihood of early settlement, nor does it affect their role as disseminators of information about those settlements, or enforcers of nondiscrimination. What this suggests is that it is not third parties' behavior, as much as their

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<sup>28</sup>It in the interest of space we simply describe these tests. However, all estimation results are available from the authors.

presence in the room, that drives the observed enforcement effect.

Finally, we run a series of tests to verify whether outcomes are driven by the issue being disputed. As discussed above, Table 2 is not suggestive of any clear patterns. However, we can look closer at these relationships by adding indicators of the issue at stake to our Heckman selection models. We introduce dichotomous indicators of the four most frequently cited agreements: anti-dumping, safeguards, agriculture, and TRIMs. The estimates do not reveal strong or consistent correlations between the issue being disputed and either (1) the likelihood of early settlement or (2) the trade benefits enjoyed by non-participants. Most importantly, their inclusion does not affect the baseline estimates.

## 5 Conclusions and Implications

This paper explores a central question of global governance: How much transparency should there be in international institutions? The existing debate highlights two opposing positions. On the one hand, privacy facilitates agreement. On the other hand, transparency allows for monitoring and oversight. This paper explores that trade-off in the context of the global trade regime. We suggest that the very institutional design feature that is widely credited with promoting settlement—private consultations—may in fact be leading to outcomes that are fundamentally at odds with the WTO’s core principle of nondiscrimination.

The high rate of compliance with WTO rules has led scholars to assume that such adherence to the rules is pervasive. Yet as we argue, compliance is not a given: it hinges on monitoring by the institution, and the expectation of legal challenges by other members. In the case of early settlement, these features are missing. As a result, we expect that settlements reached during dispute settlement are at risk of being struck at the expense of the remainder of the membership, and thus in contravention of DSU Article 3.5.

Our analysis offers support for these expectations. We show that complainants enjoy significantly larger trade benefits from early settlements than the remainder of the membership. Such disparities in the gains from early settlement complicate our understanding of consultations, and are sufficient to question the broader welfare implications of settling out of court. In sum, the price to pay for the high rate of early settlement is that a significant proportion of these settlements are reached at the expense of the membership at large. As such, this paper provides what is to our knowledge the first evidence for the existence of discriminatory settlements at the WTO.

The findings hold implications for institutional design. Although our analysis considers a par-

ticular institution that has long been faced with calls for greater transparency, the same tradeoff between equity assured by transparency, and effectiveness hinging on privacy, exists in other international institutions and at the domestic level. In all these settings, institutional features have emerged to address the cost of privacy while maintaining some of the benefit of obfuscation, usually through some third party enforcement. The International Monetary Fund created its Independent Evaluation Office in 2001, the mission of which is to provide oversight of arrangements reached between the Executive Board and national governments. The World Bank has created a parallel Inspection Panel in 1993, separate from World Bank hierarchy, which is meant to hear claims that World Bank activities approved by national governments nonetheless harm communities or individuals (Kahler, 2004). Yet it is domestic law that has grown most sophisticated in dealing with the tradeoff that interests us. In the example of antitrust law we mention in the argument above, there is a requirement, embodied in the Tunney Act of 1974, for a judge to approve any settlement reached between the Department of Justice (DOJ) and a private firm. In the most salient Tunney Act finding of recent years, Judge Sorkin ruled that a settlement reached between the DOJ and Microsoft was “not in the public interest”<sup>29</sup>

The WTO has no comparable mechanism. The key feature of all the solutions to the opacity-transparency tradeoff presented above is that whereas negotiations themselves remain private and confidential, the institution delegates considerable authority to an independent and autonomous third party to review the content of the settlement when one has been reached. The WTO’s Director General (DG) is well suited to filling the function of oversight. The DG is already involved in the specifics of disputes.<sup>30</sup> Delegating approval of early settlements to the DG may also be a way of balancing the costs of privacy with possible concerns over confidentiality of the business interests of private firms. DG approval would nonetheless hinge on having sufficient information about the content of a settlement to make this appraisal. The objective, in other words, should be to deter possible discriminatory deals by increasing information about them, rather than by increasing enforcement power alone. Changes in this direction already appear growingly likely. In recent discussions over dispute settlement reform, WTO members pushed for and agreed on a revision to the key provisions of DSU Article 3.6, requiring a formal, written document relating the “detailed terms” of each mutually agreed solution.<sup>31</sup>

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<sup>29</sup>Memorandum Opinion, United States District Court for the District of Columbia, *United States of America v. Microsoft*, Judge Stanley Sporkin, Civil Action No. 94-1564.

<sup>30</sup>E.g. if the parties cannot agree on the selection of panelists, the DG is the one to appoint panelists. This now happens in more than half of all cases.

<sup>31</sup>The proposed text reads as follows (revised or new words are in italics): *Each party [to a mutually agreed solution] with respect to a matter raised under the dispute settlement provisions of the covered agreements shall notify the*

This article also speaks to the strengths of a quantitative approach in the study of courts. Scholars studying judicial bias, for instance, cannot tell whether judges were biased in a given case—and that, indeed, is what allows judges to sometimes act on personal interests or ideologies. Yet given a sufficiently large caseload, empirical legal scholars are able to detect the presence of bias in aggregate (Voeten, 2008). Similarly, in our case, given the lack of details about settlements, we would be unable to conclude from looking at a given case whether a discriminatory settlement has occurred or not. Indeed, that is the reason for which such discriminatory settlements are made possible in the first place. Yet by leveraging the power of data covering all WTO disputes, and examining subsequent trade flows of the products concerned for all WTO members, we are able to demonstrate that privacy is associated with a higher likelihood of discriminatory settlements.

The news is not all bad, however. While we throw doubt on a previously lauded aspect of WTO law, we offer a new take on the much-criticized role of third parties. To the extent that third parties deter early settlement—a frequently denounced aspect of third party participation—they also appear to deter discriminatory settlements from being reached. When states do settle during consultations, the presence of third parties in the room helps ensure that the deals struck between litigants apply equitably to the membership at large. Third parties free-ride on complainants, and the rest of the membership free-rides on third parties. While our findings support the literature’s contention about third parties’ effect on the odds of settlement, we argue that it is necessary to endogenize the *content* of such settlements to offer a fuller picture of the effect of third parties. When we do so, we find that the presence of third parties may be a welfare enhancing feature of dispute settlement. This finding further confirms how the modest institutional reform we suggest above, requiring institutional approval of settlements, could successfully lower the costs of privacy, while retaining the benefits associated with it.

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*detailed terms of such solution* to the DSB and relevant Councils and Committees. *The notification shall be made in writing and submitted within 10 days after reaching the solution.* Any Member may raise any point relating to the solution in the DSB and the relevant Councils and Committees.

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Table 1: How Does Privacy vs. Publicity Affect the Distribution of Benefits?

	Model 1 All Disputes	Model 2 Early Settlements (Privacy)	Model 3 Rulings (Publicity)
<i>Complainant<sub>d</sub></i>	0.223* (0.119)	0.511** (0.184)	0.072 (0.142)
<i>Respondent GDP<sub>i,t</sub></i>	1.862*** (0.333)	1.843** (0.661)	1.892*** (0.389)
<i>Partner GDP<sub>j,t</sub></i>	0.025 (0.027)	-0.023 (0.044)	0.051 (0.032)
<i>Democratic Pair<sub>i,j,t</sub></i>	-0.125 (0.080)	-0.117 (0.122)	-0.134 (0.100)
<i>Disputed Imports<sub>i,j,t-1</sub></i>	0.814*** (0.020)	0.827*** (0.030)	0.809*** (0.025)
<i>Total Imports<sub>i,j,t</sub></i>	0.170*** (0.029)	0.174*** (0.041)	0.165*** (0.038)
Constant	-56.193*** (9.646)	-53.313** (18.600)	-51.234*** (11.394)
N	15845	4818	11027
R-squared	0.75	0.76	0.54

Clustered standard errors in parentheses \* p<0.10, \*\* p<0.05, \*\*\* p<0.001

Table 2: The Distribution of Major Legal Claims Across Dispute Outcomes

	Early Settlement	Ruling
Agriculture	4	11
Anti-dumping	6	24
Safeguards	3	14
Services	2	4
SPS	6	5
Subsidies	6	6
TBT	6	6
Textiles	5	4
TRIMs	0	14
TRIPs	3	2

Table 3: Do Third Parties Deter Discrimination?

	Model 3	
	Selection Early Set.	Outcome Imports
<i>ThirdParties<sub>d</sub></i>	-0.209*** (0.066)	0.218* (0.118)
<i>Respondent GDP<sub>i,t</sub></i>	-0.169** (0.084)	0.186 (0.127)
<i>Partner GDP<sub>j,t</sub></i>	-0.015 (0.053)	-0.007 (0.085)
<i>Disputed Imports<sub>i,j,t-1</sub></i>	-0.031 (0.026)	0.903*** (0.037)
<i>Democratic Pair<sub>i,j,t</sub></i>	0.090* (0.046)	-0.228** (0.100)
<i>Claims Number<sub>d</sub></i>	-0.057** (0.026)	
<i>Total Imports<sub>i,j,t</sub></i>	0.047 (0.042)	0.066 (0.071)
Constant	4.158 (2.644)	3.531 (3.976)
N	33157	
$\chi^2$	58.12***	

Clustered standard errors in parentheses \* p<0.10, \*\* p<0.05, \*\*\* p<0.001

Table 4: Do Third Parties Deter Discrimination?

	Model 5		Model 6		Model 7	
	Selection Early Set.	Outcome Imports	Selection Early Set.	Outcome Imports	Selection Early Set.	Outcome Imports
<i>Third Party Dummy<sub>it</sub></i>	-1.158*** (0.288)	1.259** (0.539)				
<i>Third Parties Logged<sub>it</sub></i>			-0.636*** (0.172)	0.705** (0.316)		
<i>Third Parties Weighted<sub>it</sub></i>					-0.058*** (0.013)	0.065** (0.025)
<i>Respondent GDP<sub>it</sub></i>	-0.196** (0.086)	0.203 (0.128)	-0.180** (0.086)	0.198 (0.128)	-0.183** (0.087)	0.194 (0.129)
<i>Partner GDP<sub>it</sub></i>	-0.010 (0.058)	-0.008 (0.086)	-0.015 (0.056)	-0.004 (0.087)	-0.013 (0.059)	-0.004 (0.088)
<i>Disputed Imports<sub>it,t-1</sub></i>	-0.031 (0.026)	0.903*** (0.037)	-0.031 (0.026)	0.904*** (0.038)	-0.027 (0.025)	0.899*** (0.037)
<i>Democratic Pair<sub>it,t</sub></i>	0.099** (0.044)	-0.230** (0.096)	0.094** (0.045)	-0.233** (0.099)	0.092** (0.044)	-0.222** (0.097)
<i>Claims Number<sub>it</sub></i>	-0.058** (0.029)		-0.055** (0.027)		-0.058 (0.029)	
<i>Total Imports<sub>it,t</sub></i>	0.051 (0.042)	0.060 (0.069)	0.050 (0.042)	0.060 (0.071)	0.049 (0.042)	0.060 (0.070)
Constant	4.889 (2.779)	2.877 (4.010)	4.492 (2.735)	3.111 (4.059)	4.640* (2.810)	3.046 (4.059)
N	33157	33157	33157	33157	33157	33157
$\chi^2$	33.84***		58.46***		19.21***	

Clustered standard errors in parentheses \* p<0.10, \*\* p<0.05, \*\*\* p<0.001

Figure 1: Average Length of Settlement, by Dispute Stage Reached

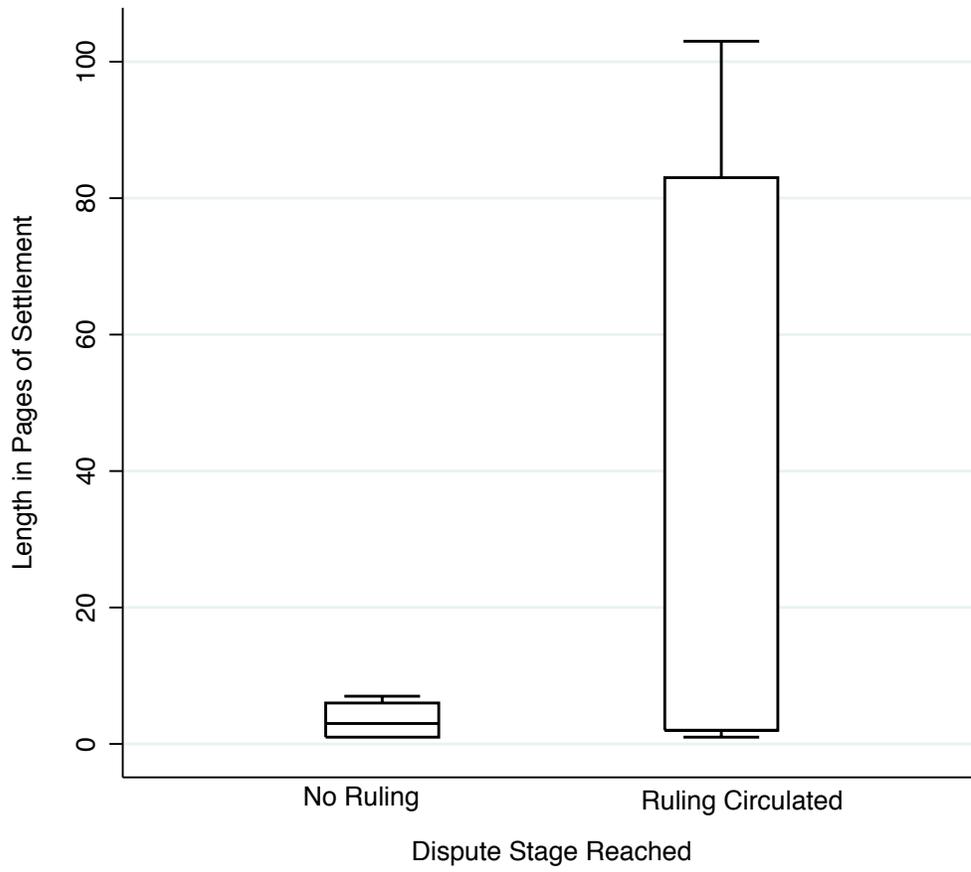


Figure 2: Substantive Advantage of Complainant Over Others, By Dispute Stage Reached

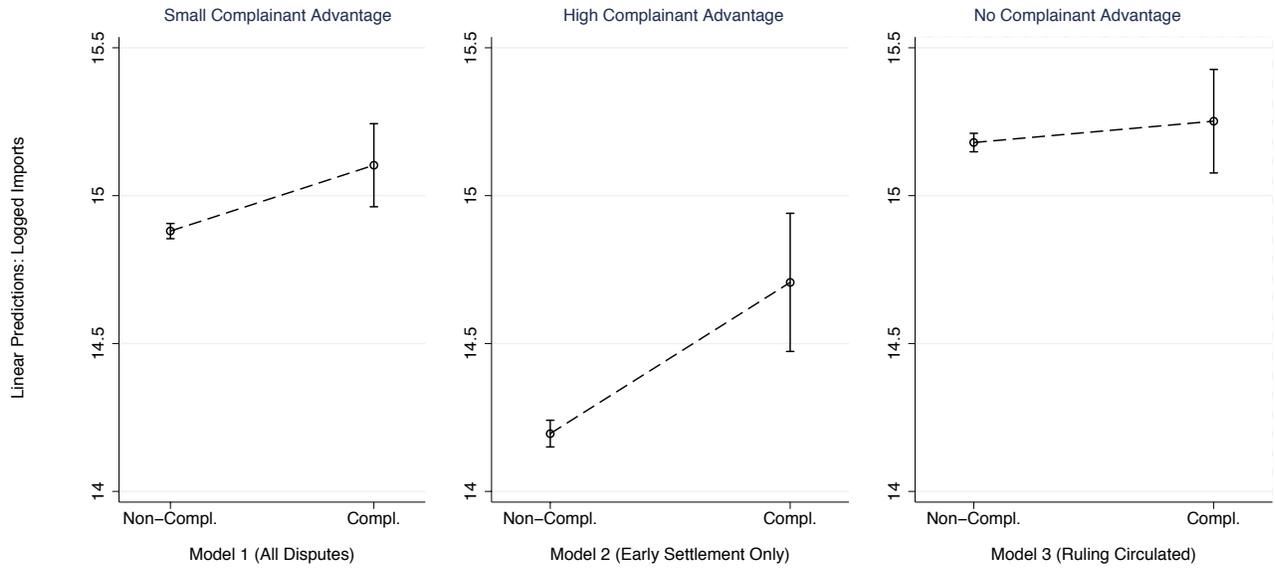


Figure 3: Marginal Effects of Third Party Participation on Membership's Gains

