

Dispute Settlement Mechanisms and Power Asymmetry in Regional Trade Agreements

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Puzzle

▶ **The resurgence in regionalism**

575 notifications of RTAs had been received by the GATT/WTO as of 31 July 2013. 379 were in force (*the WTO*)

▶ **DSMs in RTAs are much less in use**

The Dispute Settlement Mechanism (DSM) in the WTO has been used more frequently than the DSMs in RTAs

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▶ **Why do states design the DSMs in RTAs the way they do?**

Medium-level of legalism for most RTAs

▶ **Why do the DSMs in RTAs generate the outcomes they generate?**

Reinforce the power disparity & Less frequent use

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- ▶ **Less Frequent Use of RTA-DSMs**

The study on systemic difference on DSMs in the WTO and RTAs

- ▶ **Structural Differences on the DSMs**

Game theoretic model to analyze how DSMs affect the states' decision making

- ▶ **RTA-game theoretic model**

The extension of the structural analysis on the DSM in Rosendorff's (2005) from the WTO-DSM to the RTA-DSM

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Model Set-Up

- ▶ Excerpt from Rosendorff (2005)
“Stability and Rigidity: Politics and Design of the WTO’s Dispute Settlement Procedure”
- ▶ Model Set-Up
 - strong player(P_s):export x and import m , weaker player(P_w):complement
 - tariff: t for (P_s) and τ for (P_w)
 - political pressure: a for (P_s) and α for (P_w), distributed $(0, +\infty)$ cdf of Φ
- ▶ The Infinitely Repeated Prisoners’ Dilemma (PD) Game

Dispute Settlement Strategy (DSS)

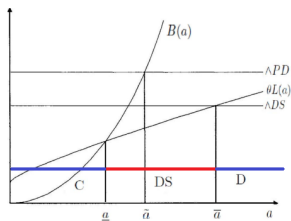


Figure 3: Under the WTO with the DSM, Rosendorff (2005)

P_S having drawn politics type \hat{a} has the following DSS:

[C] if $\hat{a} < \underline{a}$, $t = t^C$

[DS] if $\underline{a} \leq \hat{a} \leq \bar{a}$, $t = t^D(\hat{a})$ and pay compensation if lost

[D] if $\hat{a} > \bar{a}$, $t = t^D(\hat{a})$ and exit from the treaty without paying compensation if lost

RTA-Components

▶ **Costs Considerations** : $K_{strong} < K_{weak}$

Disparities in legal resources

Equally shared costs of case proceedings

Access to external legal assistance (experts of the WTO secretariat)

▶ **Winning Probability**: $\theta_{weak} < \theta < \theta_{strong}$

Vulnerable to domestic politics: economic/political conditions

Less-likely impartial third-party review, Ad-hoc panel

Power-based: not effectively mitigating power asymmetries

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1. Disparate Winning Probability θ

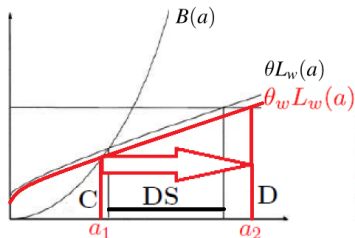


Figure 5: *Stronger Party*: lower θ

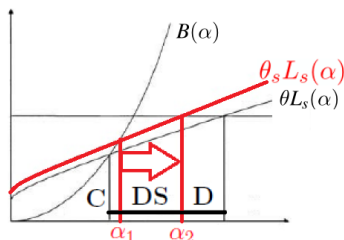


Figure 6: *Weaker Party*: greater θ

Changes in Slope \implies Changes in cutpoints

- ▶ [WTO] Same Chance of Winning, θ , for both players
- ▶ [RTA: P_s] Smaller chance to fail to win ($\theta_w < \theta$) \implies wider *DS*
 θ_w = the winning probability of P_w
- ▶ [RTA: P_w] Greater chance to fail to win ($\theta_s > \theta$) \implies narrower *DS*
 θ_s = the winning probability of P_s

2. Disproportional Costs Burdens K_i

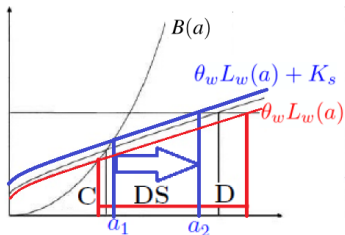


Figure 7: *Stronger Party*: with K_s

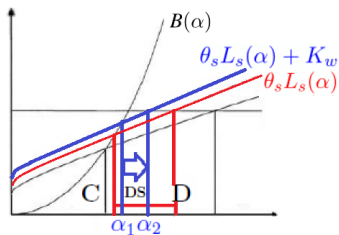


Figure 8: *Weaker Party*: with K_w

- ▶ [RTA] Costs burdens \implies Lift of $\theta_i L_i(a) \implies$ Smaller area of DS ($K_w > K_s$)
- ▶ [Magnitude of the effects]
 1. [P_s] smaller $\theta_w \implies$ flatter slope \implies **weak** narrowing effect of K_s
 2. [P_w] larger $\theta_s \implies$ steeper slope \implies **strong** narrowing effect of K_w

Increasing Gap

- ▶ Stronger Player [P_s]
Smaller chance to lose(flatter slope) + Smaller costs burdens (less narrowing effect) \Rightarrow **Larger** DS
- ▶ Weaker Player [P_w]
Larger Chance to lose(steeper slope) + Greater costs burdens (greater narrowing effect) \Rightarrow **Smaller** DS
- ▶ Hence, **Increasing the gap** in the range of DS

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Findings

- ▶ **Reinforcement of inequalities with a greater magnitude**
 1. P_s : more manipulating power than P_w
 2. P_w : less flexibility in RTAs than in the WTO.
- ▶ **Uncertain effects of RTA-DSMs to stability of the system**

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Questions and Answers

▶ **Why do states design the DSMs in RTAs the way they do?**

Medium level of legalism (An Alternative Forum)

Similar Designs (Emulation of the WTO's DSM)

▶ **Why do the DSMs in RTAs generate the outcomes they generate?**

Why: Different levels of legalism + different environment

Outcome: Increased levels of disparities in flexibility

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Implications

- ▶ [Survival]
Multilateralism survives in spite of the surge of RTAs.
The superiority of the WTO-DSM: minimizing inequality, raising stability
- ▶ [Small Countries]
High political pressure at home for sensitive trade sectors
- ▶ [RTAs] Access to external support for small and weak countries
- ▶ [WTO] More incentives or lower burdens for small and weak countries

Conclusion

THANK YOU !!

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Appendix

DSS: Cut points in the WTO

(1) Lower bound, \underline{a} s.t.

$$\theta L(\underline{a}) = D(\underline{a}) - C(\underline{a}) \equiv B(\underline{a})$$

the compensation it would have to pay = the gains from defection

(2) Upper bound, \bar{a} s.t.

$$\theta L(\bar{a}) = \frac{\delta}{1-\delta} (p^2(N - S - D + C) + p(D - 2N + S)) \equiv \Lambda_{DS}$$

where $p = Pr(a < \underline{a})$, and $I = \int_{\alpha} \int_a I(a, \alpha) d\Phi d\Phi$ for
 $I = D, N, S, C$.

the expected level of compensation to pay = the expected benefits from cooperation into the indefinite future

Appendix

DSS: Cut points in the RTA

- ▶ Lower bound, a_1 s.t. $D_s(a_1) - \theta_w L_w(a_1) - K_s = \underline{C}_s(a_1)$
the expected gain by temporary defection = the expected cooperation value
- ▶ Upper bound, a_2 s.t. $L_w(a_2) = \frac{\delta}{1-\delta}(\underline{C}_s - N_s) \equiv \wedge_{DS}$
the maximum amount of the penalty to pay = the present discounted expected losses of future punishments

▶ Where

$$\underline{C}_s(a) = \Phi(\alpha_1)C_s(a) + \int_{\alpha_1}^{+\infty} S_s(a, \alpha)d\Phi(\alpha) + \theta_s \int_{\alpha_1}^{\alpha_2} L_s(\alpha)d\Phi(\alpha).$$