

**INTERNATIONAL TRADE AND DOMESTIC POLITICS:
THE DOMESTIC SOURCES OF INTERNATIONAL TRADE
AGREEMENTS AND INSTITUTIONS.**

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INTRODUCTION

Over the past fifty years, barriers to international trade have decreased substantially. While the decline in protectionism since World War II has stemmed partly from unilateral changes in trade policy by countries, it also has been a result of agreements among countries to liberalize their trade policies. International trade agreements and especially the GATT (now the WTO) have played an important role in this liberalization process. This paper analyzes the conditions under which states have concluded such agreements to lower their trade barriers and joined such international institutions. More generally, it explores the domestic factors affecting international economic cooperation.

We make two central arguments, both relating international trade to domestic politics. The first is that domestic political reasons can provide an important motive for leaders to sign trade agreements and abide by international trade rules. The second is that the internal design of international trade agreements may depend in part on domestic politics. Again, domestic political reasons can be an important motive for leaders in choosing a specific structure for international trade agreements. In particular, I show that the inclusion of escape clause mechanisms in trade agreements can result from domestic incentives. Indeed, most strongly put, without such escape clauses in international agreements, political leaders could not afford to sign trade agreements because of domestic pressures. Hence their inclusion and character are important for such agreements and rely upon the nature of domestic politics in the countries.

We thus join the debate over the causes of economic cooperation. Many studies attribute variations in cooperation to international factors, especially the global

distribution of capabilities and international institutions (e.g., Axelrod 1984; Keohane 1984; Krasner 1976; Milner 1992). Some effort also has been made to link these variations to domestic institutional differences among democracies (e.g., Milner 1997; Reinhardt 1996). Others have related international cooperation to domestic politics by showing how such cooperation changes the domestic game that states play (e.g., Martin and Simmons 1998; Cortell and Davis 1996). Fewer studies have examined the domestic sources of international cooperation (e.g., Mansfield, Milner, and Rosendorff 2000 and 2002; McGillivray and Smith 2000; Remmer 1998; Verdier 1998; Leeds 2000). We seek to fill this important gap in the literature by examining the way that domestic politics promotes the establishment of trade agreements and shapes their very nature.

International trade agreements often stem from the economic gains that leaders expect to derive from cooperation. Equally important but far more poorly understood, however, are the domestic political gains that also motivate leaders to cooperate in trade. The argument developed here focuses on leaders' domestic political incentives for international cooperation. It follows the "commitment approach to trade agreements," rather than the "traditional economic approach" which focuses on the terms of trade prisoner's dilemma faced by states (Bagwell and Staiger 2000: 2-3).

First, we explore the domestic sources of trade agreements. Political leaders face two sets of domestic pressures in the trade realm. Special interest groups often want protection, and leaders may feel great pressure to give them protection. Political leaders, especially if motivated by rent-seeking, may therefore impose a variety of trade barriers. Furthermore, elections may not even reduce the responsiveness of leaders to special interests; instead, competitive elections may generate strong pressures for rents in the

form of campaign contributions. On the other hand, political leaders need to be reelected, and this depends in part on the reactions of voters. If voters gear their approval of leaders to their economic situation, then leaders may be caught between the pressures of elections and those of special interest groups. Too much protection may negatively affect the economy, and lead voters to seek new leaders. Hence leaders may be in suboptimal position where they have to give more protection to domestic interest than is optimal.

Leaders desire to provide only as much protection to special interests as they can without hurting their reelection prospects. In any political regime then, leaders may have to balance the policies that would enhance their electoral prospects and those that would meet the demands of special interest groups (Grossman and Helpman 1994). But when they have complete discretion over trade policy, leaders may be unable to resist the pressures of special interest groups in the short run, even though they would like to for electoral reasons.

Our claim is that signing an international trade agreement may help leaders overcome this dilemma. This outcome arises because of the way that trade agreements can enhance the utility of both leaders and voters. Trade agreements convey information to voters about the activities of leaders; such information helps leaders retain office. Voters know that their leaders may be pressured to give more protection than is beneficial for voters in general. But voters face an informational problem; they cannot distinguish perfectly between adverse economic shocks and the extractive policies of leaders. Voters may, as a result of this informational problem, remove a leader from office during economic downturns, even if that leader has not been engaged in excessive rent-seeking.

Leaders therefore would like to find a way to indicate that poor economic performance is not the result of their extractive policies. One way to do so is by entering into a trade agreement with another country. An agreement both commits leaders to less protectionist policies and conveys credibly to the voters that a less protectionist policy has been adopted. International cooperation can thus help leaders increase their chances of reelection, thereby providing a strong reason for them to pursue such agreements.¹

Our second claim is that the internal design of international trade agreements may also depend much on domestic politics. Domestic influences on the institutional design of international trade agreements may be quite powerful. Almost all international trade agreements include some form of “safeguard” clause, which allows countries to escape the obligations agreed to in the negotiations. Such escape clauses erode both the credibility and the trade liberalizing effect of international trade agreements, but they also increase the flexibility of the agreement by adding some discretion for national policymakers.² Such increased flexibility may be ideal for leaders because of domestic politics.

An escape clause is any provision of an international agreement that allows a country to suspend the concessions it previously negotiated without violating or abrogating the terms of the agreement. They are a prominent feature of many international agreements and are included in virtually all trade agreements. But the nature of the escape clauses often differs across agreements and is usually a subject of vigorous contestation in the negotiations. Since its inception in the 1940s the GATT (and the

¹ . See Mansfield, Milner, and Rosendorff 2002 for a model that shows why democracies in particular are most affected by this dynamic.

² . Rosendorff and Milner 2001 present a formal model along these lines.

subsequent WTO) has slowly built an arsenal of safeguard mechanisms to protect states from import pressures in the wake of extensive trade liberalizing agreements, including an escape clause (EC), countervailing duty (CVD) penalties, antidumping (AD) statutes, and a national security exception. They are thus means for industries to limit import competition by temporarily abrogating some portion of its treaty obligations under the GATT/WTO. These -- and other measures such as the infant industry exemption and the balance of payments exemption in the GATT -- are all designed by governments to reduce domestic pressures to withdraw from the entire agreement when protectionist pressures grow at home.

Escape clauses are an essential element of trade agreements when domestic uncertainty is high (e.g., Downs and Rocke 1995). When political leaders cannot foresee the extent of future domestic demands for more protection at home, such clauses provide the flexibility that allows them to accept an international agreement liberalizing trade. The use of an escape clause -- a flexibility-enhancing device -- in institutional design also increases institutional effectiveness whenever there is domestic political uncertainty. Flexibility in this context refers to the ability to adapt and respond to unanticipated events within the context of a well-designed institutional system. The system itself is not subject to renewed bargaining. Alternative flexibility-enhancing devices are, of course, available: sunset provisions or anticipated renegotiations are often used. But these mechanisms are even more costly and hence less used than the escape clauses. Indeed, the greater the uncertainty that political leaders have about their ability to comply with international agreements in the future, the more likely agreements are to contain escape clauses.

For escape clauses to be useful they must impose some kind of cost on their use. That is, countries that invoke the escape clause must pay some cost for doing so or else they will invoke them all the time, thus vitiating the agreement. Paying this cost signals their intention to comply in the future. But the different costs of alternative escape clause measures will affect the frequency of their use. Less costly measures will be used more often. If governments understand this, then they should prefer escape clauses that best match the extent of protectionist pressure they expect to experience from domestic interests. The costliness of the escape clause is crucial to the effectiveness of the escape clause regime, and the preferences of the domestic players in the negotiating countries will affect the optimal choice of this cost. Variation in the nature of the escape clause mechanism -- i.e., primarily its cost -- is an important feature of different agreements. Domestic preferences and institutions thus matter in the design of international institutions. Our argument is similar to the notion of efficient breach in legal theory.

Including escape clauses may also make initial agreements easier to reach. Their flexibility allows states to be reassured about the division of the long-term gains from the agreement. Indeed without escape clauses of some sort many trade agreements would never be politically viable for countries. Increased flexibility (necessary to deal with the uncertainty about the future) lessens the distributional problems of bargaining that may plague an initial agreement (Fearon 1998).

In the following two sections, we discuss these two important, yet distinct ways in which international trade agreements are shaped by domestic political considerations.

SECTION I: Domestic Incentives for Leaders to Sign Trade Agreements.

Why do political leaders make international trade agreements? International trade agreements arise in part because of the economic gains that leaders expect to derive from them; there are important terms of trade benefits that come from multilateral agreements (e.g., Bagwell and Staiger 1999; Maggi 1999). In addition to economic conditions, international factors may motivate leaders to sign trade agreements. Relations between countries are likely to affect whether they cooperate economically. Many observers, for example, argue that the amount of economic exchange between states influences whether they enter a trade agreement. Such functionalist arguments have been common since Haas' early work on the European Community (1958). Political-military relations may also provide incentives for states to form trade agreements. Studies show that countries may be more likely to enter trade agreements with their allies than with other states (e.g. Mansfield and Bronson 1997). Trade liberalization yields efficiency gains that enhance the political-military capacity of participants and alliances help to internalize these security externalities (Gowa 1994). Since trade agreements liberalize commerce among members, alliance politics may influence the likelihood that states will establish such an agreement. Military disputes are also important since they tend to discourage participants from forming a commercial agreement. All of these factors are important for understanding the motivations of states to cooperate in trade relations. But these economic and international factors are not the focus of our argument.

Equally important but far more poorly understood, however, are the domestic political gains that also motivate leaders to cooperate in trade. What kinds of domestic conditions create incentives for leaders to sign trade agreements?

International agreements may serve a domestic purpose by constraining leaders. They allow political leaders to commit themselves credibly to actions that the public would otherwise find incredible. Others have argued that international institutions promote cooperation by providing information (Keohane 1984), but they have been less specific about how this mechanism actually induces leaders to choose cooperation. Here, we identify one mechanism by which such cooperative agreements can convey information to the public about the behavior of their leaders, thus allowing them to better judge their leaders. Other mechanisms might serve this purpose too, but trade agreements do so especially well. The information provided by trade agreements benefits everyone: the public as well as the government. International cooperation can thus generate domestic political benefits for leaders, making them more likely to seek such cooperative agreements in the first place.

The goals of political leaders are to implement that policy which they most prefer and also to remain in power. The leader—whether democratic or autocratic—is interested in both the rents she derives from special interest groups and larger social welfare concerns. Trade policy provides her with one way of getting such rents. She can extract rents from interest groups in exchange for trade barriers that shield these groups from foreign economic competition.

If the leader did not have to worry about staying in office, then she could provide all groups who desired it with protection (even though this would reduce the benefits of

protection for any one group). With political survival concerns, however, the leader does not desire to give all groups protection. Indeed the more protection she gives, the worse the economy may perform and the more endangered her position may become. When she has complete discretion over policy, she may however be forced into giving more protection than she would otherwise desire. She thus lacks some credible commitment strategy for limiting the trade barriers that she implements.

Because of survival concerns, leaders have to worry about the public, and the public tends to care mostly about their economic situation. Social groups are likely to have different preferences for trade policy, if they have any preferences in this area at all. Some, say those working in import-competing industries (in the US, think of those in the apparel industry where about 75% of goods are imported or even the auto industry where over 25% of cars are imported), are likely to favor protection. Others, working in exporting industries such as electronics, computers and aircraft, are more likely to support trade liberalization. Most of the public is likely to support some level of trade barriers, but as barriers rise it is probable that their support for the leader falls. Protection is well known to impose large costs on the economy overall; the cost to any voter is small but the cost to the economy as a whole may be large (e.g., Hufbauer and Elliott 1994).³ Choosing too high a level of trade barriers is likely to hurt the economy and thus reduce a leader's support among the social groups.

When they have discretion over policy, political leaders are likely to be pushed to adopt too high a level of trade barriers. If the executive chooses a level of trade barriers different from that preferred by most of the public, this has two effects. It reduces her

³ . For instance, trade barriers against sugar imports in the US cost the American consumer over \$2 billion per year in higher prices, and despite some consumer groups' protests against them, sugar producers want political leaders to increase their protection (Barboza 2001).

chances of staying in office since it lowers the public's welfare, but it also increases the rents that the leader may derive. Groups that the leader's policy helps are likely to give a portion of the rents they derive to her as either campaign contributions, lobbying expenditures, or as outright bribes. For these reasons, the executive may deviate from the policy preferred by most voters. But she knows that after setting commercial policy, elements of the public will decide whether or not to keep her in office her at some time in the future, so she may want to commit herself to a lower level of protection. How to do this credibly is her problem.

Voters face a principal-agent problem. They elect leaders and then leaders get to choose policies for them. The public has heterogeneous preferences about trade policy; given their factor endowments, some prefer very high levels of protection and some prefer freer trade. Most prefer a positive level of trade barriers but not too much protection. The public, however, cannot directly control trade policy; only their leaders can. The public is unlikely to know the exact level of trade barriers, but they do know the domestic price of the goods they produce and consume. This seems to accord with reality, since it is not obvious that voters know the exact policy choices of their representatives. For example, American voters are much more likely to know the domestic price of sugar than the level of the quota imposed on imported sugar by the government. Voters generally are unlikely to know what trade policies their representatives have enacted, giving the leaders an opportunity to extract more rents from special interest groups. Voters have to be concerned then with their agent's behavior. When their overall economic welfare is good and rising, voters may not be too worried about their leader's behavior. But when economic conditions turn down, they may suspect that their leaders

are providing too much protection for special interests and thus weighing down the economy. Economic downturns may thus signal them to vote against or reduce their support for their incumbent leaders.

In such an environment, the public faces a problem: they do not know whether the reduction in their economic welfare was caused by an exogenous shock to the economy or by excessive protectionism on the part of the executive. They can base their reelection decision only on the information available to them. This implies that they may throw out of office incumbent leaders for events that are beyond the leaders' control. Executives may pick the optimal policies from the public's point of view, but the economy may experience an adverse shock, thereby degrading their welfare and prompting them to reject the executive. The executive thus faces some prospect of being ousted from office every electoral period, no matter what trade policy she chooses.

In addition to setting their own policies, executives have the capability to negotiate trade agreements with other countries. But an executive will only do this if the gains from an agreement are at least as great as those from setting policy unilaterally. When can a leader gain from a trade agreement? An agreement usually involves a set of mutually acceptable trade policies for the countries involved and an institution that can send signals about the countries' behavior. (It is also possible that signals about compliance can be sent by the foreign countries involved). That is, it comprises a level of trade barriers lower than the executive's optimal unilateral policy. It also includes a mechanism for the foreign country or the international institution to signal to others that the home executive has cheated and raised trade barriers above the agreement level. Trade agreements bind leaders in the sense that they make information about the leaders'

behavior more readily available. They need not actually punish leaders for their violations of the agreement; they just make such violations much more public so that they can be dealt with in other domestic forums, as suggested by Benvenisti (1999: 206).

The agreement includes a level of trade barriers below what the leader would choose otherwise and an alarm mechanism that other governments or the trade institution, such as the GATT or WTO, can use whenever the actual trade policy of a country that is party to the agreement exceeds the agreed upon level. A commercial agreement is public and therefore provides information that at least some social actors can use to more closely monitor the executive.

In particular, monitors of the trade agreement, such as an independent agency like the WTO or even the participating governments themselves, can announce, just before an election, whether the leader in each country is in compliance with the agreement. The WTO does indeed issue such reports on all member countries periodically. Its publicly-issued Trade Policy Reviews of member countries are an important aspect of monitoring. The EU also provides such periodic reports on compliance with its policies by member governments. The international institution and its member countries have an incentive to divulge this information and make sure that domestic publics pay attention to it since this disciplines the government. Moreover, the public has some incentive to pay attention to it, since the signal improves their welfare. So an international trade agreement moves countries away from their unilateral policy choices and it has important informational features.

The public (at least some of them) now have more information than before. They may adjust their voting strategies accordingly. Instead of just looking at their overall

welfare, they may also listen for the alarm sent by the international institution. If they hear the alarm, then they have more reason to reject the incumbent leader and she is more likely to lose office.

There is some evidence that leaders do worry about the domestic effects of cheating on international agreements. It would be ideal to have data on how such cheating affects public support for incumbents. But in the absence of this there is certainly evidence that leaders, when knowing they are going to violate international agreements, try to mitigate the potential impact of this by invoking imperatives of national security or explaining away such infractions legalistically. (The Bush administration's handling of the ABM treaty is a case in point.) If leaders were not worried about the domestic impact of such cheating, they would not expend the effort to explain their actions.

The executive faces a new situation relative to her trade policy decision under a trade agreement. By making an agreement, the executive trades some of her policy-setting discretion for the greater certainty that she will not be rejected (unfairly) from office. Interestingly, the leader (who is the potential violator) may benefit from the alarm too because it reduces the prospects of being punished by voters when no rules were broken. When the public's welfare declines but there is no cheating alarm sounded by the international institution, they will be less likely to blame their incumbent leader and more likely to keep her in office.

Complying with the agreement, however, reduces the rents that leaders can collect domestically. The leader now earns some lower value of the rents she gains from this level of trade barriers. With pure discretion, the executive can earn a higher level of rents

from setting policy unilaterally and providing more protection for special interests. The value of cooperation over non-cooperation for the executive thus is the difference between the gains from cooperation minus the gains from unilateral policy making. The executive trades off a greater degree of certainty of reelection when she cooperates for a lower level of rents since she employs a lower level of trade barriers. When the gains from cooperation relative to unilateral policymaking are positive, the leader should choose to make an agreement. When leaders value office highly and fear losing it, international trade agreements may be beneficial to them. They will lower the levels of protection leaders are forced to provide and thereby increase their chances of reelection.

Even if the government gains, we need to show that the majority of the public gains as well from an international agreement. If the leader always sets trade policy too high when unconstrained, then any reduction in this level through a trade agreements will be beneficial to most voters. In addition, the public has a new source of information about their leaders' behavior and this allows them to better monitor them and act more informatively.

In a world where the public cannot perfectly distinguish between a reduction in their welfare stemming from an adverse economic shock, on the one hand, and excessive government rent-seeking, on the other, leaders and the public will both gain from international trade agreements that provide information about the executive's behavior. There may be other mechanisms that countries could design to provide such information to the public, but it is hard to think of ones that are as credible. Political oppositions in the country itself cannot be counted on since they are unlikely to tell the truth about the incumbent's behavior. Social actors are likely to know this and thus to discount any

information domestic oppositions provide. Other domestic institutions, such as courts or the media, may also be seen as less credible since they too may have strategic reasons for providing such information.

International agreements can thus serve a domestic purpose. They allow executives to commit themselves credibly to actions that their publics would otherwise find incredible. They allow leaders to choose a lower level of trade barriers than they could unilaterally. They also convey information to the public about the behavior of their leaders, thus allowing them to better judge their leaders. The information provided by trade agreements benefits all groups: home and foreign voters, as well as leaders in both countries. This is an aspect that few, if any, scholars have discussed concerning the role of international institutions. International cooperation and the institutions created to monitor it can thus generate domestic benefits for leaders, making them more likely to seek such cooperative agreements in the first place.

SECTION II: Domestic Influences on the Design of International Trade

Agreements.

While there has been much debate over role of international institutions, less has been written about the internal design of such institutions. We know that international institutions differ greatly in their forms; the number of states included, the decision-making mechanisms, the range of issues covered, the degree of centralized control, and the extent of flexibility within them all varies substantially from one institution to the

next. What accounts for such variation? This paper claims that such variation can be accounted for in part as the response of leaders faced with particular domestic problems.

Almost all international trade agreements include some form of “safeguard” clause, which allows countries to escape the obligations agreed to in the negotiations (Hoekman and Kosteki 1995: 161). On the one hand, such escape clauses are likely to erode both the credibility and the trade liberalizing effect of international trade agreements. On the other hand, they increase the flexibility of the agreement by adding some discretion for national policymakers. When is such increased flexibility optimal for leaders making international trade agreements?

An escape clause is any provision of an international agreement that allows a country to suspend the concessions it previously negotiated without violating or abrogating the terms of the agreement. They are a prominent feature of many international agreements and are included in virtually all trade agreements. However, it is interesting to note that not all international agreements have such clauses; for instance, some international arms control agreements, such as the SALT agreements, do not contain such escape mechanisms. Most trade agreements do contain them, but the nature of the escape clauses often differs across agreements and is usually a subject of vigorous contestation in the negotiations. For example, in both the NAFTA and GATT Uruguay Round negotiations, antidumping and countervailing duty laws were critical issues that impeded agreement among the countries.

Since its inception in the 1940s the GATT (and the subsequent WTO) has slowly built an arsenal of safeguard mechanisms to protect states from import pressures in the wake of extensive trade liberalizing agreements. These include an escape clause (EC),

countervailing duty (CVD) penalties, antidumping (AD) statutes, and a national security exception. For each of these, the GATT (now WTO) specifies the conditions under which a government can grant relief to an industry from import competition, and industries then have the option of choosing which mechanism to file their complaints under. In each of the GATT negotiating rounds, the inclusion and/or modification of these different laws have been the subject of intense debate among the signatories.

Many have noted that these different clauses can be substitutes for one another. Hoekman and Leidy (1989) and Hansen and Prusa (1995) suggest that CVD and AD laws are really “a poor man's” EC. AD and CVD complaints allege that exporting countries are playing unfairly and thus the harmed country avoids the payment of compensation that the GATT requires on use of the EC. They are thus means for industries to limit import competition on the cheap: they mean that a country can abrogate some portion of its treaty obligations under the GATT and pay a lower penalty than if they were to use the escape clause. These -- and other measures such as the infant industry exemption and the balance of payments exemption in the GATT -- are all designed by governments to reduce domestic pressures to withdraw from the entire agreement when protectionist pressures grow at home. While these different laws are generally seen as substitutes, they do differ substantially in the costs they impose on the country using them. Usually AD and CVD clauses are seen as less costly to use than are traditional escape clauses. This type of variation is important, as explained below.

Escape clauses are an essential element of trade agreements under conditions of domestic uncertainty. When political leaders cannot foresee the extent of future domestic demands for more protection at home (and/or more open markets abroad), such clauses

provide the flexibility that allows them to accept an international agreement liberalizing trade. The greater the uncertainty that political leaders face about their ability to maintain domestic compliance with international agreements in the future, the more likely they are to seek agreements that contain escape clauses. This also suggests that in issue-areas where uncertainty about domestic pressures to comply is less, governments are less likely to desire such safeguard measures.

The use of an escape clause -- a flexibility-enhancing device -- in institutional design can increase institutional effectiveness whenever there is domestic political uncertainty. Flexibility in this context refers to the ability to adapt and respond to unanticipated events within the context of a well-designed institutional system. The system itself is not subject to renewed bargaining. Alternative flexibility-enhancing devices are, of course, available: sunset provisions or anticipated renegotiations are often used. But these mechanisms are even more costly and hence less used than escape clause ones.

For escape clauses to be useful they must impose some kind of cost on their use. That is, countries that invoke the escape clause must pay some cost for doing so or else they will invoke them all the time, thus vitiating the agreement. Paying this cost signals their intention to comply in the future. But the different costs of alternative escape clause measures will affect the frequency of their use. Less costly measures will be used more often. If governments understand this, then they should prefer the set of escape clauses that best matches the extent of protectionist pressure they expect to experience from domestic interests. Thus, the architects of international agreements will design such agreements so that the costs of the escape clauses that they most desire are balanced by

the benefits of future cooperation. Variation in the nature of the escape clause mechanism -- i.e., primarily its cost -- is thus an important feature of different agreements. Domestic preferences and institutions will thereby matter in the design of international institutions.

The key factor that renders escape clauses desirable is the presence of uncertainty. Leaders are constantly faced with political pressure for protection at home. The domestic economy is subject to many shocks. Some unanticipated change in the economy or political system produces a surge in imports that triggers a large increase in domestic firms' demands for protection. This shock can be of a very general nature; it is any exogenous and unanticipated change (e.g., price or supply changes; technological change; political change) that affects domestic firms' demand for, or ability to lobby for, protection of their markets. Currency appreciations, downturns in the economy, new competitors abroad, etc. can all produce a sudden, unexpected surge in demands for protection. Leaders who have signed trade agreements then face the quandary of trying to decide how to respond. Saying no to such pressures may have a variety of negative consequences, all of which can endanger the political tenure of leaders. Completely abrogating trade agreements, however, can be costly for leaders, as argued above. So what is a leader to do?

What if countries every now and then face intense pressures to cheat, yet do not want to spark a breakdown in cooperation and certain retaliation by other countries? Can an alternative institutional structure be devised to maintain a cooperative agreement, even in these periods of high political pressure to protect?

In the presence of such unexpected shocks, international institutions may be much better served by allowing countries to make temporary and ad hoc use of escape clauses

that allow them to break the rules for a short period and pay a cost to do so. Doing so prevents a spiral of retaliation from occurring. The defection by the country is tolerated, exactly because the other side may wish to use the same instrument in the future.

Countries are in a position similar to Rawl's "initial position," where each is behind the veil of ignorance and cannot tell exactly how one will benefit (or lose) in the future from agreements made now. Because shocks can occur in each future period that cannot be predicted beforehand, the leaders do not know the future distribution of gains and losses from the initial agreement with certainty. Hence this is likely to mitigate how hard they bargain in the first place. Including escape clauses may make both enforcement of and distributive bargaining over trade issues easier.

Very little retaliation for treaty violations is actually observed. Under current WTO rules, any punishment can only come after a finding by the dispute settlement procedure at the WTO, and frequently, the dispute is "settled" before punishments are applied. The pre-Uruguay round rules in fact made findings of allowable retaliation quite rare (Rosendorff 1999). Cooperation is deeper, more likely, and international trade institutions are more durable with escape clauses than without them. In the choice then between rules versus discretion, rules with costly discretion may be better than no discretion when the future holds unexpected, unpleasant surprises for political leaders.

Domestic political uncertainty may take a number of forms. At the most broad level, there is uncertainty regarding what one might call the future state of the world: i.e., the configuration of political pressures in future periods is not known with certainty by leaders. Uncertainty regarding the preferences of key domestic players is another possibility, one considered elsewhere in an investigation of the effect of elections on the

design of international agreements (e.g., Milner and Rosendorff 1997). Another possibility is that the agreement itself is too complex (or time is too valuable) for the domestic policy-makers to fully understand the consequences of its passage and policy-makers rely therefore on the information provided by lobbies and other interested third-parties (Milner 1997).

Many trade agreements include such escape clauses; indeed, all GATT agreements have at least one type, if not several types, of such escape clauses. Moreover, these alternative escape mechanisms have different costs for their use. In general, a country appealing to an escape clause is allowed, under the rules of the institution, to protect the affected industry for the duration of that period, as long as it (in effect) voluntarily and publicly incurs some penalty. This voluntary penalty is consistent with the reciprocity norm of the GATT, which requires a country that applies a temporary trade barrier to reciprocate by lowering some other barrier elsewhere in order to leave its trading partners unaffected by the action or to face an equivalent trade barrier by its partner.

But this penalty may take any number of forms. For example, in the use of the GATT escape clause countries must negotiate compensation with the affected exporter, or face equivalent retaliation from the exporter. For other safeguard-type measures, the cost is often less explicit and smaller. Sometimes there is a presumption that a country invoking the escape clause will be forced to devise and implement a plan of structural adjustment for the affected industry; such plans have costs, both economic and political. Moreover, the costs of filing an EC, AD or CVD complaint are also part of the cost that the import-competing firms must face. For many of these, the technical and legal

requirements for producing evidence of injury are sufficiently high to merit consideration as a source of costs borne. In any case, each safeguard mechanism entails some costs when it is used, although these costs do differ in important ways.

After invoking the safeguard, in some future period the country returns to the cooperative regime, having preserved its reputation as a cooperator. Moreover, no supranational enforcement agency must force the country to pay this penalty; the country (and everyone else) realizes that paying the penalty is in its best interest in order to preserve its credibility in the future. The institution serves as a verification agency, much as in the Law Merchants institution (Milgrom, North and Weingast 1990); it monitors whether defection occurs with a penalty.

The cost that a state must pay for using the escape clause is of great importance. If this penalty is set at an appropriate level, a country may temporarily use the escape clause and then return to the cooperative regime. If this cost is set too high, then countries will abandon the institution and defect when they experience a severe shock. If these costs are set too low, then there is repeated recourse to the escape clause, and the agreement enforces little actual cooperation over time. Escape clauses will thus be used more often when their costs of use are lower. Variations in the costs of different escape clause mechanisms will be an important feature in the design of international trade agreements.

As noted above, most international trade agreements include at least one form of escape clause. Many, such as the GATT, include several. This is due in part to the high levels of domestic uncertainty that surround trade politics. Greater domestic uncertainty, or situations where political leaders are more sensitive to unanticipated changes in political pressures, should be associated with more reliance on escape mechanisms. An

interesting test of this claim then would be to identify those political institutions that magnify the effect of unanticipated shocks and see whether countries with these types of institutions are more likely to devise and use escape clauses in their trade relations. Another test would be to deduce which issue areas are more subject to unanticipated domestic shocks and see if they are more likely to have escape clauses associated with them. Such an exercise, unfortunately, is beyond the scope of this chapter. However, two facts about escape clauses accord with this claim: certain countries which arguably are more sensitive to domestic pressures are the main proponents and users of escape mechanisms, and certain issue areas seem more likely to have escape clauses than others due to their greater levels of uncertainty.

Escape clauses in trade policy exist both at the national and the international level. Interestingly international usage has often copied domestic laws. Several countries dominate the international use of all forms of escape clauses and these are all countries that have tended to use escape clauses domestically first. The main countries using GATT/ WTO AD, CVD, and safeguard clauses are the same ones who earlier developed a battery of domestic laws to use these trade remedies. By and large, the US, Canada, the EU (or EC) and Australia are the main users of these clauses (Trebilcock and Howse 1995). These are the same countries that initially built domestic trade laws around such escape mechanisms.

The first instance of an AD law was Canada's 1904 dumping regime (Trebilcock and Howse 1995: 172). In 1947 the US instituted the world's first safeguard clause (Trebilcock and Howse 1995: 227). And the US and Canada were both the early designers of CVD laws. This suggests that the need for escape clauses may be associated

with large democracies with federal structures. It may well be that unanticipated shocks are far more damaging for political leaders in these democracies than in non-democracies. These shocks may be more likely to get them ejected from office as the negatively affected groups mobilize against the incumbents in election periods and federal institutions make such mobilization more threatening. If so, this would account for why these types of countries are more likely to have such national escape clause provisions and why they are also more likely to be proponents of these provisions at the international level.

For example, in the realm of safeguard clauses, the US has the oldest domestic laws and has been the most vocal proponent of them in international trade negotiations. American trade law puts the escape clause into practice via Section 201 of the Trade Act of 1974. Between 1975 and 1990, 62 cases under section 201 were initiated, of which 13 industries received relief, plus 7 more who received trade adjustment assistance. High profile cases included color televisions in 1982, which received protection on \$1,543 million of imports that year and nonrubber footwear (\$2,480 million in 1981) (Hufbauer and Rosen 1986). Following a petition, which can be lodged by the industry, or by a government (including the President, the US Trade Representative or Congress, among others)), the US International Trade Commission (ITC) conducts an investigation to evaluate whether imports have been a substantial cause of or threat of injury to the domestic industry. After an affirmative finding by the ITC, the President may grant protection for up to five years, with the possibility of extending it for another three years. This practice has been followed closely in the GATT, largely at the Americans' insistence. Article XIX of the GATT permits a member to escape from its obligations not

to raise trade barriers when one of its industries is suffering an economic downturn, and is experiencing “serious injury.”

In the realm of AD and CVDs the same association is apparent. American and Canadian laws have preceded international ones and set the pattern for them. Article VI of the GATT, and the Second Antidumping Code of the Tokyo Round, which define practice in AD and CVD law, allows member state to apply duties when imports are sold at “less than fair value,” following American practice. Cass et al. (1997: 24) describe the American antidumping laws (and those of other countries) as “miniature escape clauses”, in that the AD code extends protection to smaller cases on which agreement would be impossible ex ante. Between 1994 and 1996 alone, 77 AD petitions were filed in the US (Stern 1997), and worldwide, the AD clause has been invoked over 2000 times since 1970. Similarly, the American CVD code (which is consistent with the GATT's Article VI) allows member states to apply a countervailing duty when a subsidy is being provided to the foreign industry. Other forms of the escape clause appear throughout the GATT. Balance of payments exceptions (article XVIII and XII), infant industry protection (XVIII), and tariff renegotiation (article XXVII) allow temporary escape from a member's obligations under the agreement.

Trade is, of course, an area where governments are likely to face strong domestic pressures for import protection from time to time. When imports surge or when economic conditions facing an industry turn downward, pressures for protection may suddenly appear. Unfortunately, governments may not be able to anticipate perfectly the magnitude of such pressures or their origin. Cass et al. (1997: 24) claim that these safeguard mechanisms allow “protectionist sentiment to hold sway” when political pressures are

large. Democratic leaders may be especially vulnerable to such unexpected changes, and hence may seek escape clause protection more than leaders in other systems. The greater impact of uncertainty in democratic systems may make their leaders particularly desirous of escape clause mechanisms in trade.

The need for escape clauses may also vary by issue area. Trade, it is widely believed, is an area where governments face domestic uncertainty that has significant costs; such international economic exchanges are susceptible to swift changes due to price or supply shocks, technological change and/or foreign government policy changes. The same is true in the macroeconomic area. Fixed exchange rate systems especially may be vulnerable to unanticipated domestic pressures to devalue. High uncertainty over the timing and magnitude of these domestic pressures seems likely. Thus in fixed exchange rate agreements leaders might desire escape clause measures. In the Bretton Woods regime, for example, the simple rule was the requirement to maintain fixed exchange rates. But a country could devalue in the event of “fundamental disequilibrium,” a vague phrase allowing escape from the simple rule since even economists were unable to agree on what balance-of-payments equilibrium meant. The regime did not dictate in advance the size of the devaluation. Instead, it required a member-state to seek approval from the International Monetary Fund (at least for an exchange-rate realignment of more than ten percent).

The European Payments Union (EPU), the postwar multilateral trade deficit clearing system, gave signatories the right to suspend liberalization measures as a result of serious economic disturbance or if liberalization was too disruptive (Oatley, 1998). Similarly, Europe's Exchange Rate Mechanism (ERM) required member-states to

maintain bilateral exchange rates within clearly demarcated target zones, but did allow for realignments of the parity. While the ERM's architects recognized the need for occasional parity realignments, they did not specify exactly when such realignments should take place. Instead, the ERM required that realignments be negotiated among all members (Canavan and Rosendorff 1997). In all three cases, escape clause mechanisms were included in the design of these institutions to deal with situations where policy makers face high levels of domestic uncertainty over the pressures that will arise for them to abrogate any international agreement they sign.

Notice that under all three regimes (Bretton Woods, EPU, ERM), devaluation (the use of an escape clause) was not without its costs. Devaluation was permitted only in concert with other measures designed to bring core macroeconomic aggregates back to within “acceptable” parameters. Devaluation was therefore frequently associated with fiscal and monetary contraction, policy liberalization and reform, all of which come at a domestic political price.

But in other areas, domestic uncertainty is less pervasive and consequential. In an area like arms control, the public and interest groups tend to be less organized and involved. The most important constituency for these agreements is often the military, which may take part in the negotiations and hence shape them directly. The impact of unexpected changes in this area may be less for political leaders than in areas like trade. Notably, arms control agreements have frequently not included escape clauses. The ABM treaty, most of the SALT treaties and the INF treaties do not contain escape mechanisms; some of these allow countries to withdraw with certain notification provisions and some have definite time limits, but none seem to contain clauses that allow temporary

abrogation of the agreements. Arms control may be an area where domestic uncertainty is less important for leaders. Unexpected shocks that greatly increase pressures for leaders to cheat on the agreement (or pay substantial domestic costs) are less common in this area.⁴ Hence one would not expect states to be as concerned about including escape clauses in these agreements, as they are in trade and the monetary area. Where domestic uncertainty is less consequential for leaders, escape clauses will be less important and hence less used.

If it is correct that governments choose escape clause mechanisms, then one should see that variations in their cost lead to variations in the usage. Low cost escape mechanisms should have much appeal; high costs one should not. A good deal of evidence seems to suggest that this argument is valid. For instance, in US trade law, the escape clause (section 201) has been used far less often than have various other safeguard mechanisms. Hanson and Prusa (1995: 296, table 1) show that the average number of EC cases filed has never gone above 11 per year, while for AD and CVD cases the average reached a peak of 92 per year in the early 1980s. Moreover, EC complaints have been decreasing steadily with less than one a year filed in the early 1990s. In contrast, AD and CVD cases have been growing over time. What accounts for this difference in usage?

It is the greater cost of invoking EC that makes firms less likely to do so. Hanson and Prusa claim that the lower probability of success makes firms choose to file AD and CVD instead. But the claim here is that the lower probability of success results from the fact that EC actions when implemented cost the importing country more and thus make

⁴ . It is interesting to speculate on the causes of the US's abandonment of the ABM treaty in order to develop a national missile defense. These pressures for change do not seem to arise from domestic uncertainty, but rather from technological change. Having an escape clause would not resolve the problems posed by the NMD.

policymakers less likely to accept petitions for it. Thus firms see it as less successful and choose other means. The main reason they cost more is that exporters have a right to demand compensation for EC relief and, if it is not forthcoming, to retaliate.

Compensation and retaliation create large domestic costs for governments and thus they try to avoid such measures.

The GATT also provides evidence that greater costs mean less use. Under GATT rules, exporters had a right to compensation or retaliatory action if article XIX, which involved the EC, was invoked. Moreover, the standards of proof for “serious injury” caused by imports needed to invoke the EC have been the highest of all. Among all the various safeguard means in the GATT, article XIX was among the least used. It was invoked only 150 times between 1950-94. It has also seen declining use over time: being used 3.6 times per year from 1950-84 and now 3.2 times per year from 1985-94. In contrast, the AD clause is much more frequently invoked: over 2000 times since 1970 alone (Hoekman and Kostecki 1995).

In addition, scholars have noted that costliness of EC actions has led to the proliferation of so called voluntary export restraints (VERs). As Schott (1994: 94) states, “Most major trading countries, however, have been deterred from invoking Article XIX less by its requirements than by the availability of less onerous and more flexible channels of protection. These have included coercing trading partners to accept VERs and other so-called gray area measures, as well as frequent recourse to unilateral relief actions under Article VI (i.e., antidumping and countervailing duties.)” VERs are less costly to use than the EC since they do not assume compensation or allow retaliation from the affected exporter.

But VERs do impose a cost on the importing country using them. Unlike a tariff or quota which provides rents for the importing country, a VER transfers those rents to the exporter. As Hoekman and Kostecki (1995: 168-9) maintain, “affected exporters tended to accept VERs because they were better than the alternative -- often an AD duty - - as they allowed them to capture part of the rent that was created. Instead of being confronted with a tariff, the revenue of which is captured by the levying government, a VER involves voluntary cut-backs by exporters in their supplies to a market. This reduction in supply will raise prices -- assuming that others do not take up the slack. Exporters therefore get more per unit sold than they would under an equivalent tariff. ... The key point to remember about VERs is that they imply some direct compensation of affected exporters and selectively target exporters. Thus they practically meet GATT-1947's compensation requirement, while allowing for circumvention of its nondiscrimination requirement.” Hence VERs were preferred to EC actions because they were less expensive to employ, but even they imposed costs on the importing country.

Interestingly, the GATT recognized that the costliness of using the escape clause was hurting the system and pushing states to develop other means -- such as VERs -- to deal with domestic pressures. Many GATT officials found other safeguard remedies -- such as AD, VER, and CVD -- very undesirable. They preferred that countries use the EC mechanism. But they also realized that this process was too costly and thus underused. In the Uruguay Round, they made several changes to reduce the costs of the EC relative to other safeguards. First, they banned the use of VERs in the agreement on safeguards (Schott 1995: 94). This in effect raised the costs of such measures.

Second, they decided that it was necessary to reduce the costs of the EC option. So they proposed, and countries agreed, that one way to do this was to eliminate the right of retaliation. Hence in the WTO countries that use the EC no longer have to pay compensation and the injured exporters can no longer legally retaliate for the first three years of its use (Preeg 1995: 100-1; Schott 1994: 94-97). As Hoekman and Kostecki (1995: 169) note, “(b)y the time of the Uruguay Round the major objective of target countries was to constrain the use of AD and VERs and assert the dominance of Article XIX in safeguard cases. Two options were available: either to tighten the discipline on the use of AD, or to reduce the disincentives to use Article XIX. Both approaches were pursued.” Lowering the costs of using the EC then was seen as a key way to shift countries away from using alternative safeguards like AD and CVD, and toward using more EC actions. This seems to provide some evidence that leaders do indeed design international agreements with domestic pressures in mind.

In the international monetary arena, the costs of exercising relief have varied both across institutions and within institutions over time. Again one could argue that these variations are the rational responses of political leaders to the problems associated in part with domestic uncertainty. The Bretton Woods system's vagueness in the conditions under which a devaluation could occur meant that it was frequently appealed to, and effective cooperation was limited. The EPU and the ERM both were more specific about the terms of realignments; moreover, the ERM became increasingly more restrictive about the conditions under which escape was possible as the system moved towards monetary union, and accordingly less tolerant of realignments. As a result the system

became somewhat more rigid and less flexible, leading to more periods of instability and exit, as happened in Britain and Italy in 1992 (Canavan and Rosendorff 1997).

Including escape clauses may also make initial agreements easier to reach. Their flexibility allows states to be reassured about the division of the long-term gains from the agreement. Indeed it is possible that without escape clauses of some sort many trade agreements would never be politically viable for countries. Increased flexibility necessary to deal with the uncertainty about the future lessens the problems of distribution that may plague an initial agreement. The escape clause adds flexibility to an agreement that might be difficult to sustain in the presence of uncertainty. Hence bargainers are not stuck in a commitment to a distributional outcome for the infinite horizon, thereby making initial bargains easier to strike.

As many have noted about the GATT, it would have been impossible for many countries to sign without various safeguards. Ruggie (1982), for example, has argued that all of the international economic agreements, or regimes, negotiated after World War II had to embody the norm of “embedded liberalism,” by which he meant that they had to combine multilateralism with the requirements of domestic stability. Domestic safeguards that allowed countries to protect their economies were thus essential parts of this norm in both the trade and monetary areas. Without such safeguards, countries would have never signed the trade and monetary agreements.

Moreover, Hoekman and Kostecki (1995: 191) claim that “(p)olitical realities often dictate that there be a mechanism allowing for the temporary reimposition of protection in instances where competition from imports proves to be too fierce to allow the restructuring process to be socially sustainable. Indeed, a safeguard mechanism is

likely to be a pre-condition for far-reaching liberalization to be politically feasible.” Or as Sykes (1991: 259) has shown, “when self-interested political officials must decide whether to make trade concessions under conditions of uncertainty about their political consequences, the knowledge that those concessions are in fact ‘escapable’ facilitates initial trade concessions.” Following Dam (1970: 99), Sykes (1991: 279) maintains that “unanticipated changes in economic conditions may create circumstances in which the political rewards to an increase in protection (or the political costs of an irrevocable commitment to reduce protection) are great. Consequently, in the absence of an escape clause, trade negotiators may decline to make certain reciprocal concessions for fear of adverse political consequences in the future. But, with an escape clause in place the negotiators will agree on a greater number of reciprocal concessions, knowing that those concessions can be avoided later if political conditions so dictate.” Our claim is that the inclusion of escape clauses should make reaching an initial agreement easier.

This argument shares much with the theory of efficient breach used in legal theory. This theory advances the idea that “there are circumstances where breach of contract is more efficient than performance and that the law ought to facilitate breach in such circumstances” (Dunoff and Trachtman 1998: 24). In order to do so, there must be mechanisms that can determine and compel payment of the appropriate levels of damages for such breach. Dunoff and Trachtman (1998: 26) also note that “entry into contract may be facilitated by the understanding of parties that breach may be permitted under certain circumstances.” They point out that the WTO’s safeguard system and its notion of compensation or retaliation provides just such a mechanism for efficient breach.

An alternative flexibility-enhancing device is to build into any agreement the opportunity for regular renegotiation, as in the GATT. It seems likely, however, as Sykes (1991: 280) claims, that renegotiation of an entire agreement is probably by far the most costly means of ensuring flexibility and is likely to have a lower probability of success than will the inclusion of escape clauses in the original agreement.

The inclusion of escape clauses in international agreements can be an important response of political leaders to their domestic problems, especially to unanticipated domestic political pressures for protection. These escape mechanisms help political leaders to maintain international cooperation without sacrificing their domestic political positions; they thus reduce the costly, contradictory pressures that can emanate from domestic and international politics, helping to make international cooperation more compatible with domestic political success. As we have argued elsewhere (Milner and Rosendorff 1996; Milner 1997), such solutions to the two-level game faced by political leaders are essential for successful international cooperation. Designing flexibility into international agreements thus is important for political leaders when faced with domestic uncertainty and international distributional problems. The likelihood and the success of international institutions in turn depend on their internal design, as well as other factors.

CONCLUSION:

International trade agreements thus may depend on domestic politics in a variety of ways. Motivations for leaders to make such agreements can come not just from economic factors or international pressures, but also from domestic political needs. Such

agreements can help domestic leaders solve their internal problems. When pressed between concerns over political survival and special interest pressures, leaders may find that international trade agreements are ideal for allowing them to credibly commit to both a lower level of protection and to a signaling mechanism that helps them retain office. All groups, except perhaps special interests, can gain from this agreement. The international institution provides a credible commitment mechanism and a source of information to domestic voters. Its importance is less for punishing cheaters than for informing others that they have cheated.

Agreements may also be shaped the way they are because of domestic concerns. Why do virtually all trade agreements have escape clauses, especially when other agreements often do not? Such breach mechanisms are essential for leaders who face domestic uncertainty. They fear being caught in an inflexible agreement when sudden, unexpected pressures for protection arise domestically that they dearly need to respond to. Having to abrogate the agreement can be very costly, but not being able to temporarily respond to such domestic pressures may also be very costly. Having escape clauses may reduce this dilemma and make agreements more likely and more durable.

Are the two claims here contradictory? Does inclusion of escape clauses vitiate the constraining and informative nature of trade agreements for domestic groups? We argue rather that the two work together to make agreements more stable and useful. Leaders enter into such agreements to resist the temptation to erect more protection than is ideal, but they also need some flexibility to temporarily and selectively give protection in the future if sizable domestic pressures arise. The escape clause allows this, while also keeping domestic groups informed about the overall compliance of political leaders with

the agreement. Constraint with flexibility is the best option for political leaders facing very unstable domestic conditions. They can bind themselves through the agreement, but they also can respond selectively to domestic interests. In an ideal world, neither international agreements nor escape clauses would be necessary for leaders would choose the optimal policies for the world economy. But with domestic protectionist pressures and uncertainty about future pressures both facing them, leaders most desire a system where they can commit not to give too much protection but where they can also temporarily give selective protection without abandoning the whole agreement.

For these reasons, we argue that more attention needs to be addressed to the domestic political incentives for both international agreements in general and their specific internal design in particular. Political leaders face pressures from both domestic and international environments, but in most countries, and especially democracies, leaders are most attuned to their domestic constituents. This means that international cooperation may only be feasible if it solves some domestic political problem for leaders, rather than just providing certain economic benefits.

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