

## 4 A Shadow of Its Former Self

### Hierarchy and Global Trade

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Global trade has expanded rapidly since the end of the Second World War. The global institutions that have guided and supported that growth are often held up as shining examples of successful global governance in the postwar world. Credit is often given to the architecture of the trade regimes' rules: "The GATT/WTO's [General Agreement on Tariffs and Trade/World Trade Organization] unique structure and rules proved exceptionally successful in promoting trade."<sup>1</sup> Yet, those rules have been subject to challenges and changes in the past seventy-plus years.

In the nomenclature of Barnett, Pevehouse, and Raustiala (BPR), we contend the multilateral trade regime that emerged in the postwar period was, and remains, hierarchical. We reach this conclusion by examining rule creation as our focal process of global governance. Yet, challenges have begun to chip away at the hierarchical nature of the global trade regime. We identify two central changes and challenges. First, we argue that while global trade rules are hierarchical, rule-based constructs, it is now a multilevel hierarchy thanks to growing regionalism. We argue that to date regional arrangements have largely nested into the global trade regime, but there is no guarantee this will continue. If one sees regionalism as a substitute for multilateralism, the multilateral trade regime is in growing danger.

Second, while multilateral rule-making power remains exclusively with states, non-state actors have elbowed their way into the process due to the expansion of regionalism, the changing nature of global trading relationships, and the growing emphasis on non-trade issues as central to trade agreements. This has allowed networks of actors, including firms and nongovernmental organizations (NGOs), to influence the rules of the trade regime, even though they have no formal "seat at the table" in Geneva.

<sup>1</sup> Baldwin 2014, 261.

This chapter proceeds as follows. First, we establish that rule-making in global trade governance is hierarchical. Second, we note changes in rule-making over the years. Some of this change resulted from a key mechanism identified by BPR: shifting geopolitical power – which has slowed multilateral negotiations and spurred regionalism. Yet, the origins of regionalism are the global trade rules themselves – the desire for regional exceptions in the GATT were exploited first by colonial powers, then by developing countries. Third, we argue that non-state actors are playing a growing role in rule creation. This is both a cause and consequence of the increasing number of non-trade issues taking center stage in trade negotiations. In short, the trade regime has become increasingly about more than trade – agreements now cover other issues ranging from intellectual property to labor rights to environmental regulation. This is due to systemic factors, such as the changing nature of trade, but also because of state strategy at the international and domestic level. As the scope of trade agreements has grown, the ability of non-state actors to influence content has grown. As a result, networks have become involved in aspects of non-trade rule creation as well as enforcement.

### **The Global Trade Regime as Hierarchy**

In most areas of global governance the presence of a large, universal international organization designed by large states with consistent compliance would be sufficient to conclude that a hierarchical arrangement ruled the day. And for most of the post-Second World War era that would be a safe conclusion. Yet, it is worth reviewing how we come to this conclusion in the area of trade governance. After all, the GATT's enforcement mechanism was very diffuse (rather than centralized) and the GATT itself was not meant to be a large, universal international organization (IO) at its conception.<sup>2</sup> Despite these caveats the case for the GATT as a hierarchical governance structure is straightforward. Its development of a rule-based system has its origins in politics and the structure of international trade. In the wake of the Second World War and an earlier wave of global protectionism following the Smoot–Hawley tariff of 1930, the Allied nations pushed for the development of a multilateral trade organization. But while the Bretton Woods system successfully implemented an international arrangement for monetary policy, the proposed International Trade Organization (ITO) never came to fruition.

<sup>2</sup> Irwin 1995.

Instead the GATT, which began as a provisional agreement, created a rule-based system centered on the ideas of reciprocity and nondiscrimination through the most favored nation rule. It was agreed upon while negotiations for the more powerful ITO were also taking place. Eventually the United States blocked the creation of the ITO because it perceived its provisions as too far-reaching, placing too many restrictions on domestic economic policy. With the failure of the ITO, the GATT became the de facto governance institution for international trade.<sup>3</sup>

Although any state committing to GATT or WTO rules has been allowed to join, it was really the “big four” that wrote the rules themselves. The United States, the EU, Japan, and Canada have historically been the drivers of the multilateral governance process.<sup>4</sup> Barton et al. go so far as to argue that “the United States must be considered the most dominant state shaping GATT and WTO institutions over their history.”<sup>5</sup>

How exclusive to large, powerful states was the rule-making in the GATT? According to Hoekman and Kostecki many developing countries did not even bother to send delegates to several of the GATT negotiation rounds of the 1960s and 1970s.<sup>6</sup> Moreover, as more developing states began to arrive and, in some cases, objected to new agreements proposed by wealthy states, the latter moved to adopt “codes” in areas such as anti-dumping, government procurement, and customs evaluations. These codes required only agreement among like-minded states and were not subject to the two-thirds majority vote of the GATT.<sup>7</sup> And while developing countries could join these side agreements in trade-related policies they had little input on their form. Barton and co-authors, reflecting on rule-making and formal institutions within the GATT and WTO, conclude that “the change in (global) power structure has not been accompanied by change in the GATT/WTO’s fundamental constitutions rules or practices. Moreover, changes in rules and practices ... do not seem directly related to power shifts.”<sup>8</sup>

Why would less powerful states agree to this arrangement? As emphasized by Baldwin, the bargain was to allow nonbinding rules for developing countries in exchange for their membership and an implicit promise to not object.<sup>9</sup> Under the principle of special and differentiated treatment developing countries who joined the GATT (and later the WTO) were granted access to developed country markets without needing to cut their

<sup>3</sup> For a history of the GATT and failed ITO, see Goldstein and Gowa 2002; Drache 2000.

<sup>4</sup> Baldwin 2014. <sup>5</sup> Barton et al. 2006. <sup>6</sup> Hoekman and Kostecki 2009.

<sup>7</sup> Hoekman and Kostecki 2009, 104. <sup>8</sup> Barton et al. 2006, 13. <sup>9</sup> Baldwin 2014.

own tariffs. In response, developing states played little role in rule development: as Baldwin labels the dynamic – “don’t-obey-don’t-object.”<sup>10</sup>

In terms of content of rules of the multilateral trade system, governance within the GATT and the WTO was centered around specific reciprocity: those deviating from the rules to fairly apply tariff rates could be punished by aggrieved parties. Both the GATT and the WTO could hear disputes over the application of those punishments, which meant it had control over when negative reciprocity, the cornerstone of the agreement, was allowed. A dispute panel system was created to hear cases of alleged noncompliance. In theory countries could block the formation of panels or ignore their reports, yet few did.<sup>11</sup> While a sizable literature has now analyzed the reasons for disputes and their outcomes<sup>12</sup> most scholars agree that the panel system under the GATT worked surprisingly well, mimicking a domestic court system in many ways. The WTO’s enforcement mechanism is stronger and more legalistic than the GATT’s.<sup>13</sup> These quasi-judicial institutions are an important aspect of a hierarchical governance architecture. In our view both the GATT and WTO fit perfectly into BPR’s definition of hierarchy regulating what “relations between relatively dependent actors and enforce the rules through command and force.”<sup>14</sup> It is worth noting why the other two models are not applicable. Is trade governance about market mechanisms? One could imagine that, on its own, the reciprocity system could be described as market-based since it is relatively decentralized and there are no requirements to respond to all violations, leaving state members (as actors in the market) to decide their course of action. Yet, the dispute settlement system of the GATT and WTO governs the use of retaliation through reciprocity. So while there is no requirement to punish transgressions, and disputes may resolve themselves without the command of a hierarchical body like a court, there are rules governing this process.

This hierarchical (versus market-based) design choice for a trade regime is not surprising given the interwar period, where more diffuse cooperation mechanisms failed to contain a ruinous trade competition. Indeed, states vacillated between market and nonmarket trade-relevant policies in the interwar period, most prominently with the gold standard.<sup>15</sup> State intervention in markets became a political strategy spurred by political rivalry and geopolitical maneuvering, making a centralized agreement during this period unlikely. Yet, the lesson taken from the

<sup>10</sup> Baldwin 2014, 268. <sup>11</sup> Hoekman and Kostecki 2009, 74; Hudec 2000.

<sup>12</sup> Busch 2000; Busch and Reinhardt 2003. <sup>13</sup> Bello 1996; Steinberg 2004.

<sup>14</sup> See Introduction. <sup>15</sup> See Chapter 2.

interwar period was that the antidote to beggar-thy-neighbor was a strong, cooperative, rule-based system.

It would be hard to claim that the interwar period was network-like. As Great Britain tied down its main trade partners in a series of bilateral trade deals, other powerful states followed suit.<sup>16</sup> The result was a web of trade (and currency) blocs. Yet it is a stretch to describe the relationships within these blocs or between them as network-like. There was no coordination between the blocs – they were explicitly in competition with one another and the larger states within them (especially Germany) used them to augment their economic and military power.<sup>17</sup> Each bloc was dominated by a great power that exerted strong control over (materially weaker) members. None of the core elements of the BPR definition of networks: “interdependent equal actors,” “voluntary negotiat[ion],” “bargaining and persuasion,” nor enforcement through “trust” are present in the interwar trade governance system. Rather, it resembled a highly fragmented hierarchy – a point we return to in the Conclusion.

After the war, not wanting to rely strictly on market-based mechanisms again, nor encourage exclusionary networks of agreements, states moved to centralize and coordinate state governance, eschewing the market mechanism in both trade and finance.<sup>18</sup> And while countries could operate outside the GATT’s hierarchy (as the communist bloc did during the Cold War), the fact that the global trade regime was cheap to join and brought few significant demands on smaller and developing states paved the way for most states to accede to the GATT.

We argue in sections two and three, however, that the hierarchical nature of the multilateral regime is under threat. First, from regionalism and second, from the increasing scope of trade agreements. And while the exact nature of what could replace the hierarchy is not clear, it will likely involve regional agreements that are expansive in their governance ambitions.

Finally, it is worth noting what is different about the issue area of international trade that might help explain the state-centric nature of governance. At a basic level the collection of tariffs is a state function. Historically it is one of the most important functions of a state. Even in an era when tariffs no longer provide a large percentage of state income for developed economies, central governments have every incentive to oversee and control this process. For both economic and security reasons, regulation on the flow of goods across borders is traditionally a state prerogative.

<sup>16</sup> Gowa and Hicks 2013.      <sup>17</sup> Hirschman 1945.      <sup>18</sup> See Chapter 2.

Add to this the political economy insight that externalities from trade also drive incentives. Classically, we believe that the coordination of trade policies is much like a prisoner's dilemma: states have incentives to defect in the face of cooperation.<sup>19</sup> Specifically, states have incentives to impose unilateral import tariffs in order to improve their own terms of trade. In short, trade agreements are a cooperation game, not a coordination game. By establishing rules for mutual cooperation, monitoring, and punishing defections, a hierarchical trade organization can help states overcome this prisoner's dilemma. Governments thus keep a close eye (and a tight hold) on trade policy.

### **Challenges to Multilateral Rule-Making? The Rise of Regionalism**

If economists and political scientists have expressed consternation about the postwar global trade regime, it has centered on one issue: regionalism. One of the major threats to the trade governance regime and its hierarchy is the proliferation of regional trade agreements.<sup>20</sup> This threatens to turn (or according to some has turned) a system dominated by a single, global IO to one governed by an irregular patchwork of regional treaties and organizations. This new world begins to look much more like a network of smaller hierarchies.

From where does this threat to the multilateral trade regime arise? We note two main factors – one of which is closely tied to a mechanism identified in the Introduction. First, the changing geopolitical distribution of power brought developing nations to the negotiating table for the first significant WTO round of talks in the 1990s. This changing balance of power slowed multilateral negotiations. Relatedly, these new developing states felt pressures to lead at the regional level (e.g., Brazil). Second, the GATT itself sowed the seeds of discord by granting a back door to regionalism. We discuss each of these factors in turn.

#### *Geopolitics and Shifting Power*

A vigorous literature has examined the causes of the expanding number of regional trade institutions. That expansion has been rapid and has continued rapidly since the mid-1990s.<sup>21</sup> Between 1950 and 1990 the number of Preferential Trading Arrangements (PTAs) rose from around a dozen to nearly fifty. Between 1991 and 2000, however, that number

<sup>19</sup> Bagwell and Staiger 1999.    <sup>20</sup> Bhagwati 1992.    <sup>21</sup> Mueller 2019.

skyrocketed to 200.<sup>22</sup> Some scholars point to the expanding number of democratic governments as an important factor;<sup>23</sup> others point to domestic veto players as a key determinant.<sup>24</sup> Others suggest a decline in American power and leadership is at work.<sup>25</sup> Still others suggest that contagion and demonstration effects play a significant role<sup>26</sup> as well as political–military relationships.<sup>27</sup> Economic factors, of course, play a role as well, whether it be the business cycle<sup>28</sup> or trade levels.<sup>29</sup>

Yet there is near consensus on the importance of one factor: fear of the collapse of the multilateral trading system. Regional arrangements serve as a backstop in the face of a declining global trade regime. Should negotiations to expand the coverage and rules of the WTO fail, trading partners can lock in trade deals with a regional pact.

The Uruguay round of GATT negotiations, which begat the WTO, lasted for eight years and involved 123 parties. By the close of those negotiations a “grand bargain” had been reached: wealthy states would drop barriers to goods from developing countries (mostly textiles and clothes) in exchange for the inclusion of provisions on intellectual property and trade in services.<sup>30</sup> Thus, the core states were able to push the agreement across the finish line, convincing developing countries that the agreement would be in their interests.

Beginning with the Seattle ministerial meeting in 1999, however, progress in WTO negotiations ground to a halt. Although some side agreements were reached in the early 2000s, the Doha Development Round of negotiations, launched in 2001, moved slowly, eventually stalling. Indeed, by 2015 many states were openly calling for an end to the Doha Round. The *Financial Times* declared in December 2015: “the Doha Round has finally died a merciful death.”<sup>31</sup>

And while thousands of protesters in the streets of Seattle and the image of global citizens standing up to make their voices heard make a compelling narrative to explain the struggles of international trade negotiations, the core issues that have undermined the Doha Round involve tensions between the developed and the developing countries, including expanding intellectual property protections and cutting agricultural subsidies.<sup>32</sup>

Many observers blame American, Japanese, and EU insistence on keeping agricultural subsidies as a key stumbling block.<sup>33</sup> On one level

<sup>22</sup> Mansfield and Milner 2012. <sup>23</sup> Mansfield et al. 2002.

<sup>24</sup> Mansfield et al. 2007; Mansfield and Milner 2012. <sup>25</sup> Mansfield 1998.

<sup>26</sup> Yarbrough and Yarbrough 1992. <sup>27</sup> Gowa 1994. <sup>28</sup> Mattli 1999.

<sup>29</sup> Nye 1988. <sup>30</sup> Odell 2006. <sup>31</sup> *Financial Times*, December 21, 2015.

<sup>32</sup> Gallagher 2008. <sup>33</sup> Wolfe 2015.

the wealthy countries attempted to convince the developing countries to trade better access to wealthy country markets in exchange for leaving some subsidies in place and setting binding tariffs for the developing world (thus ending the “don’t-obey” part of the original deal). Yet, the newly powerful China, India, and Brazil led the charge against this bargain. Although these states had benefited from the GATT and WTO provisions they were not willing to allow binding tariffs while allowing the continued protection of wealthy state markets. Nor would they continue to accept wealthy country preferences concerning service sector rules.

Some have also pointed out that the intellectual property protections developing nations previously granted the developed economies had more detrimental effects than anticipated, including their ability to provide affordable drugs and combat health epidemics. Having learned their lesson from not asserting themselves on these issues, developing countries refused to allow wealthy countries to write the rules to which they would be bound without their input. As summarized by Wolfe: “the WTO, in common with most multilateral organizations, has not caught up with the shifting centre of gravity in global governance. The trading system is no longer a transatlantic bargain.”<sup>34</sup>

Why were the developing countries able to assert more control in the Doha Round than the Uruguay Round? First and foremost they were much more economically powerful – in part because they played a much larger role in global trade in the early days of the WTO. Trade between developing economies has increased rapidly since the mid-1990s. China, in particular, was not at the table during the Uruguay Round, famously joining the WTO in 2001. China’s, Brazil’s, and India’s trade fortunes improved dramatically after the creation of the WTO. Indeed, some scholars blame the political backlash over trade to China’s entry into the multilateral trading system.<sup>35</sup> In this way the geopolitical power shifts led to tougher negotiations for the deepening of the global trade regime.

How did these negotiating dynamics matter for regionalism? First, as negotiations began to intensify in the Uruguay Round developing states gambled that they would fare better in groups than on their own. Indeed, regionally powerful states such as Brazil, Nigeria, South Africa, and India have all attempted to create regional trading systems to solidify their own power on top of a regional hierarchy while providing power in numbers to developing states versus wealthy states in multilateral trade negotiations. For example, as Brazil finished MERCOSUR negotiations with

<sup>34</sup> Wolfe 2015, 7.      <sup>35</sup> Autor et al. 2016.



its neighbors, a Brazilian official remarked: “Dealing directly with the U.S. on international trade issues is like getting into a cage with a tiger. Only if we have others in with us do we stand a better chance of getting some satisfactory results.”<sup>36</sup> By aggregating their market power (and potentially trade expertise) developing countries use regional blocs as a tool of multilateral negotiations.<sup>37</sup>

This strategy has been pursued most aggressively by China. In fact, China’s active pursuit of bilateral and regional trade agreements has been one of the key drivers of regionalism in recent years.<sup>38</sup> Since its WTO accession China has entered into more than fifteen trade agreements with both developed and developing economies. While some of these agreements are cross-regional, China’s key focus has been on strengthening trade cooperation in the Asia-Pacific region. This is motivated largely by geopolitical concerns, with China seeking to take the lead in building regional cooperation in Asia as well as cementing its global position as a major power.<sup>39</sup>

Rising powers, especially China, realize that the WTO has been shaped by primarily by the US, EU, Japan, and Canada. While these emerging powers seek a place at the table of multilateral trade negotiations, they also realize that their influence in established trade organizations is limited. China’s WTO accession conditions were more stringent than those of other developing economies. As a result, some Chinese officials have expressed frustration over the contrast between their economic power and their bargaining leverage within the WTO.<sup>40</sup> In regional trade forums, China’s role as the dominant economic power allows it to shape institutional rules in accordance with its own preferences. Thus, by building regional cooperation in Asia, China is creating “alternative bargaining forums for Chinese trade diplomacy.”<sup>41</sup> These preferences differ in many respects from those of the USA and EU. Notably, Chinese trade agreements tend to lack formal dispute settlement provisions, or environmental or labor provisions, and tend to favor flexible arrangements over strong legal commitments.<sup>42</sup>

Again, one consequence of this is the emergence of more coherent regional trade blocks that have similar within-group trade preferences and can ultimately bargain more effectively in multilateral trade forums.<sup>43</sup> As a number of authors have pointed out, China thus “aims to accelerate the emergence of a tripartite world between NAFTA [North

<sup>36</sup> Mansfield and Reinhardt 2003, 836.

<sup>37</sup> Lawrence 1996.

<sup>38</sup> JiangYu 2011.

<sup>39</sup> Kaczmarek 2017.

<sup>40</sup> Zeng 2010.

<sup>41</sup> Zeng 2010.

<sup>42</sup> Antkiewicz and Whalley 2005.

<sup>43</sup> Cheng-Chwee 2005.

American Free Trade Agreement], EU, and East Asian groups.”<sup>44</sup> With China pursuing this strategy successfully, regionalism now has champions in the developed and developing world. The bad news for trade cooperation is that with this increasing global divergence in trade preferences, finding common ground in multilateral trade negotiations will likely be more difficult in the future.

Fear of rising Chinese economic and political influence may also push developed economies to be more cautious about further multilateral negotiations. The rising backlash against globalization in the United States and some European countries has been driven to a large degree by fears of Chinese economic dominance. This is heightened by China’s status as an authoritarian regime that lacks transparency in the eyes of many Western economies.<sup>45</sup>

Second, regionalism provides a safety net in the case of failed multilateral trade negotiations<sup>46</sup> or in the case of weak enforcement at the multilateral level.<sup>47</sup> Should the multilateral trade regime falter, and there is global defection, the independent regional arrangements serve as a backstop to a collapse of key trading partnerships. This has been true not only for developing countries,<sup>48</sup> but the United States as well. During the Uruguay round of negotiations, for example, US Trade Representative Mickey Kantor suggested that growing American interest in regional trade agreements served as a market access strategy in case that round failed.<sup>49</sup>

Mansfield and Reinhardt outline both arguments, suggesting that “periodic multilateral trade negotiations (MTNs) sponsored by GATT/WTO can prompt members to enter PTAs as a means of guaranteeing they will not be left behind if the MTN stalls and of boosting their bargaining position in the multilateral talks.”<sup>50</sup> Regionalism thus serves as an insurance policy against the failure of multilateralism. That failure materialized because of shifting power in the trade issue area. Moreover, regional agreements served as a tool for the developing world to aggregate their power, enhancing their bargaining leverage while simultaneously creating alternatives to multilateralism.

### *Institutional Design*

A second factor contributing to regionalism has been discussed extensively in the economics literature: the permissive rules of the GATT in

<sup>44</sup> Cheng-Chwee 2005, 118.      <sup>45</sup> Chen et al. 2019.      <sup>46</sup> Whalley 1998.

<sup>47</sup> Bagwell and Staiger 2001.      <sup>48</sup> Perroni and Whalley 2000.

<sup>49</sup> Mansfield and Reinhardt 2003, 835.      <sup>50</sup> Mansfield and Reinhardt 2003, 830.

allowing the existence of regional arrangements. This factor does not fit neatly into the BPR list of causal mechanisms and indeed may only be relevant to the global trade regime. In short, what we have referred to as the core states in the GATT wanted to have their cake and eat it too. They desired a comprehensive multilateral trade agreement, yet they left a gaping hole: Article XXIV, which allows for regional customs union, free trade areas, and provisional regional arrangements.

Why did the founders of the multilateral trading system allow this loophole? Three theories are suggested in the literature. First, some believe that Article XXIV was a nod to developing countries to allow them to create their own regional trade systems.<sup>51</sup> If developing countries could not fully benefit from the GATT, perhaps they could become members while writing a set of their own rules. Because their markets were generally small compared to Europe, Japan, and the US, the threat from even discriminatory regional arrangements was small. A similar logic followed the adoption of the “enabling clause” in the 1979 Decision on Differential and More Favorable Treatment of Developing Countries. The enabling clause allows developing states to form regional trade agreements even if they violate Article XXIV.<sup>52</sup> Obviously, the nature of the economic “threat” from regional arrangement would change in the future.

In addition, recall that the GATT was supposed to be a temporary agreement – the main goal of the core states was passage of the Havana Charter to create the ITO. Core states expected more developing country resistance to the ITO as it contained stronger rules on trade and proposed to create an international currency. Ironically, however, the Havana Charter went unratified by the United States (in part because of its stronger regulatory rules and currency proposals).

Second, some scholars argue that desires for European integration motivated the inclusion of Article XXIV.<sup>53</sup> The emerging idea of the US Marshall Plan was to encourage postwar regional integration as a tool of both relief and war prevention. Indeed, some saw the eventual language of the plan as conditional on European efforts at economic integration. To have this policy goal consistent with the new global trade regime an exception had to be made – thus Article XXIV took shape.

Finally, Kerry Chase has dismissed both of these claims in favor of an argument that the United States designed Article XXIV to facilitate a significant trade agreement between the United States and Canada.<sup>54</sup> As Chase argues, Canada desired a non-customs union agreement with the

<sup>51</sup> Goldstein and Gowa 2002. <sup>52</sup> Hoekman and Kostecki 2001, 355.

<sup>53</sup> Odell and Eichengreen 1998; Bhagwati 1991, 65. <sup>54</sup> Chase 2006.

United States (so as not to threaten their position in the Commonwealth). But such tariff reduction agreements that did not include provisions concerning third parties, and were not part of the GATT or Havana Charter discussions. Thus, the US State Department “wished to adjust trade rules for preferential arrangements.”<sup>55</sup> Ironically, the proposed US–Canada agreement never came to fruition and it would be nearly forty years until a bilateral agreement was reached between those two countries.

It is worth noting that, under the provisions of Article XXIV, the GATT (now WTO) has a right to pass judgment on any regional agreement. In theory, not any regional trade agreement is acceptable – the article demands that any non-multilateral arrangements significantly decrease tariffs between members while not discriminating against non-members.<sup>56</sup> Of course, of the hundreds of regional agreements notified to the GATT and the WTO only one arrangement has been officially condoned: the Czech–Slovak Customs Union which was created after those two countries emerged from Czechoslovakia.

This institutional design argument is important to explain the emergence of regionalism. Even if all of the pressures discussed in the subsection “Geopolitics” had gathered to push a regional trade agenda, in the absence of Article XXIV and the Enabling Clause to what end would those pressures have built? The desire for a backstop and more negotiating capacity provide the will; the institutional design provides the way.

These regional arrangements are themselves a form of hierarchy. While there are vast differences in design, effectiveness, and legalism among them,<sup>57</sup> all are state-centric, rule-based orders. The resulting governance system in global trade looks a bit like a many peaked tent, with the GATT/WTO forming the center, highest peak. Yet, that peak is surrounded by smaller peaks of regional arrangements. The ultimate question becomes: how much of a threat are these regional trade arrangements? Is the postwar global trade hierarchy under pressure?

A vigorous debate exists on this question in the trade and trade regimes literature. Some scholars see the multitude of regional arrangements as “building blocks” for advancing the multilateral trading system. Under this logic, regional arrangements and the liberalization they provide help tame the domestic interests and forces that would push against similar cuts in multilateral negotiations. If regional arrangements serve to lock in a state’s best trading partners, extending tariff cuts to those partners who are less important should be straightforward.<sup>58</sup> Yet, many

<sup>55</sup> Chase 2006, 16.      <sup>56</sup> Hoekman and Kostecki 2001, 352.      <sup>57</sup> Dür et al. 2014.  
<sup>58</sup> E.g. Estevadeordal et al. 2008.

do not see these regional arrangements as propitious for multilateralism, but rather view them as “stumbling blocks.”<sup>59</sup> If states have their best partners locked in, say the critics, what incentive do they have to make any further cuts to minor partners? And because many of these regional agreements do allow discrimination against third parties, reducing those tariffs will be especially difficult. Finally, if regional arrangements were supposed to assist the multilateral process, why did the Doha Round die a long, quiet death after the explosion of regional agreements in the 1990s and 2000s?

Our reading of the literature is that the stumbling blocks argument has carried the day (especially against the empirical reality of the growing failure of multilateralism), although significant controversy remains. In short, the difficulty is establishing the counterfactual of what trade patterns would look like in the absence of regional trade agreements, especially flows with third parties. Trade agreements nearly always increase trade among participants, but the core question is whether they divert trade from nonmembers by raising tariffs on those goods. Scholars now tend to analyze this question on an agreement-by-agreement or country-by-country basis. In a widely cited study,<sup>60</sup> Limão shows that American free trade agreements (FTAs) have led to less generous multilateral tariffs on goods that are heavily imported under the FTAs. Moreover,<sup>61</sup> Limão contends that agreements with non-trade provisions, which we discuss in the next section, are particularly large stumbling blocks to multilateralism. And while this evidence is not uniform across countries or agreements, there is significant evidence that regionalism has been a substitute for multilateralism. We return to this question in the context of mega-FTAs in the Conclusion.

### **Challenges to Rule-Making: Non-trade Governance and Non-state Actors**

Much to the chagrin of NGOs the GATT and WTO have remained largely closed to inputs from non-state actors. This has closed off the rule-making process from direct inputs into the multilateral process. Yet this conclusion seems to run afoul of the received wisdom that tariff-setting and trade deals are consistently influenced by firms and other non-state actors. Has the rise in the number of international actors, as identified by BPR, played no role in trade governance?

<sup>59</sup> Limão 2006; Bhagwati 1991; 2008.      <sup>60</sup> Limão 2006.      <sup>61</sup> Limão 2007.

We argue that at the level of the state and the regional agreement (versus multilateral governance), firms and NGOs can and do play a role in trade policy. Both economists and political scientists have generated significant theory and evidence to this end – usually under the heading of endogenous protection.<sup>62</sup> This has certainly influenced the goals and positions of states as they approach multilateral trade negotiations. Moreover, state leaders must be cognizant of the need for domestic ratification to approve any trade agreement.<sup>63</sup>

We argue there are two mechanisms that have led to the growing influence of non-state actors in trade governance: the changing nature of international trade and the use of trade agreements to address non-trade issues. The former is a partial, but incomplete, explanation of the latter, which also encompasses domestic political prerogatives.

In truth, non-trade provisions in trade agreements are not new – some pushed for these even in the early phases of trade liberalization after the Second World War. But these early attempts almost uniformly failed. The ITO itself failed partly because its advocates pushed for the inclusion of labor and employment standards that were thought to go too far beyond core trade issues.<sup>64</sup> While the GATT avoided these problems, it developed in the context of the Cold War and its evolution was shaped by security concerns.<sup>65</sup> Nonetheless, although trade agreements were never solely about trade liberalization, the main focus of early trade agreements was reciprocal tariff reduction.

### *The Changing Nature of International Trade*

The changing nature of international trade itself is opening new opportunities for more network-oriented structures within international trade governance. Manufacturing has become more complex and regionally dispersed, with different production stages occurring in different countries or even regions. Typically, global production now uses technology from developed economies and cheaper labor from developing economies. Economists have pointed out that such an increase in “global value chains” or “supply chain trade” positively affects trade volume even if there is no change in tariffs.<sup>66</sup> For some this is evidence that traditional multilateral trade governance through the WTO is “eroding and will continue to erode.”<sup>67</sup>

<sup>62</sup> Grossman and Helpman 1994; Gawande and Bandyopadhyay 2000.

<sup>63</sup> Mansfield et al. 2007. <sup>64</sup> Drache 2000. <sup>65</sup> Vogel 2013. <sup>66</sup> Vogel 2013.

<sup>67</sup> Baldwin 2014, 281.

There are several implications of the expansion of global supply chains for trade governance. First, large multilateral corporations now have some of the highest stakes in trade negotiations and play a key role in lobbying.<sup>68</sup> Indeed, the current “favorite” economic model of international trade, new-new trade theory,<sup>69</sup> suggests that large firms are the driving force and beneficiary of trade liberalization. Most firms do not trade internationally, but for those that do access to supply chain linkages are vitally important. This comes at the expense of smaller, more local producers that do not benefit from economies of scale and political connections in multiple countries, forcing them into niche markets or driving them out of business.

Second, these large firms tend to be less concerned with tariff levels and more concerned with non-tariff regulatory issues such as labor standards, property rights, and dispute settlement procedures. Concerns about regulatory expropriation are of particular importance.<sup>70</sup>

As a result the rise of global value chains is associated with trade agreements that focus more frequently on non-trade issues. Supply chain trade integration requires significant domestic policy commitments by developing countries. Global firms are concerned with ensuring that these are implemented in the long run. Baldwin<sup>71</sup> argues that this leads to a “hold-up problem”: developing countries have incentives to reverse commitments and expropriate foreign firms, especially stealing intellectual property, once these have made costly investments in their economies.<sup>72</sup> Fear of such expropriation then causes firms to underinvest in developing economies. How can firms, along with their home and host governments, solve this dilemma?

Baldwin suggests that this hold-up problem can best be solved through formal multilateral agreements.<sup>73</sup> But as previously discussed, developing countries have been hesitant to make multilateral commitments in the Doha Round. Thus, the home governments of large firms press bilateral and regional agreements, further eroding momentum toward multilateral liberalization.

The agreements are chock full of provisions with different goals, ranging from standard-setting, harmonization, and establishing regulatory norms,<sup>74</sup> to integrating different areas of liberalization such as services and financial liberalization.<sup>75</sup> As a result there is now much more issue linkage in trade agreements. Moreover, these non-trade provisions are mostly not covered by WTO rules, further robbing momentum of

<sup>68</sup> Osgood 2018. <sup>69</sup> Melitz 2003. <sup>70</sup> Hoekman and Nelson 2018.

<sup>71</sup> Baldwin 2014, 274. <sup>72</sup> See also Carnegie 2014. <sup>73</sup> Baldwin 2014.

<sup>74</sup> Hoekman and Nelson 2018. <sup>75</sup> Milewicz et al. 2016.

multilateral negotiations. As a result trade negotiations have become centered around more complex, non-trade issues. This provides increased opportunities for non-state actors to coordinate, often through transnational networks, opening up opportunities for less hierarchical, more network-based trade governance. And while these firms and production networks may not have a formal seat at the WTO table, they can exert more influence in smaller, regional negotiations.<sup>76</sup> Coordination and standard-setting, property rights guarantees, and integration of trade, services, and movement of capital and investment have been key to recent agreements, more so than traditional reciprocal trade liberalization. The “new NAFTA,” the United States–Mexico–Canada Agreement signed in 2018, is a case in point. What held up negotiations was not tariff levels but regulatory issues (intellectual property and labor rights guarantees) and dispute settlement procedures.

Thus the rise of global value chains has contributed to the decline of multilateral trade governance. Non-state actors in the form of large multinational corporations play a key role in the development of new types of trade networks. These are less hierarchical and potentially more network-based. In fact, the construction of global supply chain networks has given rise to trade relations among firms that most closely appropriate network-oriented structures in the area of trade. And while states still set the rules as sovereign equals within regional arrangements, their demands and constraints are directly shaped by these networked actors. This is all because global value chains have created a new form of global interdependence.<sup>77</sup>

#### *Other Non-trade Issues in Trade Negotiations*

Yet, the explosion of non-trade issues covered in trade agreements is not only a result from the changing nature of trade and the pressures from large multinational firms. Security concerns, human rights, labor rights, and the environment are not often the concerns of multinational firms negotiating trade deals. Non-trade issues of human rights and environmental protection in particular are driven by EU and US interests. States themselves bring many of these issues to the negotiating table – at times due to concerns over these issues, but also to help secure domestic ratification of any agreement that is reached.

What then explains the more recent success of non-trade provisions in trade agreements? The answer depends somewhat on the issue in

<sup>76</sup> Chase 2004.      <sup>77</sup> Farrell and Newman 2014.



question. For example, the spread of security cooperation linked to trade has followed somewhat different paths from that of human rights and environmental linkages.<sup>78</sup> Nevertheless, a number of general observations can be made about these rising linkages.

One obvious cause of the spread of non-trade provisions in trade agreements, as noted by Milewicz et al.,<sup>79</sup> is that prior trade agreements between states lower the cost of additional agreements with more far-reaching, non-trade provisions. Similarly, the inclusion of environmental or labor regulations in trade agreements paves the way for additional provisions in future agreements. This applies both to existing trade partners and to new partners seeking to enter into similar agreements.<sup>80</sup> Research suggests that trade agreements often copy or imitate the clauses and frameworks of existing trade agreements, especially those signed by the USA and the EU.<sup>81</sup> In other words, once non-tariff issues are included in an agreement it becomes highly likely that they will get adopted by other agreements signed by similar parties.

Relatedly, the inclusion of non-tariff issues subsequently lowers the cost of collective action for non-state actors, such as environmental or labor rights activists, who have a stake in trade negotiations. Recent years have seen a rising number of domestic actors with a stake in trade liberalization and more diverse interests represented in regional and bilateral trade negotiations. The inclusion of non-trade issues provides new opportunities for NGOs and other domestic groups to participate in the negotiation and monitoring of these agreements. Similarly, non-state actors can observe and learn from previous successes and consequently make their own activism more impactful.

One agreement that illustrates these dynamics and laid the foundation for the spread of non-trade issues in trade agreements was NAFTA, which was one of the first to include both labor provisions and environmental protection clauses. These provisions were shaped to a significant extent by non-state actors, such as environmental NGOs.<sup>82</sup>

At the same time, increasingly complex trade relations between states have also increased the need for better coordination across issue areas. States have learned lessons about the consequences of not coordinating over non-tariff issues. For instance, Hafner-Burton notes that the European Community struggled to find an appropriate response to the conflict in Yugoslavia in 1991. Since its existing trade agreement lacked human rights provisions, “the Community faced its neighbor’s crisis with

<sup>78</sup> Powers 2004. <sup>79</sup> Milewicz et al. 2016 <sup>80</sup> Milewicz et al. 2016, 749.

<sup>81</sup> Baccini et al. 2015. <sup>82</sup> Aggarwal 2013; Vogel 2013.

no standard legal recourse to pull out from its obligations.”<sup>83</sup> This experience contributed to the inclusion of human rights clauses in subsequent treaties involving the EU.

Similarly, controversial GATT disputes have sometimes been a motivator for environmental activism. For instance, in 1991 the USA tried to protect dolphins being killed by tuna fishing nets by banning tuna originating from Mexico where a particularly harmful fishing technique was common, but GATT subsequently found the United States to be in violation of GATT rules by imposing this ban. This controversial decision led to increased collective action on trade issues by environmental groups.<sup>84</sup> In their attempts to influence trade policy, activist groups frequently ally with other lobby groups. Environmental groups in particular have been known to join forces with importers.<sup>85</sup> From the point of view of economists, this leads to increased protectionist pressures, which is why economists tend to view trade agreements with environmental provisions as stumbling blocks for multilateral trade cooperation.<sup>86</sup> Finally, non-trade provisions are often included in trade agreements to ensure domestic ratification. By buying off potential veto players (e.g., labor or environmental NGOs) states include these provisions to convince key domestic actors to support (or at least not object to) agreements at the domestic level.<sup>87</sup>

What, then, have been the overall effects of the rise of non-trade issues on trade governance? The effects have been somewhat conflicting. Theoretically issue linkage potentially facilitates cooperation by increasing the bargaining space, making an agreement more likely. This issue linkage effect was no doubt the motivation of wealthy states using trade agreements in an attempt to influence domestic governance in trading partners. Given the clear ability of states to withhold the benefits of trade agreements in cases of violation of governance standards in areas such as human rights, this bundling of trade and non-trade issues gave wealthy states leverage.<sup>88</sup> The evolving, more complex nature of trade relations between states also necessitates increased issue linkage. Non-trade issues have opened avenues for activism for a greater number of actors – NGOs, firms, labor unions, etc. This allows for a wider range of actors to be involved in trade negotiations, and potentially opens room for less hierarchical, more network-based trade governance.

Yet there are also reasons to believe that the proliferation of non-trade issues can be a stumbling block to multilateral trade governance.

<sup>83</sup> E.g. Hafner-Burton 2009a, 35.      <sup>84</sup> Vogel 1999.      <sup>85</sup> E.g. Lechner 2016.  
<sup>86</sup> Limão 2006.      <sup>87</sup> Mansfield and Milner 2012.      <sup>88</sup> Hafner-Burton 2009b.

Non-tariff issues are mostly addressed in bilateral and regional agreements, much less in multilateral institutions. As is widely recognized, some of these provisions, such as environmental protection and labor rights, can provide effective trade barriers and increase protectionism. On the other hand, trade and security linkages could motivate increased trade integration.

Finally, non-trade issues are not promoted equally by all states. As in other areas of trade integration, the development of non-trade clauses was driven primarily by the United States and the EU. Provisions often involve the Global North driving non-tariff issues to effect changes in the Global South.<sup>89</sup> One possible effect is that regions may be drifting further apart in their trade liberalization if some states prefer to stay away from some types of provisions, for example human rights. Moreover, recent studies provide evidence that groups of developing states have supported one another in multilateral trade negotiations against developed states on efforts to resist environmental provisions.<sup>90</sup> Thus the inclusion of security provisions is quite common in Asian PTAs but they contain far fewer environmental and human rights provisions.<sup>91</sup>

### **Implications and Conclusions**

Many other chapters in this volume describe how various areas of global governance have already changed due to the mechanisms identified by BPR. In the area of global trade those changes have been slow and uneven. The hierarchical multilateral trade regime is under siege – from newly powerful state actors, from changing patterns of international trade, and from aggressive non-state actors. Will the multilateral system continue its slow death? And if so, will regional agreements take its place?

One could imagine, in the absence of progress on a hierarchical, multilateral agreement, reversion to something akin to the interwar architecture dominated by a combination of market mechanisms and networks. After all, prisoner's dilemmas can be overcome even in the absence of formal enforcement mechanisms if states interact repeatedly and care sufficiently about the future.<sup>92</sup> As countries become more integrated it may become more difficult for them to “defect” by imposing short-term barriers to trade. Moreover, countries today are relying less on tariff revenue. This potentially opens up avenues for more market-based trade governance.

<sup>89</sup> Aggarwal 2013.      <sup>90</sup> Johnson and Urpelainen 2020.      <sup>91</sup> Dür et al. 2014.

<sup>92</sup> E.g. Grossman 2017.

That said, there are reasons to believe that hierarchical organization will persist in the multilateral setting. First, the increasing complexity of trade relations makes coordination over the exact form that trade cooperation should take more important. Second, information provision is another function that a multilateral trade organization can play that cannot easily be met by purely market-based mechanisms. And lastly, participation in the WTO provides commitment mechanisms that allows states to credibly tie their hands with respect to domestic groups.

Some of these functions can no doubt be fulfilled by smaller, hierarchical regional trade agreements. And as we have emphasized, this may be the biggest source of concern for the multilateral trading system. Even in the era of growing nationalist economic policies, regionalism has momentum over multilateralism. To wit, the advent of mega-regional arrangements. Proposal such as the Transatlantic Trade and Investment Partnership (TTIP) and the Trans-Pacific Partnership (TPP) promise to link some of the largest economies in the world. Central to these mega-regional agreements are non-trade provisions, including regulatory coordination. In short, these agreements become vehicles for like-minded groups to move beyond tariff reductions on issues that do not get traction within the WTO. And even though the Trump administration moved away from these particular arrangements, they appear to be moving ahead with other states at the helm. And of course, these regionally based arrangements are hierarchical by nature.

Central to our argument is that these regional hierarchies are comparatively more likely to develop cracks for networks to open. The move to incorporate non-trade-related provisions in the trade regime has occurred at the regional level. Attempts to incorporate non-trade provisions at the WTO have largely foundered or are moving at a glacial pace. Thus, where networks are engaged in trade governance it is within the context of non-trade issues in regional agreements.

We would be remiss not to note that the decline of multilateralism has a come at a cost: some developing economies are left out, and are falling further behind states that can successfully leverage their position in supply chain trade. And while large international firms have gained a voice in trade governance, this voice is uneven, concentrated on firms located in the USA, EU, and Japan. Thus, these new emerging networks of actors still lack an important aspect of network-oriented governance structures: equality.

We have largely ignored the topic *du jure* among trade scholars: the rise of so-called populist nationalism and growing public opposition to multilateral and regional trade agreements. Signified by the election of Donald Trump, the passage of the Brexit referendum, and growing objections to

the liberal order in Western nations, this is yet another factor that challenges the multilateral regime and regional trade arrangements.<sup>93</sup>

We would argue that the threats from regionalism and the influence of the changing structure of trade are far more important factors in predicting the future of trade governance. While public opposition to any trade agreement can make reaching an agreement more difficult, we would note that despite his protests to the contrary, even Donald Trump renegotiated one of the largest trade agreements in the USMCA. And while he pulled the United States out of the TPP, TTIP is still on the table. Moreover, if populism disappeared from the global scene, multi-lateral trade negotiations would still be a long slog. The changing distribution of global economic power, the changing nature of trade, and the proliferation of actors demanding input on rule-making will still exist. As would the challenge of regionalism.

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<sup>93</sup> Copelovitch and Pevehouse 2019.

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