Tying Hands without a Rope: Rational Domestic Response to International Institutional Constraints

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How do international institutions interact with domestic politics to affect states’ policy choices? One familiar way is through the device of “blame shifting” or “tying the hands” of national leaders. Imagine a leader who wants to impose unpopular economic reforms but whose plans are resisted by the legislature. What happens if an international institution such as the IMF or the WTO prescribes liberalization? The leader may be able to claim that the institution is tying his hands, with the hope of avoiding the political backlash following reforms. In short, by serving as a commitment device for reformist leaders facing domestic opposition, an international institution makes possible policies like liberalization that may not otherwise occur. Institutional constraints as varied as IMF conditionality (Cottarelli and Giannini 1998); fixed exchange rate regimes such as the European Monetary System (EMS) (Agénor 1994; Giavazzi and Pagano 1994; Martin and Simmons 1998, 748); regional trade agreements such as the NAFTA and EU (Ibarra 1995, 59; Gould 1992, 21; Whalley 1996, 15–16; Smith 1997, 183); and WTO investigations (Francois 1999, 5–6) are all said to affect state policy-making for this reason.

Yet tying hands may not be so easy. Namely, most international institutions provide no rope; they lack enforcement power. If the domestic opposition is rational, it will know a reformist leader has an incentive to misrepresent the extent of the institutional constraint, and it will discredit the “tied hands” rationale for reform. This observation explains why the policy prescriptions of the IMF (Killick 1995, 55; Rodrik 1995, 25; Fairman and Ross 1996, 31–34; Bird and Rowlands 1997, 980–84; Rodrik 1996, 31; Dhonte 1997, 7; Ball 1999, 1837); the EMS (Weber 1991; Sandholtz 1993, 35; Frieden 1994, 27; Velasco 1997; Bleaney and Mizen 1997); and regional trade agreements (Ibarra 1995, 59) are often ignored or at least yield fewer economic
gains due to the fear of policy reversal. Domestic opponents of reformist leaders have good reason to view the rhetoric of tied hands with suspicion, as they often do. For instance, in reaction to the British government’s attempt to close some shipyards by deferring to a European Commission action, a member of Parliament (MP) said,

The Minister has sought to blame [the Commission] for the decision, but has also sought to argue in the House that it was the right decision. Will he clarify whether . . . he urged the [continued support of the shipyards] or simply accepted [the Commission’s] decision—or even welcomed it? (Smith 1997, 179)

How can an international institution help a leader implement reforms if the opposition is aware of the difficulty of enforcement?

Of course, there may be genuine external constraints on a country’s policy, such as retaliatory threats from other states or the behavior of private market actors. But these constraints may well apply regardless of the institution’s involvement. What additional leverage, if any, do the institution’s prescriptions provide? How valid is the venerable view that international institutions facilitate domestic commitment? Can leaders tie their hands without ropes?

To answer this question, I develop a game theoretic model focusing on policy-making by an agent with monopoly agenda control (for example, a chief executive, president) and a principal with veto power (for example, a legislature, congress) in the context of an institution with uncertain enforcement capability. The imagined setting is a WTO investigation of a trade dispute. The president of the defendant state seeks to lower existing trade barriers, against the wishes of a protectionist congress, and he has private information about the probability that the WTO will rule for the plaintiff. A ruling against the defendant, if issued, will make foreign retaliation more probable unless liberalization occurs, but litigation imposes transaction costs on the president.

Surprisingly, the model indicates that leaders can indeed tie their hands without ex post ropes, despite rational opposition. Presidents who know that the WTO is unlikely to rule against their country’s protectionist policy can nevertheless elicit significant liberalizing concessions from their congress. This is true even in the absence of costs for exiting or reversing a decision to comply with the institution.\(^1\) The catch is that the benefits of tying hands when enforcement is not likely are matched one for one by losses when enforcement is forth-
coming. The domestic commitment function of international institutions adds nothing to the overall level of liberalization, contrary to the expectations of many institutionalist theorists (Keohane 1984; Axelrod and Keohane 1985). Moreover, all the benefits of tying hands via a WTO ruling are realized before a ruling is issued, in the form of early settlements. Once a ruling is issued and sanctions for noncompliance are either realized or not, a leader who does not face sanctions is unable to extract significant reform from the opposition. Ironically, a leader attempting to tie his hands with an international institution can only do so in cases in which the institution does not issue prescriptions.

The model yields a number of other counterintuitive findings. Remarkably, for instance, the institution only works as a commitment device if the transaction costs of utilizing it are sufficiently high. This contradicts the conventional view that institutions promote cooperation by doing precisely the opposite, that is, lowering transaction costs. It follows that, since less developed countries (LDCs) face higher opportunity costs when litigating WTO disputes, leaders of LDCs will be more able to tie their hands using the WTO than will those of advanced industrial states. In addition, comparing my model to one without a domestic veto player suggests some testable differences between unified and divided governments. For instance, WTO cases against advanced industrial states (that is, states facing lower transaction costs for litigating) with unified governments should be more likely to go to a ruling than those with divided governments. Yet defendants with unified and divided governments should be equally likely to concede in cases ending after rulings are issued.

The remainder of this chapter develops the formal model and some key results and testable propositions, in a few cases sketching supportive, though preliminary, empirical findings. These results add up to a picture of how international institutions interact with domestic politics that differs substantially from the received wisdom(s). International institutions do indeed affect policy-making by changing the incentives for domestic actors, but not in ways imagined by functional-institutionalist logic. The conclusion discusses some of these broader implications for theory and for optimal institutional design.

**The Model**

How, if at all, can leaders tie their hands using international institutional constraints if domestic audiences are rational and aware of the
limited enforceability of such constraints? Since this is a rationalist critique, I will use a rationalist method, that is, a game theoretic signaling model, to explore its limitations. The empirical referent for this model is dispute settlement under GATT or its successor, the WTO. Like institutions governing exchange rate regimes, multilateral lending terms, and regional trade blocs, GATT/WTO dispute adjudication lacks enforcement power but potentially conditions the behavior of other states and private market actors. Thus the model’s key insights should apply to other institutions as well.

Some Background

The essence of GATT or WTO dispute settlement is as follows. A plaintiff state identifies another country’s objectionable trade practice, for example, an excessive subsidy or import barrier. Any policy that “nullifies or impairs” commitments made in the various GATT treaties is potential grounds for a formal complaint, though only states, not private parties, have legal standing in this body. If the defendant does not settle the issue to the plaintiff’s satisfaction, ultimately a GATT or WTO ad hoc court, known as a panel, is called upon to issue a ruling. Panels are composed of independent legal experts. Rulings specify the extent of violation of GATT law by the defendant and may suggest corrective measures. The court lacks a bailiff, or enforcement power, yet at any point the plaintiff may retaliate unilaterally (often without GATT/WTO approval, however). Over six hundred complaints have been filed since 1948.²

Two features of the process, which I embed in the model to follow, are worth noting. First, chief executives, or more precisely their delegated negotiators, enjoy an informational advantage over legislators with respect to GATT/WTO litigation. The executive possesses a larger and usually better trained legal and economic staff, which conducts the actual litigation. In many countries legislators have few informational resources at their disposal on any issue, let alone foreign trade (Milner 1997, 21, 84). Of course, affected firms might be relied upon to inform legislators (ibid., 21), but even for large businesses, buying legal advice for GATT/WTO litigation is often prohibitively costly, and collective action problems may diminish the willingness of individual firms to contribute to such costly public goods when an entire domestic industry is affected. Also, opposing interest groups may provide contrary advice to legislators, thereby diminishing their joint informative value (ibid., 239). Furthermore, the executive in many
countries has repeated litigation experience with GATT/WTO, while this is not generally true of groups advising legislators on industry-specific cases. Dispute proceedings of GATT/WTO occur behind closed doors, without private party access. Finally, the lack of stare decisis, and the fact that the majority of disputes end prior to rulings being issued, means that outsiders have little observable basis for refining their own estimates of legal merits across cases. For these reasons, executives are much better informed than legislators about their GATT/WTO litigation’s prospects.

Second, litigating these disputes is costly. The transaction costs include the time spent by the support bureaucracy researching cases, preparing briefs, meeting with representatives of the affected domestic industries and the other disputant(s), filing documents to conform with domestic trade law, and appearing before the WTO. The opportunities forsaken may be significant, since each case litigated is another one neglected, poorly argued, or aborted prior to filing. Disputes often last for years, especially now that the WTO has added up to twenty-nine months of additional legal steps such as appeal and arbitration. From the perspective of the plaintiff, or a defendant seeking to tie his own hands using an adverse ruling, litigation is particularly costly because it locks in the protectionist status quo for that much longer (Reinhardt 1999, 10–15; Horn and Mavroidis 1999, 15–17; South Centre 1999, 24). (And the WTO makes no provision for retroactive compensation.)

The transaction costs of GATT/WTO litigation hit LDCs the hardest (Reinhardt 1999, 16; Hoekman and Mavroidis 1999; Horn and Mavroidis 1999). LDCs typically have no or few personnel dedicated to WTO dispute negotiation, and even less frequently are those personnel permanently stationed in Geneva. Even India, presumably one of the best prepared LDCs, had no dedicated staff at home or abroad to negotiate WTO disputes as of late 1997 (India Today, November 10, 1997, 52). Michalopoulos’s (1998) exhaustive count estimates that up to 60 percent of developing members in 1997 had insufficient representation to even participate in regularly scheduled WTO activities, let alone disputes. In 1999, thirty LDC members had no WTO delegation at all. A matter as small as real estate costs, which are exorbitant in Geneva, has deterred some LDCs, especially since Switzerland’s promised housing subsidies for LDC representatives have never been delivered (Independent, July 18, 1999, 13). Furthermore, since LDCs have participated in significantly fewer disputes, they have less GATT/WTO litigation experience and higher startup
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costs in preparing new cases. As a Colombian representative put it, “The problem is not a lack of information but too much of it” (ibid.). In part due to such hurdles, Ecuador, Guatemala, Honduras, and Mexico let the United States take the lead in their (meritorious) complaint against the EU’s banana import regime. The nominal figures on WTO litigation costs are relatively low: the average case, by one estimate, costs about two hundred thousand dollars, once filed. But the problem goes deeper: LDCs are “less sophisticated buyers of legal advice” and are less able to “manage and absorb legal advice by virtue of a well-developed institutional structure” (Trade and Development Centre 1999, 45). As the Malaysian trade minister has noted, without adequately trained in-house staff, LDCs lack the ability to proactively identify and pursue the best cases (Business Times (Malaysia), April 30, 1997, 20). To resolve such difficulties, the WTO has ostensibly increased technical assistance but in practice rules out aid to the many members who fail to pay their dues, that is, precisely those states that need it the most (Michalopoulos 1998; South Centre 1999, 23–24). That many LDCs have put increases in legal aid at the top of their priorities for the Millenium Round testifies to the high transaction costs of dispute settlement in the existing regime (WTO 1999).

Model Setup

With these two features in mind, I will now proceed to the model. The model contains two players, the defendant state’s chief executive (which I will call the president, or P), who has monopoly agenda control, and the median legislator (labeled congress, or C), who has a veto role only. Since I am exploring the potential for tying hands, I will focus on the special case in which the president prefers to liberalize and the median legislator, or congress, prefers to maintain a protectionist status quo. In this model, a nonstrategic WTO panel issues a ruling when called upon, and a foreign state threatens exogenously probabilistic retaliation, conditioned on the type of ruling issued, if the defendant fails to sufficiently liberalize.

The sequence of action is as follows (see fig. 1). First, nature selects the president’s type ρ, ρ ∈ {ρlo, ρhi}, where Prob(ρ = ρhi) = π, ρlo, ρhi, π ∈ [0,1], and ρlo < ρhi. The type ρ reflects the president’s private information about the probability of an adverse ruling by the WTO. Type ρlo is more likely to win its WTO litigation than is type ρhi, but keep in mind that the president wants to lose, that is, have WTO condemn his state’s protectionist policy, so ρhi is P’s “strong” type
and $\rho_{hi}$ is P’s “weak” type. Denote the WTO’s ultimate ruling decision as $r, r \in \{0,1\}$, where $r = 1$ is a ruling against the defendant. Thus $\rho = \text{Prob}(r = 1)$.

Second, the president makes a proposal, $p_1 \in [0,1]$, where higher values reflect greater protectionism. The president most prefers a policy of 0.

Third, having observed the president’s proposal, the congress updates its beliefs about the president’s type. The congress’s posterior belief is $\mu$, where $\mu = \text{Prob}(\rho = \rho_{hi})$. The congress then chooses $a_1 \in [0,1]$, where $a_1 = 1$, to accept the proposal and $a_1 = 0$ to reject it in favor of the protectionist status quo, 1.

The case is more likely to go before the WTO panel if the initial proposal outcome is more protectionist. Specifically, the probability
of a ruling, given the actions of P and C beforehand is proportional to the level of protectionism in place, that is, \( p_1 \) if \( a_1 = 1 \) and 1 otherwise. If the case does not go to the WTO, the probability that the plaintiff unilaterally retaliates is likewise \( p_1 \) if \( a_1 = 1 \) or 1 otherwise, after which the game ends. If retaliation occurs, its level in a dispute ending before a ruling is \( s \in [0,1) \).

Fourth, if a ruling \( r \) has been issued (where \( r = 1 \) if the ruling supports the plaintiff), the president again makes a proposal, \( p_2 \in [0,1] \). Fifth, now with no updating of beliefs since P’s private information is obsolete, the congress rejects or accepts the proposal, \( a_2 \in \{0,1\} \). The foreign state retaliates at this point with a probability equal to the level of protectionism in the resulting policy (that is, \( p_2 \) if \( a_2 = 1 \) or 1 otherwise). The level of retaliation, if it occurs, is \( s_0 \) if the ruling supports the defendant and \( s_0 \) otherwise.\(^5\) I constrain \( s_1 > 1 \) and \( s_0 \in [0,1) \).

Now turn to the utilities. The president prefers less protectionism (lower accepted proposals), while the congress prefers more. Both, however, suffer equally from retaliation, if it occurs. To simplify matters, I will assume linear, or risk-neutral, utility functions. In addition, the president, but not the congress, suffers a transaction cost \( \lambda > 0 \) when compelled to litigate his country’s defense. Expressed formally, the president’s utility once the dispute has gone to the ruling stage but before the ruling is realized is

\[
U_p(\rho) = -[a_2p_2 + (1 - a_2)] - \lambda + a_2 [p(-s_1p_2) \\
+ (1 - p)(-s_0p_2)] + (1 - a_2) [-s_1p - s_0(1 - p)]. \tag{1}
\]

If the above expression is \( g \), the president’s utility prior to the first proposal is

\[
U_p(\rho) = a_1[p_1g + (1 - p_1)(-p_1 + p_1s)] + (1 - a_1)g. \tag{2}
\]

The congress’s utility once a dispute has gone to the panel but before the ruling is issued is

\[
U_c = [a_2p_2 + (1 - a_2)] + (1 - a_2) [\mu[-s_1p_{hi} - s_0(1 - p_{hi})] \\
+ (1 - \mu) [-s_1p_{lo} - s_0(1 - p_{lo})]] + a_2[\mu[p_{hi}(-s_1p_2) \\
+ (1 - p_{hi})(-s_0p_2)] + (1 - \mu) [p_{lo}(-s_1p_2) \\
+ (1 - p_{lo})(-s_0p_2)]. \tag{3}
\]
If this is $h$, then C’s utility from the start is

$$U_c = a_1[p_1 h + (1 - p_1)(p_1 - p_1 s)] + (1 - a_1) h.$$  \hspace{1cm} (4)

**Results**

By constraining $s_1 > 1$ and $s_0 < 1$, as we will see, I am assuming that the WTO’s decision conditions the level of retaliation the plaintiff is willing to enact if the defendant fails to liberalize. That WTO approval might make sanctions from other states more likely (or more extensive) is certainly plausible (Martin 1992, 45). This may, however, seem like building the desired results—enforcement of adverse rulings—automatically into the model. Yet it is not: the key is that rulings against the defendant are themselves not automatic at all. Recall that the president has two types, which respectively expect a high and low probability of an adverse ruling. Naturally, if adverse rulings are effectively enforced, we should expect the president who anticipates such a ruling with very high probability to have great bargaining power relative to the congress. Such presidents can tie their hands because they do have ropes, and thus they are uninteresting cases. The real question is whether the presidential type who expects the WTO to rule against the plaintiff can nevertheless convince the congress to accept a significantly liberalizing policy. If I demonstrate this, I will have confirmed that tying hands without an ex post rope is possible in equilibrium. By “ex post” I mean after the president learns his private information but before any action occurs.

Hence, the objective is to show that an equilibrium exists in which the congress is unable to fully distinguish the weak type of president ($\rho = \rho_{lo}$) from the strong type ($\rho = \rho_{hi}$), based on the initial proposal $p_1$. In such a “pooling” equilibrium, the weak type benefits from the congress’s belief that the president might be the strong type (meaning an adverse ruling is likely), even though he knows that the WTO will probably not rule against the status quo. Remarkably, such an equilibrium does exist for certain parameter values. The remainder of the section characterizes this equilibrium and walks through the existence proof and the intuition behind it. It then explores comparative statics concerning the consequences of tying hands and the effects of transaction costs. It also investigates alternative variants of the model to generate claims about the welfare effects of the institution and the differences in compliance rates between unified and divided governments.
A Pooling Equilibrium

Consider the following program for the players. Both types of president propose \( p_1^* \), where

\[
p_1^* = \frac{(1 - s_0)}{(1 - s)} \left[ \pi(1 - \rho_{hi}) + (1 - \pi)(1 - \rho_{lo}) \right].
\] (5)

If a ruling occurs, both types propose \( p_2^* = 0 \). The congress accepts \((a_1 = 1)\) the initial proposal if and only if \( p_1 \geq p_1^* \). The congress does not alter its beliefs about the probability that the president is type \( \rho_{hi} \), no matter what initial proposal \( P \) makes; hence \( \mu = \pi \) for all \( p_1 \in [0,1] \).

If a ruling against the defendant is issued (that is, \( r = 1 \)), the congress accepts \((a_2 = 1)\) any proposal \( p_2 \); if the WTO decides against the plaintiff, however, the congress rejects any subsequent proposal \( p_2 \).

In plain language, this program of action calls for the president to issue the same initial compromise proposal regardless of how he expects the WTO to rule, which the congress always accepts. The resulting policy does not entirely eliminate the protectionism, so there is a chance the plaintiff immediately retaliates and also a chance the plaintiff pushes for a WTO ruling. If the case goes to a ruling, then the president proposes full liberalization, and the congress accepts that proposal or rejects it entirely, depending on whether the ruling supported the plaintiff or the defendant, respectively.

This set of strategies and beliefs constitutes an equilibrium if certain conditions are satisfied. The proof follows; I will turn to the meaning of the conditions afterward.

Start by working backward. A ruling \( r \) has been issued, and the president has made his second proposal \( p_2 \). Simplifying from (3), the congress has utility

\[
a_2p_2 + 1 - a_2 + a_2 \left[ -s_1p_2r - s_0p_2(1 - r) \right] + (1 - a)[-s_1r - s_0(1 - r)]. \] (6)

If \( r = 1 \), then (6) becomes \((1 - s_1)(1 + a_2p_2 - a_2)\), which, given \( s_1 \) > 1, is maximized by \( a_2 = 1 \). If \( r = 0 \), then (6) equals \((1 - s_0)(1 + a_2p_2 - a_2)\), which, given \( s_0 \) < 1, is maximized by \( a_2 = 0 \). The congress thus has a dominant strategy to accept any proposal after an adverse ruling and to reject any proposal after a supportive ruling, due to the way the ruling conditions the retaliation by the plaintiff. Thus if \( r = 1 \), then \( a_2 \)
= 1, and simplifying from (1), the president receives utility \(-p_2 - \lambda - s_1 p_2\), which is maximized when \(p_2 = 0\). If \(r = 0\), then \(a_2 = 0\), and the president receives utility \(-1 - \lambda - s_0\). The congress is going to reject any proposal he makes, so choosing \(p_2 = 0\) is a best response.

Now back up to the preruling stage. Simplifying from (4) and (3) with the expectations for \(p_2\) and \(a_2\), the congress receives

\[
p_1[(1 - s_0) [\mu(1 - \rho_{hi}) + (1 - \mu)(1 - \rho_{lo})] + (1 - p_1)(p_1 - sp_1)] \tag{7}
\]

if it accepts \(p_1\) and

\[
(1 - s_0)[\mu(1 - \rho_{hi}) + (1 - \mu)(1 - \rho_{lo})] \tag{8}
\]

if it rejects the proposal. Hence the congress accepts iff (7) \(\geq\) (8), which when solving for \(p_1\) yields the following acceptance condition:

\[
p_1 \geq \frac{(1 - s_0)}{(1 - s)} [\mu (1 - \rho_{hi}) + (1 - \mu)(1 - \rho_{lo})], \tag{9}
\]

or \(p_1 = 1\), whichever is less.

Next consider the initial proposals the president can rationally make. If \(p_1\) is accepted, the president receives utility

\[
p_1(-1 - \lambda - s_0 + \rho + ps_0) + (1 - p_1)(-p_1 - sp_1), \tag{10}
\]

and if his proposal is rejected, he gets

\[-1 - \lambda - s_0 + \rho - ps_0. \tag{11}\]

The president thus prefers to make a proposal that will be accepted iff (10) \(\geq\) (11), which simplifies to the following proposal condition:

\[
p_1 \leq \frac{1 + \lambda + s_0 - \rho - ps_0}{1 + s}, \tag{12}\]

or \(p_1 = 1\), whichever is less.

We have yet to ascertain that the acceptance and proposal conditions can be compatible. Can \(p_1\) be lower than the ceiling defined by (12) yet higher than the floor identified by (9)? Remember that each presidential type has a different constraint, replacing \(\rho\) in (12) with \(\rho_{lo}\) or \(\rho_{hi}\) as appropriate. For the pooling equilibrium to exist, both types’
proposal conditions must obtain. Since $\rho_{hi} > \rho_{lo}$, type $\rho_{hi}$’s proposal condition is the more severe constraint. Hence both presidential types’ proposal conditions are compatible with the congress’s acceptance condition iff

$$\frac{1 + \lambda + s_0 - \rho_{hi} - \rho_{hi} s_0}{1 + s} \geq \frac{(1 - s_0)}{(1 - s)} \left[ \mu(1 - \rho_{hi}) + (1 - \mu)(1 - \rho_{lo}) \right],$$  

which reduces to

$$\mu^* \geq -\frac{\lambda - \rho_{lo} + \rho_{hi} + s_0(\rho_{lo} + \rho_{hi} - 2) + s(2 + \lambda - \rho_{lo} - \rho_{hi} + s_0\rho_{lo} - s_0\rho_{hi})}{(1 + s)(s_0 - 1)(\rho_{lo} - \rho_{hi})}.$$  

Because this candidate equilibrium calls for $\mu = \pi$ regardless of the initial proposal, if $\pi$ satisfies constraint (14), then, from (9), the congress accepts a proposal as low as $p^*_1$ and both the president’s types prefer to make the accepted proposal $p^*_1$ over any other. In the postruling subgame, elimination of dominated strategies suffices to rationalize the use of the candidate equilibrium’s strategies there. And, because both presidential types propose identical $p^*_1$’s, the congress’s updated beliefs are consistent. Thus the candidate strategies and beliefs constitute an equilibrium.

Here is the intuition. Both players know that a ruling against their country will effectively force the congress to agree to complete liberalization: WTO’s call for sanctions is enough to guarantee foreign retaliation that is more costly to the congress than are the benefits of maintaining the status quo. Conversely, a supportive judgment rules out a deterring level of retaliation. The uncertainty concerns how the WTO will rule, and the president is much better informed about the panel’s decision making than is the congress. Retaliation is, of course, possible in the absence of a WTO ruling. Accordingly, prior to a ruling, the congress has an incentive to agree to partial liberalization to the extent that its net expectation about the likely ruling direction times the levels of retaliation anticipated for each kind of ruling exceeds the likely level of preruling retaliation.

Unfortunately, the president’s initial proposal conveys no information about his expectations for an adverse ruling by the WTO. If it did, the congress would demand and receive less liberalization in the initial proposal in cases unlikely to yield adverse rulings, and it would be willing to accept even greater liberalization in cases known to be most likely to yield adverse rulings. Thus, a president who expects an
adverse ruling would prefer to reveal his private information. The other type of president seeks to free ride on him after all. What might differentiate the two is that the “strong” president has heavy incentives to await a ruling, since he knows with high probability it will work in his favor. Yet—and here is the key to my result—even the strong president is leery of awaiting a ruling, due to the transaction costs of litigating. Transaction costs raise the level of protectionism the strong president is willing to accept as an early settlement, thereby giving him enough common interests with the “weak” president to leave the congress uncertain as to which kind of president it faces. The outcome is an accepted early settlement proposal that reflects hedged bets; that is, it is not as liberal as the strong president would like but is more liberal than the one the congress would demand if it knew it faced the weak president.

Consider the following numerical example. Imagine $s_0 = 0.1, s = 0.3, \rho_{lo} = 0.25, \rho_{hi} = 0.75, \lambda = 0.5, \pi = 0.65$, and $s_1 > 1$. These values mean that the retaliation expected for a given level of protectionism is quite low after a supportive ruling and somewhat higher before a ruling is issued; the strong and weak presidential types know an adverse ruling is 75 percent and 25 percent probable, respectively; the congress believes the president is somewhat more likely to be strong than weak; and the transaction costs of litigation carry half the weight of the trade policy itself in the president’s utility function. From (5), $p^*_1 = 0.546$. From (7) and (8), the congress receives a utility of 0.383 for accepting $p^*_1$ and 0.383 for rejecting it: the congress is indifferent. From (12), presidential type $\rho_{hi}$’s proposal ceiling is 0.596, higher than $p^*_1$. The transaction costs ($\lambda$) raise the proposal ceiling in this case on a nearly one-for-one basis. From (10) and (11), types $\rho_{hi}$ and $\rho_{lo}$ receive, respectively, utilities of $-0.746$ and $-1.046$ for proposing $p^*_1$ (which will be accepted) and $-0.775$ and $-1.325$ for a lower, alternative $p_1$ (which will be rejected). Thus even the strong type benefits from proposing $p^*_1$, due to the high transaction costs of litigation.

What happens if the equilibrium condition, (14), is not satisfied? In the extreme, the strong presidential type’s proposal ceiling is lower than the floor set by the minimum acceptable proposal for the congress. That is, the transaction costs of litigating are low enough and the prospect of losing at the WTO is high enough that the president has more to gain if the congress rejects his proposal than if he proposes what would be acceptable to the congress. If this is true, the president who expects an adverse ruling will propose something unacceptable, for example, $p_1 = 0$, whereas the weaker presidential type
still benefits by meeting the congress’s acceptance condition, which is now ratcheted up because the congress knows the president is the weak type, that is, \( \mu = 0 \). The result is thus fully separating behavior, undermining the ability of the president to get any significant concessions from the congress when an adverse WTO ruling is not expected.

How sensitive is the existence of the pooling equilibrium to refinements on out-of-equilibrium beliefs? If the congress observes an initial proposal different from \( p^*_1 \), the equilibrium calls for it to believe that both types were equally likely to deviate in that fashion. Is this plausible? Start with an easy case, out-of-equilibrium proposals higher than \( p^*_1 \). Regardless of the congress’s beliefs, neither type has an incentive to issue such a proposal, since a strictly superior and still acceptable offer is available in the form of \( p^*_1 \). The harder question concerns proposals lower than \( p^*_1 \). If the congress believed such proposals would more likely come from a strong type (\( \rho_{hi} \)), it would accept a proposal as low as \((1 - s_0)(1 - \rho_{hi})/(1 - s)\), derived from (9). Type \( \rho_{hi} \) strictly prefers lower accepted proposals to higher accepted proposals and thus would certainly deviate. But the weak type, \( \rho_{lo} \), also strictly prefers such proposals and would deviate as well—after all, it would be capitalizing even more than in equilibrium on the congress’s beliefs that the president expects an adverse ruling. That any alternative belief causing the strong type to deviate causes the weak type to deviate in the same way means that my pooling equilibrium satisfies the quite stringent “divinity” refinement (Kreps 1989, 39; Fudenberg and Tirole 1991, 448–56). Hence, the existence of the pooling equilibrium does not depend on implausible out-of-equilibrium beliefs.

Tying Hands without an ex post Rope Is Possible

The potential for tying hands without a rope is measured in this model by the president’s ability to get significant liberalization approved even when he knows an adverse ruling is unlikely. Liberalization is significant in this sense only if it exceeds what the president could get in the complete information game, that is, if the congress had identical information about the WTO panel’s likely judgment. By this definition, the pooling equilibrium demonstrates that tying hands without a rope is indeed possible, despite rational opposition. (The possibility, before the fact, that such a rope might exist is, however, essential.)

What gives the institution influence even when it is unlikely to
rule against the defendant? First, the congress must know that the WTO’s ruling will affect the plaintiff’s likelihood or level of retaliation and also that an adverse ruling in particular will result in retaliation high enough to deter any protectionism. If not, then the congress has no incentive to ever capitulate. For tying hands to work, there must be some probability of enforcement, however small, to condition the congress’s expectations in those cases when enforcement is not actually forthcoming. Second, the congress must not possess accurate knowledge of the case’s merits, that is, the probability that the WTO will rule for the plaintiff. Otherwise, the congress will know when an adverse ruling is not likely, and the president will be unable to get significant concessions in that case. Third, the transaction costs of litigation must be sufficiently high. A strong president’s proposal condition—above which the president will prefer to wait for a ruling—will be too demanding if the process of eliciting a ruling is costless. Transaction costs give the strong president enough common interests with the congress to desire to settle the issue prior to a ruling, thereby allowing a weak president to take advantage of the congress’s belief that the president might be strong even when the congress observes an initial proposal it can accept.

It is important to note what this result does not depend upon. Namely, the model includes no costs for reversing a decision to comply. The standard argument about tying hands, after all, goes like this. If the president is somehow able to impose liberalization when the congress’s guard is down, doing so through the medium of an international institution may prevent reversal because the institution adds costs for reneging on the commitment. The problem with this logic is that it assumes away the difficulty of imposing the policy in the first place. My model focuses on the initial decision to liberalize (or comply more generally), a harder case. It demonstrates that, contrary to the conventional wisdom, an institution need not add to the costs of policy reversal to facilitate commitment in the face of domestic opposition.

We can quantify the benefits arising from the tying hands function of the institution. The baseline is a complete information game, in which the congress has the same knowledge as the president about the chances of an adverse ruling. In such a game, assuming that the same parameter conditions apply as before, if an adverse ruling is likely, the congress’s acceptance condition (9) becomes \([(1 - s_0)/(1 - s)](1 - \rho_{hi})\), and if unlikely, \([(1 - s_0)/(1 - s)](1 - \rho_{lo})\), which the president proposes as appropriate. Thus, the weak president’s accepted
proposal under private information contains \[\frac{(1 - s_{o})}{(1 - s)}(\rho_{hi} - \rho_{lo})\pi\] less protection than what he would be able to get accepted with complete information. (In the numerical example used earlier, this computes to a drop of 0.418 out of 1, or 42 percent off an original 100 percent tariff, a hefty quantity.) That is, the institution increases liberalization despite its relative lack of enforcement power to an extent proportional to the probability that the institution was expected to have enforcement power.

There is a downside, however. The institution’s ability to encourage liberalization even when enforcement is unlikely comes at the expense of the institution’s ability to encourage liberalization when enforcement does turn out to be forthcoming. A president who knows the WTO will rule against the status quo will be unable to elicit as deep concessions from the congress as would be possible if the congress knew what the president knew. What keeps such a president from taking advantage of his knowledge is the cost of litigating through the WTO. Like “crying wolf,” tying hands without a rope comes at the price of lesser credibility even when a rope exists. This function of the institution adds nothing to the net expected level of liberalization.

In addition, the benefits of tying hands without a rope are not evenly distributed across time in a dispute. Recall that plaintiffs will sometimes ask for a ruling even when partially liberalizing pleas are accepted by the congress. If this occurs, all benefits for the weak president are lost. After a ruling, a president’s private information is irrelevant: the congress’s subsequent action is contingent on the ruling itself, not on the president’s expectations about the ruling direction. The irony is thus that, when it lacks enforcement power, an institution can only bolster domestic commitment before it intervenes. There can be no tying of hands without enforcement in cases that fail to be settled before the institution offers its prescriptions.

The Effect of Transaction Costs

Surprisingly, for the institution to facilitate domestic commitment when enforcement is unlikely, transaction costs of utilizing the institution must be sufficiently high. For instance, the derivative of (12) with respect to \(\lambda\) is \(1/(1 + s)\): that is, the upper limit on the set of agreements the president would prefer to no agreement increases as the transaction costs of litigation go up. Transaction costs thus have the power to create common ground between even the strong type of
president and the congress, regardless of the congress’s prior beliefs about the weak president’s type. Such common ground is essential for the weak president to credibly pool or to capitalize on the congress’s fear of an adverse ruling. Put another way, equilibrium condition (14) indicates that, as \( \lambda \) goes up, the prior probability of the strong presidential type, \( \rho_{h} \), can go down proportionally, and the pooling equilibrium—and therefore the potential for tying hands—can still exist. Remarkably, from the institution’s standpoint, high transaction costs are desirable: they make possible significant liberalization even when enforcement is not forthcoming.

However, this counterintuitive assertion requires some caveats. First, transaction costs exert a threshold effect; above a certain point, defined by the \( \lambda \) necessary to satisfy condition (14), higher values do not improve the potential for tying hands. Second, raising \( \lambda \) does not affect the congress’s acceptance condition or, accordingly, the type of initial proposal issued: \( p_{1}^{*} \) does not depend on (5). In other words, increasing transaction costs, or decreasing them for that matter, has no effect on the overall level of liberalization approved. All it does is redistribute the congress’s concessions from strong types to weak types by enabling the pooling equilibrium. Third, while a president who expects a supportive ruling is more able to elicit concessions if transaction costs are high enough to make pooling possible, the expected utility of even this weak type is diminished by higher transaction costs. The benefits of a better \( p_{1} \) are outweighed by the added loss (from the transaction costs) in the event the dispute goes to a ruling.

The findings concerning transaction costs yield a number of testable hypotheses. Namely, “improvements” that reduce the transaction costs of utilizing an international institution will decrease that institution’s ability to induce liberalization, or reform more generally, in cases when enforcement is unlikely. For instance, many observers argue that the WTO has reduced the transaction costs of dispute settlement in comparison to GATT, yet (at least when dealing with countries besides the United States and the EU) foreign retaliation for noncompliance is extraordinarily rare (Petersmann 1997, 202–5; Sevilla 1998, 7–11; Ruggiero 1998; Reinhardt 1999). Counter to the conventional wisdom, this model suggests that the WTO will be less efficacious than GATT in disputes where retaliation is unlikely (for example, when the plaintiff’s legal case is weak), to the extent that the WTO has indeed reduced transaction costs.

As noted earlier, LDCs arguably face much more significant transaction costs in litigating WTO disputes. If it is true that LDCs
have the equivalent of higher λ’s in the model, then they should on average possess greater ability to tie their hands in WTO disputes and should tend to liberalize more as defendants, at least when enforcement is not forthcoming (for example, in cases they are likely to win or when facing plaintiffs outside of the United States and the EU). This should be true even controlling for obvious factors such as asymmetrical trade dependence and relative market size.

What If the Government Is Unified?

This chapter’s model assumes a division of opinion between executive and legislature. Such a division is perhaps most likely to occur when they represent different political parties, in divided government. What role might the international institution play when there is no domestic opposition, for example, when the government is unified? In particular, consider a variant of the model in which there is no congress and the president prefers to maintain the status quo. In this variant, the president would liberalize after an adverse ruling and keep the status quo after a supportive judgment. Hence, his utility at the initial proposal stage would be

\[ p_1 \left[ -\rho \lambda + (1 - \rho)(1 - \lambda - s_0) \right] + p_1 (1 - s)(1 - p_1), \]

which is maximized by

\[ \tilde{p}_1 = \frac{2 - s - s_0 - \lambda - \rho - \rho s_0}{2(1 - s)}. \]  

(15)

In the numerical example used earlier, the presidential weak type would propose 0.589, and the strong type, 0.196. Weighted by \( \pi \), these average to 0.334, whereas the expected \( p_1^* \) in the original model is 0.546, notably higher. It follows that a unified government (even one with a protectionist executive) may sometimes concede more as a defendant than would a divided government (even one with a liberalizing executive). To understand why, the key, again, is transaction costs. The unified government’s equilibrium initial proposal, \( \tilde{p}_1 \) (15), is a decreasing function of \( \lambda \), yet the divided government’s offer of \( p_1^* \) (5) is not. The transaction cost parameter determines whether a unified government’s initial proposal is lower or higher than a divided government’s.

This line of reasoning suggests two testable hypotheses. First, recall that the likelihood of a ruling occurring in the model is proportional to the level of protectionism in the initial (accepted) proposal, for example \( \tilde{p}_1 \) or \( p_1^* \). Accordingly, the probability of the dispute going
to a ruling is higher in cases with unified government defendants ($\tilde{p}_1$) than in those with divided government defendants ($p_1^*$), if transaction costs are low, as they should be for advanced industrial states using the GATT or WTO dispute settlement regimes. Conversely, if transaction costs are high, as in the case of LDC defendants, the probability of a dispute going to a ruling is greater in cases against divided governments than in those against unified governments.

Second, regardless of differences prior to a ruling, both the original and the variant model, focusing on divided and unified government, respectively, prescribe identical equilibrium behavior once a ruling has been issued. Specifically, an adverse ruling evokes full compliance and a supportive ruling locks in the status quo. Thus, unified and divided governments should exhibit a similar level of concessions in disputes ending after rulings are issued.

How closely do these hypotheses match the reality of GATT and WTO trade conflicts? Data are available to run preliminary tests. In particular, Reinhardt (1996, chap. 4) lists 256 GATT disputes conducted between 1948 and 1994, along with a dummy measure of divided government, a dummy reflecting whether GATT issued a ruling of any sort, and a three-category ordinal measure of the level of the defendant’s liberalization reflected in the dispute outcome, relative to the status quo. Reinhardt (1999) provides a dummy indicator of LDC status, as officially defined by GATT/WTO, in addition to a measure of relative GDP size. Consider the first hypothesis. Table 1 shows the results of a probit regression of whether a ruling was issued, conditional upon a set of interactions between LDC and unified/divided government. There are no divided government LDC defendants in the sample; therefore, that cell is empty. That leaves two variables on the right-hand side: A dummy for LDC unified governments and one for advanced industrial unified governments (both referring to defendant states). Advanced industrial divided governments are the baseline category. If my hypothesis is correct, the coefficient for advanced industrial unified government should be positive and significant, which is exactly what turns up. Granted, this empirical finding is merely suggestive, but it is particularly striking insofar as it is a “new fact,” that is, something we would not have looked for in the absence of this chapter’s model.

Table 2 shows results bearing upon the second hypothesis, concerning just those disputes ending after rulings have been issued. The dependent variable is the level of liberalization (higher is better). The right-hand side includes a dummy for divided government, as well as
GDP ratio as a control. I expect divided governments to concede at the same rate as unified governments in disputes ending after rulings. The results support the claim; that is, the null hypothesis that divided government makes no difference cannot be rejected. If anything, our intuition would be that divided governments concede less (Cowhey 1993, 302), and that they do not do so in this case again suggests that the model provides useful insight.

Other Results

The model yields a number of other surprising conclusions. For instance, does the institution increase liberalization overall, relative to a world in which no institution exists? The latter world can be represented by a variant of the model with exactly the same probability of

<table>
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<tr>
<th>TABLE 1. Probit Estimates for Whether Ruling Was Issued, GATT Disputes, 1948–94</th>
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<tbody>
<tr>
<td>Prob(Ruling)</td>
</tr>
<tr>
<td>Defendant is LDC with unified government</td>
</tr>
<tr>
<td>Defendant is advanced industrial state with unified government</td>
</tr>
<tr>
<td>Constant</td>
</tr>
<tr>
<td>Number of observations</td>
</tr>
<tr>
<td>LL (restricted)</td>
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<tr>
<td>LL (unrestricted)</td>
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<td>Pseudo-$R^2$</td>
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*2-tailed $p < .05$. 

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<tr>
<td>Level of Liberalization</td>
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<tr>
<td>Divided government dummy</td>
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<tr>
<td>Ratio of plaintiff’s GDP to sum of plaintiff’s and defendant’s</td>
</tr>
<tr>
<td>Intercept 1</td>
</tr>
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<td>Intercept 2</td>
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* 2-tailed $p < .05$. 
foreign retaliation but without the ruling device and hence transaction costs and the president’s private information. In such a variant, the president makes a proposal that the congress accepts or rejects, and afterward the same expectation of foreign retaliation obtains as in the original model, subsequent to a ruling. For any given policy \( p \), then, both players’ expectations about the probability and costs of retaliation are

\[
-p[\pi \rho_{hi} s_1 + \pi (1 - \rho_{hi}) s_0 + (1 - \pi) \rho_{lo} s_1 + (1 - \pi)(1 - \rho_{lo}) s_0],
\]

which we can abbreviate as \(-pk\).

Congress accordingly accepts \( p \) only if \( p - pk \geq 1 - k \), which is true iff \( k \geq 1 \), which in turn obtains (substituting the expression in (16) for \( k \) and simplifying) only when

\[
\pi \geq \frac{1 + s_0 (\rho_{lo} - 1) - s_1 \rho_{lo}}{(\rho_{lo} - \rho_{hi})(s_0 - s_1)}. \tag{17}
\]

The president, strictly preferring lower accepted \( p \)'s, proposes and gets approved \( p \) if condition (17) applies; the outcome is 1 otherwise. Recall that the original model never has an expected value of protectionism strictly equal to zero. Thus, amazingly, the institution actually decreases the president’s ability to liberalize overall, compared to the counterfactual in which the institution does not exist if condition (17) holds.

Granted, this condition is generally more stringent than, say, the pooling equilibrium threshold (14): \( \pi \) would have to exceed 1.3, a disallowed value, for the institution to be counterproductive in the earlier numerical example, for instance. But the condition can obtain. The key is \( s_1 \), the maximum level of retaliation expected, which does not enter the calculations for \( p^* \) from the original model. Here, however, \( s_1 \) strictly lowers the \( \pi \) necessary to sustain the result, since the derivative of (17) with respect to \( s_1 \) is \((1 - s_0)/(\rho_{lo} - \rho_{hi})(s_0 - s_1)^2\), which is always negative. In other words, if the maximum plausible level of retaliation crosses a certain threshold, the institution may actually obstruct liberalization instead of facilitating it. The reason is subtle: the ruling mechanism provides information about the likelihood of retaliation, before the president’s and congress’s final opportunity to decide policy. In the worst case scenario after a ruling (that is, an adverse ruling with guaranteed retaliation), the congress can adjust its policy prior to suffering the consequences of recalcitrance.
Without such a preview, the congress has to factor the worst case scenario into its one-shot decision, thereby making it much more open to liberalizing—if the maximum expected retaliation is sufficiently high. In part, this may be an artifact of the finite, as opposed to infinitely repeated, game structure. However, it seems quite plausible to view one of the institution’s main functions as staging interaction in an iterated format, as many scholars have observed (Axelrod and Keohane 1985, 234). Surprisingly, doing so can be counterproductive in some cases.

Consider a related point. As long as the institution exists, the maximum expected level of retaliation $s_i$ need not be higher than the minimum necessary to compel a protectionist legislature to liberalize. Exceeding that level only costs both parties, without improving the level of liberalization in equilibrium. Yet, in a dispute occurring outside the WTO or other institutional framework, as the earlier paragraph suggests, the higher the complainant’s threatened maximum level of retaliation, the more concessions the defendant will make. Consequently, I expect retaliation threats to involve much greater sums, ceteris paribus, in ungoverned international trade disputes than in WTO conflicts.

The model also points to the importance of the levels of retaliation possible prior to a ruling and after a ruling supporting the defendant. Note that $p^*_i$ is proportional to $(1 - s_0)/(1 - s)$. That is, the possibility of retaliation in the absence of a ruling decreases the equilibrium level of liberalization, and the possibility of retaliation even when WTO supports the defendant increases the likely liberalization by the defendant. The ideal world, from the standpoint of maximizing liberalization, is one in which plaintiffs are bound not to retaliate before a ruling yet are encouraged to retaliate (against sustained protectionism) even when the WTO approves the defendant’s protectionism. The WTO embodies only half of this prescription, since it discourages retaliation in either circumstance.

A final hypothesis concerns the decision to litigate a defense in GATT/WTO disputes. The model predicts that, regardless of their beliefs about their case’s merits, defendants are equally likely to litigate, as opposed to settling early. Intuition would suggest in contrast that defendants who expect to lose will be more likely to settle. This alternative is ruled out when the pooling equilibrium exists. Domestic politics is the explanation: executives may seek to tie their hands with an adverse WTO ruling, and in such cases they would like to litigate precisely when they expect to lose, not win. Yet that likely win-
ners want to deceive the domestic opposition means that they act identically to likely losers, thereby nullifying the effects of a case’s real merits on the decision to litigate a defense.

**Implications**

The previous results have a number of significant implications for international relations theory and institutional design. Traditional rationalist theories (for example, Martin and Simmons 1998, 748) suggest that institutions promote cooperation by allowing leaders to tie their hands. The results here support this argument, and indeed strengthen it, by showing how it can be true even when we acknowledge that a domestic opposition will view attempts to tie hands with suspicion.

However, my findings contradict much conventional wisdom in rationalist institutional theory. The benefits of tying hands occur in proportion to the ex ante probability of enforcement, even if enforcement is not forthcoming in a given case. There is no way to bootstrap a domestic commitment effect if enforcement is 100 percent absent. In addition, the benefits of tying hands (in terms of the institution’s effect on policy) when enforcement turns out to be unlikely ex post are matched by losses when enforcement turns out to be likely ex post. That is, the possibility of leaders “crying wolf” diminishes their leverage when a wolf actually appears. Hence, even when noncompliance with EU regulations would result in significant costs for Britain, a British leader invoking such regulations may have little credibility at home, as revealed by one MP decrying the “hidden agenda that leads the British Government, in the most subservient way, to give in to every arbitrary and legally dubious whim on which [the European Commission] decides” (Smith 1997, 197). Tying hands does not have a net positive effect on the institution’s influence over policy.

Furthermore, all the benefits of tying hands are realized before the institution makes its policy prescriptions in a given case. Surprisingly, to tie her hands, a leader cannot rely on a judgment by the international institution, or on any resulting retaliation; if such a judgment or retaliation occurs, she has lost her opportunity. An institutional prescription and the consequent foreign retaliation eliminate the uncertainty domestic opponents have about the probability of foreign retaliation, which is the only lever a leader has when an adverse ruling or retaliation is not very likely.

The model also sharply contradicts traditional institutionalist
theory with respect to transaction costs. For example, Keohane (1983, 155–57) argues that by reducing the transaction costs of negotiating and otherwise interacting, institutions promote cooperation—which in the WTO disputes context means liberalization. My model, however, demonstrates that if the institution lowered transaction costs, it would eliminate all of its potential to influence state policy in cases in which the institution lacks enforcement power. For the WTO dispute settlement regime in particular, imposing high costs on those seeking to negotiate through the institution or to obtain the institution’s information is precisely what permits reformist leaders to convince recalcitrant legislatures that the WTO will condemn the status quo when it actually might not or when foreign retaliation is not going to occur, which is certainly the majority of cases. High transaction costs can be good, from the institution’s perspective. This result is particularly important because it points to the incompatibility of a number of mechanisms that are often regarded as reinforcing. If the institution reduces transaction costs, it may facilitate negotiation and reciprocity, but it will destroy the ability of leaders to tie their hands and impose reform against the wishes of a domestic opposition.

Likewise, the model suggests that information provision is not always beneficial, again in contrast to traditional theories of institutions (Keohane 1983, 159–61, 165). The logic is not so surprising, however. In particular, the institution is more able to influence state policy if the recalcitrant domestic opposition that it aims to constrain is unaware of the institution’s lack of enforcement power and inability to sway foreign states to retaliate. The institution dilutes its tying hands potential by providing greater information about the intentions of other states or even the institution’s own workings, in the case of adjudication systems like the WTO’s.

Taken as a whole, the results here enforce a perspective on international institutions that is similar in many ways to conventional functional theories. It views institutions through their influence on strategic, rational actors at various levels of analysis. It lends support to an oft-cited hypothesis, that is, the domestic commitment effect of international institutions. Yet it goes well beyond the standard view. In particular, it points out inconsistencies in the deductive logic of functionalism, especially concerning the compatibility of different institutional functions and the role of transaction costs and information provision. The perspective is not merely critical, however, since the model points to a great number of testable propositions to which adequate attention has not been addressed. In that respect, I offer this model as a
constructive attempt to identify more conditional hypotheses on how and when institutions “matter,” as opposed to reiterating stale debates over whether institutions affect state policy at all.

I conclude this chapter by highlighting the model’s implications for optimal institutional design. To maximize its influence on state policy when it nevertheless lacks enforcement power, an international institution should have the following characteristics. It should make it costly for states to elicit normative judgments from the regime. It should privilege sovereign state leaders with information and access to its proceedings, at the expense of domestic audiences and private actors. It should remove barriers to and even encourage unilateral retaliation when a member state fails to abide by its prescriptions, yet it should cap allowable retaliation just above the extent of the target state’s violation. It should stridently ban unilateral retaliation without due process, for example, prior to the issuance of an institutional judgment, but it should not penalize unilateral retaliation against member states that fail to fully cooperate subsequent to an institutional judgment, even after a judgment that approves such failure.

How does the WTO score on these dimensions? By lowering some transaction costs, such as the unilateral veto over panel establishment and authorization of rulings (Sevilla 1998), the WTO may have ironically harmed its ability to induce liberalization. In other areas, however, the WTO has added to the costliness of litigation: for example, extending deadlines, imposing many new steps in the legal process, and adding vast quantities of complex new law to be sorted through (Reinhardt 1999, 12–17). The net effect on transaction costs may be a wash. The early WTO has been precisely optimal in terms of its lack of transparency to private parties and nonexecutive government actors in disputant countries. This is likely to change, however, since the United States has recently made increased transparency its key demand for reform of the regime.\textsuperscript{15} The WTO is particularly flawed in its treatment of retaliation by plaintiffs. To be sure, unilateral action prior to a ruling is indeed discouraged, but the all-important potential for retaliation after a ruling for the plaintiff is hamstrung by new requirements to arbitrate the quantities involved. Arbitration, after all, splits the difference between the parties’ demands, which is bound to leave any ultimate retaliation lower than what is necessary to compel liberalization by the plaintiff. The result is a case like the U.S.-EU banana dispute, in which after years of delay the WTO has approved sanctions of hundreds of millions of dollars less than the
trade affected by the protection in question; the EU has so far evinced no intention to change its policy as a result. The WTO’s focus on “defendants’ rights” therefore obstructs its mission to encourage liberalization of disputed policies (Reinhardt 1999).

One final question is this: Should leaders resort to the tied hands defense of unpopular reforms, attempting to shift the blame to international institutions? Rodrik (1997, 79–80), for example, argues that doing so results over the long run in costly political backlash against such institutions, spilling over to undermine even policies that are beneficial for the affected domestic groups. The model here implies a similar, though not so pessimistic, answer. In the short run, playing the international institutional constraint card may prove useful to a reformist leader. In the long run, the short-term gains will be offset by decreased credibility when such international constraints occasionally prove genuine. A wise leader recognizes the limits of such a strategy.

Notes

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1. Constraints applying only after the liberalizing policy has been implemented cannot explain why such a policy is chosen over the status quo in the first place. Why would a domestic opposition permit a leader to sign on to a regime whose prescriptions it opposes when that regime cannot easily be exited? Answering this puzzle requires more than the assumption of costs for exiting an institution.

2. See Reinhardt 1999, esp. 3–5; Komuro 1995; and Petersmann 1997 for a more precise description of GATT and WTO procedures and the differences between them. This synopsis obscures those differences, but it captures the key strategic elements of the process.

3. In a 1998 ruling the WTO opened the door to legal submissions by NGOs, but this has affected only one dispute so far (South Centre 1999, 17).

4. Rulings for the defendant do indeed occur in practice. GATT decided substantially for the plaintiff in no more than 85 of 129 rulings (65.9 percent) from 1948 through 1993 (Reinhardt 1998, 5).

5. Making the foreign state’s behavior exogenous is the most significant shortcut in this model. Nevertheless, it seems quite reasonable to suppose
that the plaintiff will be (a) more likely to continue litigation the more protectionist is the defendant’s initial stance and (b) more likely to retaliate the more protectionist is the defendant’s ultimate policy. (Note that the level of retaliation, once initiated, is allowed to vary here.)

6. By “adverse,” I mean a ruling against the defendant state’s protectionist status quo (which is precisely what the president, but not the congress, desires).

7. This chapter’s use of the WTO ruling itself, rather than the enforcement such a ruling may yield, may strike some readers as inappropriate to quantify “tying hands without a rope.” It may concord better with intuition to restructure the game so that the president has private information not over the likely WTO ruling but over the probability of foreign retaliation contingent on the ruling. However, such a representation condenses to exactly the same model: here, the president’s private information about the likely ruling is the critical basis for the congress’s estimates about foreign retaliation. Moreover, it stretches credulity to assume that the president has private information about the probability of foreign retaliation, since that information is the property of foreign leaders conducting an adversarial dispute process. This is why I adopt the model construction used here; the results are the same.

8. I refer to perfect Bayesian equilibrium, which requires that both players choose best responses to each other’s strategy and that the updating of beliefs for the congress be consistent with these strategies in all game histories such a combination of strategies can generate. (The pooling equilibrium, as it turns out, also satisfies relatively stringent conditions concerning plausible out-of-equilibrium beliefs. See subsequent discussion.)

9. Specifically, if (12) is \( z \), then \( \partial \lambda / \partial z = 0.769 \) in this example.

10. There are a number of possibilities, depending on parameter values, all of which rule out a pooling equilibrium involving a nontrivial (e.g., \( p_1 < 1 \)) yet accepted proposal. What follows is an illustration of the extreme case in which the strong president would have nothing to gain from an accepted proposal, relative to what happens after a ruling, even if his private information were common knowledge.

11. Lower proposals, recall, are valued in themselves, plus they reduce the chances of foreign retaliation and costly litigation. This is valid at least for certain plausible parameter values that satisfy equilibrium condition (14). Formally, the derivative of (10) with respect to \( p \) must be negative for lower accepted proposals to be strictly preferred to higher ones, for either type. This is true iff

\[
p_1 < \frac{2 + s + s_0 + \lambda - \rho - s_0 \rho}{2(1 + s)}.
\]

The out-of-equilibrium proposals under consideration are necessarily lower than the proposal condition (12), which is lower than the ceiling described by
the equation just given, for both types, as long as $\rho_{lo} > (s - s_0 - \lambda)/(1 + s_0)$. This in turn is satisfied for any value of $\rho_{lo}$ as long as $\lambda + s_0 > s$.

12. We are assuming that the president’s country is the defendant in a dispute that has already been filed. Thus, if the president is the only decision maker, it seems plausible to infer that he is responsible for, and prefers to keep, the protectionism giving rise to the dispute in the first place.

13. Unfortunately, data on the merits of the case—the property operationalized as $\rho$ in the model—are not presently available.

14. The data set used for all analyses in this chapter is available at <http://userwww.service.emory.edu/~erein/>.
