INTERNATIONAL LAW AND INTERNATIONAL RELATIONS

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Table 14.8 reveals, where the interaction term is low – the most favorable conditions for legalism, according to this framework – all seven treaties have endorsed standing tribunals.

   The dramatic impact of this interaction appears also in an ordered probit regression of legalism. Table 14.9 summarizes the results of this statistical test, which uses asymmetry and the interaction term as continuous variables that range from zero to 1, capturing more variation than the preceding tabular analysis. Proposed integration (low = 0; high = 1) and legalism (none or low = 0; medium = 1; high or very high = 2) remain categorical variables. Despite the small sample size, which is not ideal for maximum likelihood estimation, * both integration and the multiplicative interaction term exhibit highly significant and strong effects on legalism.[45] These effects, moreover, are in the predicted direction. The coefficient of the interaction term is the largest in magnitude, indicating the decisively negative relationship of asymmetry to legalism where the level of proposed integration is high. *

   This simple analytical framework, tested with basic indicators of GDP concentration and treaty type, successfully accounts for thirty of the thirty-two cases at the more extreme levels of legalism, where the implications of the theory are clearest. * * *

<center>* * *</center>

<center>CONCLUSION</center>

In this article I offer a political theory of dispute settlement design in international trade. My aim is to demonstrate and account for significant variation in the level of legalism across different regional accords. With a dual emphasis on economic asymmetry and the proposed depth of integration, I predict the extent to which trading states will delegate judicial review authority to impartial third parties. My central assertion is that in drafting governance structures for international trade, political leaders weigh the benefits of improved treaty compliance against the costs of diminished policy discretion. To make this judgment, they assess their

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[45] In maximum likelihood analysis of small samples, positive findings of significance may be more reliable than negative results. Hart and Clark report that in probit models of binary dependent variables, the risk of false positive findings does not change appreciably as sample size decreases. Hart and Clark 1999. They conclude that "the likelihood that small samples will induce Type I errors is small," in contrast to the substantial risk of false negative findings.

economic stake in intrapact trade; their relative economic power vis-à-vis other parties to the accord; and the depth or intensity of the proposed liberalization. Thanks to their market size and lesser dependence on trade, relatively large countries tend to prefer less legalism than their smaller counterparts. Because treaties require unanimity, the institutional preferences of larger countries tend to prevail in negotiations, defining the lowest common denominator.

The implications of this approach – chief among which is that legalistic mechanisms are unlikely where asymmetry is high or integration is shallow – stand up to empirical scrutiny against a sizable set of more than sixty regional trade agreements. In almost every pact with high asymmetry, legalism is absent – even, in contrast to functional accounts, where integration is deep. Where asymmetry is low, legalism occurs only where at least a common market, and not just free trade or a uniform external tariff, is the ultimate policy objective. ***

Seen from a broad perspective, this theory of trade dispute settlement design ostensibly relies on a hybrid of neoliberal institutionalist logic and structural realist indicators of relative economic power. Unlike those systemic approaches, however, it is grounded in a political calculation of costs and benefits in the domestic arena, not in expectations about absolute or relative gains internationally. Political leaders in this model are not primarily focused on overcoming market failures or improving their defensive positions in an anarchic international system, however germane such considerations may be to the decision to pursue economic integration in the first instance. Given a regional trade initiative, negotiations over dispute settlement design in my view are driven by domestic political concerns. Without delving into the particulars of comparative politics, my analytical framework connects generic domestic political incentives to issues of international institutional design, *** bridging the steadily receding divide between comparative and international political economy. *

* * *

[My] account privileges the moment of institutional creation, when member states negotiate and establish a system for the resolution of disputes. This moment need not coincide with the signing of the initial treaty. In a few pacts, such as the CACM, MERCOSUR, and AFTA, member states adopted or amended their permanent dispute settlement mechanisms well after their commitments to liberalize trade. Like asymmetry and the depth of integration, dispute settlement designs may change over time, with one blueprint substituted for another as in EFTA. Within the

parameters of that design, at every level of legalism, a range of behavioral outcomes – from frequent use to utter irrelevance – are possible. Nevertheless, outcomes still remain subject to boundary conditions established by the institutional blueprint of each treaty, rendering the basic design itself worthy of investigation.

APPENDIX A: SOURCES FOR TREATY TEXTS

The date following the treaty title indicates the year the treaty was published. The original signing date for each treaty can be found in Table 14.2.

AFTA (ASEAN Free Trade Area). 1992. *International Legal Materials* 31:506.

Protocol on Dispute Settlement Mechanism, available from the ASEAN Secretariat or online at <http://www. asean.or.id/economic/dsm.htm>.

Andean Pact. 1979. Treaty Creating the Court of Justice of the Cartagena Agreement. *International Lega Materials* 18:1203.

Statute of the Court of Justice of the Cartagena Agreement, available from the Organization of American States or online at <http://www.sice.oas.org/trade/junac/tribunal/cartage2.stm>.

ANZCERTA (Australia–New Zealand Closer Economic Relations Trade Agreement). 1983. *International Legal Materials* 22:945.

Baltic Free Trade Agreement. Available from the foreign ministries of member states.

CACM (Central American Common Market). 1994. *Basic Documents of International Economic Law* 2:529.

Statute of the Central American Court of Justice. 1995. *International Legal Materials* 34:921.

CARICOM (Caribbean Community). 1974. *United Nations Treaty Series* 946:17. New York: UN.

CEAO (West African Economic Community). 1981. *United Nations Treaty Series* 1257:362. New York: UN.

CEEC (Central and East European Country) Pacts. Available online at <http://www.wto.org/wto/online/ddf.htm>.

CEFTA (Central European Free Trade Agreement). 1995. *International Legal Materials* 34:3.

Chile and Mexico Pacts. Available from the Organization of American States or online at <http://www.sice.oas.org/trade.stm>.

CIS (Commonwealth of Independent States). 1995. *International Legal Materials* 34:1279.

COMESA (Common Market for Eastern and Southern Africa). 1994. *International Legal Materials* 33:1067.

EAC (East African Community). 1967. *International Legal Materials* 6:932.

EC (European Community). Agreement Establishing the European Economic Community and Protocol on the Statute of the Court of Justice of the EEC. 1958. *United Nations Treaty Series* 298:11, 147. New York: UN.

EC Associations. Available in *Official Journal of the European Communities*, or online at <http://europa.eu.int/eur-lex/en/>.

EC–Israel. 1996. *Official Journal of the European Communities* 39:1–11.

ECOWAS (Economic Community of West African States). 1975. *International Legal Materials* 14:1200. Revised Treaty. 1996. *International Legal Materials* 35:660.

Protocol A/P.1/7/91 on the Community Court of Justice. 1996. *Revue Africaine de Droit International et Compare* 8:228.

EEA (European Economic Area). 1993. *Common Market Law Reports* 29:1247.

EFTA (European Free Trade Association). 1960. *United Nations Treaty Series* 370:5. New York: UN.

EFTA. 1994. *Official Journal of the European Communities* 37:1–83.

EFTA Associations. Available online at <http://www.efta.int/docs/EFTA/Legal-Texts/FTAs/FTAdefault.htm>.

GCC (Gulf Cooperation Council). 1987. *International Legal Materials* 26:1131.

Mano River Union. 1974. *United Nations Treaty Series* 952:264. New York: UN.

MERCOSUR (Common Market of the South). 1991. *International Legal Materials* 30:1041. Protocol of Brasilia for the Settlement of Disputes. 1997. *International Legal Materials* 36:691. Ouro Preto Protocol, available from the Organization of American States or online at <http://www.sice.oas.org/trade/mrcsr/ourop/index.stm>.

NAFTA (North American Free Trade Agreement). 1993. *International Legal Materials* 32:605.

OECS (Organization of East Caribbean States). 1981. *International Legal Materials* 20:1166.

SACU (Southern African Customs Union). 1973. *United Nations Treaty Series* 860:69. New York: UN.

U.S.–Israel. 1985. *International Legal Materials* 24:654.

UDEAC (Central African Customs and Economic Union). 1964. *International Legal Materials* 4:699.

APPENDIX B: EXCLUDED REGIONAL ECONOMIC AGREEMENTS, 1957–95

This list draws largely on de la Torre and Kelly 1992; IMF 1994; and WTO 1995. These sources also include pacts that were superceded by subsequent agreements included in Table 14.2 or listed here.

Nonreciprocal Agreements

U.S. Caribbean Basin Initiative

EC Lomé Conventions with African, Caribbean, and Pacific States

EC Cooperation Agreements with Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia

EFTA Cooperation Agreements with Albania, Egypt, and Tunisia

1976 Australia–Papua New Guinea Trade and Commercial Relations Agreement

1980 South Pacific Regional Trade and Economic Agreement

1991 CARICOM–Venezuela Agreement

1991 CARICOM–Colombia Agreement

Cooperation or Framework Agreements

1976 Economic Community of the Great Lakes Countries
1980 Latin American Integration Association
1983 Economic Community of Central African States
1984 Indian Ocean Commission
1985 Economic Cooperation Organization
1985 South Asian Association for Regional Cooperation (signed limited preferential trade pact in 1993)
1989 Asia Pacific Economic Cooperation Forum
1991 African Economic Community
1992 Southern African Development Community (signed free trade agreement in 1996)
1992 Black Sea Economic Cooperation Project
1994 Association of Caribbean States
1994 Free Trade Area of the Americas

Unavailable Agreements

1961 Borneo Free Trade Area
1962 African Common Market
1964 Arab Common Market
1975 Bangkok Agreement
1989 Arab Maghreb Union
1991 Thailand–Lao People's Democratic Republic Trade Agreement
1992 Slovak Republic–Czech Republic Customs Union
1993 Slovenia–Czech Republic Free Trade Agreement
1993 Slovenia–Slovak Republic Free Trade Agreement
1994 Kazakhstan–Kyrgyz Republic–Uzbekistan Customs Union
1994 Economic and Monetary Community of Central Africa (renewal of moribund 1964 UDEAC)
1994 West African Economic and Monetary Union (successor to dissolved 1973 CEAO)

Loosening the Ties that Bind: A Learning Model of Agreement Flexibility

Barbara Koremenos

* * *

*** Existing international agreements are testament to states' willingness and ability to cooperate despite the international anarchy in which they find themselves. Given the difficulties of cooperation under anarchy documented in the recent international relations literature, understanding how states manage to bring about the formal cooperation embodied in international agreements is of both theoretical and practical interest.

States can make agreements more desirable in prospect and more robust in practice by varying their provisions for duration and renegotiation. These provisions help states account for the uncertain economic, political, and technological contexts in which agreements are made and (ideally) kept.

* * *

Nevertheless, the issues of duration and renegotiation have been almost completely ignored in the political science literature on international relations. They have been wholly neglected in theoretical studies of international cooperation, and there has been surprisingly little discussion of these issues from an empirical point of view. In fact, although some discussions of individual agreements cover the issues of duration and renegotiation for the agreement in question, no work exists that attempts

to account for or even describe the observed patterns and variation in agreement duration and renegotiation.[1]

* * *

What I am attempting essentially is to bring theory – in particular, formal international relations theory – to international law. I argue that uncertainty in the international environment – uncertainty that is of varying forms and degrees across issue contexts – leads states to choose particular duration and renegotiation provisions. These provisions, in turn, affect whether or not states conclude international agreements and whether or not they renege on them.[2]

This study is the first theoretical work to address the nominal (that is, negotiated) length of international agreements.[3] My theoretical work takes as its departure the economic theory of contracts, since agreements are essentially contracts between states, with the key difference that there is no external authority available to enforce them. The economic literature on contract duration formalizes the key trade-off in choosing contract duration between the benefit associated with spreading the (assumed) fixed cost of contracting over additional periods and the loss associated with staying for additional periods in a suboptimal contract.[4] This basic insight is helpful but insufficient to explain the range of duration and renegotiation provisions present in even the small set of agreements I consider here.

My theory identifies key factors affecting the choices of duration and renegotiation provisions in these agreements. The two most important factors are the degree of agreement uncertainty (formally, the variance of the distribution of gains from an agreement) and the degree of noise in the environment (formally, the variance of confounding variables whose effect on outcomes may be confused with that of an agreement). The greater the agreement uncertainty, the more likely states will want to limit the duration

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[1] One exception is Bilder, who surveys a number of techniques that states can use to help themselves manage the risks of international agreements. Bilder 1981. He identifies and devotes two pages to the technique of "Limiting the Duration of the Agreement." Also, Grieco mentions issues of agreement durability in his concluding chapter (see fn. 22 below). Grieco 1990.

[2] Moreover, I would argue that renegotiation clauses (as well as other forms of flexibility provisions like escape clauses) help reconcile the tension between two doctrines of international law: *rebus sic stantibus* and *pacta sunt servanda* (treaties should be performed in good faith).

[3] Two recent studies by Gaubatz and Bennett examine realized durations of alliances using hazard-rate models. See Gaubatz 1996; and Bennett 1997. These studies ignore the fact that many agreements are initially concluded with a finite duration. They therefore conflate planned agreement terminations with those resulting from a violation of the agreement.

[4] The three main papers are Gray 1978; Dye 1985; and Harris and Holmstrom 1987.

of the agreement and incorporate renegotiation. The factor working against renegotiation is noise. The greater the noise, the more difficult it is to learn how an agreement is actually working; hence incorporating limited duration and renegotiation provisions becomes less valuable.

The model provides a framework within which to discuss the Nuclear Non-Proliferation Treaty (NPT). I describe the basic features of the agreement and summarize the available information about how the parties themselves framed the duration and renegotiation issues while negotiating the agreement. ***

The remainder of this article is organized as follows. In the second section I develop a formal model in which an agreement characterized by uncertainty may be renegotiated to incorporate new information. The uncertainty is related to the division of gains under the agreement, with the parties resolving this uncertainty over time as they gain experience with the agreement. This form of uncertainty corresponds to the uncertainty experienced by the parties to the international agreement I discuss in detail in the third section. *** In the fifth section I offer conclusions.

MODEL: LEARNING ABOUT THE WORKINGS OF AN AGREEMENT

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In this model an agreement is like an experience good in which a complete knowledge of the effects of the good is gained only by using it. Over time, by observing the outcomes obtained under the agreement and attempting to distinguish the once-and-for-all effects of the agreement from the normal period-to-period fluctuation in outcomes, the parties come to learn with increasing precision the true distribution of benefits created by the agreement.[5]

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[5] There are other forms of uncertainty, and, importantly, states respond to these with alternative flexibility provisions. For example, in the context of economics agreements, the uncertainty is often persistent; states cannot learn once and for all about the division of gains from an agreement because that division is subject to repeated shocks. In such a case, states may follow the example of the G5 finance ministers and have a *series* of finite-duration agreements with renegotiation in between. Koremenos 1999. In a recent study I consider the same environment but with a large number of parties. Koremenos 2000. In such a case renegotiation costs may be prohibitive (since they rise with the number of parties). Hence parties may choose to establish an institution (like the IMF) empowered to adjust the terms of the agreement in response to the repeated shocks. Bordo and Kydland's work on escape clauses during the gold standard addresses a different type of uncertainty: political shocks, such as wars and banking panics. Bordo and Kydland 1995 and 1996. Such uncertainty leads states to incorporate "suspension" mechanisms instead of "adjustment" mechanisms. Downs and Rocke and Rosendorff and Milner consider similar models in a trade context. See Downs and Rocke 1995; and Rosendorff and Milner [2002].

How can states make use of what they learn about the distribution of gains from the agreement? They may choose to make their initial agreement of finite duration, and then "re"negotiate a new agreement when the first one comes to a close. If they do so, they can use the information they have gained through their experience under the agreement to realign the division of gains in the renegotiated agreement. Under certain conditions (made precise below) this planned renegotiation and realignment reduces *ex ante* uncertainty and thereby raises the expected utility of the parties. Put another way, careful selection of the duration and renegotiation provisions allows the parties to conclude efficient agreements (ones that increase the size of the pie available to the parties) that otherwise might fail because of distributional problems.

Of course, states may also be uncertain about the absolute level of gains from a potential agreement. In this analysis I focus solely on distributional uncertainty. My justification is both theoretical and empirical. Uncertainty about the absolute level of gains is probably at least as pervasive as distributional uncertainty. However, what would make absolute uncertainty interesting from the viewpoint of cooperation theory is if its presence precluded any agreement at all. In other words, are there many cases in which there was substantial uncertainty about whether an agreement would produce a net gain and hence in which provisions for limited duration and renegotiation made cooperation possible? The one issue area for which absolute uncertainty might play such a role is the environment. Nonetheless, in that issue area, questions of distribution also loom large.[6] In any event, the distribution question seems at least as important empirically and much more interesting theoretically.[7]

Assumptions

The following assumptions underlie the model:

> States care about the future – that is, their discount factor is not zero.
> States are risk averse.
> There is uncertainty about future states of the world.

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[6] For example, writing about the Convention on Biological Diversity, Raustiala argues that the convention "addressed three (linked) central concerns: the conservation of biodiversity, the promotion of sustainable use, and the equitable sharing of benefits. It is this latter objective, with its clear redistributive implications, that was and remains the cause of much debate." Raustiala 1997, 491.

[7] See also fn. 12 below.

The costs of making agreements completely contingent are sufficiently large that the parties do not ever choose to do so.[8]

There are costs to negotiating (and renegotiating) agreements.

There are costs to reneging on agreements.

States have shared *a priori* beliefs about the information they do not possess, and they revise their beliefs according to Bayesian logic as their interactions evolve.[9]

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Consider the role each assumption plays. If states did not care about the future, they would not bother to conclude agreements. If states were not risk averse, they would always conclude indefinite agreements in order to avoid paying renegotiation costs and would not care *ex ante* about how much the distribution of gains might differ from that originally agreed upon. If there were no uncertainty about future states of the world, there would be no additional information to incorporate through renegotiation, and all agreements would be indefinite in order to economize on renegotiation costs. If agreements could be made perfectly contingent on the realized state of the world, states would do so and thereby save on renegotiation costs by eliminating the need for renegotiation. If negotiation and renegotiation were costless, states would renegotiate every time new information arrived, and all agreements would be of short duration. If reneging were costless, states would renege often (assuming renegotiation costs were not too high) and would be less likely to adopt finite-duration agreements. Instead, they would use reneging as a form of contingent renegotiation within indefinite-duration agreements.

Basics of the Model

There are two prospective parties to the agreement. In the absence of an agreement, each party obtains an outcome every period. This outcome depends on the particular context, but it could represent something like GNP or some measure of military security. Each party has an expectation about what its outcome will be every period – for example, state 1 expects its GNP to be $1 trillion. This is the party's base outcome. Of course, the actual outcome will rarely, if ever, correspond exactly to the base. The

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[8] For a justification of this assumption in the context of the economics literature on incomplete contracts, see the discussion in Hart and Holmstrom 1987.

[9] In Knightian terms, the parties face *risk,* not *uncertainty.*

actual outcome will consist of the base plus or minus some amount. For example, state 1's actual GNP might be $0.9 trillion or $1.1 trillion. I refer to this unanticipated variation as the outcome shock or noise.

I assume the agreement yields a total gain that is known at the time the agreement is concluded. What is not known at that time is how this gain will accrue to the two parties in practice. I assume that the parties can set the expected value of the two shares in the initial agreement.

The division of the gain agreed upon in the initial agreement reflects the relative bargaining power of the two parties. For example, suppose that states 1 and 2 have equal bargaining power and they conclude a joint research venture that will result in a total profit of $25 billion. What cannot be known in advance is exactly how whatever technology emerges from the venture will benefit industry in each of the two states. Initially, each state invests an equal amount, and the parties set the expected gain to be the same for both states, $12.5 billion.

The basic problem facing the parties to an agreement in this model is to sort out the effects of the agreement from other random fluctuations in outcomes. For example, suppose that, after the joint venture is concluded, state 1's GNP is $1.05 trillion. How can state 1 know how much (if any) of the $50 billion increase in GNP results from the joint venture and how much results from an agricultural boom spawned by favorable weather? The answer is that it cannot know exactly, but it can learn over time.

The states face a choice between an agreement of indefinite duration and one finite-duration agreement followed by an agreement of indefinite duration. In the simple two-period case I consider formally, the choice becomes one two-period agreement with no renegotiation or two one-period agreements with renegotiation in between to realign the distribution of gains.

Renegotiation takes place whenever a finite-duration agreement comes to an end. Thus the reservation outcome for both parties in the renegotiation consists of the no-agreement outcome. Essentially, the parties are in the same situation with renegotiation as in the original negotiation except that they have learned something about the realized distribution of gains from the agreement in the interim. Once the parties choose an indefinite-duration agreement, no further renegotiation takes place.

I assume that if and when the parties renegotiate the agreement, they incorporate an adjustment factor that makes the expected gain to each of the parties the same as it was in the original agreement. This adjustment factor takes account of the information gained about the realized value of