Trade, Development, and The Shadow of Dependence: Latin America and the United States in the World Trade Organization

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Abstract: While previous literature generalizes about the dispute trends of developing countries and their limitations to access and utilize the dispute settlement mechanism of the WTO, this project focuses on Latin American participation in the DSM. Latin America is a unique region in that all the countries have been a part of a WTO dispute in some manner, either as a complainant, defendant, or as a third party (Torres 2012). I hypothesize that continued dependence on the US for trade and investment opportunities will restrict how Latin American states behave in the DSM, especially in targeting the US. Utilizing an empirical test, I find that states with preferential trading arrangements with the US are less likely to file a complaint against their large trading partner because the states directly control their trade policies and smaller states fear retaliation. BITs have the opposite effect, in that Latin American states feel freer to target the US since states cannot control FDI flows.

Introduction

While the Dispute Settlement Mechanism (DSM) in the World Trade

Organization (WTO) was purported to be a fair mechanism where all member states

would be able to bring disputes to be adjudicated quickly to continue easing trade

relations in today's globalized world, time has provided a different reality. One

thing that is immediately noticeable in observing DSM behavior is the overwhelming

presence of certain complainant states: the United States (US), the European Union

(EU), Japan, China, Canada, and India. It is also clear that certain states, mainly those

that are classified as developing, are excluded from the dispute settlement process.

Outside of South Africa, no sub-Saharan African countries have engaged in a WTO

dispute. Other developing regions of the world (Central and South Asia, Latin

America, and the Middle East) are marginalized in their use of the DSM.

Previous scholars have examined the reasons why developing countries are

less likely to be involved in formal dispute resolution in the WTO. The consensus

among these scholars is that developing countries lack the resources to adequately

staff a legal delegation at WTO headquarters in Geneva to pursue trade complaints.

These developing countries also are unable to observe and collect evidence against

their numerous trade partners that is necessary to initiate a complaint. However, it

is my critique that the legal capacity argument is only part of why small states are

unable to independently navigate the DSM. It is important to consider the

differences (ie, political, economic, historical, cultural) that exist in the developing

world which may result in various behaviors.

In this project, I focus specifically on Latin America. While, overall, Latin America is considered to be a developing region, there is a large amount of diversity among its countries. Brazil and Argentina are the economic leaders of the region and are bolstered by their membership in the G-20. All the countries are members of the OECD. Torres (2012: 5) claims that "all the countries in the region have taken part in the DSM in one way or another", meaning either as a complainant, defendant or a third-party. It is rare to find a region outside of the developed world where all the countries have participated in the DSM.

While previous scholars have considered domestic characteristics that preclude developing states from using the DSM regularly, I theorize that there are systemic relationships that also affect that propensity. Latin America has been tied to the US inextricably since the introduction of the Monroe Doctrine almost 200 years ago. Because of the economic and political dependence that has grown since then, I theorize that Latin American dispute behavior is very much tied to their relationship with the US as well as their own individual capacities to engage in the DSM. Many states in Latin America have trade agreements with the US, and the US is the main trading partner for many of these states as well. The US has also signed a number of bilateral investment treaties (BITs) with Latin American countries as well. In this paper, I empirically test hypotheses relating to both trade and development ties with the US, expecting that those states that are more likely to depend on the US to represent their trade interests in the WTO are those that have close formal economic ties with the US.

Developing Country Use of the WTO and the DSM

There are three main foci of the literature as to why developing countries are less likely to be involved in the DSM. The first is the legal capacity theory, which argues that developing states do not have the resources necessary to engage in the DSM. The second is that developing states lack governmental mechanisms to communicate and identify possible trade issues. The third is that developing states fear retaliation if they were to target larger states in the DSM, that will negatively impact their trade and development relationships.

A state's legal capacity is defined as its ability "to monitor and enforce rights and obligations" with the WTO and DSM (Busch et al 2009: 560). Legal capacity has been operationalized in a number of different ways since it is defined so broadly. Early studies (such as Besson and Mehdi 2004; Bown 2005) utilize GDP per capita as a proxy value for legal capacity. However, a state's wealth alone does not cover its limitations for participation (Raghavan 2000). Many developing countries do not have a permanent delegation in Geneva, and, of those who do, their legal staffs are not very large or specialized in trade law (Michalopoulos 1999).

States with higher levels of legal capacity are also more likely to be involved in a dispute, as either the complainant or the defendant. Simmons and Guzman (2005) find that states with a lower legal capacity only file complaints when they are certain that they can win. Also, states with a lower legal capacity seem to be more willing to settle a dispute if they are the defendant so they do not become involved in a longer dispute which will be costly. Bown (2005, 2009) finds that states lacking the resources that comprise legal capacity self-select out of DSB

complaint involvement. While technical assistance is provided by the WTO to these states in order to promote full participation (Shaffer 2005), it does not fill the knowledge and resource void that defines the developing world's experience within the DSB (Lacarte-Muro and Gappah 2000). Lesser-developed countries lack the political and economic capacity to act as a "watchdog" over their trading partners, and, therefore, they are more selective about the complaints they choose to file (Simmons and Guzman 2005). In fact, many prefer to join already existing complaints as third parties in order to pursue their trade policy agendas (Busch and Reinhardt 2006; Busch et al 2009).

Since the DSM is not as efficient as originally envisioned, the cost of being able to engage in long and expensive disputes also limits developing country participation in dispute resolution (Butler and Hauser 2000; Fattore 2013b). Originally, the DSM was envisioned to be a quick and efficient way for states to have their disputes settled without disrupting their trade relationships. Instead, what has happened is that disputes drag on for years, making the dispute settlement process more expensive than ever envisioned. If a state does not have the resources necessary to initiate a dispute, it certainly will not be able to follow through with the process of its adjudication. If the WTO were to enforce the original dispute timeframe, states with lower levels of legal capacity may be able to engage more fully in the dispute resolution process, since this could "reduce litigation costs ... by shortening case duration" (Grinols and Perrelli 2006, 617).

The second issue with developing country use of the DSM focuses on their lack of governmental mechanisms to communicate and identify trade issues that

may turn into disputes. States depend on interest groups to identify and help governments build cases against their rivals in the market, whether it is the domestic market or third party markets (Fattore 2012). Domestic firms provide their government "with a strong legal case supported by a detailed factual record….[a government] does not want to waste its resources, impair its international credibility, and tarnish its reputation… by bringing and then losing a weak legal case before the WTO" (Shaffer 2003: 34). In democracies, industry interest groups play an even bigger role in the identification and preparation of WTO complaints (Keohane et al 2000). Developing countries that do not have a strong relationship with interest groups are at a disadvantage. Also, those states that are unable to pursue disputes with the commitment preferred by industry interest groups find themselves without help in identifying trade issues. Instead, multinational corporations will appeal to states that they feel will better be able to represent their interests in Geneva (Fattore and Allison 2013).

Finally, developing states are concerned with retaliation if they file complaints against their wealthier trade partners. Bhagwati (1991) describes this trend as "aggressive multilateralism". While states are committing to more multilateral agreements, they continue to focus on their unilateral well-being. Thus, states have an incentive to use the WTO system to their individual benefit rather than the collective benefit. Because of this unique two-level scenario, national governments find themselves needing to please their domestic constituents while staying committed to their international agreements. Goldstein and Martin (2000) find that states act strategically in regards to the complaints they file in the WTO.

There has also been evidence of retaliatory behavior in the DSM: the banana

disputes involving the US, the EU, and their banana producing trade partners as well

as the major airplane disputes between the US and EU (Boeing vs. Airbus) and Brazil

vs. Canada (Embraer vs. Bombardier) (Fattore 2013a). Therefore, developing states

that lack the resources necessary to be involved in a number of disputes at once fear

that retaliatory behavior could result in hurting their trade relationships as well as

becoming mired in a number of costly trade disputes in Geneva.

Latin American Trade Dispute Trends

While previous literature generalizes about the dispute trends of developing

countries, I plan to delve deeper into Latin American participation in the DSM. Latin

America is a unique region in that all the countries have been a part of a WTO

dispute in some manner, either as a complainant, defendant, or as a third party

(Torres 2012). Latin America also is home to states at various levels of

development. By investigating Latin American trade behavior, it will be hard to

make generalizations about all developing states. Instead, this study will provide

the opportunity to consider the causal mechanism prompting these particular states

to be involved in certain disputes and not others.

The US has been Latin America's largest trading partner throughout the post-

war period. "Washington has now signed free trade agreements with more than a

third of the hemisphere's nations and annually exchanges more than $800 billion in

goods and services with Latin America…" (Regenstreif 2013). Dependency theorists

such as Dos Santos (1970) would expect that these relationships would constrain

Latin American states from challenging US trade behaviors in the region, even if

they were against WTO rules. I expect that Latin American states that have signed

trade agreements and/or bilateral investment treaties (BITs) will be sensitive to the

possibility of retaliation from the US if they were to file a formal trade complaint

against them in the WTO. Therefore, these states will be more tolerant of US trade

behavior.

H1: Latin American states that have signed a trade agreement with the US will be less likely to file a trade complaint against the US in the DSM.

H2: Latin American states that have signed a BIT with the US will be less likely to file a trade complaint against the US in the DSM.

The only Latin American state that would be the exception to these

hypotheses is Mexico. While Mexico has been a member of NAFTA since its creation

in 1994, the dispute settlement mechanism for that trade region is not as strong as

the one that is found in other trading arrangements, such as the EU. Therefore,

Mexico (as well as Canada and the US) have turned to the DSM to settle their

regional trade disputes. Gantz (1999) has pointed out why NAFTA states seem to

prefer the DSM to their own dispute mechanisms. First, under NAFTA, the Free

Trade Commission that is formed to hear complaints is virtually composed of the

disputing parties, while, in the WTO, there is not such an overwhelming bias in the

body that considers disputes. Second, when compared to the NAFTA dispute

settlement system, the WTO's DSM is much more efficient. Finally, "there is …

stronger pressure for compliance under the WTO" (Gantz 1999: 1084) where there

is not under NAFTA.

H3: Mexico will be more likely to file a trade complaint against the US in the DSM due to the lack of efficiency and parity in the NAFTA system.

Due to the low participation of certain states as complainants in the DSM, these hypotheses may not give a complete picture of Latin American dispute behavior. In an effort to delve deeper into this question, I also test hypotheses regarding third party behavior. While Torres (2012) claims that all Latin American states have participated in the DSM in one way or another, it is not surprising that it is not as a complainant but as a third party to a dispute filed by another (usually larger and more powerful) state. While I hypothesize that states with trade and investment ties to the US will be less likely to file complaints against it, I expect that, when the US files a complaint, Latin American states will be more likely to join that dispute as a third party. While smaller states may be concerned about retaliation for dispute initiation, joining a dispute as a third party will reinforce their ties and commitment to trade and investment from the US.

H4: Latin American states that have signed a trade agreement with the US will be more likely to join a dispute as a third party if the US is the original complainant.

H5: Latin American states that have signed BITs with the US will be more likely to join a dispute as a third party if the US is the original complainant.

Data and Methods

In order to test the hypotheses presented in a previous section, I will utilize data provided by the WTO regarding disputes filed by Latin American states targeting the US between January 1, 1995 and December 31, 2009. The unit of analysis for the dispute initiation model is the dyad-year. If, during a single year, the state has filed more than one dispute against the US, that year appears twice in the dataset. If no or one complaint has been filed during a given year by a single state, then that year appears only once.

The dependent variable is a simple dichotomous variable measuring whether a dispute has been initiated (coded 1) by a Latin American state against the US during a given year or no complaint has been filed in the DSM (coded 0). The data was coded using information from the WTO's Chronological List of Dispute Cases that is available online. Out of the 301 dyad years, only 8.6 percent of them have disputes initiated against the US. This illustrates how rare it is for a Latin American state to be engaged in a dispute against the regional hegemon.

The main independent variables focus on trade and investment relationships with the US. The first variable is a dichotomous variable for the presence of at BIT between the Latin American country and the United States (coded 0 if there is no BIT and 1 if there is). This variable is coded using information from the Office of the US Trade Representative. There are only a handful of Latin American states that have signed BITs with the US: Argentina (since 1994), Bolivia (from 2001-2011), Ecuador (since 1997), Honduras (since 2001), Panama (since 1991), and Uruguay (from 2006).

The second hypothesis is tested using a variable for a preferential trade agreement (PTA) with the US. It too is a dichotomous variable, coded 0 if the state does not have a trade agreement with the US in a given year, 1 if it does. This variable is also coded using information from the Office of the US Trade Representative. With the ever-expanding CAFTA-DR agreement, many more states have signed trade agreements with the US than they have BITs. These states include Chile (which signed a free trade agreement with the US in 2004), the CAFTA-DR states (Costa Rica, 2009; Dominican Republic, 2007; El Salvador, 2006; Guatemala,

2006; Honduras, 2006; and Nicaragua, 2006), and Mexico, which has been a member of NAFTA since its creation in 1994. Peru signed a trade promotion agreement with the US in 2009 and is included in this dataset as well. The final hypothesis is tested using a simple dummy for those observations containing Mexico in the dyad. I expect the BIT and trade agreement variables to have a negative effect on trade dispute initiation, while the Mexico variable should have a positive effect.

The control variables included in this model describe the Latin American state as well as its trade reliance on the US. The first control variable is the democracy score for the Latin American state. Democratic states are more likely to be involved in a trade dispute (Simmons and Guzman 2005). The logarithmic change of the Latin American state's GDP per capita is used as a proxy measure for the state's legal capacity. While not a superior proxy, GDP per capita has been used quite often in the dispute literature (Bown 2005; Besson and Medhi 2004). Wealthier states are able to participate fully within the DSM when compared to their less wealthy counterparts and are more often involved in WTO disputes (Simmons and Guzman 2005; Bown 2005, 2009). I expect legal capacity to have a positive effect on dispute initiation. GDP per capita is measured in current US dollars (prior to the logarithmic change) and is taken from the Penn World Table (Heston et al 2006). Also, I expect bilateral trade to have a negative effect on the probability of a dispute progressing to higher levels of dispute resolution. A dyad with a high level of bilateral trade may be more willing to either negotiate a settlement or accept a panel or appeal decision, in order to avoid disrupting current and future trade. This

is coded using data from the International Monetary Fund's Direction of Trade database, and is measured as the total imports and exports between country X and Y.

I expect disputes with a focus on "complex" issue (such as agriculture or a politically sensitive issue such as national security or environment regulations) will be more likely to lead to a formal complaint being filed in the DSM. A complex issue is coded 1 in this dichotomous measure. This operationalization is borrowed from Busch and Reinhardt (2006). Finally, a count variable is included to show how many years have past since the founding of the WTO and the DSM. I expect this to have a positive effect, as states will become more familiar and knowledgeable about the DSM and its workings.

I will estimate a logit using the following model:

Dispute initiation= f (BIT agreement, PTA, Mexico dummy, initiator demscore, initiator GDP per capita, trade dependence, politically sensitive issue dummy, years since 1995)

In order to test the two hypotheses regarding third party participation, I will use a different dependent variable to test against the independent variables that are already used in the first model. Hypotheses 4 and 5 lay out the expectation that Latin American states will be more likely to be a part of a dispute as a third party if the US initiates the dispute. Considering that the US initiated 94 disputes between 1995 and 2009, there has been plenty of opportunity for Latin American states to join them as a third party. The unit of analysis for this second model is each dispute initiated by the US between 1995 and 2009. The dependent variable is whether a given Latin American state has joined the dispute as a third party (coded 1 if the

state does, 0 if the state does not join). The information from this variable is derived from the WTO website.

The independent variables of interest are the same as in the previous model: a dichotomous variable that identifies whether a Latin American state has a BIT with the US and another variable for a PTA. The control variables included in the third party model that are derived from the initiation model include the log of the GDP per capita of the Latin American state, the same state's Polity score for democracy, and its trade dependence on the US. I also include a few new control variables about the target of the US complaint: a dummy variable for a EU or China target (acting against a more powerful state through the US) and a dummy variable that is coded 1 if another Latin American state is the defendant.

I will estimate a logit using the following model:

Third party participation= f (BIT, PTA, EU target, China target, Latin American target, initiator demscore, initiator GDP per capita, US trade dependence)

Results

The results for the dispute initiation models are presented in Table 1. Model 1, which includes all the main independent variables, illustrates that none of the first three hypotheses are supported. Hypothesis 1 concentrates on the relationship between those Latin American states who have signed a trade agreement with the US and whether that makes them less likely to file a trade dispute in the DSM against the US. While the coefficient for this variable is negative (in the predicted direction), it is statistically insignificant.

The propensity for a Latin American state with a BIT signed with the US is the focus of Hypothesis 2. While this variable's coefficient is statistically significant,

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it is positive, meaning that those states with US-based BITS are more likely to file a dispute against the US. This is an interesting result, considering that many small states fear retaliation. While I conceptualize dependence in this paper as trade as well as dependence on foreign direct investment, it becomes obvious that small states may fear trade retaliation, but not retaliation regarding investment opportunities. This may be due to the fact that states themselves do not directly invest, but instead, facilitate investment. While states can discourage investment in certain places, they cannot directly impact investment in the way they can trade (by putting up tariffs, quotas, and other protective barriers).

Finally, Hypothesis 3 claims that Mexico has a higher propensity to initiate a dispute against the US in the DSM because of the weakness of the NAFTA dispute settlement mechanism. Model 1 does not support this hypothesis. While the coefficient for the variable is in the predicted direction (positive), it is not statistically significant. In regards to this hypothesis, I feel as though the empirical model itself is extremely limited in that it does not necessarily get to the root of the numerous disputes between Mexico and the US in the WTO, as well as the true weakness of the institutional structure of NAFTA. This relationship would be best examined via case study, which will be discussed later.

In Model 2, I decide to drop the Mexico dummy in order to concentrate on generalities across Latin America. Therefore, I focus in on Hypothesis 1 (PTAs) and Hypothesis 2 (BITs). Fourteen of the twenty states included in this study have either signed a trade agreement with the US or a BIT. However, only two states (Honduras and Panama) have signed both. This is important to highlight that these

are two distinct groups of states. While the substantive results for Model 2 are not that different from Model 1's results, both Hypothesis 1 and 2 are supported due to the statistical significance of their coefficients. While Latin American states with BITs with the US are more likely to file complaints against the US in the WTO, Latin American states that have signed trade agreements are less likely to file a complaint against the US. As discussed earlier, this is due to the direct impact that a state has on trade retaliation while states can indirectly coerce their corporations not to invest in another state.

Both models provide similar results for the control variables. Latin American states that are more democratic have a higher probability of initiating a dispute in the DSM, supporting Simmons and Guzman (2005). States with higher levels of bilateral trade with the US are also more likely to initiate a dispute against the US. Obviously, when there is more trade, there is more opportunity for disagreements to arise among those states. Interestingly, the more years that have passed since the WTO's founding in 1995 decreases the probability of a Latin American state to file a dispute against the US. I had expected the opposite, in that it took time for smaller states to get used to the WTO's institutional structure and the workings of the DSM. However, it seems as though Latin American states jumped at the chance to bring their complaints as soon as the DSM was open for business. Two of my control variable are statistically insignificant. First, I expected that disputes centered around a politically relevant topic (such as agriculture) were more likely to result in a formal dispute. While this coefficient was not statistically significant, it was in the predicted direction. Finally, the GDP per capita of the Latin American states

negatively affected its chances of filing a dispute against the US.   In this model, the legal capacity of Latin American states did not have any affect on the model.

The results for the third party participation model are presented in Table 2. Neither Hypothesis 4 nor Hypothesis 5 is supported by the results of this model. However, by examining the substantive effects of their coefficients, it is obvious that there are similar results to what we find in the initiation model. States that have signed BITs with the US are less likely to join a dispute that the US initiates as a third party, while states that have signed a trade agreement with the US are more likely to join as a third party. Again, this supports the revelation that trade ties have a strong effect on following the US's agenda in the WTO rather than FDI, because of strong state regulation of trade and weak regulation of investment.

The target dummies also provide interesting results. Both the China and EU variables are statistically significant, meaning that Latin American states are more likely to act against other large states through US-initiated conflicts. Busch and Reinhardt (2006) claim that smaller states join disputes as third parties to guarantee that the complainant and defendant consider the global implications of their negotiations and possible resolution (rather than just the bilateral implications and benefits).   This certainly seems to be happening in the Latin American case. However, the Latin American target dummy is statistically insignificant, but, substantively, it is positive and falls in line with the other target variables.

The final set of control variables focus on the Latin American state's characteristics. Interestingly, states with higher levels of GDP are more likely to join a dispute as a third party in the Latin American context. This contradicts Bown's

(2005) findings that states with lesser levels of development are more likely to join as third parties. Higher levels of trade dependence on the US leads to a greater propensity for Latin American states to join as third parties. Finally, the Polity score of Latin American states were statistically insignificant.

Conclusion

In this paper, I explore how economic dependency on the US affects Latin American behavior in the WTO's dispute settlement mechanism. I conceptualize dependency as formal agreements between the US and the Latin American states included in this study, mainly focusing on preferential trading agreements or bilateral investment treaties. The main finding that emerges from this study is that formal trade agreements creates an environment where these Latin American states are more likely to support the US agenda in the DSM. They do not target the US for its trade behavior, and they are more likely to join disputes as third parties if the US initiates. States that have signed BITs with the US are less restricted in their actions in the DSM. They are more likely to file complaints against the US in the DSM, and are less likely to join US-initiated disputes as a third party.

I theorize that this occurs because states control trade relationships (and in a way, the means for retaliation) and that states do not have as much control over FDI. A state can be quick to retaliate through trade, by throwing up trade barriers against that state. However, FDI occurs at the transnational level. States can encourage investment in certain areas through the signing of BITs, but it is truly up to transnational corporations to decide when, where and how much they invest.

Because Latin America is an extremely diverse region, economically, culturally, and historically, there are regional nuances that are lost in this large statistical study. Therefore, the next step in this project will be to examine different groups of Latin American states. I expect that there are differences on US dependency across Latin America, and that will have an impact on how the US affects their behavior in the DSM. I plan on focusing on three distinct groups. The first is the group of South American "leaders": those states that are moving away from the economic shadow of the US and are crafting economic (trade and investment) relationships with China and the EU. The second group are the Central American states that are much more dependent and connected to the US in terms of trade and investment. Finally, Mexico will be my third case study, as it is the only Latin American member of NAFTA. Mexico is cooperative with the US through a preferential trade relationship but the institutional failures of NAFTA creates the illusion of Mexico being aggressive towards the US in the DSM.

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Table 1: Effects of PTAs and BITs on Latin American WTO Dispute Initiation Against the US

Variable	Model 1 Coef. (S.E.)	Model 2 Coef. (S.E)
BIT	1.9392** (0.9411)	1.9740* (0.9295)
PTA	-13.8728 (969.7329)	-3.3818** (1.3166)
Mexico	10.5719 (969.734)	---
Democracy	0.6566** (0.2815)	0.6597** (0.2818)
Trade dependence	2.1239*** (0.5378)	2.1549*** (0.5211)
Years since 1995	-0.1891** (0.7411)	-0.1914** (0.0735)
Politically sensitive issue	0.6113 (0.8588)	0.6050 (0.8600)
GDP per capita	-0.2512 (0.7119)	-0.2672 (0.7068)
Constant	-24.3339*** (6.1915)	-24.5136*** (6.1475)
N	301	301
Chi2	68.88***	68.80***
Pseudo R2	0.3891	0.3886

* $p>0.05$, **$p>0.01$, ***$p>0.001$

Table 2: Effects of PTAs and BITs on Latin American States Joining US-Initiated WTO Disputes

Variable	Model 1 Coef. (S.E.)	Model 2 Coef. (S.E)
BIT	0.0306 (0.3881)	-0.0689 (0.3895)
PTA	0.5601 (0.3690)	0.3909 (0.3808)
EU target	---	0.6063* (0.3790)
Latin American target	---	0.6279 (0.4449)
China target	---	1.0597** (0.4591)
GDP per capita	0.8490*** (0.2376)	0.7544*** (0.2343)
Democracy	0.0275 (0.0564)	0.0288 (0.0558)
Trade dependence	0.0118** (0.0045)	0.0112** (0.0044)
Constant	-10.5832*** (1.9112)	-10.2877*** (1.8951)
N	1811	1811
Chi2	30.59***	36.47***
Pseudo R2	0.0630	0.0751

* p>0.05, **p>0.01, ***p>0.001