

International Arbitration, Efficiency and Domestic Politics

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ABSTRACT

Why do powerful players in the international system make concessions? Why do they accept binding institutions? First this paper argues that domestic politics often sets the stage for negotiations and structures the character of the final agreement. Second the paper shows how dispute settlement institutions may be adopted in order to resolve intractable elements in the negotiations. Such mechanisms are not necessarily adopted in order to reduce transactions costs, instead they are a vital part of an overall package in which costs and benefits need to be very carefully distributed among parties to the agreement. In short, there exists a set of international bargains dominated by distributional conflict that touches on domestic political coalitions, in which institutions play an important role in settling domestic political claims. Two bi-lateral, asymmetric bargains--the Free-Trade Agreement between the U.S. and Canada and the Jay Treaty between the U.S. and Great Britain--exhibit properties consistent with both of these claims. The analysis and evidence suggests that issues narrow in scope and one-sided in payoffs are candidates for DRMs, and that domestic institutions decide the effectiveness of enacting coalitions.

Introduction

On January 2, 1988, Canada and the United States signed a wide-ranging Free-Trade Agreement (FTA). This treaty was the result of energetic Canadian efforts to forestall what was perceived to be a rising tide of unilateral protectionism by their powerful neighbor to the South. In the event, the agreement yielded some shelter to Canadian interests in specific issue areas. In particular, as Goldstein (1996) has persuasively demonstrated, the establishment of bi-national dispute settlement panels shifted outcomes in U.S. anti-dumping (AD) and countervailing duties (CVD) cases in favor of Canadian defendants.

It is not surprising that Canada should have desired such a treaty. The concession on trade law was an important one, hampering the efforts of powerful political interests—for example, the U.S. lumber industry—to obtain special protection. Of course, Canada too would have to make concessions—some domestic interests would win, others lose. However, on balance this must have yielded political gains for the government. What requires explanation is why the U.S. acceded to it. The U.S.-Canadian relationship is obviously an asymmetric one. Why didn't the U.S. trade on this asymmetry and obtain its first preference—no binding dispute settlement—without troubling with concessions of its own (by means of credible threats of exclusion from U.S. markets, for example)? Goldstein shows clearly how the preferences of the executive branch in the U.S. shaped the composition of the bi-national panels, which had the effect of shifting outcomes away from protectionism. But what is less effectively explained is why the legislative branch in the U.S., which had to vote on the treaty under fast-track authority, accepted the treaty, and the panels that were part of it, in the first place.

Goldstein observes at first that dispute settlement under the FTA was a “weak” international institution, but she goes on to demonstrate its effectiveness. The dispute settlement elements of the treaty derive their strength from the way in which U.S. domestic law is enmeshed in international treaty obligations and institutions (see Keohane 1996). Surely members of the U.S. Congress could have anticipated

this effectiveness? As it stands, either the House was myopic, and so allowed the executive branch to pull a fast one, or its preferences weren't as protectionist as supposed—in which case the institutional device of bi-national panels would have been a complicated way to obtain what the Congress was willing to concede directly—reform of U.S. trade law.

The first purpose of this essay is to offer a straightforward domestic politics explanation for why the U.S. accepted the agreement, and the bi-national panels incorporated into it. I will go on to show how this explanation also seems to work in another case of bi-lateral bargaining under conditions of acute asymmetry in power—the Jay Treaty between the U.S. and Great Britain in 1794. Great Britain granted small but significant concessions to a remote and powerless actor not because it was unwilling to play rough in international politics—the oligarchy that governed Britain throughout the 18th. Century was at least as greedy and violent as any regime in the early modern state system—but because a coalition of domestic interests with political influence were able to obtain narrow gains from the treaty while imposing costs on others within the U.K.. What is also interesting to note is that here too bi-national panels with very similar characteristics were adopted in order to resolve intractable elements in the negotiations.

It is understanding the role played by these panels that is another purpose of this essay. Understanding them will clarify an under-appreciated aspect of the role played by Dispute Resolution Mechanisms (DRM) in international political exchange. A review of the literature on international cooperation reveals a common but consequential tendency to treat in an undifferentiated way both the general gains from political exchange—made possible by combined treaty provisions of all kinds—and the specific efficiency gains made possible by DRMs (where there exist transactions costs due uncertainty and the danger of opportunism). Just because arbitration mechanisms abound in the international community, it should not necessarily be imagined that they are a response to a functional need to reduce transactions costs (just as lots of compliance may not mean that there is lots of effective international cooperation occurring, see Downs, Rocke and Barsoom, 1996). They may just be one part of a larger package in

which costs and benefits, about which there is no uncertainty, are more or less finely allocated.

The argument is a simple one. Efficiency and distributive considerations exist simultaneously in the minds of anyone negotiating an agreement. On one hand, most agreements represent explicit political trades, in which uncertainty may be at a minimum. Governments tweak their negotiating proposals in an effort to maximize the return to their supporting coalition, bearing in mind what they believe the reservation point of other governments to be (international bargains of this kind are, therefore, coordination rather than cooperation problems—see Morrow 1994). Does this increase world welfare, or national welfare, or the level of subsequent political and economic exchange? Maybe, but maybe not—that is irrelevant—all they must do is, in one instance, increase the *political* welfare of each governing coalition. (In other words, if we imagine exchange between two countries to be described by an n dimensional pareto frontier, it is possible for contracting governments to jointly agree on a shift *along* the frontier which nonetheless yields political gains to each of the coalitions within each country).

On the other hand, agreement (of whatever kind) may indeed be made more likely because the institutional arrangements incorporated into it reduce uncertainty for future exchanges of all kinds—in other words, make possible a move *towards* the pareto frontier. Costs are reduced because institutions are adopted which supply information and enforcement to the contracting parties. This increases the level of transactions between the principals, and everyone is better off. In the issue area of trade, for example, most agreements, and their associated institutions, have—in part—this property (see, for example, Smith 2000).

In summary, governments enter into exchange in order to get stuff (in other words, for (re)distributive reasons) and to that end an important role *may* be played by institutional arrangements that help governments by lowering transactions costs, so yielding mutual gains in welfare. Every one knows this (or they should do). Martin and Simmons (1998, 745) put it quite clearly: “In most circumstances, governments have simultaneously to worry about reaching efficient outcomes and resolving distributional

conflict'. The claim here is that there exists a (surprisingly) large set of cases in which distributional conflict is almost all that matters. Further, that institutions may play a role in settling distributional claims, institutions which, therefore, serve no "efficiency" purpose in the sense of reduced transactions costs. For example, arbitration may not be adopted with a view to increasing the level of exchange, but rather so that the existing gains from trade are allocated in a perfectly foreseeable way. This in turn may make a larger agreement viable (wherein lie the gains for the enacting coalition).

If it is true that the DRMs incorporated into the U.S./Canadian FTA or into the Jay Treaty were merely devices to help allocate the payoffs from a wide-ranging and perfectly understood political exchange, then the puzzle identified at the beginning becomes more acute. Even in the presence of acute power asymmetries it may make sense for both sides to accept arrangements that lower uncertainty/transactions costs. But I argue as a matter of fact that the institutions adopted in each case did not have that purpose. So why would the powerful accept any agreement, under conditions of certainty, that was much less than one-sided? As suggested, the answer lies in the way the distributive elements in the agreement touched the domestic coalitions that supported the governments in question. Each government contrived to juggle payoffs so as to earn net political gains. This was difficult to do—even under conditions of wide-ranging issue-linkage. It is in these kinds of situations, I argue, that institutions can play a role. The international institutions adopted allowed for the finely calibrated division of payoffs among domestic interests, in such a way as to make international agreement viable. In other words, they allowed governments to divide the political pie into smaller, more carefully measured slices.

In summary, while these are two cases in which, at first glance, power and/or the need to lower transactions costs might appear to play an important role, it turns out that something else was really going on. Domestic political payoffs, and the ability to adjust them by means of an external commitment and its associated institution, tell the whole story.

The paper that follows falls into three parts. I begin with a short discussion of the existing state of theory as it applies to these questions. The goal is to show the way in which existing approaches have tended, unintentionally, to commingle the two different aspects of international negotiations—distribution and efficiency—and, as a result, mis-diagnose the institutions to which they give rise. I go on to report in a telegraphic manner on two revealing episodes in international politics in which a significant power asymmetry existed, but in which, nonetheless, political exchange occurred. In each case the link between the establishment of DRMs and domestic politics was clear. Furthermore, the role played by distributive considerations was all that mattered. Finally, based on the discussion of these two cases I develop some tentative hypotheses about the relationship between domestic politics and some kinds of international institutions that could serve as the basis of future research.

Exchange and Efficiency

All political exchange is efficient, in the sense that it yields *political* gains for the enacting coalitions. For the purposes of this essay I will draw a distinction between the efficiency of realizing a well-understood, one-shot exchange, and the efficiency realized by lowered transactions costs for a series of uncertain exchanges in the future (the gain from strict as opposed to diffuse reciprocity). In the first case distribution and information are crucial, in the second (which must be preceded by an agreement of the first kind—see Morrow 1994, 388) monitoring and enforcement are crucial. This distinction will serve to highlight an important point about the existing state of scholarship on international exchange and cooperation and international institutions—that it has tended to focus on efficiency of the latter sort, with its emphasis on transactions costs and mutual gains.

No one enters into an agreement with a view to the mutual gains involved. They want to get stuff for themselves. To that end it is regrettable but necessary to make concessions to others. As a result, as Adam Smith showed, mutual gains are the unintended consequence of the desire of individual gain. What is striking is that while this is very straightforward, and perfectly well-understood, scholars often

slip into the habit of using mutual gain and individual gain interchangeably as objects of policy—see, for example, the otherwise excellent discussion of exchange and cooperation in Milner (1997, 8). This in turn leads to a tendency to assume that in a world of unrealized mutual gains it is transactions costs—rather than mere disagreement—that limit international cooperation. Or, that where we do observe international cooperation it is because these costs have somehow been overcome. It is but a small step then to assume that international institutions, therefore, are very often adopted because of their function in reducing transaction costs.

This functional view of institutions argues that DRMs (usually some kind of supranational court) provide monitoring and (weak) enforcement services. They monitor government compliance with agreements by collecting information from private or public actors who bring cases before them, and then make more or less binding judgements on the questions in dispute. In fact, by providing information, they can promote compliance even in the absence of effective enforcement capabilities. First, the knowledge that compliance information will be distributed to other governments deters defection from the agreement (see Garrett and Weingast 1993). Second, other governments can practice retorsion, making judicial action unnecessary (it is likely that the possibility of legal retaliation gave GATT panels their effectiveness—see Krugman 1995). In summary, uncertainty about who is cheating, and about the consequences of cheating, is moderated by DRMs, so yielding efficiency gains to all concerned (for a summary of this approach in international politics see Pollack 1997).

Downs and Rocke (1995) discuss another important way in which uncertainty has consequences for the kinds of international institutions adopted. They note that political environments change, coalitions shift, and commitments that might have been politically efficient at one point in time may become a liability at a later stage. Moe (1990) has observed that political institutions are adopted so that policies may outlive the political control of the enacting coalition. Downs and Rocke take this in a slightly different direction by showing how “imperfect” institutions allow an enacting coalition to adjust to turbulence in the political environment. States can escape, if necessary, from GATT obligations, but

will not have the incentive to do so unless domestic political pressure has passed some threshold. Nevertheless, the bottom line is that even admittedly imperfect institutions yield some efficiency gains to all concerned.

Of course, while this kind of efficiency (the reduction of transaction costs) pre-occupy scholars who study international institutions, others in international politics, to say nothing of those interested in domestic politics, often assume that distributive questions are the only ones motivating political entrepreneurs. If we assume that international politics, and international institutions, are a function of domestic politics, then it may make sense to drop a pre-occupation with transactions costs, monitoring and compliance in favor of more old-fashioned questions of who gets what. And indeed, scholars now commonly recognize the mutual entanglement of international and domestic politics.

Governments want to establish international regimes that benefit their constituents and increase the likelihood of re-election, regardless of any aggregate welfare gains (this is consistent with the endogenous tariff literature, see Nelson 1988). By establishing a policy, and its associated payoffs, by means of an international regime, the policy becomes more difficult to alter nationally since altering the policy requires the agreement of several governments. A government can always withdraw entirely from the institution, but this option is more costly if the international reputation of the government is damaged or the institution has developed a constituency that will protest the government/s withdrawal. Under this reasoning, the regimes and their institutions may serve a subtle combination of purposes, in keeping with the logic proposed both by Moe and by Downs and Rocke. On the one hand they bind national governments to policies even after the majority that established the institution has lost power. On the other hand, privileged constituents know that whatever the character of future governing coalitions, escape clauses exist in the event that commitment becomes too perilous given changes in the underlying environment.

In other words, instead of being concerned with the cooperation of multiple governments in supplying

the collective good of lowered transactions costs, institutions are solutions to domestic political problems. While searching for domestic compromises, policy makers sometimes choose to involve the international arena. If international institutions do include gains in “transaction efficiency”, so well and good. These gains may provide further benefits that help make domestic compromises work. In this situation policy makers are probably more willing to invest the resources necessary to create those institutions that offer general welfare gains as well as “sticky” solutions to distributional political dilemmas. However, the argument of this paper is simply that the prospect of such gains by no means governs the attitudes of the relevant actors.

One reason why gains in “transaction efficiency” are not as common an object of policy as supposed may be explained, in part, by a tendency to conflate different kinds of uncertainty in international politics. There is the uncertainty provoked by the danger of opportunism—as discussed above—moderated by appropriate institutions. However, there is another kind of uncertainty common in international politics, the uncertainty provoked by the existence of multiple equilibria in any complex bargaining space. Institutions may help to resolve these dilemmas by providing a stable and legitimate focal point, so locking in a particular set of distributional arrangements. In this case, parties to the contract exchange information and reveal preferences (cautiously and strategically) until an equilibrium is identified which yields payoffs to both coalitions—remembering always that what may be good for an enacting coalition may be welfare reducing for a country as a whole, to say nothing of world welfare. In this case the institution isn’t adopted until uncertainty has been reduced. Its adoption then ensures a stream of expected payoffs in the future.

Institutions also have a role where there is no uncertainty for the contracting parties. They may induce equilibrium outcomes not available in the absence of an institutional environment—in other words increase the set of possible outcomes. The appropriate division of payoffs between contracting parties might be too time-consuming, complicated, or politically risky to be accomplished by the terms of the contract itself. Delegation to an institution may make such fine division possible—that is what will be

argued below. However, when institutions address these aspects of incomplete contracting it is important to note that there may be no uncertainty about the balance of outcomes. For example (as in the case of the FTA bi-national panels) those agreeing to their establishment may well have anticipated quite accurately the specific percentage of CVD cases that U.S. interests would subsequently lose. They simply didn't know who, exactly, the losers were going to be—convenient of course, should it be necessary to shift blame.

Finally, the example of a limit case in international exchange where no uncertainty and no institutional innovation played a part is instructive. Consider one of several issue-areas which have played a prominent role in regional trade in North America; rules of origin for auto production. Under North American Free Trade Agreement (NAFTA) rules the origins of 69 components included in autos during assembly must be traced back through original equipment manufacturers and, in turn, through their sub-contractors and sub-sub-contractors, so as to ensure that 60% North American content is guaranteed (Hufbauer and Schott 1993, 40-43). Hundreds of pages in the agreement cover these issues, establishing the value-added by components at each stage in the assembly process. And yet this is designed to be an improvement on the “roll-up” provisions of the U.S./Canadian FTA! To be sure autos are an especially sensitive issue area, but it is powerful evidence that when it really matters negotiators know exactly what the payoffs are likely to be from any particular proposal, and are willing to go to great lengths to eliminate uncertainty in an agreement. In short, sometimes even in very complicated cases they don't rely on *ex post* governance but rather make bargains the hard way, by sweating the details.

In summary, a continuum of international agreements exists, running from the limit case where only distributive consequences matter, to situations where the political value of the agreement—the distributive payoff—is closely linked to reductions in transactions costs. That is to say, there is a continuum which runs from agreements where bargaining is over movements around the pareto frontier, to bargains that move both countries towards the pareto frontier. Because of the tendency to view the reduction of

transactions costs as a commonplace goal, it is therefore also assumed that the many institutions observed in international politics are serving the latter goal. One of the important points of this essay is that there are good theoretical reasons why institutions might help even where distributive conflicts and certainty predominate.

The other important point is that domestic politics may play such an important role in international agreements that obvious power asymmetries, the kind of consideration that past generations of international relations scholars would have assumed to be crucial determinants of outcomes, can't explain important elements in the agreement, or even the fact of the agreement itself. This suggests that the international level of analysis should be turned to only after a thorough examination of the constellation of domestic political forces—the reverse of what is still often the case.

In summary, neither realism (with its emphasis on power) nor neo-liberal institutionalism (with its emphasis on transactions costs) can help to explain some important kinds of international agreements. Both approaches make claims about the general conditions governing the conduct of international politics—the constant possibility of conflict, or the common interest in efficient transactions—that neglect the importance of the domestic distributional consequences of agreements. That is where the analysis in this essay begins.

The U.S./Canadian FTA.

The preparations and negotiations over the FTA began after a new Canadian Prime Minister, Brian Mulroney, met President Reagan at a summit in March 1985 (what follows relies, in part, on Hart 1994).¹ While the gains to be had from free trade featured prominently in the political rhetoric, it was Canadian fears of the direction being taken by U.S. trade policy which prompted the Prime Minister to act. In the U.S. a restive and protectionist legislative branch was in the process of trying to recover some of the control over trade policy delegated in the past to the executive branch. In response, in an

effort to defuse these pressures, the executive more vigorously than ever employed trade remedy law to defend sectoral and regional interests. The U.S./Canadian trading relationship was in danger of being damaged by policies aimed at Japan and the European Union.

At the heart of the trade law dispute were U.S. Countervailing Duties (CVD) and Canadian subsidies. For U.S. negotiators, CVDs represented a device by which specific interests, and their legislative representatives, could obtain protection without seriously undermining GATT obligations (from which U.S. trade law was exempt). The Canadians believed that these laws were reviewed by judicial bodies—the U.S. Court of International Trade and the U.S. Court of Appeals for the Federal Circuit—that were far too deferential to U.S. agency (i.e. Commerce department) determinations. For Canadians the subsidies, against which the CVDs were often aimed, served to cement a crucial political network of inter-provincial transfer payments. This in turn made free-trade a campaign issue in provincial elections—for example the election in Ontario in the summer of 1988. In short, domestic politics, and domestic institutions, served to seriously restrict the winset for each of the principals doing the negotiating.

The bargaining problem for Canadian negotiators was that while Canada and the US were each others largest trading partner, the relationship was asymmetric. Eighty percent of Canadian exports entered the US market where only twenty five percent of US exports were directed to the Canadian market (Goldstein 1996). Under these circumstances it would be hard to get the U.S. to make significant concessions unless a very wide-ranging set of issues were addressed at once, so allowing for a variety of political exchanges that would engage all kinds of interests within the U.S.. This was the strategy adopted by Canada.

For the U.S., the negotiations meant that some outstanding issues could be addressed, and an agreement obtained that would have a demonstration effect for the Uruguay round of multilateral trade negotiations. This proved to be significant. The interests involved in financial services and international

investment had a lot at stake in proposals for change in the multilateral trade regime. The Uruguay round was to represent a fundamental shift in the scope of issues under the jurisdiction of the international trade regime, to say nothing of the DRMs to be incorporated into it. Concentrated interests with a strong claim on the executive and some members of the U.S. senate—for example Senator D'Amato—had intense preferences over openness in finance and investment with Canada.

Among the issues which remained on the table until the end of very protracted negotiations (October, 1987) were the following: a regime to control subsidies and a new basis for the application of U.S. law in anti-dumping (AD) and CVD cases, a variety of customs matters (technical standards, fees etc), trade in services, intellectual property, investment, and a variety of sectoral issues such as agricultural subsidies and quotas, horticulture, autos, alcoholic beverages and soft lumber (a longstanding problem).

However, the set of Canadian preferences and the set of proposals capable of being accepted by the Congress would only overlap if the agreement was very carefully calibrated. Canadian preferences were for a free trade area with complete exemption for Canadian goods from U.S. trade law first, no free trade area second, and a free trade area without any exemption third (Hart 1994, 297-308). With the Canadians unwilling to make a deal at any price—that is a deal without exemptions—a free trade area agreement would not have been possible given U.S. preferences. The U.S. preferred a free trade area without exemptions first, but no free trade area to a free trade area with exemptions.

In this situation, the DRM had the effect of expanding the win set of the contracting governments to create an overlap of policy preferences. The Canadian negotiators altered their demands for restrictions on US trade law from exemption to an alternative DRM that could evaluate US law impartially (there was no hope of getting an agreement that directly restricted U.S. legislation). In other words, a new possibility—no exemptions but supra-national judicial administration—was now acceptable over no deal at all. The US first preference continued to be for a free trade area without any DRM covering

countervailing duties and anti-dumping restrictions—would they accept a DRM administering U.S. laws rather than no deal at all?.

The U.S. tested whether the Canadians would accept no free trade agreement over an agreement without shelter from U.S. law by refusing throughout to consider the issue of dispute settlement. The Canadians signaled their preference by breaking-off negotiations very close to the deadline (which was a function of the expiration date of fast-track authority for the U.S. executive)(Hart 1994, Goldstein 1996). Only then did the political principals—in particular James Baker, the Treasury Secretary—become involved, and it was then that the US finally met the Canadian demands for a supra-national panel that would be able to make “binding” decisions over the interpretation of U.S. national law for countervailing duties and anti-dumping legislation. The panel was given the capability to offer limited remedies to private actors, and further appeals were very difficult. In addition, the costs of appeal were reduced and the time reduced (Goldstein 1996, 546).² In exchange, the U.S. obtained a liberal investment regime in Canada (this concession was still being negotiated the day after agreement had been reached on the DRM).

The DRM established by the FTA may have lowered uncertainty for individual Canadian firms, but its most important accomplishment was the way it predictably redistributed payoffs in the CVD-AD game towards Canadians in general. The U.S. gave up shelter for products such as magnesium, steel and swine in order to obtain markets for financial derivatives, insurance and investment capital. In keeping with Becker’s (1983) analysis of conflict among interest groups, economic winners within the U.S. were able to translate their market success into political influence. Worth noting also was that these winners probably had superior access to the executive, whereas the losers depended on the legislative branch.

More efficient methods of accomplishing the same thing were available if this were quite simply a case of reducing transactions costs. Any economist would reject the whole apparatus of U.S. administrative

trade law. Remedies for injured sectors, if politically absolutely necessary, should be accomplished by subsidy. The structure of the DRM was such that it made possible a proposal that was *politically* preferable to no deal for both parties. The Congress was unwilling to generally shelter Canada from U.S. trade law, but accepted the bi-national panels and a certain amount of shade for the Canadians—as provided by rules it had authored—in exchange for the deal as a whole. In the issue area of investment and property rights there existed powerful political constituencies in the Senate as well as within the administration. Baker thought that the Senate finance committee was an insuperable obstacle to alterations in the discretion with which U.S. trade law was applied, but in fact, led by Bill Bradley, the committee gave crucial impetus to re-starting negotiations after the Canadians had walked (Hart 1994, 325, 327).³

In summary, the FTA was a good example of successful political exchange in unpropitious circumstances. In keeping with the fact that it had much less at stake, the U.S. clearly refused to make any serious proposals on sensitive issues until the very last minute. In the words of the Canadian negotiator, Reisman, the U.S. “waited for Canada to undress first”. However, in spite of rising protectionism, and a huge trade-deficit, a deal was done. Financial and investment interests were satisfied, while the congress only had to surrender half a loaf on trade law, because of the innovation of a bi-national DRM which constrained but did not supplant it

Jay's Treaty

In November 1794 the United States and Great Britain signed a treaty of Amity, Commerce and Navigation (known to U.S. diplomatic history as the Jay Treaty, after the U.S. representative) in which an incredibly wide range of outstanding political, military, and commercial disputes were addressed (what follows relies, in part, on Bemis 1924, Charles 1958 and Combs 1970). It was the U.S. which had actively sought a settlement. The political impetus came from the way in which unsettled business between the U.S. and Great Britain was creating domestic political problems for the Federalists. The

disdain of the British, the seizure of U.S. ships and the painful constraints of British mercantilist policies gave rise to a tide of anti-British sentiment, which rallied behind a tariff proposal by Madison in the House of Representatives. In it any country without a treaty of commerce with the U.S. should face discrimination. By the early 1790s the federalist majority had disappeared in the House, where the proposal passed with strong support from mid-Atlantic states; it only failed in the Senate through Adams' tie-breaking vote against. The Federalists, in particular Hamilton, feared that these disputes would force Washington's hand and lead the U.S. into a war for which it was completely unprepared. They therefore pushed forward Jay's mission to the British.⁴

By contrast for many years following the Treaty of Paris the British had not bothered to treat with the United States. It was viewed as weak and politically unreliable (due to the disabilities inherent in the articles of confederation). In the words of Lord Sheffield, an ardent mercantilist and strongly anti-American, the United States "were not to be feared by such as us" (Combs 1970, 8).⁵ At the same time existing patterns of North Atlantic trade yielded to the British all the benefits of a mercantilist policy without the costs of protecting the former North American colonies. This disdain was tempered by some domestic political considerations. Expropriated Tories and others represented a vociferous constituency that sought reparations from the U.S. for damages dating from the war of independence (which they had been pursuing through the courts with limited success) and West Indian planters resented being cut-off from direct commercial connections to the mainland of the U.S. Furthermore, the beginning of the French war in 1793 also made Britain more amenable. Its strict policies of blockade and the seizure of prizes enraged many neutrals—especially Sweden and Russia, who threatened an alliance of armed neutrality. The U.S., and in particular the merchants of the great East Coast sea ports, was also hard hit. Britain would have been reluctant to add to its list of enemies, but would under no circumstances accept any limits on the use of its navy.

Indeed, there can be few episodes of bi-lateral negotiations in which the points in dispute covered such a wide range. The geopolitical future of the U.S. was at stake, as the British attempted to assert a right

to territory far lower down the Mississippi than imagined at the time of the Treaty of Paris. Furthermore, the forts on the Great Lakes, supposed to be returned to the U.S. by that treaty, remained firmly in British hands. In fact the British long entertained the hope of an independent American-Indian nation in the mid-west, which would have effectively blocked U.S. expansion westwards. The support offered the Indians (although often largely rhetorical) and the claims made on the Mississippi served to enrage opinion among western settlers in the U.S.

In commerce, no benefits for the U.S. could be had from the one major diplomatic connection enjoyed by the U.S., that with France, due to the British blockade. U.S. commerce was further hemmed in a variety of other ways. The profitable trade with the West Indies had been cut off by independence. Meanwhile, while U.S. ships enjoyed most favored nation treatment in the U.K. from the point of view of customs, other fees meant that British ports cost American merchants more than American ports cost the British. In addition, the Navigation Acts restricted the goods that could be imported from the U.S., confining them to commodities and naval stores. Yet the U.S. depended on Britain for 80% of its imports, and, since the government was funded by the tariff, for the solvency of its embryonic system of public finance (a matter very close to the heart of Hamilton).

In the event, Jay and his treaty were subject to relentless criticism by both the Republicans, led by Jefferson, and even some Federalist allies. The disputes fanned by this treaty led directly to the establishment of party politics in the young republic (Charles 1958). However, it is not clear that he could have obtained a better deal. The United States was weak—in trade, in finance, and in its military preparedness. Furthermore, the British had very good information concerning this weakness. Yet Jay obtained two crucial concessions, without which there would have been no treaty and, for the U.S. at least, the likelihood of a dangerous and divisive war. He obtained the return of the forts on the Canadian border (and resisted British claims to duty-free entrance for their goods throughout the region) which the British relinquished in 1796. He also established two bi-national arbitration panels: one to resolve claims over the debts owed British merchants and displaced Tories, and one to settle

claims by U.S. merchants concerning the seizure of prizes in the West Indies and elsewhere.⁶ The “spoliations commission”, as the panel on prizes was called, in particular served to constrain the British administration of prize law. There was also an agreement to establish a boundary commission to discover precisely the headwaters of the Mississippi and a provision—hedged about with severe limitations—by which trade between the U.S. and the British West Indies could be re-instituted (only in boats of less than 70 tons, for example). This provision was struck down in the Senate.

If the U.S. desire for a treaty is obvious, the puzzle remains why the British conceded as much as they did. In retrospect a case can be made that John Jay obtained a surprisingly good deal given the significant asymmetry between the two actors. (As discussed below, he was not dealing with a very fastidious regime). In keeping with the argument made above, the explanation lies within British politics, where colonial, financial and merchant interests all exhibited conflicting preferences. What is more, also in keeping with the argument of this paper, the DRMs incorporated into the agreement divided a bundle of payoffs in a manner acceptable to both parties and so made agreement possible. In short, they were instrumental in facilitating political exchange, rather than economic efficiency.

It is true that the crisis of the French war, and in particular the possibility of an armed neutrality among Sweden, Denmark and perhaps the U.S. may have caused the British to take negotiations seriously for the first time.⁷ Yet the prospect of a hostile combination of neutrals had not prevented Britain issuing a secret Order in Council which allowed British cruisers to sweep up nearly the whole of the U.S. trade with the French West Indies without warning in November 1793. In the event—at a moment which significantly undermined Jay’s bargaining power—Hamilton signaled clearly to a British representative in the U.S. that Washington would never become a party to the armed neutrality. All the other evidence also indicates that British would admit no limits to the use of naval instruments in the war with France. For example, it never considered moderating the hated practice of impressing seaman—including U.S. citizens—from neutral vessels for service in its navy (this so inflamed passions in the U.S. that it contributed significantly to the war of 1812). Yet Britain made enough concessions on this occasion,

even in the matter of naval spoils, to meet the reservation point of the U.S. and get an agreement. The answer is found in British domestic politics.

The dilemma for British merchants was that while some were owed debts dating back to the revolutionary war, others were eager to expand trade in the U.S., which took 17% of British exports in 1794 (Bemis 1924, 34). However the legal tangle surrounding the unpaid debts made the extension of new credit very difficult, and trade depended on credit. The issue of debts was further complicated by the confiscations of Loyalist property with its vociferous constituency of exiles.⁸ Meanwhile, West Indian planters had been badly hurt by the severed connection with the U.S., and they too had great influence within the British oligarchy (see, for example, Jane Austen's *Mansfield Park*). In summary, two powerful interests with good access to the governing regime wished for a settlement that dealt with debts and trade. By contrast the fur traders of Canada, and the Hudson Bay company, feared that the return of the forts would impede their profitable trade with the Indians of the mid-west, and block their use of the waterways that served as the boundary.

The core of the dilemma related to the treatment of neutral shipping. Not only could the British not admit limits on such a crucial weapon, but the prize money obtained from seizing contraband had historically played a crucial role in rewarding the members of the British navy for what was otherwise was a hard, dangerous and badly paid service (run on the basis of rum, sodomy and the lash, according to Winston Churchill). The U.S. made no serious effort to challenge the British right to take enemy goods from neutral ships. In exchange the British agreed to the spoils commission which would hear appeals from American captains and supply redress where necessary. This commission ultimately made restitution to U.S. merchants in excess of 1,300,000 sterling. In other words, the commission made it possible to satisfy both parties—the British made no concessions on the principles which governed their treatment of neutrals, while the U.S. obtained shelter from that treatment for an influential class of merchants. The device of the bi-national panel granted U.S. merchants some relief, but left British policy unchallenged. This made the deal viable, even in the U.S. senate where it passed 18-8.

In combination with the Commission on Debts, what this outcome suggests is that the bi-national panels, by which payoffs were precisely divided among important interests within each enacting coalition, created overlap in the winsets of each coalition

British domestic institutions may have also played a role. Colonial interests in Britain—which either faced losses in the case of the Canadians, or little improvement in the case of the West Indian planters—were constrained to rely on back-bench sympathy in Parliament. By contrast there is a suspicion that those British shipping interests sheltered by the Navigation Acts (the rationale for which was ostensibly strategic) enjoyed special influence in the executive through the Privy Council, where the orders for seizing neutrals at the beginning of the war originated.

Conclusion

As noted at the beginning, this short essay has two simple purposes. Some international institutions, even some with all the hall marks of DRMs, play an important role in international political exchange not because they reduce transactions costs, but because they helped to divide and allocate well-understood payoffs. Furthermore, even under conditions of acute asymmetry, domestic politics set the stage for negotiations and accounts for the pattern of concessions that led to agreement.

One objection to the cases examined in this essay is that they deal with very specialized circumstances—that they are outliers, so to speak. This means that analysis of them can lead to few useful generalizations. I would argue that although they are certainly special cases, this has the virtue of casting a clear light on the issue I am interested in unpacking—the mixture (or not) of distributive and efficiency considerations in international politics and international institutions. By way of conclusion I layout some tentative hypotheses, and suggest how they might be investigated.

Ž If international negotiations embrace a wide range of issues, then any institutional arrangements established probably serve distributional purposes. This is obviously consistent with the stories reported above. The logic is straightforward—negotiations aimed at complicated exchange throw up almost as many distributional problems as they solve through issue-linkage. These may be mitigated by an international institution (or pie-slicing device) of the right kind. (See Brams and Taylor 1996 on the formal properties of fair division).

Ž If DRMs have a narrow scope—that is, they are restricted to a discreet set of issues—then they are less likely to be aimed at lowering transactions costs. This too is fairly straightforward. Why invest in an institution—which costs something to set up—and then limit the gains from it. If it serves to reduce transactions costs, the more issues it addresses, the greater the gains. On the other hand, if designed to solve a distributional problem, then its purview will, of necessity, be strictly delimited.

Ž If the *status quo*, whether economic or political, yields one-sided benefits in a particular issue area, then that issue area is a good candidate for an international institution that re-distributes benefits with some precision. Again, consistent with the reports above, the logic is sensible—actors may, in order to obtain one preference, yield in part to the preferences of the other party in another issue area. The difficulty is how to finely adjust benefits. International institutions of the kind described above can help.

Ž If the domestic opponents of the enacting coalition have colonized one particular chamber, then the appropriate DRM may be a way to circumvent that institutional advantage by changing payoffs via an administrative/judicial procedure. In other words, international arbitration mechanisms of the kind described above might help solve domestic distributional problems in the event of divided government. This is not straightforward in the cases reported above. The U.S. House has powers of the purse that cannot easily be avoided. The Commons in the 18th century was, perhaps, more of a check on the executive than today, given modern party discipline. However, the domestic interests that supported an enacting coalition, in combination with external institutional commitments, were able to carry the day.

How to operationalize these hypotheses? Scrupulous categorization of international institutions would be the best way to go, followed by careful analysis (Smith 2000 is a model of how to follow this approach). There remains a significant dilemma: How is it possible to measure complexity in international negotiations and in international agreements in a meaningful way? Nonetheless, this essay has set the stage in an important way: any subsequent analysis will *not* begin by assuming that DRMs are directed at lowering transactions costs—a healthy shift in point of view.

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NOTES

1. An earlier version of this paper was presented at the annual meeting of the Mid-West Political Science Association, Palmer House Hilton Hotel, Chicago, April 15, 1999. The discussion that follows owes much to the helpful comments of Rachel Brewster.
2. No such remedies were included in the dispute resolution panel created to handle all other concerns. Access was limited to national governments in both panels, although national governments agreed to forward all complaints under the countervailing duties chapter, making access less costly in this forum.
3. Hart (1994, 268) makes a fascinating observation on the way in which executive branch negotiators often went out and brokered a deal internationally, and then assembled the domestic coalition afterwards.
4. Indeed, Jefferson saw the mission as a brilliant, if devious, way to circumvent the Federalist majority in the House: "...it certainly is an attempt of a party, which finds they have lost their majority in one branch of the legislature, to make a law by the aid of another branch and of the executive, under color of a treaty, which shall bind up the hands of the adverse branch..." Jefferson to Madison, September 21, 1795. Cited in Charles 1958.
5. While Jay has been vilified from the moment the treaty was sent up to the Senate, Lord Sheffield maintained that, to the contrary, the British Foreign Secretary Grenville had been duped by Jay! (Bemis 1924, 270).
6. It is interesting to note that the joint commissions in the Jay Treaty were appointed in exactly the same way as the bi-national panels in the FTA—each country appointed two panel members, and they, in turn, appointed the fifth.
7. In 1785 Adams had been sent as U.S. ambassador to London, where he was received once by the King and once by Pitt, and then ignored for the next three years. The British, meanwhile, sent no representative of their own to the U.S..
8. The debts commission quickly foundered on the question of loyalist confiscations. Although creditors claimed that the total owed was as much as 3,000,000 sterling, the matter was eventually settled by a lump sum payment from the federal treasury of 600,000 sterling in 1802.