



The Relationship between Trade Dispute Settlement, Soft Power, and Trade

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Abstract. Liberalism views that trade agreement and trade may prevent war and conflicts from happening between states. Trade and trade agreement were perceived to be a way of cooperation and prevent conflict from happening. However, many developed countries have been endorsing new issues, such as gender, environment, and labor, into both under bilateral or regional free trade agreements (deep agreements) and not providing flexibility for developing countries. Deep agreement is a soft power of developed countries to developing countries. The feature of both bilateral and regional free trade agreements is having dispute settlement mechanism in those agreements. However, there are different level of development. Some developing countries have difficulties in fulfilling their obligations in those agreements due to lack of capacity. When enforcement for commitment of such agreement is imposed, developing countries will not be able to fulfill its obligation. Dispute settlement allows complainants to retaliate when its claims are supported by the adjudicators. Retaliation or trade compensation for nullification or impairments of benefits for those parties in dispute is a kind of trade sanction. Trade sanctions could create uncertainty and reduce trade. If regional trade agreements emphasize on promoting enforcement of new global norms as a soft power from developed countries to developing countries, it will not create more trade but it will reduce trade. This paper argues that the approach on promoting new issues to developing countries should be cooperation approach rather than enforcement approach.

Keywords: dispute settlement, soft power, trade.

1 Introduction

There is a very famous quote from Frederic Bastiat that implies that whenever trade does not occur between countries and is not facilitated enough, eventually war will happen. Despite the argument of Bastiat in the beginning of the 19 centuries, the advocate of free trade continues to occur. The World Trade Organization (WTO) has declared that there are almost 582 Regional Trade Agreements (RTAs) that have been notified in the WTO (WTO Database 2023). The establishment of RTAs have managed to reduce world tariff barriers from 10.46 % in 1995 To 3.9% in 2020. The proliferating RTAs is granted by article 24 of GATT 1994 and encouraged as long as it is a stepping

stone to form a strong Multilateral Trading System (MTS) (Baghwati, 1993). Trade has been perceived by liberalism as a way to mitigate conflict between states. A country that trades more with other countries will have less probability of war than those countries with less trade (Nye, 1990).

There is a strong endogeneity of trade conflict, trade cooperation and trade flows. Trade may solve and mitigate conflict. However, trade can also create cooperation as well as create conflict. The means to reach the solvency of conflict is by establishing a certain agreement through negotiation. An agreement usually demands reciprocity of compliance so that both parties respect the commitments that have been agreed by both parties declared under every provision in the agreement. Dispute settlement mechanism provides that a party could exercise its rights to bring into a dispute settlement process whenever the other party or parties in the agreement do not respect or are consistent with the agreement.

Trade dispute settlement may be conducted by adjudication based or negotiation based. The consequence of a certain party which does not respect the commitment in the agreement when it is found to be inconsistent with the agreement should alter the action of inconsistency to the agreement, provide compensation or may result in a trade sanction. This may create conflict and policy uncertainty to both exporters and importers among parties under the agreements.

This paper attempts to explore the debate in the literature by using qualitative studies of articles from scholars that are listed in journals and other resources. The main idea is to find the impact of trade cooperation and trade conflict on trade flows. The studies attempt to find a key theory of the relationship between trade cooperation, trade conflicts, and trade flows or trade. The key theory will be a stem and a mind structure of this literature studies. It is obvious that the most recent development of the studies will also be covered in this paper. This paper observes related articles in the literature from 2000 – 2023 and attempts to summarize and provide critical thinking on the development of the literature. Adding to this notion, the dimension of the current development will also be incorporated to reflect the existing context of the literature.

This paper argues that trade agreement is not merely for trade reason but also becoming a venue for introducing new global norms and issues. Since the state of development between countries are different, many of those issues are becoming burden for developing countries to fulfill. If flexibilities are not provided for developing countries, then it is becoming soft power. This paper argues that the approach on promoting new issues to developing countries should be cooperation approach rather than enforcement approach.

This paper is structured into four main sections. First section is the introduction. Second section provides the relationship between trade conflict, trade cooperation and trade flows, Third section will emphasize on how trade cooperation under an agreement may create conflict. The Fourth section provides the growing amount of deep agreement and how it provides soft power. The Fifth section provides that there are limited amount of research in the field of trade disputes and trade flows. The sixth section will provide conclusion and recommendation.

2 Trade Conflict, Trade Cooperation, and Trade Flows

Trade conflict and trade dispute may be interchangeable in the literature (See Chen and Tongurai 2023 and Chang and Sellak 2023). For the sake of understanding we will utilise trade conflict as a whole set of conflicts related to trade between countries such as trade war. While we will use the word “trade disputes” as disputes arise from a party or parties of an agreement due to the other party or parties being perceived not to respect their commitments in the agreement. Trade conflict between countries will not be separated from the understanding of theory of conflict (Stein 2003). Marxism perceived that social conflict will remain in the society due to competition to gain limited resources and society will reach a consensus to attain social order (Stein 2003).

Some researchers believe that trade may ease conflicts between countries (Stein 2003). However, Stein (2003) also observed that there is an endogeneity between conflict and trade. Trade may also initiate conflict between countries whenever a country does not allow enough opportunity to be available to its trading partner to trade (Stein 2003). However, trade will provide a higher opportunity cost of a country to initiate a conflict with another country (Stein 2003). Trade conflicts usually happen when a country imposes a certain trade barrier to its trading partner such that its trading partner cannot trade (see Chang and Sellak 2023 for USA-China conflicts).

Basic economics explains that tariff or trade barriers are welfare reducing instead of welfare improving (Krugman and Obsfeld 1992, Feenstra 2015). The theory of terms of trade explains that a small country will have lower welfare whenever tariffs are imposed on imported goods. However, Krugman and Obsfeld (1992) explains that well-constructed lobbying groups will prevent a government from removing tariffs unilaterally due to the joy of rent from protection. Even though economists perceive that unilateral action is hard but possible to do, unilateralism is still the first best solution to remove trade barriers for welfare enhancing policy to a country (Krugman and Obsfeld 1992, Feenstra 2015).

Nonetheless, economics also explains that the world is in asymmetric information and among countries there are prisoner dilemmas. A country will be endorsed to cooperate between countries to obtain better welfare to resolve conflict arising from trade barriers (Feenstra 2015). Jean Baptiste Say in 1803 with his advocates on free trade explained that free trade is a form of economic integration (Hosny 2013). Cooperation will bridge the removal of trade barriers among countries (Allan 1963, Hosny 2013). Balassa (1961) and Kahnert et al (1969) revealed that economic integration would be welfare enhancing and Allan (1963) as it is quoted by Hosny (2013) explains that the steps of economic integration are translated as an establishment of cooperation through an agreement (Hosny 2013).

The debate in the literature continues that multilateralism through the establishment of a multilateral trading system may be able to remove barriers among countries (Baghwati 1993, Baghwati and Panagariya 1996). Multilateral agreements would be able to address all countries and tend to be cheaper (Baghwati 1993). It is an agreement between Baghwati (1993) and Balassa (1961) that Viner (1950) prevails both theoretically and empirically. Viner (1950) asserted that regional trade agreements or arrangements will create trade diversion and trade creation (see also Baghwati and Panagariya 1996).

It is of the view that economic integration is less welfare enhancing through regional arrangement (Viner 1950, Balassa 1961). It is perceived by literature that economic integration by reducing barriers among countries will increase trade between parties at the expense of third efficient parties that are not part of the agreement. FTAs are trade enhancing with the cost of trade diversion. Therefore, some economists perceive that it is the second-best option after multilateralism.

Nonetheless, some economists attempt to provide arguments that Viner (1950) arguments of trade diversion is not purely a cost to developing countries ((Meier (1960), Abdel Jaber (1971), and Andic, Andic and Dosser (1971), Allen (1961), Brown (1961), Bhambri (1962), El-Naggar (1964), Cooper and Massell (1965b), Mikesell (1965), Chou (1967), Kahnert et al (1969)). Even though trade diversion happens to developing countries as a party or parties to an agreement, trade barriers removal should be perceived as development tool of policy (Andic, Andic and Dosser 1971; Abdel Jaber 1971; Balassa and Stoutjesdijk 1975, Axline 1977, and Khazeh and Clark 1990, Robertson 1970).

This debate is continued with various exploration empirically by many economists to assess ex-post performances of Free Trade Agreements (FTAs) or Regional Trade Agreements (RTAs). Empirical evidence has been explored by economists. Alhassan and Pavaslioglu (2023) explains that strong economic and political institutions within the party or parties of the free trade agreement will be a dominant factor to determine trade creation and trade diversion of that party or parties (See also Azis et al (2018)). Some evidence showed that ASEAN enjoys trade creation effects due to AFTA and ASEAN + 1 FTAs (Ukabe and Urata (2014), Shiah et al 2009, Wong et al 2017). While other evidence provides that ASEAN is more an indication of trade diversion than a trade creation for the case of Singapore and Vietnam (Doahn and Heo 2009).

While in other parts of the region, Clausing (2001) found that Canada–United States free trade agreement by using data at the commodity level, the estimation showed that there are strong indications of substantial trade creation effects and revealed only weak indications of trade diversion. While Adarov (2023) asserted that Eurasian economic integration has been trade enhancing and a strong result demonstrated that there are trade creations. However, the degree of trade creation and the increase of trade may vary between countries (Adariov 2023). One of the answers to the difference in the degree of trade creation is economic and political institutions that may vary between countries as a party to the agreement (Azis et al (2018) and Alhassan and Pavaslioglu (2023)).

3 Trade Cooperation expose Conflicts

Despite the fact that a country as a party bound itself with other countries or a country to a particular agreement, parties to a particular agreement will attempt to ascertain those parties to fulfil their commitments by creating incentives for compliance. Under multilateral fora WTO members create a dispute settlement mechanism whenever a member is conceived to be inconsistent with its commitments under WTO as a means to maintain a rules-based multilateral trading system. Jackson (1997) recognizes that

the World Trade Organization (WTO) is a breakthrough which brought all members of the WTO impulsive into the same rules both developed or developing members of WTO.

However, the WTO dispute settlement mechanism as the crown jewel of the rules based multilateral trading system is in deep challenge (see Sacerdoti 2023, Hoekman and Mavroidis 2020). The main reason for such a challenge happens due to the fact that one of WTO member states started blocking the appointment of the Appellate Body (Sacerdoti 2023). The debate begins with a publication from USTR with regards to the weakness of the Appellate Body in the WTO (Hoekman and Mavrodis 2020). The sustainability of WTO as an organisation which maintain rules based multilateral trading system will be endangered due to lack of enforceability since some cases are allowed to be “appeal into the void” (Scaerdoti 2023) or “appeal into defunct” (Hoekman and Mavroidis 2020).

The basic function of WTO Dispute Settlement is to settle conflict among members. The discussion whether dispute settlement should put enough attention on the format of adjudication approach or negotiation approach (Hoekman and Mavrodis 2020). The debate of adjudication versus negotiation approaches to dispute settlement mechanisms have been a long dialogue among researchers in the literature. Hoekman and Mavroidis (2020) asserts that even when a dispute settlement is not being solved by adjudication, WTO dispute settlement mechanism should provide and maintain the mechanism of negative consensus in the Dispute Settlement Body (Hoekman and Mavrodis 2020).

The discussion on dispute settlement mechanism is connected to the finding of solution of Appellate Body impasse and maintaining rules based multilateral trading system (Sacerdoti (2023), Papaconstantinou, G.A., Pedreschi, L.F. (2022), Gonzalez, A.M., Sakhi, A. (2022), Davey (2022), Umenze (2021), Kalachigin (2021), Raj (2021)). WTO reform (Liu Z (2021), Hamann (2021)). However, the literature also attempts to provide the debate on the determinant of trade disputes by exploring both political and economic variables. Some literature provides evidence that political and economic variables shape the initiation of trade disputes among countries (Abedin and Odano (2005)). Rosendorf and Smith (2017) argues that trade dispute is driven by domestic politics and changes in leadership (Rosendorf and Smith (2017)). Some studies explore that tariff overhang is one of many variables as determinant of trade disputes (Kuenzel 2016). While comparative studies are also being conducted on countries based on the level of democracy (Reinhardt 2000). Reinhardt (2000) found that democracies are initiating more disputes and less cooperatively.

Some researchers also attempt to provide the description of developing countries' participation in the dispute settlement mechanism under WTO. Some researchers attempt to endorse utilisation of developing countries in WTO dispute settlement (Wu et al 2023, Bouet and Metivier 2020). Some scholars provide recommendations on improving how developing countries participate more in dispute settlement (Bown and Hoekman 2008, Bown and Mc Culloch 2010).

The discussion expanded to the existing bilateral and regional arrangement dispute settlement mechanism. Tohey (2017) explores CPTPP and Trans Pacific Alliance for Dispute Settlement (See also Gallardo et al (2021), Kazun (2016)). Alajmi (2021) raises the debate of spaghetti bowl in jurisdictional conflict between RTA and Multilateral

Dispute Settlement Mechanism. The consistency and avoiding overlap of jurisprudence on particular cases will create confusion and spaghetti bowl in dispute settlement mechanism (Alajmi 2021).

4 Deep Agreement and Soft Power

Proliferation of Free Trade Agreements (FTAs) is a fact that we need to be aware of. FTA accelerates from 50 agreements in 1990s to above hundreds of agreements in 2025 (Mattoo et al, 2020). Based on WTO database, there are 845 agreements that is submitted to WTO which consists of 615 notification RTA in force (WTO, 2025). However, there are 230 FTAs which are inactive. There are 341 agreements are notified under article XXIV of GATT 1994 and 211 agreements are notified under article V GATS (WTO, 2025). This indicates that most agreements are comprehensive and only 63 agreements are notified under enabling clause (WTO, 2025).

However, Mattoo et al (2020) observation showed that preferential trade arrangements have been progressing in its coverage. Mattoo et al (2020) showed that the average PTA in the 1950s only comprises of 8 policy areas. Mattoo et al (2020) added that current FTAs have been comprised of averaged 17 policy areas. Mattoo et al (2020) showed that there is a strong indication that FTAs are becoming Deep Trade Agreements (DTAs). Tariff is no longer a key area of negotiation in FTAs.

Some enlargements in terms of number of policy areas covered (extensive margins) and deepening of specific commitments within a policy area (intensive margins) happen in many of those trade agreements. RCEP and CP TPP have entered into the form of DTAs. RCEP covered sustainability, Micro and Small Medium Enterprises (MSMEs), labor, and various policy areas. Mattoo et al (2020) asserts that development agenda drives the forces of getting those policy areas in place in the agreements. All issues are wrapped under the concept of Sustainable Development Goals (SDGs). The logic of pursuing the achievement of SDGs in 2030 forced many countries to adopt those policy areas into the agreement (Mattoo et al, 2020).

Every scholar recognizes the different rate of development states between developing and developed countries in fulfilling their needs and obligations. We all recognize the notion of less than full reciprocity under WTO Agreement discussion and common but differentiated responsibility under Climate Change commitments. However, both of these expressions have not been reflected from the agreement categories as DTAs.

In addition, many of DTAs are linked to Dispute Settlement Mechanism (DSM). Most of Dispute Settlement Mechanism may not adopt WTO DSM purely but rather adopt some and resolve the adjustment bilaterally (see USMCA DSM). The growing interest of introducing some standards of OECD into bilateral trade agreements between developed and developing countries seems to be the key feature some of modern plurilateral agreements such as CPTPP and IPEF.

5 Trade Dispute and Trade Flows: Lack of Researches

The exploration of the impact of WTO trade disputes on trade flows is limited. The theory that may link trade disputes and trade flows is based on the uncertainty caused by disputes. Beshkar and Park (2017) asserts that international trade disputes under WTO may create both first order and second order uncertainty. Since the WTO dispute case litigation process creates uncertainty, the impact of uncertainty to trade is a more robust theoretical background to explain the impact of WTO Trade Dispute on trade flows.

Some evidence has been provided that trade policy uncertainty will create barriers to trade (Osnago et al (2015), Borojo et al (2022), Liu et al (2022), Handley (2011,2014), and Constantinescu et al (2019)). Osnago et al (2015) explains that trade policy uncertainty may create export barriers. Osnago et al (2015) uses the data of tariff hang as uncertain trade policy variable to explore the impact of uncertain trade policy on trade flows.

Borojo et al (2022) explains that by using PPML and Heckman Sample Selection, trade policy uncertainty is a more important barrier to trade for emerging economies and low-income developing countries. Liu et al (2022) asserts that by using trade policy uncertainty (TPU) index and standard deviation, movement of 1% of standard deviation of trade policy uncertainty will reduce import by 1.14%. Handley (2011, 2014) asserts that by reducing trade policy uncertainty is at least as effective quantitatively as unilateral applied tariff reductions for Australia. Constantinescu et al (2019) provides empirical evidence that policy uncertainty will reduce growth of trade and trade link to Global Value Chain. There is a statistically significant relationship between this measure of policy uncertainty and growth in trade, including trade linked to GVCs.

Bown and Reynolds (2015) explores descriptive analysis of WTO case disputes databases from WTO with the bilateral trade data. Bown and Reynolds (2015) demonstrated that there are no clear patterns on trade flows and trade disputes. Different types of policies subject to disputes will have different impacts on trade flows (Bown and Reynolds 2015).

Chaudin, Kucik, and Pelc (2016) provides evidence that dispute settlement does not increase trade. However, Chaudin, Kucik, and Pelc (2016) does not provide enough explanation as to the cause of the decrease in trade due to trade dispute litigation. However, Stein (2003) explains that there is endogeneity in trade. Growth of trade may cause trade friction (Conybeare (1987), Stein (2003), and Stein (1993)).

6 Conclusion and Recommendation

6.1 Conclusion

The debate in the literature always observes trade as a tool to ease conflict and war among countries. However, there is some evidence that there is endogeneity in trade and conflict. A country traditionally usually uses economic integration policy to open up its trading partners' market. Every trade agreement negotiated will attempt to create

a dispute settlement mechanism to make sure that each party fulfils its right and obligation in the agreement or it is available to serve for enforcement reason.

However, many trade agreements pursue new issues such as environment, labour, gender, and other non-trade issues. Some regional trade agreements do not provide flexibilities to developing countries while some developing countries may not be able to fulfill its obligation and use its rights. Asymmetric condition and imbalances in terms of development states are becoming issues in negotiating those provisions. This effort of bringing non-trade issues into trade agreements is driven by soft power to introduce new global norms with the standards of developed countries. This approach is acceptable and would be able to avoid conflict whenever the approach is cooperation approach instead of enforcement approach.

The literature only provides a limited amount of research on finding the impact of trade disputes on trade flows. The relationship between cooperation, conflict, and trade is intertwined which may need scrutiny to find the right channel of relationship. The closest channel that could link the relationship between trade flow and trade disputes is the explanation that trade disputes cause uncertainty to both exporters and importers. Uncertainty will cause costs to trade and create new barriers to endorse trade among countries.

Trade disputes may also create spaghetti bowl or jurisdictional overlap whenever free trade agreements and multilateral dispute settlement arrangements are not inline and consistent. The approach of negotiation which leads to politicization of dispute will add to the uncertainty. It will be trade reducing instead of trade enhancing to all parties in the agreement. This paper argues that dispute settlement mechanisms should remain on multilateral basis or in line with the system of multilateral basis. FTAs should have de-politized dispute settlement system so that no one is left behind in the agreement.

Trade dispute is a form of conflict between parties in the agreement and it contributes to uncertainty. It may create new barriers to trade among countries. Initiating trade disputes should take the impact of trade disputes to trade into account. Trade disputes and cooperation should be incorporated in FTAs and the approach should be cooperation in resolving trade disputes and not confrontational by using threat of and real trade sanction and retaliation to solve disputes.

6.2 Recommendation

This paper recommends that A country should not use trade disputes as a means of punishing other parties but it is a facility to endorse cooperation among parties so that they can implement the rights and obligations based on their commitment in the agreement. The approach of establishing non trade issues in regional trade agreements should be more on the form of cooperation instead of enforcement approach.

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