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Introduction

In 1876, the United States signed a trade agreement with the Kingdom of Hawaii which eliminated high U.S. sugar tariffs. Hawaii responded by ramping up sugar production for export to the United States, so much so that these exports increased fivefold from 21 million pounds in 1876 to 114 million pounds in 1883. Boosting sugar production required a large investment: sugar producers adopted new sugar-processing technologies, bought government and private land, undertook large-scale irrigation projects, and invested in fertilizers. The Hawaiian government signed the treaty expecting other markets for its sugar exports to open up soon thereafter. However, when the treaty expired in 1883, Hawaii had no viable alternative export market.[1] Thus, during negotiations over the treaty's renewal, the United States demanded exclusive rights to Pearl Harbor; otherwise, the United States threatened to reinstate the high sugar tariff. The Hawaiian government conceded.

Almost 140 years later, this type of pressure remains a widespread phenomenon. Consider several recent examples: the European Union (EU) threatened not to renew trade agreements with Mongolia, Sri Lanka, Vietnam, and Nepal unless they improved their human rights records; the United States warned that it would not renew trade agreements with China, Vietnam, Cambodia, Romania, and Russia until they made political concessions; and China refused to renew many of its trade agreements unless its partners supported its "one China" policy.[2] Indeed, incentives to renege on agreements abound as the intermingling of political and economic arrangements offers many opportunities for states to coerce their partners into making foreign policy concessions.

[1] For a full account of this case, see Croix and Grandy (1997) and Kuykendall (1953). Note that Australia had become a sugar exporter and the Canadian population was too small to serve as a substitute (Croix and Grandy 1997). Additionally, Continental Europe had begun producing large quantities of beet sugar as a substitute for imported cane sugar (Rolph 1917).

[2] See Dumbaugh (2008). China frequently requires its partners to recognize it as the legitimate government of the area encompassing both China and Taiwan.

These examples of coercive diplomacy – the use of threats and assurances in combination to influence another state's behavior – highlight the dangers of cooperating with other states in the international system: states may hold their partners hostage at a later date to extract concessions from them. Yet the possibility that states will be taken advantage of has an unfortunate consequence: states often refuse to cooperate in the first place, preferring to "go it alone" rather than be subjected to extortion. When states cannot promise to refrain from holding their partners hostage, cooperation failures abound, making states worse off than they would be if they could commit to not exercising coercive diplomacy over their partners.

Making this kind of commitment is difficult, however, because coercive diplomacy is such a useful tool. In countless situations, one state seeks a concession from another and therefore turns to coercive diplomacy as the most expedient way to extract it. Coercion has been widely used by many states throughout history, as efforts to promote national interests and obtain political goals without resorting to war preoccupy leaders around the world. Thus, as a result of its ubiquity and centrality in international relations, the exercise of coercive diplomacy is a controversial and hotly debated topic. Yet despite its place at the core of interactions between states, coercive diplomacy is not well understood. When do states attempt to coerce their partners, and what problems does this cause? How do states address these issues, and what are the political and economic consequences of their actions?

This book takes up these questions in detail, examining coercive diplomacy's effects on bilateral interactions and assessing its implications for states' abilities to influence their partners. To date, most analyses of coercive diplomacy have concentrated on understanding whether and when states achieve their desired results by applying coercive methods. However, by employing game-theoretic tools, statistical modeling, and detailed case study analysis, this book builds and tests a theory that explains the mechanisms underlying these dynamics to provide a more complete and nuanced account of coercive diplomacy. With a particular focus on the World Trade Organization, the book argues that the potential for coercive diplomacy creates political hold-up problems – difficulty cooperating due to fears of exploitation – but that international institutions can solve these problems by enabling states to commit to not employing certain tools for coercive purposes. Yet, by limiting states' manipulation of some policies for coercion, institutions cause their members to rely on alternative, often weaker instruments. International institutions thus have the power to enhance cooperation among members, but they do so specifically by diminishing states' abilities to coerce their partners.

1.1 THE ARGUMENT IN BRIEF

My argument rests on the idea that the potential for coercive diplomacy restricts interstate cooperation, as it induces states to reduce otherwise productive investments to avoid providing their partners with political leverage. For example, a state may decide not to build a factory to produce a good for export to a partner state if it worries that, ex post, the partner will threaten to raise tariffs on the good unless the state gives in to additional demands. A state may similarly refuse to accept loans, engage in trade, or permit foreign direct investment if it anticipates that its partner will breach these agreements unless it makes further concessions. These political hold-up problems pervade interstate relations, preventing mutually beneficial exchange.

As a result, states commonly seek credible ways to commit to not extorting concessions from their partners. Membership in international institutions represents one such solution. For example, WTO membership deters states from holding their partners up due to the WTO's strong enforcement capacity. The WTO thus allows members to guarantee that they will not to use their WTO-regulated trade policies to wring concessions from their partners.

However, international institutions do not affect cooperative relations among all states equally; rather, they mostly affect pairs in which one state has the capability and incentive to exercise coercive diplomacy against its partner. In particular, a state that wields more power than its partner is better *able* to extort concessions from that partner, and a state that experiences political tensions with a partner is more *willing* to do so. States with disparate interests and capabilities therefore most often engage in coercive diplomacy and thus find cooperation the most difficult outside of international institutions. Institutions thus reshape relations between these states in particular.

Although international institutions solve political hold-up problems by allowing states to commit to not using certain tools for coercion, members do not simply give up on influencing other states. Instead, they *shift coercion* to an area unregulated by the institution. To be sure, states have many instruments at their disposal, such as trade policies, foreign aid provision, foreign asset treatment, diplomatic measures, and military force. Generally, states select the most effective methods, weighing factors such as public opinion, probabilities of success, monetary costs, potential retaliation, and lobbying by domestic groups. Although the precise calculations vary on a case-by-case basis, these considerations figure in the decisions of virtually all states that seek to shape their partners' behaviors. Membership in international institutions, however, changes the cost-benefit assessment, leading states to craft new ways to coerce their partners. In doing so, international institutions thereby alter the ways that states use power in the international system.

In effect, because members of a particular international institution limit their manipulation of those tools which the institution regulates, they experience fewer political hold-up problems in these areas. At the same time, institutions push coercive behavior into alternative realms that typically offer less potent levers of influence. Removing certain instruments from states' foreign policy tool kits restricts their options for exerting pressure on their partners, resulting in diminished coercive abilities. International institutions thus represent a distinct trade-off for many states: they permit cooperation within the institution but restrict states' leverage over other members.

In the remainder of this introduction, I offer a preliminary account of the argument advanced in this book. The discussion elucidates the key intuitions that ground my argument regarding the effects of political hold-up problems on coercive diplomacy. I begin by depicting the nature of the cooperation problems that occur due to states' desires to extract political concessions from their partners and describing how international institutions can solve these issues. I then explain how coercive tactics change as a result of membership in these institutions and characterize the implications for cooperation and coercive behavior in these areas. After situating my argument in the broader theoretical context and describing its scope conditions, I conclude the chapter with an overview of the book.

1.2 COERCIVE DIPLOMACY AND INTERNATIONAL TRADE

To make this argument, I begin by explaining the nature of coercive diplomacy and highlighting the particular salience of trade as a coercive tool. At its core, coercive diplomacy is an indispensable practice in international affairs in which states seek to alter other states' behaviors. Coercers may offer concessions if a given target complies with their demands or may enact penalties if it fails to do so. Coercive diplomacy thus consists of threats and assurances, either explicit or implicit, and can therefore be considered a form of extortion or blackmail.

When exercising coercive diplomacy, states choose among a variety of instruments, including bilateral foreign aid provision, trade policies, financial regulations, foreign direct investment (FDI), foreign asset treatment, diplomatic maneuvers, military tools, environmental policies, technology sharing, immigration regulations, and intelligence cooperation. How do states select which policies to use? Scholars have shown that states do so based on the tools' associated costs and benefits, which depend on many factors, such as national security concerns, the preferences of domestic groups, potential retaliation, the partner country's likely response, and lobbyists' and constituents' interests. Though all coercers face these types of considerations, their circumstances and constraints differ such that each state makes a unique calculation when selecting its tactics.

However, while the precise factors involved in adopting a specific policy vary by state, trade-policy manipulation represents a particularly salient and widely used tactic because of its universal importance and primacy in the international system. Moreover, scholars have long recognized that trade can serve as a key tool of extortion (Baldwin 1985; Hirschman 1969) and have linked trade to economic growth, political power, military capabilities, and even state survival. I therefore maintain a focus on trade as an especially potent instrument of coercion.

Because states often rely on trade as a primary weapon in international relations, the potential for coercive diplomacy can severely disrupt trade relations between states. The dynamics between the United States and Hawaii discussed previously highlight the danger of opening to international trade: a state may be taken advantage of by a trading partner if the profitability of its investments depends on its partner's continued cooperation. To avoid becoming targets of coercive diplomacy, states commonly underinvest in the production of goods that could make them vulnerable to this exploitation. For instance, a state less optimistic than Hawaii would have anticipated the United States's opportunistic behavior and underinvested in sugar production.[3]

Yet, although scholars have long acknowledged that trade can be used for political leverage when the target of such pressure cannot costlessly shift trade elsewhere,[4] it is less well recognized that this possibility leads to underinvestment: the expectation that a partner will either discontinue or threaten to discontinue an agreement to extract political concessions often leads states to refuse to invest and trade with the partner ex ante. Because this trade would be mutually beneficial absent the possibility that a state would be held up for concessions, the decision to refrain from trading represents a market failure. For example, prior to Taiwan's 2002 WTO accession, it restricted economic exchange with China out of fear that such exchange would provide China with political leverage. Similarly, before Mexico joined the institution in 1986, it frequently sought to reduce its vulnerability to the United States's coercive efforts through limitations on trade and investment. Nepal also tried to curb trade with India prior to its 2004 WTO entry because of India's frequent threats to disrupt this trade unless Nepal provided political concessions. I discuss these examples extensively in Chapter 5.

Nonetheless, the linkage of disparate foreign policy issues need not always lead to political hold-up problems. In fact, sometimes bargaining over multiple items helps states to cooperate when it allows them to reach agreements more easily (Davis 2004; Martin 1994; Poast 2012). Political hold-up problems, by contrast, occur when states do not settle such issues jointly. Rather, states fear that once they reach a deal, one side will renege at a later date to extract additional concessions. If an investment's profitability depends on its partner's willingness to stick to the agreement, these concerns may render states unable to cooperate.[5] Thus, unlike haggling over many areas at once, which makes

[3] Although the Hawaiian government was aware that it could be held up when it signed the initial agreement, it hoped that it could open other markets for its sugar by the time the treaty was renewed. Charles de Varigny, the Kingdom of Hawaii's foreign minister, explained, "Seven years [the length of time before the treaty's renewal] would give us time to establish our sugar production on a solid basis. After all, we would have an opportunity through similar negotiations to open up other markets" (Croix and Grandy 1997, 177).

[4] See Hirschman (1969, 13) and Keohane and Nye (1977, 211). Keohane and Nye (1977, 19) argue that this occurs primarily under conditions of "asymmetrical interdependence," which I discuss further in Chapter 2.

[5] This argument builds from Hirschman's (1969) observation that political leverage from trade interdependence requires that the target of coercion face a cost to switching trade partners.

states better off by facilitating agreements, political hold-up problems make states worse off by depressing cooperation because of worries that it will lead to extortion.

Furthermore, these cooperation problems do not affect all states equally because some states are more vulnerable to these pressures than others. First, a state that is much stronger than its partner is better able to engage in coercive diplomacy. When a state wields more power than its partner does, it can afford to make threats and assurances that will convince its partner to provide concessions. Second, states face greater incentives to exercise coercive diplomacy when they have more dissimilar policy goals. If a state wants to garner support for a particular policy, it has little reason to coerce states that already share the same views, but it may threaten to renege on commitments to bully dissidents into adopting its preferred course of action.

As an example of a state extorting concessions from another state once it became more powerful than its partner, consider the relations between West Germany and Poland in 1950. West Germany wanted Poland to allow German family members who had been left behind in Eastern Europe to reunite with their families. Instead, Poland passed the Law on Citizenship, which required Germans in Poland to become Polish citizens. However, West Germany had a trade agreement with Poland that it could use as ransom (Spaulding 1997, 378). It therefore waited until the Polish economy had weakened and Poland had become dependent on the trade agreement to obtain German import credit to make up for critical shortages. It then demanded emigration concessions as a condition of renewing the treaty; failing those concessions, it would terminate its cooperation. Because Poland relied on the trade agreement, it complained about extortion but allowed ten thousand people to return to West Germany (Spaulding 1997, 382).

Relatedly, interactions between the United States and former Communist countries provide examples in which states that experienced political tensions had difficulties cooperating. The United States frequently used its trade policies to try to elicit improvements in many of these states' human rights records but had little incentive to do so with those nations that already respected rights (Pregelj 2005). Coercive diplomacy is therefore most prevalent between asymmetric pairs of states that differ in terms of capabilities and political views.

1.3 WTO REDUCES POLITICAL HOLD-UP PROBLEMS

Owing to political hold-up problems' endemic nature in the international arena, states seek out ways to preempt them. International institutions provide a potential solution, as they can tie states' hands with respect to the policies they govern. Furthermore, because trade represents a key coercive tool and causes especially detrimental hold-up problems, the institution that regulates it plays a critically important role in the international system. Therefore, I pay particular attention to the WTO, the primary multilateral institution that governs trade relations among its members. Note that the WTO was created in 1995 to replace the General Agreement on Tariffs and Trade (GATT), the institution that had served this function prior to 1995. Throughout the book, I use the term WTO to refer to both the GATT and the WTO, unless otherwise specified. In my theoretical framework, I treat these institutions in the same manner because they both can solve political hold-up problems in the trade domain, although I discuss their differences in the next chapter.

Established after World War II, the WTO represents one of the oldest international institutions and is considered a success story in terms of liberalizing trade among its members.[6] Part of the WTO's ability to do so stems from its rule-based approach and emphasis on reciprocity, transparency, and nondiscrimination between states. The institution requires all members to agree to provide each other with the same low MFN tariff rates, such that WTO members may not discriminate by offering some members better tariff treatment than others (although several exceptions to these rules exist, as I explain in Chapter 4).

For example, consider the GATT's impact on India's relations with Nepal. In 1989, Nepal's economy essentially shut down. Unemployment rose dramatically: many went hungry, and protests erupted in the streets. Domestic chaos ensued. What sparked this massive upheaval? Nepal's largest trading partner, India, had imposed an economic blockade on Nepal to pressure it to stop buying weapons from India's historic rival, China. After a year of hardship, turmoil, and political turnover, Nepal finally gave in to India's demands, and trade was restored. India thus succeeded in extracting concessions from Nepal by wielding its trade policies as a coercive tool.

Because India manipulated its trade relations with Nepal for political purposes, it presented Nepal with a dilemma: on one hand, international trade lay at the heart of Nepal's national development, economic growth, and prosperity. Thus, Nepal placed extreme importance on trade relations with India. On the other hand, this trade represented a potent weapon, as even states with the best intentions are often unable to refrain from using trade for extortion. Nepal's trade with India therefore provided India with a tool of coercion, but limiting trade with India to reduce this risk would have harmed Nepal's opportunities for growth and progress. Nepal was caught between two dismal alternatives. Nepal sought a third option, however. Its experience with India led it to apply for GATT membership, because joining the institution would mean that India would have to play by a set of established rules when determining its trade policies toward Nepal. GATT membership thus represented a potential way out of Nepal's predicament.

Nepal's experience was far from exceptional; states throughout history have proven unable to resist the temptation to use trade arrangements for coercive diplomacy. Consequently, many states curb trade with their partners when

[6] Although see Gowa and Kim (2005) and Rose (2004).

they fear that it will be employed against them in the future. However, international institutions offer states an escape from this bind by allowing them to tie their own hands and those of their partners due to the institutions' effective enforcement capabilities. Once states join these institutions, they can therefore cooperate in the areas overseen by the institutions whenever mutual benefits occur, rather than cooperate only with states where mutual trust to uphold agreements exists.

Furthermore, because political hold-up problems impact certain pairs of states more than others, and international institutions help to solve these problems, these institutions benefit some pairs of states in particular. Specifically, because states with large power disparities and political tensions have the most difficulty cooperating outside of the institution, these states reap the greatest gains from institutional membership within the domains the institutions govern.[7]

International institutions thus help some states overcome the danger of extortion by increasing the penalty associated with violating agreements. They do so by providing clear rules accompanied by transparent and impartial dispute adjudication to enable observers to learn whether members have violated their agreements. Members may thereby develop reputations as cooperators or violators, which allows other states to make informed decisions about future cooperation (Maggi 1999). Unlike bilateral arrangements, international institutions permit treaty violations to tarnish members' reputations in both international and domestic arenas. Enhancing these actors' abilities to identify defectors also permits them to penalize states that breach agreements. Institutions therefore enable multilateral punishments, which can increase the cost of violating agreements to the point that states no longer find such violations beneficial (Keohane 1984). Furthermore, once states become accustomed to operating within an international framework, norms for compliance may be created (Acharya and Johnston 2007, 37).

In particular, the WTO's dispute settlement system enforces members' commitments by adjudicating disagreements. Industries with interests in states' compliance with the WTO's laws identify potential violations, after which their government decides whether to take their complaints to the WTO. Once a state initiates a case against another, the two parties begin consultations. If they cannot reach an agreement, a panel consisting of three expert judges chosen from other member states adjudicates the dispute.[8] This process resolves

[7] An implication of my theory is that adversaries trade less than allies absent the WTO. This is also an implication of Gowa's (1995) important work; however, rather than being caused by political hold-up problems, Gowa (1995) argues that trading with adversaries causes security externalities. The two theories' implications diverge regarding the role of institutions, as I argue that the WTO boosts trade for nonallies in particular by resolving hold-up problems, whereas Gowa's (1995) argument implies that the WTO magnifies trade for allies. This is discussed further in Chapter 4.

[8] Under the GATT, panel adoption could be blocked, as discussed in Chapter 2.

uncertainties about the law and allows states to develop reputations for compliance (Davis 2012; Maggi 1999). By enforcing long-term trade agreements, the WTO therefore allows states to commit to not using their trade policies as tools of coercive diplomacy, increasing trade and investment for states that might be tempted to do so otherwise.[9]

1.4 Coercive Diplomacy's Displacement and Reduced Effectiveness

Members of international institutions do not simply give up on exercising coercive diplomacy, however. Instead, states seek to influence their partners using tools that these institutions do not govern. For instance, while the WTO curbs its members' abilities to punish other members by raising tariffs on their goods,[10] they may instead threaten to reduce foreign aid, freeze assets, restrict visas, reduce intelligence cooperation, limit loans, or recall ambassadors if their partners do not comply and offer assurances in these areas if their partners meet their demands.

However, because states frequently select trade as a primary instrument of coercive diplomacy, restricting the use of this instrument generally renders efforts to influence their partners less effective. Indeed, although many doubt trade sanctions' efficacy, I show that trade-based threats and assurances tend to be more effective than most alternative policy instruments. Thus, although the WTO increases overall economic cooperation, doing so often comes at the expense of efforts to coerce other states.

1.5 Broader Theoretical Context

This book explores foreign policy motivations for protection that are often overlooked because of a divorce between research on trade policy and research on coercive diplomacy. By bringing together concepts from each of these fields, I develop new insights into interstate relations. Specifically, I show how sanctions and other coercive measures cause political hold-up problems, often preventing trade and investment, and explore many unexpected implications of this observation. I demonstrate that incorporating political hold-up problems into the study of coercive diplomacy permits the understanding of many facets of international relations, suggesting the substantive value and theoretical potential of doing so.

9 The WTO itself has no capacity for coercive diplomacy, as it merely enforces mutually agreed upon rules, allowing me to isolate my argument from the possibility that WTO membership causes states to practice coercive diplomacy through the institution.

10 Several exceptions to this rule exist, as I discuss in detail in Chapter 4; however, I note that they are limited and do not allow WTO members much leeway for trade policy manipulation.

Furthermore, in addition to its contribution to the scholarly literature, this book engages with policy debates over the practice of coercive diplomacy in international relations. Questions regarding the use of coercive methods have become intertwined with disputes over membership in international institutions, as many policy makers worry about sacrificing foreign policy autonomy to these international bodies. At the same time, in an era of rapid globalization, states seek to engage with international institutions to participate in multilateral economic and political transactions that enhance growth, stability, and prosperity. Thus, a more complete understanding of how coercive diplomacy shapes relations between states, particularly in the context of international institutions, is called for.

My argument builds on the large body of literature known as contract theory, which was developed primarily in the field of economics to investigate how economic actors construct contractual arrangements (Bolton and Dewatripont 2005). Hold-up problems between firms represent a key concept in this domain and occur primarily when a firm must make a highly irreversible investment whose profitability depends on another firm's cooperation. In such a case, underinvestment may occur because the firm worries that once it invests, the other firm will confiscate the gains from the investment (Tirole 1988, 25). Typically, firms solve these problems either by writing an enforceable contract beforehand to ensure that the investor will benefit from its investment or through vertical integration, whereby the same firm owns the entire supply chain.

Similarly, the large literature on the politics of foreign direct investment (FDI) suggests that investors refrain from investing in countries that might subsequently violate their property rights or extract concessions. When investors have immobile assets, they cannot make credible threats to relocate, so that once they invest, the bargaining power shifts to the host country. Even when governments seek more FDI and thus have a long-term incentive to stick to the terms of the deal, they face a "time-inconsistency problem" whereby the short-term benefits of violating the agreement may outweigh the long-term costs. If investors anticipate that once the investment is made, the government will change the terms of the deal, they do not invest in the first place.[11] However, this problem may be ameliorated by bilateral investment treaties and other agreements and by domestic host-country characteristics such as democratic institutions and strong property rights laws, which can help to tie the government's hands (Büthe and Milner 2008b; Jensen 2003; Tobin and Rose-Ackerman 2011).

I build on these insights by investigating hold-up problems between governments rather than between firms, or governments and firms, which presents special complications to solving these issues. As a result of the considerable difficulty states experience in enforcing their contracts along with the pervasive links between international economics and politics, these political hold-up

[11] This is known as the "obsolescing bargain."