Trade and investment disputes: the role of economists

Marion Jansen, Joost Pauwelyn and Theresa Carpenter explore whether economists can be of use in addressing contentious questions in international trade and investor–state disputes.
International economic dispute settlement is under increased scrutiny. How are decisions made about the ‘fairness’ of national or foreign policies? How are damages to be paid by governments to private investors calculated? This column introduces a book with contributions from academics and practitioners that explore whether economists can be of use in addressing these and other contentious questions in international trade and investor–state disputes.

Over the past decades, global markets have increasingly integrated both in terms of the size of trade and investment flows and in the number of actors. Markets are governed by a set of national, regional, and global legal frameworks for trade and investment (Muchlinksi, et al. 2008 and WTO 2017 provide an overview of international dispute settlement systems governing investment and trade, respectively). These frameworks interact at different levels.

When parties to international treaties are in disagreement, this can give rise to disputes. The orderly functioning of the relevant dispute settlement system is important to maintain support for, and adherence to, the system.

International trade and investment are governed by rather different frameworks. Both frameworks are subject to increased scrutiny by policymakers and the general public alike, as we will see below. At the same time, new international economic law is under negotiation, notably in the areas of taxation (base erosion and profit shifting), e-commerce and data flows.

This column discusses findings from The Use of Economics in Trade and Investment Disputes, an edited volume that focuses on trade and investment but that – in our view – contains useful insights for ongoing and future international initiatives (Jansen et al. 2017).

Several trade and investment disputes have in the recent past attracted considerable public and media attention. This was particularly true for disputes dealing with important public policy issues, such as the so-called beef hor-
WTO disputes involving the US and the EU, or investor-state dispute settlement cases regarding the regulation of cigarette marketing (Phillip Morris – Australia) or the phasing out of nuclear energy (Vattenfall – Germany).

Public scrutiny has taken the form of protests (such as those against the now-suspended Transatlantic Trade and Investment Partnership negotiations) and statements by policymakers against ‘rules being enforced by judges.

More effective use of economics could, in our view, contribute to the legitimacy of the WTO and investor-state dispute settlement systems, by increasing the acceptance of rulings by affected parties and the general public.
abroad’. Attempts have also been made to strengthen or alter relevant dispute settlement systems (eg. Hindelang and Krajewski, 2016 and Council of European Union, 2016).

In Jansen et al. (2017), the contributing authors examine how decisions are taken in disputes such as these, with a focus on the role economics has had, or could have, in decision making. The combination of contributions from leading practitioners and academics makes it possible to distinguish between what is theoretically desirable and what is practically feasible.

Four economic concepts are arguably of critical importance for both international trade and investment law. Those concepts are captured in the legal terms:

- ‘likeness’/‘like circumstances’ (close to the concept of ‘relevant markets’ in competition law);
- ‘causality’ (to assess whether a disputed policy ‘caused’ damage);
- ‘necessity’ (to assess whether a disputed policy may have been ‘necessary’ to attain another legitimate policy objective); and
- damage calculation (to assess the extent of damage caused by the disputed policy).

To assess these concepts, parties to disputes have frequently submitted two types of quantitative economic evidence, ie. econometric evidence to assess ‘likeness,’ and evidence based on simulations to assess ‘causation’. Simulation-based evidence has also been used in the context of damage calculations.

International trade and investment law both seek to regulate economic relations among private or public stakeholders. One might therefore expect that economic evidence has played an important role in the settling of trade and investment disputes. In fact, our book reveals that:
• there is no agreement among experts as to the amount and nature of economic evidence to be used in disputes;
• economic evidence is not necessarily used coherently in trade and investment disputes; and
• economists are not well equipped when it comes to advising on the potentially most critical concept for dispute settlement, ie. ‘necessity’.

Dealing with economic evidence in trade and investment disputes has proven to be a challenge
Numerous WTO panel reports reflect a certain unease of panellists – who are typically legal experts – to constructively use economic arguments. Quantitative evidence has frequently been ignored or dismissed by panellists. As pointed out in the contribution by Damien Neven and Petros Mavroidis, external experts have repeatedly expressed dissatisfaction with the quality of analysis and the lack of economic expertise in panel and Appellate Body reports.

This attitude of adjudicators stands in stark contrast to the high popularity of quantitative economic evidence among policymakers, including those active in the area of trade. Adjudicators’ hesitance to use economic evidence in trade disputes stands in contrast with the domain of competition policy, where it has become standard for adjudicators to rely on economic evidence.

A significant debate around the use of economics in WTO dispute settlement has nevertheless taken place, as reflected in the American Law Institute reports and a number of other publications (eg. Bown and Pauwelyn 2010), including the WTO’s World Trade Report (see notably the 2005 issue) and the WTO-supported refereed journal, the World Trade Review.

Important differences exist between trade and investment
The debate on the relationship between law and economics is arguably significantly less advanced in the field of
investment law. It is widely accepted that a certain level of economics, or ‘accounting’ – in the terminology of David Unterhalter in his contribution to the book – is necessary for damage calculation. Yet the methodological discussion on how to conduct such calculations appears less advanced, notably when it comes to the question of how to assess causation. Also, the question of how to assess whether different firms are active in similar product lines or industries does not seem to have triggered the soul searching that has taken place in the trade community around the ‘likeness’ concept. Such differences across trade and investment dispute settlement are interesting and may be justified. They suggest, however, that there is significant scope for cross-fertilisation between the law-and-economics debates in the two fields.

Other differences appear to stem from differences in the legal concepts applied across the two types of international economic law. In his contribution, Wolfgang Alschner describes the relevance of an Aristotelian notion of corrective justice for damage calculation under investment law. This notion considers that justice is done when the situation that existed prior to the wrongdoing is re-established. Under WTO law, the purpose of the retaliation stage appears instead to be to induce compliance rather than to re-balance the level of benefits between the complaining member and the responding member (eg. Malacrida 2010). The purposes of the damage calculation under ISDS and the retaliation stage thus differ to a certain extent.

Another difference between the two fields appears to lie in the role expected benefits from the agreement play at the adjudication stage. Carla Chavich and Pablo López Zadicoff illustrate in their contribution to the volume that the difference between expected (ex ante) returns from an investment undertaken under the umbrella of an investment treaty and the effective (ex post) returns is central to investor-state disputes. A similar concept – the nullification or impairment of the ‘benefits accruing directly or indirectly’ to contracting parties – is also referred to in WTO legal texts (GATT Article XXIII), but has not played a prominent role in dispute settlement.
Economic guidance is weak in what may be the most critical area
More effective use of economics could, in our view, contribute to the legitimacy of the WTO and investor-state dispute settlement systems, by increasing the acceptance of rulings by affected parties and the general public.

To help adjudicators - and in particular the non-economists among them – to assess the quality of economic evidence provided in disputes, our edited volume contains guidelines for best practices for the use of economics in trade and investment disputes in the annex to its conclusions.

Unfortunately, however, it is precisely in one most sensitive area of dispute settlement that economists are so far not very well equipped to provide guidance to adjudicators. The analysis by Bown and Trachtman (2009) on the Brazil-tyre case shows – in our view – that while economists can provide very valuable guidance on policy options in the case of market failures (like the negative externality on health and environment generated by the disposal of tyres), they are not always well-positioned to rank those policy options, as this would require quantifying variables like the health or environmental benefits of policy options relevant for any specific case.

Addressing this situation is in our view important with a view on maintaining support for international dispute settlement systems and also with a view on assisting lawmakers in the design and application of new international rules, such as those currently under discussion and design on digital trade.

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References

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