# *ECONOMICS OF TRADE DISPUTES AND INVESTOR-STATE DISPUTES*

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# Trade and investment disputes: highly technical but oh-so-controversial

Boeing-Airbus

Hormone Beef

GMO

Vattenfall-Germany

Philip Morris - Australia

# *Economics of trade disputes and investor-state disputes*

- Are trade and investment agreements a matter of law or of economics?
- Should economic reasoning play a role in trade or investor-state disputes?
- If yes
  - qualitative/quantitative evidence? Which methods?
  - should economists be involved in relevant panels or arbitration bodies?
  - Should approaches in trade and in investor-state disputes be coherent?

# *Economics of trade disputes and investor-state disputes*

A forthcoming edited volume

**Presentation based on**

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- outcome of EU funded DISSETTLE research network
- with contributions from practitioners and academics from economic and legal fields.

# *Economics of trade disputes and investor-state disputes*

- Mega-regionals: a re-convergence of international trade and investment law?
- Economics in international economic law disputes: pros and cons.
- Competition, investment, trade: parallels and differences
- Incoherent use of economics within the trade policy arena?
- Incoherent use of economics across fields of international economic law?

# Mega-regionals: a re-convergence of international trade and investment law?

- Up to late 19th century: bilateral treaties addressed trade and investment in one document (e.g. setting up of trading posts to sell goods);
- From late 19th to late 20th century: separation of trade and investment (e.g. GATT vs BITs)
- Since late 20th century: trade and investment again addressed in same treaty (FTAs, mega-regionals)

*Pauwelyn (2014)*

# How to settle disputes?

- Which court?
- Which parties?
- How much economics?

# Competition, investment, trade: parallels and differences

## Competition

- National
- State => firm
- Guidelines for use of economics exist
- Arbitrator often significant power to request info/data from parties

Use of economics well established

## Trade

- Multilateral/regional
- State ⇔ State
- Guidelines for use of economics do not exist
- Arbitrator has limited power to request info/data from parties

Use of economics disputed

## Investment

- Mostly bilateral
- Investor => state
- Guidelines for use of economics do not exist

Use of economics mainly limited to damage calculations

# Incoherence in the use of quantitative economics within the trade policy arena?

Quantitative economic evidence …

- … is frequently used in trade policy making (e.g. G20 documents; WTO communications in run-up to Bali ministerial);
- … has repeatedly been used by WTO Arbitrators;
- … has had a ‘difficult stance’ in WTO disputes.

# Incoherence in the use of quantitative economics within the trade policy arena?

Quantitative economic evidence based on individual models can easily be questioned/criticized …. :

- … but **policy makers** appear to feel comfortable to use evidence that is in line with policy messages of/for their constituents;
- … but **WTO Arbitrators** are obliged to come up with an estimate for the 'retaliation' value is 'equivalent' or whether countervailing measure is 'appropriate';
- … and this appears to make **WTO panels** hesitant to use such evidence (examples: the 'alcohol cases').

# Hesitant use of economics in trade disputes

Panel and Appellate Body decisions appear to have struggled to take quantitative evidence submitted by Parties on board.

The fact that (a) any *individual* model/regression specification is open for criticism on 'technical' grounds and that (b) no benchmark for accepted model/regression specifications exists may have contributed to this.

# Economics in international economic law disputes (trade)

## Pros

- Clarify what kind of factual evidence is relevant
- Assess significance of factual evidence
- Measure or quantify effects
- Higher objectivity of the system (move away from "splitting the difference").

## Cons

Lack of:

- Applicability: specific (economist) versus general (law)
- Stability: economics prone to "fashions"?
- Efficiency: use of economics is costly and can be prohibitive for resource constraint parties
- Power to quantify: difficult to measure welfare trade offs

# Incoherence in the use of economics across policy areas?

## "market determination"

- Competition policy: relevant market ("sophisticated" economic analysis)
- Trade disputes: like products (usefulness of economics disputed)
- ISDS: same industry (economics yes, but relatively ad hoc)

## "causality"

- Trade disputes: sophisticated econometrics, yet often not accepted by panels ("The resources that one can pour into debating an economic analysis of a concept like causation would appear to be more or less unlimited")
- ISDS: rule of the thumb adjustments to take into account alternative causes

# The big elephant in the room

- How to distinguish “policies that are necessary to pursue legitimate policy objectives” from treaty-inconsistent policies
- Question has frequently arisen in trade disputes (e.g. Korea beef; Brazil-tyres) but has only recently arisen in ISDS
- Question: how to quantify “value of the regulatory goal” vs. “size of the underlying externality”

# Welfare maximization: a balancing act

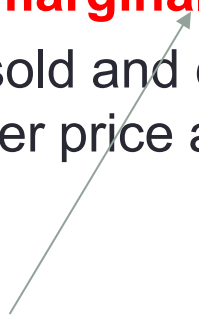
A standard welfare maximization argumentation for ‘Brazil-retreated tyres’ (Bown and Trachtman, 2008):

1. Brazilian welfare depends on the number of retreaded tyres consumed.
2. The number of retreaded tyres consumed depends on their price.
3. The price is determined between consumer demand and producer supply.
4. Producers base the price they demand to consumers on their production cost structure.
5. These production costs do not include the ‘social benefits’ of retreaded tyres, i.e. the benefits in terms of reducing public health risks

# Welfare maximization: a balancing act

A standard welfare maximization argumentation for ‘Brazil-retreated tyres’:

6. The ‘first best policy instrument’ is an instrument that reduces the ‘marginal cost’ of producing an additional retreated tyre by the ‘marginal social benefit’ of producing that tyre.
7. The ‘first best policy instrument’ in this case would be a subsidy to producers of the size of this **marginal social benefit**.
8. More retreated tyres will be sold and consumed thanks to the subsidy at the same consumer price as before.



*How to quantify this?*

# Future of economics in trade and investor-state disputes

- Dealing with communication challenges (law vs. economics)
- Keeping it simple; being pragmatic
- Establishing due processes
- Requesting transparency (models; data)

…. But what about loss of “constructive ambiguity”?