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Introduction

The Use of Economics in International Trade and Investment Disputes: Complex, Contentious but Oh-So-Important for the Sustainability of Trade and Investment Treaties

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Global markets have become increasingly integrated both in terms of the size of trade and investment flows and in terms of the number of players involved. Global trade and investment flows are governed by a set of national, regional and global legal frameworks that interact at different levels. Increasingly, questions arise regarding how those frameworks fit together and how they can be made more coherent.

This volume focuses on one particular aspect of this question: how dispute settlement arrangements in the different fields of international economic law covered by the agreements fit together, with the focus on the fields of international trade law and international investment law, and how in each of these fields the discipline of economics has played or can play a role. It brings together contributions from practitioners and academics to assess both the latest academic insights on the use of economics in international economic law and the practical implications of increased interweaving of the two disciplines for those involved in a dispute.

The overarching theme of the volume is highly technical and potentially complex because it invokes the expertise of different disciplines, notably economics and law. At the same time, this theme is of high practical relevance as it goes to the very heart of the raison d'être of treaties of international economic law and of their acceptance by the general public. Indeed, public debate on and protest against international treaties has repeatedly arisen around decisions taken in disputes, notably when such cases dealt with important public policy issues, such as in the case of the so-called hormones or biotech products disputes (US-EC) at the WTO or the ISDS

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(Investor – State Dispute Settlement) cases regarding regulation of cigarette marketing (Phillip Morris – Australia, also a WTO dispute) or the phasing out of nuclear energy (Vattenfall – Germany). In the case of negotiations of the Transatlantic Trade and Investment Partnership (TTIP), the potential of ISDS within this framework has led to protests and significant public debate. Though technical, the theme treated in this volume is therefore highly relevant for ongoing negotiations in the trade and investment arena and for the public acceptance and sustainability of bilateral, regional and multilateral trade and investment treaties alike.

Though highly relevant for today's public debate, the question of how trade and investment can fit together within one single treaty is not new. The Havana Charter that was negotiated in the aftermath of the Second World War contained provisions on trade, investment and competition policy within one single legal document. This reflected a continuation of commercial practices whereby, notably, trade and investment matters were regulated within single legal texts. In the nineteenth century, for instance, bilateral treaties around the setting up of trading posts to sell goods addressed trade and investment in one document (Pauwelyn, 2014; Tietje et al., 2014).

Ultimately, only chapter 4 of the Havana Charter has been adopted, and this chapter only dealt with trade matters. With the adoption of what was to be called the General Agreement on Tariffs and Trade (GATT), a multilateral agreement was born that solely focused on trade matters. This marked the beginning of a period of several decades in which matters of trade, investment and competition policy were to be handled within separate legal frameworks and by different sets of legal institutions. This period is arguably coming to an end with the negotiation of so-called mega-regional agreements in the second decade of the 2000s. The newly concluded Trans-Pacific Partnership (TPP) and the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union (EU) both cover matters of trade, foreign direct investment and competition under the umbrella of a single legal text, as will the TTIP being negotiated between the EU and the United States.

Within the context of international law, all three areas – trade, investment and competition – will typically be considered to fall under the umbrella of "international economic law" as they tend to oppose the economic interests of parties of different nationalities. Although the term "international economic law" makes the role of economics for these fields of law rather explicit, this volume will show that the use of economics in disputes has been very different across the three fields and has only found broad acceptance in one of them: competition law. In the area of investment and trade, the relevant dispute settlement bodies appear to have struggled with the questions of whether, how much and how to use economic reasoning or evidence in the context of disputes settlement.

Economics can play a number of roles in the context of international economic law (see Pauwelyn, 2013; Anne van Aaken, Chapter 8, this volume; and Lau and Schropp, Chapter 4, this volume):

- Drafters can use economics ex ante when defining the actual content of a treaty;
- Economic analysis can inform the decision of a claimant to file a dispute;
- Adjudicators may use economic concepts and theories when giving meaning to or interpreting legal provisions;
- Adjudicators may rely on economic concepts or quantitative methods (econometrics, simulations or financial accounting models) to assess the facts to be established in specific disputes.

In this volume, the focus will be on the latter two roles, though reference will also be made to the first two. While the volume focuses on the role of economics in trade and investment law, a number of contributions make reference to the use of economics in competition law and its relevance for the other two fields (notably Breckenridge, Chapter 13, and Malashevich and Kobe, Chapter 7, in this volume).

Dispute settlement mechanisms in the investment and in the trade realm are characterised by a number of fundamental differences that may, to a certain extent, explain why the use of economics has differed across the two fields (see Gaukrodger and Gordon, 2012).

One difference relates to the legal basis for dispute resolution. The legal basis of ISDS is spread around dispute resolution provisions contained in around 3,000 bilateral investment treaties, in a number of international conventions (e.g. the ICSID Convention, NAFTA and TPP) and in arbitration rules and contracts. The legal basis for trade disputes, instead, is anchored in Annex 2 of the WTO Agreement: the Understanding on Rules and Procedures Governing the Settlement of Disputes. A number of regional agreements also contain dispute provisions, but the WTO's DSS remains the most important reference point for disputes in the field of international trade.

ISDS draws on ad hoc party-appointed arbitration panels (not subject, to date, to an appellate mechanism), while the WTO DSS foresees that the appointment of panellists is by agreement of both parties or by the WTO Director General (subject to appeal before the WTO Appellate Body whose members are appointed by consensus of all WTO members).

Another major difference is that ISDS allows private parties to bring claims against states, while in the case of the WTO only states can bring claims against other states. In addition, under ISDS claimants typically seek monetary compensation, whereas the final remedy in WTO disputes is a withdrawal of measures that are found to be WTO inconsistent. Retaliatory measures may be applied by the harmed parties, pending withdrawal, but compensation for past harm – the standard remedy in ISDS cases – is not foreseen in the WTO/trade system.

Notwithstanding these differences, the two dispute settlement systems are also marked by numerous similarities. For the purpose of this volume, the most relevant similarity is that adjudicators are frequently called to examine questions that deal with the same or similar economic concepts.

For instance, in both trade disputes and ISDS, the question arises of how the line of economic activity that is said to have suffered from government intervention relates to other economic activities. In trade disputes, this question arises at the dispute stage in cases where it is necessary to assess whether products identified by the claimant have been treated less favourably than domestically produced "like" products. Economic analysis has been used in a number of cases that involved assessing the "likeness" of products,[1] as highlighted in several chapters in this volume (Iacovides and Jansen, Chapter 9; Lau and Schropp, Chapter 4; Teh and Yanovich, Chapter 2) and as discussed in a relatively rich academic literature (e.g. Choi, 2003). Parallels have also been drawn in the literature between the concept of "likeness" in trade disputes and the concept of "relevant market" in merger cases (Melischek, 2013) or investors in "like circumstances" for purposes of national treatment in ISDS disputes.

In ISDS, a related question has arisen in the context of damage calculation, where arbitrators have been led to apply "but for . . . " assessments in order to evaluate what the value of the claimant's investment or company would have been, but for the allegedly wrongful government intervention (Abdala and Rozenberg, Chapter 17 in this volume). In such cases, stock market indices composed of companies "within the same industry" have sometimes been used to assess trends and evolutions in the absence of government intervention. De facto, therefore, the composition of the market index is assumed to give a reliable indication about a concept that is related to the concepts of "likeness" and "relevant markets".

[1] Those cases are *Japan – Alcoholic Beverages II*, *Korea – Alcoholic Beverages*, *Chile – Alcoholic Beverages*, *Philippines – Distilled Spirits* and *Thailand – Cigarettes*. See also the discussion in Jansen and Iacovides in this volume (Chapter 9).

Another concept that plays a role in both trade disputes and ISDS is that of "causation". In trade disputes the question of causation arises prominently in cases evoking the Agreement on Subsidies and Countervailing Measures (ASCM) when claimants argue that a defendant's policy has caused material injury or other adverse effects (see Flett, Chapter 6, Miranda, Chapter 11, and Lau and Schropp, Chapter 4, in this volume). The term "causation" here refers to the need to establish that any injury has its origin in the evoked government policy and is not caused by any other policy or by an independent phenomenon of economic or other nature that may have occurred at the same time. The same question arises in the context of ISDS damage calculations where it needs to be established whether any losses by the claimant during the identified period may be related to factors other than the allegedly wrongful action by the defendant state (see Abdala and Rozenberg, Chapter 17, and Bentes, Chapter 12, in this volume).

A third concept relevant for both trade and ISDS is the concept of "necessity". "Necessity" plays a role when the defendant government evokes the need to introduce a specific policy for legitimate policy reasons. In multilateral trade law the original GATT text – dating from 1947 – already foresaw in Article XX that governments may at times be induced to use policies "necessary" to pursue legitimate policy objectives – such as public health or safety – that may have the side effect of distorting trade flows. Governments' desire to pursue legitimate policy objectives has also been recognised in numerous other WTO and free trade treaties, although this is a relatively recent phenomenon occurring only in the latest generation of investment treaties (Tietje et al., 2014). The concept of "necessity" has therefore also been evoked by defendant states in ISDS, including through reliance on the concept of "economic necessity" in the wake of a financial crisis under general international law rules on state responsibility (e.g. *LG&E versus Argentina*, as discussed in Alschner, Chapter 14 in this volume).

Last but not least in this non-exhaustive list of similarities comes the fact that arbitrators in both trade and investment disputes have to assign a numerical value to the harm caused by the measure that is found to infringe the relevant rules (Bown and Pauwelyn, 2010). Until relatively recently, when it came to calculating damages or permitted trade retaliation, WTO arbitrators as well as investor–state tribunals would resort to "splitting the difference" – that is, adding up what the two opposing parties claimed and then awarding half of that amount, rather than using sound economic models and data (Pauwelyn, 2013). Increasingly, though, it is accepted that quantitative economic methods can play a valuable if inessential tool in this phase of trade or investment disputes (see Abdala and Rozenberg, Chapter 17, Alschner, Chapter 14, Gottschling and Geffert, Chapter 15, and Zarbiyed, Chapter 18, in this volume on damage calculation in ISDS, and Iacovides and Jansen, Chapter 9, and Lau and Schropp, Chapter 4, in this volume on trade retaliation).

The communalities described above refer to four questions that form crucial elements of trade and investment dispute settlement. Handling these questions in an appropriate and coherent way may prove to be crucial for the sustainability of dispute settlement in international economic law (IEL).

The concepts of "likeness" and "causation" are evoked in large numbers of cases, which should represent a strong enough reason for requesting increased coherence and predictability regarding the approaches used to assess these questions. Such coherence is needed across different cases within the same field of IEL, but also across different fields. This is particularly the case if trade and investment issues are dealt with within the same legal treaty. If questions of causality are addressed differently within trade disputes than within ISDS, this may put the reliability of adjudication under such treaties into question.

Transparency and coherence regarding the assessment of "necessity" is at least equally important for the sustainability of dispute settlement in IEL. The term may systematically play a role in cases invoking public policy issues, such as health, the environment or economic/financial emergencies or crises, and thus cases that are likely to be under intense public scrutiny. As a consequence, adjudicators' approaches to dealing with "necessity" may influence greatly the extent to which governments and the public at large perceive IEL to restrain national governments' policy space. Responsible and coherent assessments of "necessity" may therefore be vital for continued public acceptance of trade and investment rulings involving public policy issues. Trade negotiators are aware of this, as reflected in the discussions around dispute settlement in the context of TPP and TTIP negotiations.

Last but not least, getting the calculations right when it comes to assessing damage or defining retaliation measures may be crucial for continued acceptance of rulings by parties to the treaty. For the parties, especially claimants in ISDS, damage calculation is often the most important part of an award. For most law-trained adjudicators, in contrast, legal analysis is what they value and revel in, and damage calculation is often treated as a technical and at times annoying afterthought (Pauwelyn, 2013). Lack of attention to the remedies stage of cases and perceived inaccuracies or injustices at that stage, however, may bear the risk of decisions not being accepted and possibly not being implemented by parties to the relevant treaty.

Where economics is applied in trade or investment disputes, therefore, it should be done in a way that increases the accuracy and acceptance of the resulting rulings. Coherence and transparency will be crucial to achieve such an outcome. The chapters in this volume will provide valuable hints as to where there may be need for increased coherence across the different fields of IEL. The chapters also provide insights into why it may have been difficult to achieve such coherence and why agreement on whether, when and how to use economics in trade or investment disputes has not been reached so far.

The volume is divided into three sections. The first section contains contributions by practitioners in the field of IEL. Those practitioners have played different roles within dispute settlement systems, including that of adjudicator, support to adjudicators, party to cases or provider of support to parties. The practitioners' views will provide valuable insights into how economists and lawyers work together in IEL disputes and into the challenges and opportunities that such collaborations entail. Practitioners will also provide their views on what works and what does not work when it comes to using economics in trade or investment disputes and on what can be done to make the use of economics work to the advantage of dispute settlement in IEL.

The contribution by Robert Teh and Alan Yanovich (Chapter 2) sets the stage for this section as it provides an insider view on the challenges WTO panels face when dealing with economic evidence submitted by parties. In their chapter they discuss in detail instances in which economic evidence has been submitted, and they also provide clues as to how the use of economic analysis could be better integrated into the WTO dispute settlement practice.

Tom Graham – former chair of two international trade law practices in major US law firms and WTO Appellate Body member at the writing of this volume – discusses the role of economists and accountants in an international trade law practice with a focus on domestic trade remedy litigation (Chapter 3). From there he expands on and discusses possible roles for economists in WTO dispute settlement.

Additional practitioner views are provided by Christian Lau and Simon Schropp (Chapter 4), both economists in an international law firm. Based on specific cases, they assess what works and what does not work when it comes to defining when and how economists and lawyers work together and how they integrate each others' working methodologies.

David Unterhalter – former Appellate Body member – argues that interpreting WTO agreements in accordance with the customary rules of interpretation of public international law is not the only tool that adjudicators have for interpreting WTO treaties, and concludes that economic reasoning may usefully inform interpretation without trespassing beyond the remit of what interpretation permits (Chapter 5).

James Flett provides the view of a "user" of economic analysis in the context of dispute, where he frequently represents one of the parties to the dispute (Chapter 6). The point of departure of his analysis is that law and economics need to be blended in a way that achieves security and predictability whilst avoiding circumvention. He also emphasises in his chapter that any blending of the two fields needs to be affordable for all parties involved in disputes.

Last but not least, Bruce Malashevich and Kathryn Kobe provide insights from the application of economic techniques in competition policy cases (Chapter 7). They examine the administrative and judicial practice in the UK, Canada, Germany, the United States, Mexico, Brazil, Chile, China and Korea, where both practical and theoretical techniques have been applied in competition law cases. They find that their application varies significantly across countries.

The second section contains contributions that provide an in-depth analysis of the nature of the academic fields of law and economics and their application to trade disputes. These contributions provide insights into how thought and work processes applied in the two fields may be complementary or – on the contrary – create obstacles for the creation of synergies between law and economics in the context of trade disputes. They also provide insights into how the interaction between law and economics has played out so far in WTO trade disputes. Likeness, causation, necessity and retaliation are discussed in several of the chapters of this section, with a spotlight on causation in the final two.

In the first chapter of this section, Anne van Aaken discusses the challenge of having to deal with competing and evolving economic theories in international trade disputes (Chapter 8). She emphasises the "evolving" nature of social sciences and argues that economics is no exception to this rule. In this context, adjudicators face two challenges: first, how to deal with evolving knowledge when legal rulings are expected to be predictable, and second, how to deal with the "competing theories problem" that is likely to arise from time to time in a context where economic knowledge evolves. Marios Iacovides and Marion Jansen focus on another challenge in the second chapter of this section (Chapter 9): the challenge to communicate across disciplines. They argue that this challenge arises in particular when dealing with quantitative economic evidence, which turns out to be the most common situation in which legal and economic experts work together in the context of trade disputes. These challenges are compounded by the fact that the typical panel in trade disputes is composed of trade delegates unaccustomed to economic analysis, as highlighted in the chapter by Petros Mavroidis and Damien Neven (Chapter 10). They argue that the professional and educational background of the panellists and Appellate Body members is fundamental in explaining the hesitance of the WTO DSS to be informed by economics analysis.

The next two chapters of the second section focus on the use of economics in the case of causality analysis in trade disputes. Jorge Miranda (Chapter 11) offers a detailed discussion of the findings of the WTO Panel and Appellate Body in both the original and the implementation proceedings in the United States – Upland Cotton. He comes to the conclusion that while the analysis involved was in certain respects disorderly and ad-hoc, the panels' ultimate findings are consistent with international trade theory.

Pablo M. Bentes (Chapter 12) reviews more generally how WTO panels and the Appellate Body have considered economic evidence in the context of causation analyses in disputes dealing with actionable subsidies. He argues that a more developed analytical framework for a panel's analysis of economic evidence would assist WTO panels in giving effect to the causation requirement embodied in Part III of the SCM Agreement.

The chapter by Amar Breckenridge (Chapter 13) provides the opportunity to draw parallels between the use of economics in merger analysis and its use in trade disputes. The focus of the chapter is on the use of simulation models that he considers a powerful quantitative tool for conducting counterfactual ("but for") analyses that could notably be used for analysing causation.

The third section focuses on the use of economics in international investment disputes. The focus of the section is on the use of quantitative economics in damage calculations, but other themes – such as necessity – are also discussed. Parallels with WTO disputes are systematically drawn, and one chapter draws parallels with merger and cartel damage cases. The section also provides insights into some of the fundamental principles underlying international investment law, such as the principle of sanctity of contracts and the notion of corrective justice.

In the first chapter of Part III, Wolfgang Alschner discusses the relationship between loss, liability and damages in international investment arbitration and considers the possible role of economics in establishing this triple identity (Chapter 14). His discussion centres on the notion of corrective justice, whereby justice is considered to be done when the situation that existed prior to a wrongdoing is re-established. In the second chapter of the section (Chapter 15), Bastian Gottschling and Willis Geffert also discuss the use of economics in damage calculations, but with a stronger focus on the role of investment risks and their implications for the principle of "sanctity of contracts", a principle that is of great importance for investment law.

Carla Chavich and Pablo López Zadicoff discuss the usefulness of economics in investor–state arbitration in matters that go beyond the quantum stage (Chapter 16). The authors identify a number of issues that benefit from an economic perspective before damages are determined: the relationship between historical profitability and liability, the basis for the application of the necessity defence, and the use of economic tools to define the nature of the claim.

Manuel A. Abdala and Alan Rozenberg (Chapter 17) describe how market capitalisation can be used to build "but for" scenarios regarding the value of publicly traded assets in investment treaty disputes.

Finally, Fuad Zarbiyev investigates the interplay of international law and economics in the context of valuation of an expropriated asset protected by investment treaties (Chapter 18). The language of compensation provisions incorporated into investment agreements provides, in his view, a useful starting point to examine the interplay between law and economics in determining the value of an expropriated asset.

The concluding chapter of this volume provides a summary of the different contributions to the book with a view to providing practical guidance as to the use of economics in future trade and investment disputes. The chapter starts by discussing the advantages and disadvantages of using economics in disputes, as expressed by contributors to this volume. The different options available for using economics in trade disputes are discussed and a distinction is made between the use of quantitative and qualitative economic information. This concluding chapter contains guidance on how the different disciplines of IEL can inform each other when it comes to the use of economics, and it offers practical guidance on how economists and lawyers can work together in order to create optimal synergies between economics and law.

Last but not least, the concluding chapter presents a discussion on due process for the use of economics in trade disputes. In line with the arguments developed in the beginning of this introductory chapter, this discussion on due process contains a call for increased transparency and coherence. We argue that transparency and coherence could be enhanced by the establishment of common guidelines for the use of economics in trade and investment disputes, following the example given by competition law where such guidelines have been established by numerous national competition authorities. We are cognisant of the fact that it may be more difficult to establish such guidelines in bilateral, regional or multilateral contexts, but we nevertheless believe that it is worthwhile to make the attempt. The appendix to the Conclusion will provide the reader with draft guidelines that could form the starting point for discussions at the institutional or political level.