

The Costs of Decentralized Enforcement of WTO Law

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Legal Background

The principal enforcement mechanism of WTO law is the right to exercise a form of authorized-retaliation against Members failing to comply with their obligations. This system allows for a scenario in which Members choose not to comply while suffering the costs of retaliation. In Europe, private parties have challenged this system several times. The last case of this long saga is the FIAMM case concluded in September 2008, with a judgment by the European Court of Justice (ECJ) that appears to have consolidated an approach facially precluding any possibility of directly resorting to WTO law in order to review the legality of the EC legislation or to obtain damages.

From Bananas ...

The ECJ dismissed the appeal lodged by two Italian companies, FIAMM and Fedon, claiming compensation for damages suffered because of the retaliatory measures ('suspension of concessions') imposed by the US. The WTO Dispute Settlement Body (DSB) authorized the US to suspend tariffs concessions up to ca. \$ 191.4 million annually as a consequence of the EC import regimes for bananas (Fig.1) from African Caribbean and Pacific (ACP) countries, which was found in violation of WTO law.



Figure 1. Bananas vendor.

... To FIAMM

Duties were raised to 100% (from as low as 3.5%) on a number of products, ranging from the spectacle cases produced by Fedon (Fig.2) to industrial batteries, produced by FIAMM. The producers of these products are often referred to as collateral victims of 'trade wars'.



Figure 2. Spectacle case produced by Fedon.

Central Research Questions

Against this background, the Article seeks to advance the debate on the status of WTO law in the Community legal order by addressing the following questions:

- Is it beneficial to enhance WTO compliance by introducing a form of decentralized enforcement?
- Is it desirable to grant unilaterally direct effect to WTO law? Or should this only be decided in a multilateral setting?
- Should collateral victims of trade wars be compensated?
- What are the costs and benefits of different rules in this area?

Innovation and Methodology

The Article originally contributes to the existing scholarship on this subject in two ways:

1) It develops a theoretical framework, drawing from Law and Economics, to analyze the question of desirability of decentralized private enforcement of WTO law. It is worth noting that while the economic analysis of law has been long employed to shed light on the functioning of many areas of law, the field of international law remains highly understudied (Fig. 3).

This research is the first attempt to develop a general framework to better understand the consequences of endorsing different rules in relation to the WTO legal status under domestic legal systems.



Figure 3. Applying Law and Economics to International Law is relatively new and it demands conjugating economic insights with legal arguments in a balanced fashion.

2) The Article is also innovative in its legal analysis because it offers one of the first comments to the recently decided FIAMM case, and in particular, on the issue of EC non-contractual liability for lawful acts, whose conditions were discussed at length for the first time in the case.

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The Economic Framework and its Main Results

Having in mind the effects on compliance, we work with two clusters of rules :

- direct effect and non-contractual liability for unlawful acts and
- non-contractual liability for lawful acts

The first cluster of rules will open the door to review the legality of EC legislation in light of WTO law and, consequently, it will force WTO compliance. Hence, we develop alternative theoretical frameworks to understand whether forcing compliance through decentralized mechanisms is likely to bring about an efficient allocation of resources.

To this end, we apply the property vs. liability rules, originally developed by Calabresi and Melamed in 1972. Yet it is submitted that to fully understand the legal complexity of the WTO legal framework, the models needs to be refined; accordingly we conceptualize a rule that we call 'aspirational property rule operating through a limited liability rule.' By introducing a form of decentralized enforcement, this rule would be transformed into a pure property rule, which we show to be inefficient and, eventually, counterproductive for the system of liberalization of trade.

We test our conclusions also against Joost Pawelyn's study, which has charted the evolution of WTO law through the exit and voice theoretical framework (originally articulated by economist Albert Hirschman). Under this framework we conceptualize increasing compliance by means of decentralized enforcement (e.g. direct effect), as the *closure of an exit option*. We conclude that given the current high degree of legalization of the WTO system, the marginal costs of decentralized private enforcement are likely to outweigh its benefits.

Finally, we investigate the hypothesis of whether granting damages to collateral victims of trade wars may be meaningful. From a Law and Economics perspective, it is particularly interesting the reasoning of AG Maduro. In this context he argued that 'the acceptance of a principle of no-fault liability would meet the requirements of good governance. It would force the political authorities ... to assess better the costs that could ensue for citizens of the Union and to set them against the *advantages*' We submit that this position is not convincing from an economic perspective and show that a system endorsing a no-fault liability rule may have unreasonably high administrative costs.

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Conclusions

Applying economic insights has helped us in gaining a new perspective on the question of forcing compliance of WTO law through decentralized enforcement. Mechanisms to achieve compliance have their own costs (Fig. 4) and we have shown that forcing WTO compliance beyond the minimum requirements of the WTO legal framework is likely to entail significant costs.

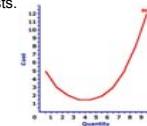


Figure 4. Stylized representation of marginal cost curves, in its standard U shape. This graph serves to illustrate the idea that forcing compliance is likely to have costs increasing with the degree of compliance already achieved.

Accordingly, we concluded that the approach of the European Courts has a sound economic rationale.

Two important caveats apply to our analysis.

- We did not attempt to shed light on issues of equity. However, it is submitted that equity gaps are better addressed through risk insurances policies or alternative compensation mechanisms.
- Moreover, most of our conclusions rest on the present circumstances underlying the WTO legal and socio-economic system. Changes in this system may alter our results.

For further information

This is a work in progress. A first draft of the paper will be soon uploaded on: www.eam.com. Please contact arcuri@fy.eur.nl for questions or comments.

