

PROPOSAL: THE IMPACT OF THE DISPUTE SETTLEMENT UNDERSTANDING (DSU) ON ECONOMIC EFFICIENCY AND COUNTRIES APPEALING BEHAVIOR

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Since its inauguration ten years ago, the WTO accumulated solidly the collection of legal decisions according to its DSU. It is a rare occasion in the field of international law that rules are well defined, implemented and, most importantly, enforced upon member countries in the WTO. The documentation of these decisions are readily available.

We would like to ask the following questions:

- (1) Are the current GATT and WTO rules appropriate for the resource allocation and on the income distribution in the world economy?
- (2) Do the final outcomes of legal decisions lead the world economy closer to a cooperative solution or the lower Nash equilibrium in the prisoners'-dilemma like situation (John Jackson, Claude Barfield)?

And,

- (3) How is the appealing-to-WTO behavior affected by the formation of rules based on the accumulation of DSU rulings?

The first two questions economic and the last question is related to incentives to bring "legal" actions to the WTO, and accordingly a question in economic analysis of law.

Accordingly, I welcome a student who is interested in trade, applied game theory and "law and economics." The student will interpret and analyze the decisions of WTO panels and appellate bodies. We try to relate them, using quantitative methods, economic analysis and the analysis of the behavior of appeals or complaints from nations. The student will write sections of our joint paper.

SUMMARY

Dongyung Park, Calhoun College Class of 2006

In the summer of 2005, I had the great fortune of working with Professor Koichi Hamada and Professor Takashi Shimizu on a project titled "The Impact of the Dispute Settlement Understanding on Economic Efficiency and Countries' Appealing Behavior."

The title suggests that this is a two-part problem. In order to answer the first part, we used the concept of "efficient breach of contracts," which was outlined and applied to WTO Dispute Settlement scenarios by Warren F. Schwartz and Alan O. Sykes in "The Economic Structure of Renegotiation and Dispute Resolution In The World Trade Organization." An efficient breach

occurs when the promisor of a contract gains more from the breach than the promisee loses, thereby improving the overall efficiency. While Schwartz and Sykes argue that WTO dispute settlement procedures encourage efficient breaches by banning unilateral retaliation (which was a mechanism used by GATT, a predecessor to WTO), they fail to note the difference between a fair efficient breach and an unfair, but still efficient, breach. For example, if the promisor gains eleven utility points for breaching a contract and the promisee loses five, then an efficient breach is reached. If there is a mechanism set up to force the promisor to hand over at least five utility units to the promisee, then it would be a fair breach. Otherwise, it would be unfair. It must be noted that we are not worried about the issue of *justice*. We are distinguishing a fair breach from an unfair breach only because we want to examine the different ways they influence the behaviors of the players, which has a significant effect on the overall efficiency.

If a system promotes unfair breaches, it also encourages indiscriminant breaches of contracts, efficient or otherwise. If the punishment is light enough that the promisor can foresee a gain from the breach, he/she will breach without hesitation, regardless of its overall efficiency. At first glance, the WTO Dispute Settlement Understanding seems to promote unfair breaches. It often takes two to three years for any dispute to resolve. During that time, the alleged violator has the freedom to keep violating the terms of contract, often in the form of raising tariffs or restricting market access for imported products. If the panel or the appellate body determines that there was a violation, all that the violator has to do is to stop breaching the contract. The panel or the appellate body does not order compensation for past violations unless the violator does not comply with the decision. The overall economic effect of this is unclear. We don't know whether the benefits of efficient breaches offset the cost of inefficient breaches.

The second question required a game theory approach, which was Professor Shimizu's specialty. In order to examine the "suing behavior" of WTO members, we had to construct a game tree that describes the dispute settlement procedure. While Professor Shimizu designed a simplified game tree in order to build a theoretical model, I made a detailed tree that maps every possible path that a dispute settlement procedure could take (please see the attached graphic file). Then, I spent a considerable amount of time reading summaries of every dispute settlement case between 1995 and 2004, coding each one according to the path it took. I also categorized each case by issues, countries, hostility level, and related products. I was surprised to find that a majority of the cases were resolved before they ever reached the panel review stage. It seemed to signify that the Dispute Settlement Body (and the WTO at large) has more influence on its members' behavior than I originally suspected. At the same time, however, many of the same issues under similar circumstances were brought up in different disputes, showing that at least in some cases, precedents did not effectively discourage suing.