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“Intellectual Property Rights and Dispute Settlement
In the World Trade Organization”

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Abstract: This paper makes several basic points relating to the *economics* of Intellectual Property Rights, the TRIPS Agreement, and the World Trade Organization dispute settlement process.

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Intellectual Property Rights and Dispute Settlement In the World Trade Organization

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In this paper I wish to make several basic points relating to the *economics* of Intellectual Property Rights (IPRs) and the World Trade Organization (WTO) dispute settlement process (DSP).

I Political Externalities and Trade Agreements

The prevalent view among international trade theorists is that multilateral trade agreements exist to deal with terms-of-trade externalities between countries. As Rick Bond (2003) points out, the basic features of the General Agreement on Tariffs and Trade (GATT) and the WTO are widely thought — by trade theorists but by almost no one else — to reflect this function. The approach is beautifully developed in Bagwell and Staiger (2002). But this view, prevalent though it might be among trade theorists, is a fantasy. The GATT, the WTO, and the associated schedules of national concessions do *not*, with very rare exceptions, constrain a country from exploiting monopoly power in world markets by taxing its exports. Article XI explicitly exempts “duties, taxes or other charges,” and, therefore, export taxes, from its

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elimination of quantitative restrictions “or other measures.” The GATT does require most-favored-nation (MFN) treatment for export taxes, and it does allow countries to bind export taxes in their schedules of concessions. But, with very rare exceptions, they have just *not* done so. Bagwell and Staiger (2002) employ a two-commodity model in which export taxes are completely equivalent to import tariffs for everything the government is assumed to care about: They therefore analyze the GATT in a model in which the actual GATT would be completely meaningless.¹

It is not sensible, I should think, to base a theory of the agreement on Trade-Related Aspects of Intellectual Property (TRIPS) on an entirely imaginary theory of multilateral agreements about trade in goods.

The true value of the Bagwell-Staiger work, I think, lies in their insistence that trade agreements should be viewed as responses to international externalities. Identifying this externality exclusively with the terms of trade, though entirely understandable in light of the existing trade theory literature which Bagwell and Staiger followed and further developed, was most unfortunate. It has condemned the work to apparent irrelevance. Fortunately many of the ideas in this literature, such as the role of reciprocity, can still be applied when the externality is more relevant than the terms of trade: various types of international political externalities, for example. See Ethier (2003, 2004). By and large, these theories deliver trade agreements consistent with the actual GATT and WTO *only* if political externalities *dominate* terms-of-trade externalities.

II The Role of Punishment

It is widely believed that the WTO DSP has something to do with punishment: It does after all authorize a retaliatory withdrawal of concessions when a decision is not complied with. The common view among economists, as Rick Bond (2003) explains, is that at least one of

¹I don't mean to single Bagwell and Staiger out for blame. They're doing what most other trade theorists have for half a century been doing: They just do it better.

the purposes of the DSP is to facilitate punishments that can deter violations of trade agreements. From this viewpoint, the interesting question, as Rick also points out, is why the punishments (basically tit-for-tat) are so weak.

I believe this view reflects a fundamental misunderstanding of the punishment role of the WTO DSP. That role is not to *facilitate* punishment: It is to *constrain* it. The actual source of punishment potential is not to be found in the formal activities of the Dispute Settlement Body (DSB), but in the bilateral essence of the bargains embodied in the multilateral trade agreements. If our partner does not give us what we bargained for, we will not deliver what we have promised. The bilateral nature of the WTO and its DSP in a *legal* sense was argued persuasively by Joost Pauwelyn (2003), (but I must admit that my knowledge of the law is such that I am easily persuaded). I am arguing now that there is an important *economic* aspect to this bilateralism as well.

The DSP constrains this punishment potential in three crucial ways. *First*, it accords the peaceful resolution of trade disputes primacy over punishment for past violations. Article 22, paragraph 1 of the WTO Dispute Settlement Understanding (DSU) states, “Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary, and, if granted, shall be consistent with the covered agreements.”

Second, the DSP seeks to maintain reciprocity by restricting the punishments to a substantially equivalent withdrawal of concessions (Article 22, paragraph 4 of the DSU: “The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment”), *and* by itself calculating what is substantially equivalent. That is, the purpose is *not* to punish: It's to maintain reciprocity in the face of violations. Of course there is still some element of punishment here, because a complainant country can, and often does, choose to withdraw those concessions that are the most damaging politically to the government of its non-compliant partner. But this reflects the inherent bilateralism and not the intent of the DSP. A government that feels it needs to back out of a trade commitment can do so *legally*, by negotiating with the foreign countries principally affected over appropriate reciprocal suspensions, or *illegally*, by simply refusing to honor its commitment. The latter route allows the government to grandstand to domestic

interest groups and to postpone the reciprocal suspensions. But, in the end, it must either negotiate or forsake playing a role in determining what those reciprocal suspensions will be.

Third, the DSP attempts to constrain disputes to remain *bilateral* and not develop into multilateral issues. All the details of the DSP reflect the aim of keeping disputes bilateral. Most notable is the fact that, although collective punishment would greatly enhance deterrence, the DSP has no provision at all for any kind of collective punishment: Only complainants themselves can punish noncompliance with a finding by the DSB. The purpose is not to limit the ability of other countries to become involved: They can either become co-complainants, if they wish, or declare themselves to be interested parties, thereby reserving the right to contribute input to the DSP process. Rather, the purpose is to prevent an individual dispute from escalating into a conflict that could threaten or split the WTO.

In summary, the WTO DSP has nothing really to do with facilitating *punishment*. Its purpose is to *prevent* retaliation from undermining trade agreements as a collection of bilateral, reciprocal, non-discriminatory deals between sovereign states. The underlying philosophy of the GATT/WTO is that no country be forced, *ex post*, to implement policies that it does not want, *ex post*, to implement. Presumably no country would be willing to sign on, *ex ante*, without such assurance. However, renegotiation must preserve reciprocity to preserve the integrity of the original agreement: The purpose of the DSP is simply to preserve reciprocity even when renegotiation does not succeed. See Ethier (2001).

III The TRIPS Agreement

The significance of the TRIPs agreement is not that it addresses IPRs in an international context: International patent and copyright conventions and agreements have been doing this for over a century. The TRIPs agreement goes beyond this in two ways. *First*, the earlier conventions were essentially concerned with national treatment (a UK inventor should be able to apply for a patent in Japan on the same terms as a Japanese inventor) whereas TRIPs addresses harmonization (all countries should implement a common minimal standard of intellectual property protection). Scotchmer (2003) provides an analysis of such

harmonization. *Second*, TRIPS puts all this into a comprehensive global context with a formal dispute settlement mechanism. (Note that this **not** an international *enforcement* mechanism that can be utilized by, or for the necessary benefit of, individuals with grievances: The WTO is a contract between states.) This may very well turn out to be what is most important from a legal perspective: Rochelle Cooper Dreyfus and Graeme Dinwoodie (2003) establish its significance for the nature of the future development of US patent law. This will presumably have economic implications.

But from the perspective of economics I think its most interesting and significant aspect could eventually lie elsewhere. Previous international agreements and conventions regarding IPRs were concluded between countries who regarded the protection of such rights to be in their mutual self interest. Countries who did not think such protection to be on balance in their self interest, because they were net importers of intellectual property, simply did not participate. Thus in the nineteenth century the US declined to conclude a copyright agreement with Britain when the US was a heavy consumer of British literature, but experienced a change in values as the literary balance of trade changed.

The TRIPS agreement has changed all that. The Uruguay Round can be seen, on one interpretation, as including a Great Bargain in which many (developing) countries, that believed — rightly or wrongly — that the protection of intellectual property was not in their self interest, agreed to it in exchange for trade concessions on goods, such as textiles and apparel, important to them as exports or as potential exports.² Newer WTO members have accepted it to gain accession. This was the first really significant example of such an inter-bloc bargain in all the GATT rounds.

The Great Bargain featured an asymmetry of implementation reflecting an asymmetry of power. The TRIPS agreement was to be implemented reasonably promptly, but the developed country trade concessions were to be delayed. For example, abolition of the Multi-Fiber Agreement (MFA), the main developed country concession, was to be gradually adopted over a ten year period, with most of the action scheduled for the tenth year. So, at this point, it is far from clear that the Great Bargain will indeed be consummated. This is reminiscent of the 1990s Europe Agreements between the European Union (EU) and former communist states of central Europe. The latter agreed to immediate trade concessions in return for a hope of eventual EU membership.

²This should not be interpreted as a bargain between monolithic blocs of developed and developing countries respectively. For example, some developing countries value highly the rents that accrue to them from export quotas on textiles and apparel.

In view of the Great Bargain, we can expect disputes in which the suspension of trade concessions is the threatened response, or the action necessary to maintain reciprocity, in response to an asserted failure in the protection of IPRs. Thus I welcome Rick Bond's (2003) emphasis of the possibility of such suspensions. I should point out that this is indeed a very real possibility. When a country is authorized to suspend concessions to a trading partner that has refused to abide by a negative DSB ruling, the concessions should be in sectors reasonably close to that in which the original violations are taking place. See Article 22, paragraph 3 of the DSU. But if this is not practical, either because withdrawals in such sectors would be unduly damaging to the aggrieved country or because they would not be sufficiently politically painful to the government in violation, the suspensions can take place in more distant sectors. If necessary, they can even involve suspension under related agreements, such as the General Agreement on Trade in Services (GATS) or the TRIPS. So what Rick Bond (2003) wants is indeed currently available; the question is just how strictly the "practicality" test is to be applied. Experience to date suggests that the test will not be applied strictly enough severely to prevent such cross-agreement suspensions.

I think, however, that the reason why the possibility of such cross-agreement suspensions is desirable is not that without them the set of retaliatory responses is too small, though that no doubt may often be true. It's that this is necessary for the DSP to fulfill its function of maintaining the reciprocity of relevant bilateral bargains of an inter-agreement nature.

IV TRIPS and Hostages

Rick Bond (2003) refers to the possibility of a country with intellectual property suspending trade concessions in response to a failure by a trading partner fully to implement or to observe its TRIPS obligations. But the opposite possibility — a country suspending its TRIPS commitments in response to a goods trade violation — is probably even more interesting. For example, when the EU declined to abide by a negative DSB finding in its banana dispute with the US, Ecuador, a co-complainant (and the country with the world's largest banana exports), was authorized to suspend concessions in response. Ecuador did not

think that suspending trade concessions would be very useful in this regard: It imports small quantities (relative to world markets) of a wide variety of consumer goods, and so could not inflict political pain with restrictions there, and its imports of producer goods were intermediate products vital to Ecuadorian industry. So the country decided that it would suspend some of its TRIPS obligations. This threat got the attention of the EU, which complained to the DSB for arbitration under Article 22, paragraph 6 of the DSU. The result was basically in Ecuador's favor.

Critics of the TRIPS agreement often assert that it amounts to a massive transfer from poor countries to rich countries, with the former having little prospect of developing significant intellectual property of their own and the latter little incentive to invest in innovations especially useful for the poor countries. This may be so. There is, however, another significant consideration, apparently overlooked, that could turn out to be of greater long term importance.

Since the late 1980s and early 1990s the developing countries have dramatically reoriented their trade policies from import substitution to eager participation in the multilateral trading system. But most of these countries, like Ecuador, are unable to exert much negotiating leverage through an ability to withdraw trade concessions. TRIPS, along with the possibility of cross-agreement suspensions, could help to change all that. It may well give at least some developing countries meaningful *hostages* in their relations with developed countries. For this to be possible, such countries must adopt TRIPS-consistent policies with enough bite to be thought significant by the developed countries.³

It is sometimes claimed that the developing countries have been slow to utilize the WTO DSP and that the lack of significant punishment ability in the event of noncompliance could be part of the reason.⁴ TRIPS could conceivably turn out to be just what is required for developing countries to make full use of the WTO DSP. In any event, it can't but help to aid those countries in trying to make sure that the Great Bargain is indeed consummated and that the MFA is actually eliminated.

³See Grossman and Mavroidis (2004) for a relevant discussion.

⁴The evidence is mixed: See Horn, Mavroidis, and Nordström (1999) and Bown (2003).

V Concluding Remarks

There is still more to think about. A combination of a TRIPs violation and the threatened withdrawal of a trade concession (or the opposite) could involve other closely related concessions in still other ways, despite their asymmetric natures. For example, the implementation of IPRs protection by a developing country could stimulate an inward technology transfer allowing the production of goods that can, because of a developed country trade concession, be exported. Thus noncompliance in a dispute could undermine both. But the evident scepticism about the ability of the TRIPs agreement to stimulate technology transfer suggests that such cases may not be common.

More generally, I would like to see an analysis of a model of trade agreements based on an exchange of trade concessions for concessions about the protection of IPRs. What are the relevant political externalities? Should such agreements possess the same features as agreements based solely on goods trade: MFN, national treatment, reciprocity? What should be the role of a DSP in such agreements, and what features should the DSP possess?

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