EUI WORKING PAPERS

LAW 2020/05
Department of Law

TEN LESSONS FROM 'INSTITUTIONAL ECONOMICS' FOR DESIGNING MULTILATERAL TRADE AND INVESTMENT INSTITUTIONS

Ernst-Ulrich Petersmann

European University Institute
Department of Law

TEN LESSONS FROM 'INSTITUTIONAL ECONOMICS' FOR DESIGNING MULTILATERAL TRADE AND INVESTMENT INSTITUTIONS

Ernst-Ulrich Petersmann

EUI Working Paper **LAW** 2020/05

ISSN 1725-6739

Printed in Italy
European University Institute
Badia Fiesolana
I-50014 San Domenico di Fiesole (FI)
Italy
www.eui.eu
cadmus.eui.eu

Abstract

Why were procedural and substantive trade rules – but not investment agreements – transformed into multilateral treaties following World War II? Why do state-capitalist conceptions of international economic law (e.g. in China's bilateral Belt and Road Cooperation), neo-liberal conceptions (e.g. in US trade agreements) and ordo-liberal conceptions (e.g. in European free trade agreements) result in such different legal and institutional designs of trade and investment agreements? The ten sections of this paper discuss ten lessons from institutional economics for the legal design of multilateral trade and investment institutions, with due regard to the increasing geopolitical rivalries among Anglo-Saxon neo-liberalism, European ordo-liberalism and authoritarian state-capitalism (e.g. in China and Russia). It concludes that maintaining the worldwide legal and dispute settlement system of the World Trade Organization (WTO) - and interpreting its regional and national exception clauses broadly in order to reconcile diverse, national and regional institutions of economic integration and of 'embedded liberalism' - remains in the interest of all WTO member states. Multilevel trade and investment adjudication are of constitutional importance also for the transformation of the global division of labor into a carbon-free economy mitigating climate change. Yet, its institutional design is increasingly challenged not only from neo-liberal and state-capitalist, but also from ordo-liberal constitutional perspectives.

Keywords

Constitutionalism; embedded liberalism; institutional economics; ordo-liberalism; neo-liberalism; WTO

Author contact details:

Ernst-Ulrich Petersmann

Emeritus Professor of International and European Law

European University Institute

Ulrich.Petersmann@eui.eu

Table of contents

Trade and Investments Depend on Rules and Institutions*

Economic activities – like production, distribution and consumption of goods and services and related investments - are influenced not only by offer and demand from private economic actors like producers, investors, traders and consumers. They are also strongly influenced by political values (like human rights), legal institutions (like common law liberties, protection of monetary stability, property rights, contract law, corporate law, rule of law), technological progress (e.g. enabling past 'industrial revolutions' based on steam power, electricity, information and communication technologies), social institutions (like markets, trust, corruption, religious and cultural traditions like gender equality), political governance institutions and government policies as explored by 'institutional economics'.[1] Humans create legal institutions in order to live and cooperate peacefully, limit risks (like 'Hobbesian wars of each against each other'), reduce transaction costs (e.g. due to uncertainty and incomplete information) and promote welfare through agreed rules limiting coordination problems and abuses of public and private power.[2] The design of legal institutions depends on public and private preferences and traditions, including also economic efficiency considerations based on cost-benefit analyses and economic assumptions that, for instance,

- individuals seek to maximize the achievement of their preferences (methodological individualism), for instance, they prefer – all things being equal – cheaper goods and services, and less costly means of realizing their other human goals;
- the only valid source of values is individual preferences (normative individualism);
- 'perfect competition' (as a spontaneous information, coordination and sanctioning mechanism) tends to maximize satisfaction of 'real demand' and supply, for example by inducing producers to remain responsive to consumer interests and limiting power and 'moral hazard';
- also voluntarily agreed, market exchanges allocating property rights may be superior to governmental allocation (Coase theorem);
- political competition for, within and between government(s) may produce benefits for citizens similar to those generated by economic market competition, for instance by promoting regulatory competition and limiting 'moral hazard' inside federal states[3] and among members of the Eurozone with more or less fiscal and debt disciplines;
- also the development of, compliance with, or disregard for international law rules (like customary law, national jurisdiction, establishment of international organizations) may be influenced by economic considerations and choices.[4]

---

* E.U. Petersmann is Emeritus Professor of International and European law, European University Institute (EUI), Florence, Italy. ulrich.petersmann@eui.eu. This paper was prepared for an international conference on 'Rethinking the Role of Institutions in Economic Integration' at the University of Amsterdam in 2020.

[1] Cf. C.Ménard/M.M.Shirley (eds), Introduction to a Research Agenda for New Institutional Economics (Cheltenham: Elgar Publishing 2018); W.K.Viscusi/J.M.Vernon/J.E.Harrington, Economics of Regulation and Antitrust (2nd ed., MIT Press 1995). On the need for 'responsive regulation' and the role of 'procedural justice' in promoting voluntary compliance see: P.Drahos (ed), Regulatory Theory. Foundations and Application (Australian National University Press 2017), chapters 1-3, 7-8.

[2] On the importance of transaction costs in the emergence of firms and other market institutions see: R.Coase, The Problem of Social Cost, in: *The Journal of Law and Economics* 3 (1960), 1-44; O.E.Williamson, *Markets and Hierarchies. Analysis and Antitrust Implications* (New York: Free Press 1975).

[3] Cf. R.D.Cooter, *The Strategic Constitution* (Princeton University Press 2000), 127ff.

[4] Cf. J.P.Trachtman, *The Economic Structure of International Law* (Cambridge Mass.: Harvard UP 2008).

Yet, the economic 'theory of second best' admits that – in the real world without 'perfect market competition' and without equal access to human capabilities, economic resources and opportunities – a move toward 'free markets' may not enhance efficiency.[5] Hence, the utility-maximization paradigm of welfare economics for limiting the scarcity of resources through rational economic choices within the existing rules and institutions must be supplemented by the social contract paradigm of 'constitutional economics' emphasizing the need for reasonable choices of constitutional and legislative rules protecting human capabilities (like equal access to education, health protection, satisfaction of basic needs), corresponding human and constitutional rights of citizens, and rules and institutions limiting market failures as well as governance failures.[6]

Constitutional economists apply the market assumption of individual pursuit of self-interests also to political markets. Constitutional contracts are interpreted as rules-based, contractarian processes (e.g. assigning all persons equal values), in contrast to post-constitutional governance that is often more akin to result-oriented search of truth, for instance when organizations (like firms, political governments) receive limited, delegated powers for realizing specified goals. As 'political failures' may be just as pervasive as 'market failures', the search for legal protection of individual preferences (e.g. by means of legal protection of human and fundamental rights) and for legal restraints on abuses of public and private power must explore not only legislative, but also potential constitutional rules and the use of multilevel governance mechanisms based on international law and 'institutional checks and balances'. Hence, rather than calculating efficiency only by way of cost-benefit studies, constitutional economists search for inclusive, reasonable agreements among citizens protecting democratic preferences, limiting special interests and constraining government powers to discriminate (e.g. in response to rent-seeking pressures). Yet, the 'social contract ideal' of citizens making reasonably informed 'constitutional choices' is often confronted with the reality that economic actors and political regulators have only limited knowledge of the complex interactions among private and public, national, transnational and international legal, economic, political and social rules and institutions.[7] Their decisions may be influenced also by 'rational ignorance' and intuitive or irrational motives.[8] The 'paradox of freedom' – i.e. the inherent risks of human freedoms destroying themselves by 'destructive abuses' (e.g. of public and private power) rather than 'constructive uses' respecting the equal freedoms of all others – has prompted all 193 UN member states to adopt national Constitutions (written or unwritten) limiting governance failures in the supply of national public goods (PGs). The more globalization continues to transform national into transnational PGs that no state can unilaterally protect without international rules and institutions, the stronger becomes the need for 'constitutionalizing' also foreign policy powers and the law of international organizations. The 'institutional economics' underlying multilevel governance of transnational PGs remains under-researched.[9]

Just as national Constitutions can become effective only through progressive transformation of their constitutional rules into democratic legislation, administration and adjudication protecting rule of law and equal rights of citizens, so can 'world order treaties' - like the UN Charter and the WTO Agreement

---

[5] On the history of feudal, capitalist, communist and neo-liberal 'inequality regimes' distorting market competition, the distribution of incomes and wealth see: T.Piketty, *Capital and Ideology* (Cambridge Mass.: Belknap Press 2019).

[6] On constitutional economics exploring the constitutional-legal-institutional rules constraining the activities and choices of economic and political agents see section VI below and J.M.Buchanan, Constitutional Economics, in: J.Eatwell/M.Milgate/ P.Newman (eds), *The New Palgrave: The Invisible Hand* (New York: Norton, 1989, 79ff.

[7] Cf. G.Brennan/J.M.Buchanan, *The Reason of Rules. Constitutional Political Economy* (Cambridge: CUP 1985).

[8] On behavioral economics exploring intuitive or irrational economic behavior see, e.g.: A.van Aaken/J.Kurtz, Beyond Rational Choice: International Trade Law and the Behavioral Political Economy of Protectionism, 22 *Journal of International Economic Law* (2020), 601-628.

[9] Cf. E.U. Petersmann, *Multilevel Constitutionalism for Multilevel Governance of Public Goods. Methodology Problems in International Law* (Oxford: Hart, 2017).

– protect global PGs only through additional legislative, administrative and judicial implementing acts (like political or judicial interpretations clarifying indeterminate treaty provisions). The 'sovereign equality' of states and related legal freedoms protect 'regulatory competition' among states; however, they are often abused, for instance if governments (like the US Trump administration) welcome the adoption by the WTO Dispute Settlement Body (DSB) of 'constructive WTO dispute settlement rulings' supporting their legal complaints vis-à-vis other WTO members, but reject similar WTO dispute settlement findings against themselves as defendant on the ground that the rulings create 'new obligations' not consented to by their government.[10] Moreover, unequal distribution of human and economic resources risks aggravating social inequalities to a point that citizens lose trust (e.g. in social justice) and circumvent the law (e.g. through tax avoidance, black markets, illegal transactions).[11] Institutional economics (as discussed in section II) therefore emphasizes the need for 'social embedding' of international economic regulation and for 'institutionalizing public reason', for instance by independent monetary authorities protecting monetary stability, independent competition authorities protecting non-discriminatory conditions of competition, impartial third-party adjudication protecting rule-of-law and equal rights of citizens, and 'social market economies' protecting also social rights and 'social peace' (as discussed in section III).

History confirms this dialectic evolution of law as an instrument of rules-based, social and economic ordering and of result-oriented utility-maximization. The – often spontaneous – emergence and functioning of local markets (e.g. responding to supply and demand for local goods and services) depended, inter alia, on legal guarantees of contract law (*pacta sunt servanda*), private property rights, monetary means of payment or barter, tort and criminal law (e.g. limiting fraud). In response to abuses of monetary and police powers entailing legal insecurity and market distortions, democratic and republican city states (e.g. since the ancient Greek and Italian city republics) introduced republican laws limiting monetary, tax and fiscal powers of governments, and regulating monetary, trade, investment and health policies, related contractual and property rights, and transnational trade and investment agreements (e.g. among city republics around the Mediterranean Sea, the 'Hanse cities' around the Baltic seas).[12] The 1944 Bretton Woods Agreements and decolonization initiated progressive worldwide, legal and institutional reforms of economic regulation aimed at limiting abuses of power (e.g. in authoritarian and imperial trade regimes) and protecting transnational PGs.

Design of Economic Law Requires Institutional Economics

Empirical evidence confirms close interrelationships between legal systems and economic welfare (e.g. widespread poverty in communist countries like China, Cuba and the Soviet Union prior to their introduction of market reforms based on private property and commercial laws). Institutional economics explores the organization and institutions related to production, distribution and consumption of goods and services, including the legal limitation of 'market failures' (e.g. related to abuses of power, cartel agreements, mergers and acquisitions, externalities, information asymmetries, public goods), 'governance failures' and 'constitutional failures' through democratic regulation and institutions. It complements neo-liberal welfare economics (e.g. focusing on markets and competition as incentives for reducing the scarcity of goods and services through division of labor exploiting comparative advantages) and 'constitutional economics' (e.g. exploring economic rights of citizens and principles for constituting market competition, monetary stability and rule-of-law reducing transaction costs in free societies). The institutional characteristics of economies and of their legal, political and social organization vary

[10] On the illegal blocking and contradictory criticism by the USA of the WTO dispute settlement system see: E.U.Petersmann, How Should WTO Members React to their WTO Governance Crises? in: *World Trade Review* (18) 2019, 503-525.

[11] Cf.A.Case/A.Deaton, *Deaths of Despair and the Future of Capitalism* (Princeton University Press 2019).

[12] For 'institutional economics analyses' of the ancient economies of Rome and Greece see: T.Terpstra, Neo-Institutionalism in Ancient Economic History, in: Ménard/Shirley (n 1), chapter 26.

enormously across space and time. Understanding the concrete social-historical factors shaping the functioning of economies can be enhanced through comparative studies (e.g. of behavioral production and consumption patterns, informal social belief systems, formal legal and political institutions). Neo-liberal economies (e.g. like the USA), ordo-liberal economies (e.g. like the European common market) and state-capitalist economies (e.g. in China) are founded on different values (like Anglo-Saxon utilitarianism, European rights-based economic constitutionalism, totalitarian power monopolies in China). The less social, economic, political and legal interactions can be separated in the evolution and design of economic institutions (e.g. 'equilibrium prices' and 'exchange rates' balancing supply and demand of traded goods and currencies), the more interdisciplinary cooperation is needed for understanding and designing institutions in national and international economic regulation.

Since the founding thinkers of institutional economics (like R.Coase, D.North, E.Ostrom, O.Williamson) received their respective economic Nobel prizes, globalization and hegemonic power politics continue to transform worldwide economic regulation, as illustrated by the 2020 global health pandemic and the assault on the WTO legal and dispute settlement system by the US Trump administration. The Bretton Woods agreement and the 1947 General Agreement on Tariffs and Trade (GATT) had been negotiated and progressively implemented under the leadership of the USA; they were strongly influenced by Anglo-Saxon, economic liberalism aimed at liberalizing trade barriers and promoting monetary stability and convertibility of currencies. GATT 1947 never entered into force and was applied only on the basis of a 'Protocol of provisional application'. The design of GATT institutions and of GATT's dispute settlement system progressively evolved through decisions of the GATT Contracting Parties and additional trade agreements resulting from eight 'GATT Rounds' of multilateral trade negotiations. The WTO institutions and multilevel WTO dispute settlement system resulted from the multilateral Uruguay Round negotiations (1986-1994) ushering in the 1994 Agreement establishing the WTO and its Dispute Settlement Understanding (DSU). The separation of legislative, executive and judicial powers of WTO institutions (cf. Article III WTO), the multilevel WTO governance structures (cf. Article IV), the coordination of WTO activities with those of other worldwide and regional organizations (cf. Articles V WTO, XXIV GATT), and the multilevel WTO dispute settlement system 'providing security and predictability to the multilateral trading system' (Article 3 DSU) reflect ordo-liberal 'constitutional economics' (e.g. explaining welfare gains from informed consent to rules, rule of law and third-party adjudication of trade disputes) rather than only utilitarian neo-liberalism (e.g. pursuing maximization of individual 'utilities' and of 'Pareto'- and 'Kaldor-Hicks'-efficiencies).[13] Since 2017, the US Trump administration's assault on the WTO legal and dispute settlement systems is driven by hegemonic, mercantilist power politics and neo-liberal interest group politics. Since December 2019, the illegal US blocking of the filling of Appellate Body (AB) vacancies prevents the AB from accepting new appeals; it risks undermining the whole WTO legal and dispute settlement system. The geopolitical rivalries among Anglo-Saxon neo-liberalism, European 'social market economies' and authoritarian state-capitalism (e.g. in China and Russia) entail new risks (e.g. as illustrated by US justifications of discriminatory import restrictions by invoking national security exceptions), transaction costs and institutional challenges (e.g. for limiting market distortions by state-owned enterprises (SOEs), limitation of security risks resulting from dependence on Chinese SOEs controlling transnational energy, communication and technology networks).[14] The global health pandemic (Covid-19) of 2020 revealed insufficient health care institutions and medical supplies in many countries and protectionist, nationalist responses with adverse effects on the public health emergencies in other countries.

[13] On the differences between Anglo-Saxon, utilitarian neo-liberalism and European, constitutional ordo-liberalism see: E.U.Petersmann, Economic Disintegration? Economic, Political and Legal Drivers and the Need for Greening 'Embedded Liberalism', in: *JIEL* 2020 (forthcoming).

[14] Cf. C.Long, The China Experience: An Institutional Approach, in: Ménard/Shirley (n 1), chapter 15.

Transnational Public Goods Require 'Embedded Liberalism'

Trade liberalization before World War I reflected 'dis-embedded liberalism' based on laissez faire-attitudes in most countries vis-à-vis the social adjustment problems created by colonialism and the first industrial revolution (based on machines driven by steam power). The post-war second industrial revolution (based on mass assembly line production driven by electricity) was embedded into domestic economic regulation, competition and social policies in most industrialized countries. The 'embedded liberalism'[15] underlying GATT 1947 not only permitted governmental regulations of 'market failures' (like externalities, market power, PGs, information asymmetries) and of related 'governance failures' and constitutional problems (like principal-agent relationships, cognitive and volitional limitations of 'rational choices' observed by behavioural economists); it also enabled and promoted welfare states through reciprocal trade liberalization enhancing mutually beneficial division of labour and economic and legal cooperation in producing private and public goods. The economic 'theory of optimal intervention' justifying GATT's legal ranking of alternative policy instruments in terms of their economic efficiency (e.g. allowing non-discriminatory internal taxes, product and production regulations; limiting border tariffs; and prohibiting discriminatory non-tariff trade barriers subject to 'exceptions' for non-economic, non-discriminatory domestic regulations) enabled mutually welfare-enhancing, legal harmonization reducing transaction costs and political conflicts – without limiting national sovereignty over non-discriminatory, domestic regulation of the economy and polity.[16] As reciprocal trade liberalization depends on inclusive policy-making supported by citizens ('all politics is local'), some GATT lawyers interpreted these political, economic and legal theories justifying GATT's 'embedded liberalism compromise' as 'constitutional functions' of GATT rules for promoting equal freedoms, non-discrimination, rule of law, judicial remedies and social justice also inside domestic economies and polities for the benefit of citizens. [17]

WTO law responded to the third industrial revolution of computers and telecommunications by additional, multilateral harmonization of product and production standards, competition and trade remedy rules, liberalization and regulation of services trade, protection of intellectual property rights, and of transnational rule of law through compulsory jurisdiction for settlement of trade disputes through domestic judicial remedies and WTO dispute settlement procedures. WTO law changed the embedded liberalism underlying GATT 1947 in ways reflecting both neo-liberal Anglo-Saxon interest-group politics (e.g. resulting in the WTO Anti-dumping and Trade-related Intellectual Property Rights (TRIPS) Agreements)[18] and ordo-liberal insistence on strengthening 'sustainable development', non-

[15] This term was coined for describing the dual GATT 1947 objectives of international trade liberalization and domestic political autonomy (e.g. to regulate markets and their social adjustment problems, and to stabilize the economy in case of external shocks) by J.G.Ruggie, International regimes, transactions and change: Embedded liberalism in the postwar economic order, in: *International Organization* 36 (1982), 379-415.

[16] Cf. M.Corden, *Trade Policy and Economic Welfare* (OUP 1974). On the economic, legal and political functions of GATT 1947 see GATT's chief economist J.Tumlir, GATT Rules and Community Law, in: M.Hilf/F.G.Jacobs/E.U.Petersmann (eds), *The European Community and GATT* (Deventer: Kluwer, 1986), 1-22.

[17] Cf. the contributions by F.Roessler, E.U.Petersmann, J.H.Jackson, R.E.Hudec, J.Bourgeois, P.Pescatore, T.Cottier, M.Matsushita and numerous other American, Asian and European GATT lawyers to M.Hilf/E.U.Petersmann (eds), *National Constitutions and International Economic Law* (Deventer: Kluwer 1993).

[18] The inconsistencies of anti-dumping laws and practices with non-discriminatory competition rules are widely recognized; they prevented WTO negotiators from agreeing on a Preamble text explaining the economic rationale of the WTO Anti-dumping Agreement. Many competition lawyers express concerns (e.g. in H.Ullrich *et alii*, eds, *TRIPS Plus 20. From Trade Rules to Market Principles*, Heidelberg: Springer, 2016) that some anti-dumping and TRIPS rules – whose drafting was dominated by domestic industry lobbyists – offer too much protection stifling competition and innovation (e.g. as exemplified by recent complaints of 35 major technology companies that 'patent trolls' are being abused for rent-seeking licensing practices blocking development and use of new technologies; cf. 'Apple, Microsoft and BMW urge EU to stop patent trolls'

discriminatory conditions of competition (e.g. as reflected by the non-discrimination and 'necessity' requirements in the WTO Agreements on technical barriers to trade and (phyto)sanitary standards, the phasing-out of the Agreement on Textiles and Clothing) and rules-based dispute settlement. Compared with the 'provisional application', lack of parliamentary ratification and 'grandfather exceptions' of the intergovernmental GATT 1947, the WTO Agreement strengthened the 'constitutional dimensions' of WTO law, as illustrated by the democratic ratification of the WTO Agreement, its incorporation into the domestic legal systems of many WTO members, the separation of legislative, administrative and judicial powers of WTO institutions (cf. Article III WTO Agreement), majority voting (cf. Article IX), the compulsory jurisdiction of the WTO dispute settlement system, and the (quasi)automatic adoption of more than 420 WTO panel, appellate and arbitration reports.

Anglo-Saxon neo-liberalism and 'private ordering ideals' (e.g. based on private and common law rules for contracts, property, torts, arbitration, criminal law) reinforced calls for liberalization, deregulation, privatization and interest-group-driven economic policies ushering in 'hyper-globalization' (e.g. of financial markets, global value chains) enhancing financial instability, social inequality inside countries, environmental pollution and climate change. The failures of the Doha Round negotiations, circumvention of WTO disciplines by China's totalitarian state-capitalism, and, since 2017, the hegemonic trade mercantilism of the US Trump administration increasingly disrupted the WTO legal, dispute settlement and negotiation systems, ushering in illegal blocking of the WTO AB system, increasing non-compliance with WTO subsidy and trade remedy disciplines, hegemonic abuses of trade sanctions (e.g. in the context of the US-China trade wars) and protectionist US trade restrictions (e.g. on aluminium and steel). Arguably, similar to the successful adjustment of GATT's embedded liberalism to the challenges of decolonization, the embedded liberalism underlying the WTO trading system[19] needs to be adjusted not only to the 'new nationalism' underlying President Trump's hegemonic mercantilism, the United Kingdom's 'Brexit' from the European Union (EU), and protectionism in BRICS countries (Brazil, Russia, India, China, South Africa). In order to enable WTO members to realize their 'sustainable development' objectives, WTO rules and institutions must also adjust to the 2015 Paris Agreement aimed at mitigating climate change. The adoption by all 193 UN member states of the UN 'sustainable development goals' - and the increasing 'climate change litigation' requiring governments to limit greenhouse gas emissions in order to protect human rights[20] - justify interpreting 'embedded liberalism' in conformity with the universal recognition of 'indivisible' civil, political, economic, social and cultural human rights and the underlying 'constitutional insight' that the complex interactions among civil societies, polities, economies, social and cultural cooperation require domestic empowerment of citizens and their support for protecting transnational PGs. Just as democratic constitutionalism differs among countries in response to their different circumstances, histories and democratic preferences, so must institutional economics respect the diversity of local circumstances, for example by responding to the reality of populist nationalism (e.g. by the US Trump administration) denying international PGs.

Financial Times of 16 January 2020, available at https://www.ft.com/content/26230960-37a7-11ea-a6d3-9a26f8c3cba4).

[19] My use of the term embedded liberalism differs from that by A.Lang, *World Trade Law after Neoliberalism* (OUP 2011), who describes the period from 1947 to the early 1970s as 'the period of embedded liberalism' (p.16) and the following period up to around 2000 as 'the neoliberal turn' (p.17). While some Tokyo Round and Uruguay Round Agreements and national trade policies in some GATT/WTO member states pursued neo-liberalism since the late 1970s, other GATT/WTO agreements (like the 1979 GATT 'Enabling Clause', the WTO Dispute Settlement Understanding) and domestic economic law developments (e.g. in EU competition, monetary, social and environmental regulation) pursued ordo-liberal regulation rather than deregulation and liberalization of markets.

[20] Cf. A.Nollkaemper/L.Burgers, A New Classic in Climate Change Litigation: The Dutch Supreme Court Decision in the Urgenda Case, in: *EJIL Talk* (blog of 6 January 2020). References to climate change lawsuits can be found in: http://climatecasechart.com/ .

Globalization Requires Multilevel Governance of Transnational Public Goods

Market mechanisms of demand and supply tend to offer spontaneous incentives for decentralized production of private goods and services demanded by people. The 'non-excludable' and 'non-exhaustive' characteristics of 'pure PGs' – like sunshine or human rights, whose benefits are non-rivalrous in consumption and non-excludable – impede their production and offer in private markets. PGs theories distinguish different kinds of – and diverse supply strategies for - pure or impure PGs and 'common pool resources'.[21] Globalization transforms national into transnational PGs (like markets, monetary stability, legal, food and health security, climate change mitigation) requiring multilevel governance institutions limiting the collective action problems of intergovernmental politics. For example, behavioural economics and 'public choice theories' explain why 'intergovernmental supply of PGs' requires 'institutional checks and balances' limiting abuses of public and private powers: Just as executive powers inside national jurisdictions have often been abused until democratic and republican constitutionalism progressively succeeded - in many countries – in protecting constitutional rights of citizens and collective supply of national PGs, so have the multilevel constitutional 'checks and balances' and judicial protection of constitutional and human rights inside the EU – or the multilevel judicial protection of transnational rule of law among the 164 WTO members – enhanced the efficiency of multilevel governance of transnational PGs, for instance by reducing transaction and coordination costs.

Most transnational PGs are 'aggregate PGs' that must be produced collectively through aggregation and integration of local, national, regional and worldwide 'building blocks' (e.g. for limiting green house gas (GHG) emissions). Transforming 'pure' into 'impure PGs' (e.g. by formation of 'clubs') – like the WTO trading, legal and dispute settlement systems - can reduce 'collective action problems' (e.g. by making club-membership conditional on cooperation and limitation of free-riding). The particular characteristics of PGs risk leading to actions that may be rational from an individual's perspective (like use of fossil fuels) but harmful from a collective PGs viewpoint (like reduction of GHG emissions so as to promote 'green', carbon-free economies). International organisations facilitate international cooperation among state actors, for instance by enabling access to information, negotiating agreed rules, supervising and promoting rule-compliance. The optimal supply strategies differ depending on the particular characteristics of PGs (like non-proliferation of nuclear weapons) and on the diverse preferences and interests of countries. Multilevel governance of transnational PGs often suffers from

- participation gaps (e.g. withdrawal of the USA from the 2015 Paris Agreement on climate change mitigation);
- incentive gaps (e.g. for less-developed economies dependent on fossil fuels) and
- jurisdiction gaps (e.g. inadequate international agreements on fossil fuel subsidies, carbon taxes, border carbon adjustments and emission trading systems).

Even if international organizations succeed in limiting collective action problems, abuses of executive powers (like President Trump's imposition of discriminatory tariffs violating WTO law, illegal blocking of WTO AB judges) require multilevel, legal reforms. Social support for protecting PGs may depend on protecting 'fair competition' and social justice in economic, environmental and political cooperation among citizens.

[21] On the economic distinction between private goods, non-excludable and non-exhaustible 'pure PGs', non-exhaustible 'impure PGs', and non-excludable 'common pool resources', their respective 'collective action problems', and the legal strategies for limiting market failures, governance failures and 'constitutional failures' (like formation of 'clubs' limiting free-riding among WTO members and among citizens) see Petersmann (n 9).

'Constitutional Pluralism' Requires Respect for 'Legal-Institutional Pluralism'

Modern human rights law (HRL) and the 'sovereign equality of states' protect individual and democratic diversity as well as legal diversity among today's 193 UN member states. Almost all states have adopted (written or unwritten) national Constitutions, have ratified one or more UN human rights conventions, and cooperate in the context of hundreds of international organizations for the collective supply of transnational PGs. The hundreds of national legal systems, thousands of international treaty systems, and millions of transnational legal systems (e.g. governing transnational corporations, their foreign investments and trade in goods and services) entail 'legal-institutional pluralism', embedded into diverse national Constitutions constituting legal and political governance systems for the collective supply of national PGs. National and transnational governance of 'aggregate PGs' (like monetary, trade, investment, environmental, human rights and legal systems) interact in complex ways. The interdependencies between diverse social, political, economic, cultural and legal systems require respect also for the reality of 'constitutional pluralism' and 'legal-institutional pluralism' constraining human cooperation. The complex regulatory challenges entail that national and international economic organizations tend to be based on 'incomplete agreements'; their effective functioning depends on additional legislation, administration, dispute settlement procedures, and their constant interactions with related, regulatory (sub)systems and adaptations to changing circumstances (like the global Covid-19 health pandemic of 2020 demonstrating the need for better health cooperation and for shared emergency supplies of medical goods and services).

Empirical studies of 'embedded liberalism' confirm that the legal design of multilevel institutions in economic integration differs among jurisdictions, for instance inside and among state-capitalist economies (like China and Russia), neo-liberal economies (like the USA) or ordo-liberal economies (like the European common market) and their diverse polities and legal systems. Each of these competing economic systems proceeds from competing value premises, such as the political power monopoly of China's communist party, the US democracy prioritizing civil and political constitutional rights of US citizens, and the more comprehensive protection of multilevel civil, political, economic, social and cultural human and constitutional rights in the multilevel constitutional law of the EU and its 27 EU member states. The initial post-1945 expectation of inducing all GATT member countries to follow the US model of neo-liberal liberalization of market access barriers, deregulation, privatization and financialization of markets (as spontaneous information-, coordination- and sanctioning mechanisms) has proven illusory. As a consequence, GATT/WTO trade rules and investment rules need to be adjusted to the reality of member states with diverse neo-liberal, ordo-liberal or state-capitalist economic systems and to the resulting geopolitical rivalries (e.g. between US-dominated Bretton Woods institutions at Washington, China-dominated Asian institutions like the Asian Infrastructure Investment Bank at Beijing). The competing value premises entail that, for example, China's Belt and Road Initiative (BRI) agreements with more than 60 countries along the ancient territorial and maritime 'Silk Roads' are based on different legal and institutional principles (e.g. for dispute settlement, government procurement, protection of individual rights) compared with the free trade agreements (FTAs) concluded by the USA or by the EU. Due to the institutional diversity inside and among states, views on how to define 'market distortions' in the global trading system,[22] or how to design international trade and investment adjudication,[23] are increasingly contested.

Welfare Economics Must be Complemented by Constitutional Economics

All societies are governed by rules that may be justified by a variety of reasons such as

- power politics (e.g. rules imposed by authoritarian rulers);

[22] Cf. A.Lang, Heterodox markets and 'market distortions' in the global trading system, in: *JIEL* 22 (2019), 677-719.

[23] See section X below.

- social and religious beliefs (e.g. religious leaders imposing Islamic, Jewish or Catholic law, Chinese and other emperors invoking 'mandates of heaven');
- democratic consent (e.g. to constitutional agreements, parliamentary legislation, delegated administrative rules and judicial decisions); and
- economic efficiency (e.g. trade, competition and common market rules justified in terms of 'Pareto efficiency' and 'Kaldor-Hicks efficiency').

Theories of knowledge (e.g. by Nobel Prize economist F.A. Hayek) justify markets, price mechanisms and spontaneous emergence of 'market rules' as decentralized information, coordination and sanctioning mechanisms reflecting decentralized knowledge among individuals, which no central government can possess. Welfare economists demonstrate the existence of 'market failures' (like abuses of power, cartel agreements, externalities, information asymmetries, PGs) that distort the efficient functioning of market mechanisms; they may justify governmental trade and competition rules and other market interventions aimed at 'efficiency gains' resulting from governmental limitations of 'market failures'. Public choice economists warn of 'governance failures' and 'constitutional failures' that risk impeding or distorting governmental attempts at correcting market failures. 'Constitutional economists' address the constitutional question of how people can live together in liberty, peace and prosperity by using the 'exchange paradigm' for exploring efficient 'choices of constraints': How should constitutional rights, obligations and institutions be designed in order to 'constitute markets', protect democratic preferences, limit governance failures, and enhance economic welfare and social support through 'embedding' economic law into 'social justice systems' responding to democratic preferences and citizen demand for PGs?[24] 'Constitutional reforms' (e.g. in communist economies) may be of more existential importance for citizens than the utility maximization paradigm of 'efficient choices within existing constraints' (like use of 'black markets').

GATT and WTO law, regional economic integration law and domestic implementing laws rank alternative economic policy instruments according to their respective economic efficiency as explained by theories of 'optimal intervention'. For instance:

- Articles III, XVI GATT allow non-discriminatory domestic economic regulations (like tax, competition, consumer and environmental protection rules, consumption and research subsidies).
- Discriminatory border tariffs and production subsidies may be legally 'actionable' in case of tariff bindings (Articles II, XXIII, XXVIII GATT) and injurious market distortions (Articles 5, 6 WTO Subsidy Agreement).
- Discriminatory non-tariff trade barriers tend to be prohibited (e.g. Article XI GATT) unless they can be justified as being necessary for protection of non-economic PGs like public health, 'public morality' (Article XX GATT) and national security (Article XXI GATT).

In contrast to neo-liberal Chicago School recommendations for liberalizing market access barriers, deregulating and privatizing economic activities, and for 'financialization' enhancing the self-regulatory forces of market competition, the ordo-liberal European and Virginia Schools of 'constitutional economics' perceive economic markets as legal constructs (rather than as gifts of nature). Their efficient, welfare-enhancing functioning depends on, inter alia

- 'constituent principles' (like economic freedoms, property rights and other fundamental rights of citizens, monetary and price stability protected by independent central banks);

[24] Cf. V.J.Vanberg, *The Constitution of Markets. Essays in Political Economy* (London: Routledge, 2001); R.B.McKenzie (ed), *Constitutional Economics. Containing the Economic Powers of Government* (Lexington: Lexington Books, 1984); J.M.Buchanan, *The Economics and the Ethics of Constitutional Order* (Ann Arbor: University of Michigan Press 1991). Constitutional economics locates the ultimate sources of value only in individuals and in their constitutionally limited, democratic agreements and informed exchange contracts.

- 'regulative principles' (e.g. for limiting 'market failures' by competition, environmental and social policies and institutions); and
- constitutional 'checks and balances' (e.g. democratic constitutionalism limiting 'governance failures', protecting rule-of-law and holding governments accountable, judicial remedies of citizens, subsidiarity principles protecting decentralized governance mechanisms).

Ordo-liberal 'constitutional economics' influenced the embedding of Germany's 'social market economy' into German and European constitutional law. The EU's 'micro-economic common market constitution',[25] 'macro-economic monetary constitution',[26] their progressive evolution and judicial review[27] were influenced by German and European ordo-liberalism.[28] Its 'principled thinking' is characterized by 'order policies' aimed at limiting 'process policies' (like public borrowing) through

- 'interdependent, rules-based orders';
- 'governing through market mechanisms' and regulatory competition; and
- republicanism protecting PGs (res publica).

Ordo-liberalism calls for legal safeguards that the competitive order (protecting 'performance competition' and price mechanisms) remains embedded into mutually coherent monetary order (e.g. protecting price stability, fiscal discipline), democratic constitutionalism (e.g. holding 'European network governance' accountable through multilevel competition, monetary and other regulatory agencies and their parliamentary and judicial control) and social order (e.g. protecting labour markets, welfare states, social justice and judicial remedies). Constitutional economists criticize neo-liberal focus on utility-maximization, 'Kaldor-Hicks efficiencies' and gross-domestic products on the ground that satisfaction of the basic needs of all citizens, enhancement of 'human capacities' (A.K.Sen) and their mutually agreed protection through constitutional rights offer better benchmarks for human well-being. The EU Charter of Fundamental Rights (EUCFR) guarantees civil, political, economic, social and 'European citizenship rights' that protect not only 'negative freedoms' (e.g. constraining abuses of public and private power). Rights empowering individuals to exercise 'positive freedoms' (e.g. human rights to education, health protection, freedom of association, decent life and work conditions) through governmental protection of individual self-development (e.g. 'human dignity') can be seen as constitutional core values of social market economies. The 'social market economy' progressively established in Germany since the 1960s, and the EU law commitments to a 'competitive social market economy' (Article 3 TEU) with ever more guarantees of social rights structured around three priorities – equal opportunities for education, professional training and access to labour markets; fair working conditions; and access to social protection and health care for all – illustrate how ordo-liberal constructivism differs from neo-liberal faith in self-regulatory capacities of markets generating ever larger social inequalities inside neoliberal economies like the USA.

---

[25] E.g. based on multilevel common market freedoms, competition, environmental and social rules, multilevel competition institution, and 'regulatory competition' constrained by multilevel judicial protection of civil, political, economic and social rights.

[26] E.g. based on EU legal disciplines for monetary, fiscal, debt and economic policies supervised by multilevel, independent central banks and intergovernmental economic cooperation.

[27] Cf. H.C.H.Hofmann/K.Pantazatou/G.Zaccaroni (eds), *The Transformation of the European Economic Constitution* (Cheltenham: Elgar 2019); C.Kaupa, *The Pluralist Character of the European Economic Constitution* (Oxford: Hart 2016).

[28] On the EU's sectoral (e.g. micro-economic, macro-economic and social) 'constitutions' see: K.Tuori, *European Constitutionalism* (Cambridge: CUP 2015), 127 ff. On 'constitutional economics' and the controversies over applying ordo-liberalism to the EU's monetary union see: T.Biebricher/ F.Vogelmann (eds), *The Birth of Austerity. German Ordoliberalism and Contemporary Neoliberalism* (London: Rowman & Littlefield 2017).

Need for Constitutional Economics and Justice beyond States

Constitutional economics justifying multilevel economic constitutionalism (like multilevel legal and judicial protection of EU common market freedoms, European competition law and fundamental rights) has become an integral part of European integration law as practiced in the 30 member states of the European Economic Area (EEA). The 'Geneva School of multilevel ordo-liberalism'[29] focused on constitutional justifications of worldwide economic order so as to enable welfare states and multilevel legal, institutional and judicial guarantees of non-discriminatory market competition limiting abuses of public and private powers beyond European integration. Notably the economists (like GATT's chief economist J.Tumlir) and lawyers working inside GATT's economic research and legal divisions were more influenced by 'constitutional economics'[30] than by utilitarian Chicago school economists (e.g. in view of their dubious, normative premises underlying the distributive effects of 'Kaldor-Hicks efficiencies'). Some of the constitutional, competition and social policy principles of 'ordo-liberalism' have influenced the progressive legal construction and political legitimation of the GATT/WTO legal and dispute settlement systems, for instance in

- designing multilevel legal restraints of trade policy instruments according to their respective economic efficiency (as illustrated by Articles I-III, XI GATT, VI-IX GATS);
- separating trade and monetary policy instruments (cf. Article XV GATT, XI GATS);
- interpreting GATT/WTO market access commitments as protecting non-discriminatory conditions of competition;
- protecting and prioritizing sovereign powers to regulate and protect non-economic public goods in non-discriminatory ways (cf. Articles XIX-XXI GATT, XIV-XIVbis GATS);
- providing for legal accountability and multilevel judicial remedies limiting rule-violations and other abuses of power (e.g. in Articles X, XXIII GATT, XXIII GATS); and
- promoting progressive evolution of the incomplete GATT/WTO system through progressive legal, political and judicial clarifications and development of indeterminate GATT/WTO rules and underlying principles, in close cooperation with trade-related, other international organizations.[31]

---

[29] For a discussion of the 'Geneva school of law and economics', and its comparison with other schools of 'law and economics', see: E.U.Petersmann, International Economic Theory and International Economic Law - On the tasks of a legal theory of international economic order, in: R.S.J.Macdonald/D.M.Johnston (eds), *The Structure and Process of International Law* (The Hague: Nijhoff 1983) 227–261; H.Hauser *et alii*, The Contribution of Jan Tumlir to the Development of a Constitutional Theory of International Trade Rules (in German with English summary), in: *Ordo – Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft* 39 (1988), 219-238; Q. Slobodian, *Globalists. The End of Empire and the Birth of Neoliberalism* (Cambridge Mass.: HUP 2018), 7ff, 183ff, 208ff, 260ff. My review of Slobodian's book criticizes his failure to recognize the ordo-liberal - rather than neo-liberal - foundations of the 'Geneva school': cf. *Journal of International Economic Law* 19 (2018), 915-921. See also the critical book review by F.Roessler in *World Trade Review* 18 (2019), 353-359.

[30] E.g as taught by the ordo-liberal 'Freiburg school' (e.g. of W.Eucken, F.Böhm, F.A.Hayek, V.Vanberg) and 'Virginia school' (e.g. J.Buchanan) defining economic efficiency not only in terms of 'Pareto'- and 'Kaldor-Hicks efficiency' (based on utilitarian premises), but also by (hypothetical) individual and democratic consent to inclusive, reasonable rules reconciling the interests of all affected citizens. J.Buchanan cooperated closely with the Freiburg School and received the 1986 Nobel Prize in Economic Sciences for his 'development of the contractual and constitutional bases for the theory of economic and political decision-making' (e.g. rejecting 'any organic conception of the state' as superior in wisdom to its citizens).

[31] Slobodian (n 29) describes the WTO as 'the paradigmatic product of Geneva School neoliberalism' (at p.25), and the 'creation of the WTO (as) a crowning victory of the neoliberal project of finding an extra-economic enforcer for the world economy in the twentieth century' (at 23). The GATT/WTO jurisprudence (e.g. on interpreting GATT/WTO rules as protecting non-discriminatory conditions of competition) reinforces this ordo-liberal function of states and of the GATT/WTO dispute settlement systems as 'guardians of the competitive order'.

Yet, policy recommendations from institutional and constitutional economics remain controversial, as illustrated by

- the disagreements on the future design of the European monetary and banking union and related constitutional restraints of the EU (e.g. for financing national expenses through 'Euro-bonds');
- the 'Brexit' and the United Kingdom (UK)'s rejection of any supervision of the future EU-UK FTA by EU, EEA or European Free Trade Area (EFTA) institutions;
- the failures of the WTO's Doha Round negotiations since 2001 to adjust WTO rules to the regulatory challenges of the 21st century;
- the US assault on the WTO dispute settlement system ushering in the 'blocking' of the WTO Appellate Body and its jurisprudence;
- the EU initiatives at replacing investor-state arbitration inside the EU as well as in the external relations of the EU by new kinds of multilevel adjudication; and
- by the increasing challenges also to other international jurisdictions like the International Center for the Settlement of Investment Disputes (ICSID), the International Tribunal for the Law of the Sea, the International Criminal Court and the European Court of Human Rights as independent and impartial institutions for protecting transnational rule-of-law and reducing international transaction costs.

Need for Adjusting WTO Rules to Geopolitical Regulatory Competition

President Trump's withdrawal from the 2015 Paris Agreement, his assault on the WTO legal system, the US-China trade wars, and China's 'Belt and Road Initiative' for bilateral economic cooperation agreements with 65 countries along the ancient 'Silk Roads' challenge the ordo-liberal multilateralism underlying EU law, WTO law, and the Paris Agreement on climate change mitigation. The institutional diversity among the more than 400 regional economic integration agreements suggests that mankind must learn through 'trial and error' and progressive 'institutionalization of public reason' (J.Rawls) on how to overcome the current geopolitical rivalries among

- Anglo-Saxon neo-liberalism (as illustrated by the 'Brexit' and Britain's rejection of European regulatory harmonization and European courts);
- President Trump's mercantilist disregard for multilateral trade and environmental agreements protecting global PGs (like climate change mitigation);
- authoritarian state capitalism (e.g. in China and Russia) and
- European ordo-liberal, multilevel economic constitutionalism.

Due to the mutually incoherent value premises of utilitarian neo-liberalism, hegemonic mercantilism, totalitarian state-capitalism and rights-based, multilevel economic constitutionalism, these systemic divergences among WTO members are increasingly disrupting the WTO legal, dispute settlement and negotiation systems (e.g. as a result of the invocation of national security exceptions for justifying discriminatory US import restrictions on steel and aluminium). In contrast to the end of the post-1945 cold war among communist dictatorships and Western democracies, the current geopolitical rivalries are unlikely to disappear in the near future, for instance in view of the fact that China's successful economic and social transformation since 1978 seems bound to make China the world's largest economy and increasingly limit US military and economic hegemony and political leadership.[32] The systemic rivalries (e.g. among ordo-liberal multilevel constitutionalism in Europe, neo-liberal utilitarianism in the United Kingdom and the USA, communist state-capitalism in China) risk further increasing due to the need for mitigating climate change by, *inter alia*, carbon taxes, border carbon adjustments, limitation

[32] Cf. K.Mahbubani, *Has China Won? The Chinese Challenge to American Primacy* (New York: Hachette, 2020).

of fossil fuel subsidies and GHG emission trading systems (cf. section IX), as well as due to the increasing challenges of WTO adjudication and investor-state arbitration not only by neo-liberal and mercantilist, but also by state-capitalist and ordo-liberal WTO member states (cf. section X below).

As a consequence, the subsidiarity principle suggests that the WTO provisions on 'exceptions' (e.g. GATT Articles XX, XXI, GATS Articles XIV and XIV*bis*) and the 'embedded liberalism compromise' underlying WTO law may need more flexible, legal interpretations enabling WTO members to adjust their economic laws and institutions to the changing regulatory challenges (e.g. by using WTO trade remedy rules for protecting domestic industries against foreign market distortions, use of WTO exception clauses and WTO 'waivers' for making carbon border adjustments WTO-consistent so as to limit GHG emissions and 'carbon leakage'). The more the 'new nationalism' in neo-liberal WTO members (like the UK, the USA) and in some of the 'BRICS countries' (like Brazil, Russia, India, China and South-Africa), and US President Trump's assault on the WTO legal and dispute settlement system render the success of WTO reform negotiations unlikely, the stronger become the reasons for decentralized reforms of world trade rules through (inter-)regional and bilateral agreements among 'willing' and like-minded governments insisting on protection of their diverse conceptions of national sovereignty (e.g. on protection of non-economic *national PGs* like 'cyber sovereignty' inside communist China). During the 2020 global health pandemic (related to the COVID-19 virus), many WTO members introduced import and export restrictions on goods and services (like land, air and maritime transports) in conformity with the medical guidance and advice from the World Health Organization; some of these 'crisis measures' are likely to raise strategic long-term questions regarding the previous openness and dependence of countries (e.g. over 80% of active pharmaceutical ingredients of US medicines coming from abroad) and of industries on foreign supplies (e.g. by global supply chains and 'just-in-time-deliveries' of inputs for manufacturing).

Need for Cooperation among Global Public Goods Regimes: the Example of Climate Change Mitigation

The UN pursues its 2030 'Sustainable Development Goals' (SDGs) in cooperation with networks of 17 UN Specialized Agencies, the WTO and additional multilateral treaty regimes (like human rights conventions, the 2015 Paris Agreement on climate change mitigation). In conformity with Nobel Prize economist J.Tinbergen's theory of 'separation of policy instruments',[33] each of these functionally limited 'PG treaty regimes' focuses on different, complementary policy instruments for protecting a specific global PG. The 2015 UN Resolution on the 2030 Agenda for Sustainable Development coordinates the implementation of the altogether 17 SDGs (like overcoming poverty, hunger and global warming, protecting health, education, gender equality, access to water, sanitation and clean energy, urbanization, the environment, human rights and social justice); it aims at 'localizing the SDGs' so as to empower local institutions, actors and civil society support.[34] It recognizes 'that the United Nations Framework Convention on Climate Change is the primary international, intergovernmental forum for negotiating the global response to climate change' (para. 31). As trade and climate change regulation are inseparable, the UN also relies on WTO negotiations (e.g. on promotion of 'sustainable development' through limiting fishing and fossil fuel subsidies) and on comprehensive coordination among national and international actors, including the EU as an international member of both the 1994 WTO Agreement and the 2015 Paris Agreement. The Paris Agreement entered into force in November 2016 and was ratified by 187 Parties (2019). 182 countries plus the EU notified their 'nationally determined contributions' (NDCs) by 2019. These voluntary contributions to reduce GHGs differ enormously; they remain normatively under-defined and insufficient for realizing the climate change

[33] Cf. J.Tinbergen, *On the Theory of Economic Policy* (North Holland 1952) (arguing that – in order to be effective – a public policy instrument should only aim to secure one goal).

[34] Cf. *Transforming our World: the 2030 Sustainable Development Agenda*, UN General Assembly Resolution A/RES/70/1 of 25 September 2015.

mitigation objectives of the Paris Agreement. The USA – as the largest economy and second-largest emitter of GHGs – notified its withdrawal from the Agreement. During the UN climate conference in Madrid in December 2019 focusing on 'carbon market systems', other major emitters of GHGs (like China, India, Australia) avoided committing to ambitious limitations of GHGs. The Paris Agreement includes neither trade and competition rules to safeguard a level playing field among competing industries in countries with diverse carbon constraints, nor effective legal disciplines (e.g. for fossil-fuel subsidies, GHG emissions, carbon taxes, border carbon adjustments) and dispute settlement procedures (e.g. regarding NDCs and their consistency with WTO law).

The EU's 'New Green Deal Initiative' of 2019

In response to the European Parliament's resolution of 28 November 2019 declaring a climate and environmental emergency,[35] the European Green Deal Communication of December 2019[36] launched a new growth strategy for the EU to make Europe the first climate-neutral continent by 2050. All EU member states (except Poland) accepted, in December 2019, this EU goal to achieve climate neutrality (i.e. zero net emissions of GHGs) by 2050 in conformity with the objectives of the Paris Agreement. The 'Green Deal' provides that all EU actions and policies should support the necessary transformation of the European economy, including the EU's external actions in favor of a new 'green deal diplomacy' promoting international alliances (e.g. with African countries and China) for promoting 'green economies' and climate change mitigation. The strong domestic political support (e.g. in civil societies, national and European parliaments) for a 'new green identity' of the EU requires EU 'leadership by example' also in adjusting the WTO and Paris Agreements to the need for introducing carbon taxes, border carbon adjustments and other climate mitigation policies. This risks provoking international conflicts among WTO and UN member states with state-capitalist, utilitarian neo-liberal or rights-based, ordo-liberal economies and policies. In March 2020, the EU Commission proposed a new 'Regulation of the European Parliament and of the Council establishing the framework for achieving climate neutrality and amending Regulation (EU) 2018/1999 (European Climate Law)';[37] it aims to establish the legal framework for

- progressively achieving EU climate neutrality through a variety of European Green Deal initiatives promoting and financing investments;
- a 'just transition fund' supporting social fairness and a level playing field;
- a new EU industrial strategy addressing the twin challenges of the green and digital transformation and
- a new circular economy action plan.

The European Commission is requested to publish regular evaluations, engage in stakeholder consultations, monitoring and impact assessments, and propose more detailed legislative measures in cooperation with the European Environmental Agency. The proposed Regulation will transform the 2050 climate-neutrality objective into a legally binding EU objective; it also aims at protecting fundamental rights and the objective of a high level of environmental protection in accordance with the principle of sustainable development as prescribed in Article 37 EUCFR.

[35] Document 2019/2930(RSP).

[36] COM(2019) 640 final.

[37] Document COM(2020) 80 final, 2020/0036 (COD) of 4 March 2020.

Constitutional rights as incentives for climate change mitigation

The importance of this linkage of human rights with climate change mitigation was confirmed in the ruling of the Dutch Supreme Court on 20 December 2019 in *State of the Netherlands v Urgenda*[38] (a Dutch NGO suing the state on behalf of around 900 citizens), which confirmed the 2018 Court of Appeals judgment that Articles 2 (right to life) and 8 ECHR (right to private and family life) entail legal duties of the Dutch government to reduce GHG emissions by at least 25% (compared to 1990 levels) by the end of 2020. Similar to recent findings of UN human rights bodies and other national courts acknowledging human rights to live in an environment without pollution endangering human health,[39] the Dutch Supreme Court judgment confirms, inter alia:[40]

- HRL (e.g. the ECHR) and related constitutional and environmental law guarantees (like the 1998 Aarhus Convention on access to justice in environmental matters) may be invoked by citizens in order to enforce positive obligations to take appropriate measures mitigating climate change;
- even if the respondent state is only a minor contributor to climate change, a court can determine the legal responsibilities to reduce emissions of an individual state that shares responsibility with other actors for climate change ('partial causation justifies partial responsibility'; the failure of other states to meet their responsibilities does not justify non-performance);
- as the disputing parties agreed that climate change presents serious risks, the court did not need to decide on these facts; it relied on the precautionary principle and the internationally agreed need for reducing emissions by at least 25% by 2020, leaving it to the political government branches to determine how to implement this legal obligation.

The Dutch government's commitment to comply with the judgment sets a welcome political precedent for legal, judicial and rules-based, political protection of PGs like climate change mitigation; it confirms the Netherland's historical record of successful adaptation to environmental changes like rising sea levels. In order to garner the social and democratic support for implementing the 'New Green Deal' inside and beyond the EU and make the WTO and Paris Agreements mutually coherent, EU leadership for climate mitigation policies must go beyond merely environmental discourse by emphasizing the constitutional and ordo-liberal foundations of EU environmental policies limiting 'market failures' (like environmental pollution) and 'governance failures' (e.g. to prevent climate change). The EU will elicit sufficient support to overcome internal and external opposition to climate mitigation policies only if limitation of fossil fuels and of GHG emissions, the introduction of carbon taxes and border carbon adjustments, and prevention of 'carbon leakage' (e.g. by shifting production of cement, steel and other products using fossil fuel-based energy from the EU to third countries with less stringent restrictions) are not perceived as 'green protectionism' distorting 'fair competition' and creating social injustices.

Challenges and Reforms of Trade and Investment Adjudication

The increasing number of – and interactions among - international 'PGs treaties' cannot realize their legal and policy objectives without transnational rule-of-law protecting overall coherence between national and international, legal and political governance systems. As illustrated by the US withdrawal from the 2015 Paris Agreement and by the US assault on the WTO legal and dispute settlement system, neo-liberal interest group politics and nationalism ('America first') risk neglecting harmful externalities like environmental pollution, climate change and US violations of multilateral WTO commitments. They confirm the need for stronger multilateral rules, dispute settlement procedures and for

[38] De Staat der Nederlanden (Ministerie van Economische Zaken en Klimaat) tegen Stichting Urgenda, Hoge Raad der Nederlanden, Civiele Kamer, Nummer 19/00135, 20 December 2019.

[39] References to climate change lawsuits can be found in: http://climatecasechart.com/. See also: J.Peel/J.Lin, Transnational Climate Litigation: The Contribution of the Global South, in: *AJIL* 114 (2020)

[40] Cf. Nollkaemper/Burgers (n 20).

'institutionalizing public reason' holding governments accountable for violations of multilateral treaties protecting transnational PGs.

Legitimacy and Efficiency of Economic Adjudication

The second half of the 20th century has seen an unprecedented increase in the number of international trade, investment, economic and other courts at bilateral, regional and worldwide levels of governance. They often interact – e.g. in international trade, investment, regional economic integration law, human rights and international criminal law - with domestic courts aimed at multilevel protection of transnational rule of law for the benefit of citizens. The legitimacy of specialized trade, investment and intellectual property courts and arbitration tribunals – e.g. in the sense of justification of their legal and judicial authority, protection of their independence, and their personal integrity vis-à-vis rent-seeking interests groups – remains contested in democratic and civil societies, just as the 'politicization' of judicial appointments in national courts (e.g. in the USA) is increasingly contested.[41] Legitimacy challenges of courts depend on their diverse judicial mandates, subject matters, specific goals, design choices, applicable law, processes, audiences, institutional contexts and results:[42]

- Normative legitimacy is concerned with the 'right to rule' (e.g. to issue judgments, decisions or opinions) according to agreed standards; it explains why those addressed by an authority should comply with its mandates also in the absence of perceived self-interest or brute coercion.
- Sociological legitimacy derives from empirical analyses of perceptions or beliefs that an institution has a right to rule.
- Both the internal legitimacy (e.g. the perceptions of regime insiders like WTO diplomats) and external legitimacy (e.g. beliefs of outside constituencies like EU citizens, traders, producers, investors and consumers affected by trade and investment adjudication) may be based on specific support (e.g. of individual judgments) or diffuse support (e.g. individual's favourable dispositions toward a court generally and willingness to tolerate unpalatable decisions).
- The overall legitimacy capital may increase or decline over time depending on source-, process- and result-oriented factors. For instance, due to the US blockage of the nomination of WTO AB judges since 2017, the AB has been reduced to one single member (from China) since 10 December 2019, in clear violation of the collective duties of WTO members to maintain the AB as defined in the WTO Dispute Settlement Understanding, e.g. as being 'composed of seven persons', with vacancies being 'filled as they arise', and being 'representative of membership in the WTO' (Article 17 DSU). The German Constitutional Court judgment of 5 May 2020 finding that the European Central Bank and the CJEU have exceeded their powers due to their disregard for the constitutional principles of limited delegation of powers and 'proportionality' in the exercise of EU powers, challenges the democratic legitimacy and effectiveness of EU decision-making.
- Source-based legitimacy of international courts may require not only consent by states, but also - due to the universal recognition of human rights - democratic consent of affected citizens and other non-state stakeholders (like the EU as a WTO member).
- Process-based legitimacy raises questions concerning, inter alia, the relevant parties and their procedural rights.

---

[41] R.H.Fallon, *Law and Legitimacy in the Supreme Court* (Cambridge Mass.: HUP 2018); A.Cohen, *Supreme Inequality: The Supreme Court's Fifty-Year Battle for a More Unjust America* (Penguin Press 2019).

[42] The following legitimacy criteria are explained in: N.Grosman/H.Grant Cohen/A.Follesdal/ G.Ulfstein (eds), *Legitimacy and International Courts* (Cambridge: CUP, 2018).

- Result-oriented legitimacy concerns how well international courts perform their functions (e.g. to settle disputes, protect rule of law, clarify indeterminate rules and principles) and enable the disputing parties to solve their problems (e.g. through rule-compliance).

Empirical evidence suggests that the WTO objective of 'providing security and predictability to the multilateral trading system' through compulsory third-party adjudication of disputes over the interpretation and application of WTO rules 'in accordance with customary rules of interpretation of public international law' (Article 3.2 DSU) has considerably reduced transaction costs in international trade, for example in view of the facts that

- WTO rules cover more than 95% of world trade;
- most of the more than 420 WTO panel, appellate and arbitration findings were adopted and implemented by WTO member states; and
- the WTO jurisprudence has promoted overall coherence and predictability in the interpretation and application of the – often vaguely drafted – WTO rules.

The approval of WTO agreements by national parliaments and democratic institutions also conferred democratic legitimacy on the WTO dispute settlement jurisprudence. Constitutional economics suggests that democratic approval of WTO rules promoting and protecting non-discriminatory conditions of trade, rule-of-law and other democratic preferences of citizens enhances also economic efficiency satisfying economic and legal demand of citizens benefitting from international trade and the global division of labour. WTO law protects not only international third-party adjudication among WTO member states and other supra- or sub-national WTO members (like the EU, Hong Kong, Macau and Taiwan). Numerous WTO provisions provide also for individual access to domestic courts or international commercial arbitration (e.g. pursuant to Article 4 of the WTO Agreement on Preshipment Inspection), which offer less costly judicial remedies for the settlement of transnational trade disputes. From an economic perspective, independent and impartial third-party adjudication can limit public and private actions and related costs in ways promoting constitutionally agreed rights, rule-of-law and other PGs for the benefit of all citizens in conformity with their democratically expressed preferences – in the context of WTO law no less than in the context of other national and international legal systems protecting PGs like rules-based cooperation among citizens. Efficient allocation of governmental authority and 'jurisdiction' for peaceful settlement of disputes is no less important for promoting consumer and citizen welfare than efficient market allocations of private goods and services.[43] Judicial protection of rule-of-law can assist citizens and governments in maximizing long-term benefits and minimizing costs in the pursuit of individual and collective preferences. As rules-based cooperation in multilevel governance of PGs tends to promote also 'efficiency': Why is it that WTO adjudication and investor-state arbitration have become so controversial in recent years?

Neo-liberalism vs Ordo-liberalism: Beware the 2020 USTR Report on the WTO Appellate Body

In his recent book on *Globalists. The End of Empire and the Birth of Neoliberalism* (2018), history Professor Q.Slobodian describes the WTO as 'the paradigmatic product of Geneva School neoliberalism', and the 'creation of the WTO (as) a crowning victory of the neoliberal project of finding an extra-economic enforcer for the world economy in the twentieth century'.[44] Yet, like many other Anglo-Saxon commentators on neo-liberalism, Slobodian overlooks the categorical differences between Anglo-Saxon neo-liberalism and European ordo-liberalism: US neo-liberalism and Chicago School economists prioritize liberalization of market access barriers, deregulation, privatization and financialization of markets in order to empower utilitarian market actors (*homo economicus*) to pursue their self-interests and enhance the self-regulating forces of market competition as spontaneous

[43] Cf. Trachtman (n 4).

[44] Slobodian (n 29), at 23-25.

information, coordination and sanctioning mechanisms. The German, European and Virginia Schools of ordo-liberalism perceive markets as legal constructs of reasonable citizens (rather than as gifts of nature), who cannot maximize their general consumer welfare without legal limitations of market failures, governance failures and 'constitutional failures'.[45] GATT/WTO jurisprudence (e.g. on interpreting GATT/WTO rules as protecting non-discriminatory conditions of competition) emphasized the systemic, ordo-liberal functions of states and of the GATT/WTO legal and dispute settlement systems as 'guardians' of non-discriminatory conditions of competition. The Report on the Appellate Body of the WTO by the US Trade Representative (USTR) of February 2020[46] perceives WTO law as an instrument of US power politics and disregards ordo-liberal 'constitutional economics' justifying the multilateral WTO legal and dispute settlement systems. The legal justifications by the Trump administration of their illegal 'blocking' of WTO AB nominations insist on US interpretations of WTO rules and US criticism of AB findings without any evidence that legal interpretations by the AB violated the customary rules of treaty interpretation or the (quasi)judicial AB mandate for impartial, independent and prompt third-party adjudication through quasi-automatic adoption of WTO panel and AB reports by the Dispute Settlement Body (DSB). The 2020 USTR Report – notwithstanding its valid criticism of some WTO rules and dispute settlement practices (e.g. that the AB no longer consults with the parties when deciding to disregard the Article 17.5 deadline) – suffers from legal biases and incorrect claims such as:

- US denial of (quasi)judicial functions of WTO third-party adjudication, even though numerous WTO publications and WTO dispute settlement reports over more than 20 years acknowledged the (quasi)judicial mandates of WTO dispute settlement bodies (i.e. WTO panel and AB reports as adopted by the DSB);
- US disregard for judicial AB arguments in the performance of the DSU's mandate 'to clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law' (Article 3 DSU), for instance whenever the AB found compliance with the time limit of 90 days (Article 17.5 DSU) – which was imposed by US negotiators in 1993 notwithstanding the widespread criticism that no other court seems to be limited by such an unreasonably short time limit – impossible to reconcile with the other AB tasks (e.g. due to illegal US blocking of the filling of AB vacancies);
- contradictory USTR claims that AB legal findings against the US violated the DSU prohibition to 'add or diminish the rights and obligations in the covered agreements' (Article 3.2 DSU) – even if the AB had justified these legal findings on the basis of the customary rules of treaty interpretation and its (quasi)judicial mandate -, notwithstanding the USTR's regular support of AB reports accepting 'creative WTO interpretations' advocated by the USTR as a legal complainant;
- US description of US 'zeroing practices' as a 'common-sense method of calculating the extent of dumping'[47] even if their biases had been consistently condemned by the AB and DSB as violations of the WTO obligations of 'fair price comparisons' (which are hardly mentioned in the USTR report);
- one-sided focus on WTO texts as interpreted by US negotiators without regard to the customary law and DSU requirements to clarify the meaning of the often indeterminate WTO provisions with due regard also to WTO legal texts revealing the 'context, object and purpose' of WTO provisions and the explicitly recognized 'systemic character' of what the WTO Agreement calls 'this multilateral trading system' (Preamble) and its 'dispute settlement system' (Article 3 DSU);

[45] Cf. Petersmann (n 13).

[46] USTR, *Report on the Appellate Body of the WTO*, Washington February 2020.

[47] USTR Report (n 46), at 2.

- denigration of AB members as 'three unelected and unaccountable persons'[48] whose 'overreaching violates the basic principles of the United States Government' (idem, Introduction), notwithstanding the election of AB members through consensus decisions of 164 DSB member governments (including the USA), their (quasi)judicial mandate, and the approval of WTO agreements (including the DSU) by the US government and US Congress;
- insulting claims that the AB Secretariat has weakened the WTO dispute settlement system by not respecting WTO rights and obligations.[49]

The USTR Report acknowledges that its purpose 'is not to propose solutions'. The Introduction to the Report repeats what the US ambassador has stated in DSB meetings since 2017: 'WTO Members must come to terms with the failings of the Appellate Body set forth in this Report if we are to achieve lasting and effective reform of the WTO dispute settlement system'. Yet, nothing suggests that – if WTO members should accept the false US claims of the AB's 'persistent overreaching… contrary to the Appellate Body's limited mandate', and 'the Appellate Body's failure to follow the agreed rules' – the US would be willing to comply with its DSU obligation of filling AB vacancies 'as they arise' (Article 17.2 DSU) and return to WTO third party adjudication, appellate review and customary rules of treaty interpretation (including 'judicial interpretations' in the 'prompt settlement of WTO disputes) as prescribed in the DSU. Past WTO members' 'appeasement' of false USTR claims (e.g. in Ambassador Walker's informal mediation proposal for overcoming the WTO dispute settlement crises) never changed the USTR's refusal to return to WTO third party adjudication as prescribed in the DSU. The 'Economic and Trade Agreement' signed by the Chinese and US governments on 15 January 2020 provides for discriminatory Chinese commitments to buy US products, discriminatory US import tariffs and US trade restrictions (e.g. targeting Chinese technology companies) without third-party adjudication. This bilateral 'opt-out' – by the two largest trading nations – from their WTO legal and dispute settlement obligations seems to be the policy option preferred by those USTR officials who pursue additional 'bilateral US trade deals'; they now publicly reflect on US withdrawal from the WTO Agreement on Government Procurement, and on 'unbinding' US tariff and market access commitments, in order to better use power asymmetries in rebalancing bilateral US trade deficits through bilateral reciprocity negotiations, as advocated by Trump's trade policy advisor P.Navarro. The US-China trade deal provision for dispute settlement through unilateral USTR determinations seems to illustrate the hegemonic trade mercantilism, which USTR Lighthizer would like to impose on the rest of the world. De facto, the US Trump administration already disregards WTO rules (e.g. GATT Articles I, II and III) and WTO dispute settlement procedures whenever it suits US political interests and US interest group politics.

Hence, WTO members willing to defend the multilateral WTO legal and dispute settlement system should beware of hegemonic US power politics undermining WTO law and denying global PGs like multilateral trade and environmental protection systems. The response to the USTR demand of 'why' the WTO dispute settlement crises have emerged seems obvious: as WTO members have failed to adequately control WTO jurisprudence, the US Trump administration prioritizes mercantilist power politics rejecting multilateral legal and judicial restraints on its 'asymmetric deal-making'. The response to the question of 'how' to reform the WTO dispute settlement system must be to defend, and reform the rules-based, multilateral trading system, while continuing pragmatic use of Article 25 DSU 'appellate arbitration' as a temporary substitute for circumventing the illegal US blocking of the WTO AB system. Appeasement of US destruction of the WTO legal and dispute settlement systems has systemic repercussions far beyond the WTO. Without a multilateral WTO dispute settlement system, the UN sustainable development goals, climate change mitigation, future WTO negotiations, and also US efforts at inducing market-oriented reforms in China's totalitarian state-capitalism are unlikely to succeed. Authoritarian strongmen may benefit from intergovernmental power politics and neo-liberal

[48] *Idem*, at 8, 13.

[49] *Idem*, at 120.

interest group politics. Yet, citizens all over the world will suffer from neglect of the ordo-liberal task of limiting governance failures and 'constitutional failures' in multilateral governance of transnational PGs.

Constitutionalism vs ordo-liberalism: Reforms of investor-state arbitration inside and beyond the EU

Constitutional democracies protect equal private autonomy rights also in the field of commercial arbitration subject to the proviso that national courts (e.g. if requested to enforce private commercial arbitration awards) must review the legal consistency of the awards with the 'public policy' and constitutional law in the country where the complainant seeks recognition and enforcement of the award.[50] Due to the worldwide recognition of human rights, 'public policy' considerations are increasingly recognized to include also procedural human rights of access to justice and certain substantive (e.g. *jus cogens*) human rights guarantees.[51] When, since 1959, Germany and other European countries began concluding bilateral investment treaties (BITs) for protecting their foreign investments in less-developed host countries (like Pakistan) through procedural and substantive 'principles of justice' - like 'full protection and security' of investor rights, non-discrimination, 'fair and equitable treatment' (FET), due process of law and judicial remedies -, BITs were justified on grounds of economic ordo-liberalism and the need for protecting private property rights.[52] The 1966 Convention establishing the International Centre for the Settlement of Investment Disputes (ICSID) provided a multilateral, procedural framework for investor-state arbitration (ISA), for instance by prescribing in its Article 53 that ICSID investor-state arbitration awards

> 'shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.'

According to Article 54.1,

> '(e)ach Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court of that State'.

The, by the end of 2019, 775 ICSID investor-state arbitration proceedings and numerous additional investment arbitrations governed by commercial arbitration procedures have given rise to increasing criticism in many of the 163 ICSID member states, for instance on the ground that the more than, by 2020, 3'200 international investment protection agreements and related arbitration procedures unduly privilege foreign investor rights and investment protection standards without adequate regard to the regulatory duties of host states to protect human and constitutional rights of all citizens by reconciling investment regulation with all other economic and non-economic public interest regulation.

The 2018 Achmea judgment of the CJEU[53] - according to which ISA in relations among EU member states is inconsistent with the EU constitutional law guarantees of the autonomy of EU law, the exclusive jurisdiction of the CJEU for interpreting EU law, and with multilevel judicial protection of individual rights and judicial remedies by the CJEU in cooperation with national courts – illustrates how European multilevel constitutionalism has progressively imposed further constitutional restraints on economic

[50] See, e.g., Article V of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

[51] Cf. A.Jaksic, *Arbitration and Human Rights* (Frankfurt: Lang 2002).

[52] Cf. N.Tzouvala, The Ordo-liberal Origins of Modern International Investment Law: Constructing Competition on a Global Scale, in: *European Yearbook of International Economic Law: Special Issue 2019* (Heidelberg: Springer 2020), 37-54.

[53] Case C-284/16 *The Slovak Republic* v. *Achmea BV* [2018] ECLI:EU:C:2018:158.

ordo-liberalism and path-dependent conceptions of commercial autonomy and state sovereignty. The CJEU continues to recognize private party autonomy to submit private and commercial law disputes to private arbitration, without taking a position on whether transnational arbitration is governed

- by the national law of the seat of the arbitration (i.e. the *lex fori*, where the arbitration took place, assimilating the arbitrator with a judge in the country of the seat);
- by a plurality of municipal legal orders having a connection with a given arbitration, including also the law of the country where enforcement is sought; or
- by an autonomous, transnational arbitral legal order (*lex mercatoria*) recognized by the community of states as general principles of law (like private party autonomy, the autonomy of the arbitrator's judicial function, recognition of transnational arbitral awards as a 'decision of international justice').[54]

Yet, according to the Achmea judgment, both private legal autonomy and the national sovereignty of EU member states have become limited by the autonomy of EU constitutional law to the effect that the more than 200 intra-EU BITs among EU member states can no longer justify ISA in view of the EU Treaty provisions reserving multilevel judicial protection of EU law, individual rights and non-discriminatory treatment to national courts and European courts.[55] In January 2019, the EU member states adopted three Declarations committing themselves

- to the termination of their intra-EU BITs before the end of 2019;
- to request all courts to set aside arbitration awards based on intra-EU BITs, and
- to inform ISA tribunals in all pending cases about the legal consequences of the Achmea judgment.[56]

According to the EU Commission, the legal reasoning of the Achmea judgment - which concerned an intra-EU BIT providing for ISA governed by the UN Commission for International Trade Law (UNCITRAL) arbitration procedures, with EU law being part of the applicable law – applies also to ISA governed by the Energy Charter Treaty (ECT) and by ICSID procedures; it requires a 'modernization' of the ECT and ICSID procedures for ISA similar to the EU initiatives for a new 'investment court system' in other EU trade and investment agreements with third countries. Yet, the 'Achmea objection' was rejected by arbitral tribunals in pending ECT/ISA cases. Hence, domestic enforcement courts have been requested to seek another preliminary ruling from the CJEU on whether the application of the ISA procedures of the ECT and ICSID inside the EU is also precluded by Articles 267 and 344 TFEU.[57] In

[54] On these competing representations of transnational arbitration and their consequences for the arbitrator's power to adjudicate, the arbitral process and the fate of the ensuing award see: E.Gaillard, *Legal Theory of International Arbitration* (Leiden: Nijhoff 2010), who concludes: 'these are mental representations, visions of international arbitration that, as such, are a matter of belief – if not of faith – and not of scientific truth. A mental representation is never right or wrong; it can only be coherent or incoherent, efficient or inefficient' (p. 152).

[55] Cf. CJEU (n 53), referring especially to Articles 18 TFEU (prohibition of discrimination), Article 19 TEU (judicial protection of rule-of-law in the EU), 267 TFEU (preliminary rulings reference procedure), 344 TFEU (exclusive jurisdiction of the CJEU for interpreting EU law), to 'the preservation of "the particular nature" of EU law' and of the 'EU principle of mutual trust'. The judgment did not review the compatibility of the substantive clauses of *intra*-EU BITs with EU law.

[56] For a detailed analysis of these Declarations and of the legal consequences of the Achmea judgment on ISA proceedings (e.g. in view of the 'sunset clauses' of BITs) and on *intra*-EU BITs see: M.Fanou, *The EU as an Actor Shaping the Future of ISDS: Unveiling the interplay between the clash of two autonomies and the reform of investor-State arbitration* (EUI doctoral thesis publicly defended on 14 February 2020 and available in the EUI library).

[57] For details see: Fanou (n 56), chapter IV. In September 2019, the EU was served its first notice of dispute by Swiss-registered Nord Stream 2 AG (a subsidiary of the Russian firm Gazprom) and is about to find itself, for the first time, as a respondent in an ISA case under the ECT (which was ratified by both the EU and EU member states).

their political Declaration of January 2019, EU member states agreed, inter alia, to set aside - or not to enforce - intra-EU ISA awards due 'to a lack of valid consent' to an arbitration agreement. Yet, many legal questions regarding the relationships between intra-EU arbitration awards based on ECT or ICSID procedures, procedural and substantive EU law principles, and enforcement actions by national courts inside EU member states remain controversial for the time being. For instance, are national courts legally required to refuse enforcement of arbitration awards ordering compensation of foreign investors if such compensation violates EU law (e.g. EU state aid prohibitions) and its enforcement undermines public policy (ordre public) inside the EU?[58]

In the *Kadi*-judgment, the CJEU refused implementing UN Security Council regulations on grounds of EU fundamental rights.[59] Similarly, in Opinion 2/2013, the CJEU opposed EU participation in the ECHR in order to protect EU fundamental rights and judicial remedies.[60] Even though the EU is not a party to the ICSID Convention, all EU member states (except Poland) are legally obliged - under Article 54 of the ICSID Convention - to 'recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State'. It remains to be clarified by the CJEU whether – in intra-EU ISA - Article 54.3 ICSID,[61] Article 351 TFEU[62] or other EU law principles justify giving legal primacy to EU law principles over the ICSID obligations of EU member states. Opinion 1/2017, in which the CJEU interpreted the ISA provisions in the EU-Canada Comprehensive Economic and Trade Agreement (CETA) as being consistent with EU law,[63] could suggest that the CJEU may support the view of the EU Commission that also ECT and ICSID arbitration procedures need to be 'modernized' in order to make them compatible with EU constitutional law principles.

Based on the Lisbon Treaty's conferral of exclusive EU competence for the common commercial policy, including foreign direct investment (FDI), the EU Commission continues to pursue international negotiations aimed at transforming ISA into multilateral investment court systems (MICs), for instance by modernizing the UNCITRAL-, ECT- and ICSID arbitration procedures and ISA provisions in EU trade and investment agreements with third states. Following the CJEU Opinion 2/2015 that ISA is a shared competence of the EU and its member states,[64] the EU began separating its external FTAs (e.g. with Singapore, Vietnam, Korea, Japan, Mexico) based on exclusive EU commercial policy competences from investment protection agreements concluded as 'mixed agreements' providing for new investment court systems. It remains uncertain how the on-going reform negotiations (e.g. in

---

[58] In the *Micula et alii v Romania* ICSID Case No. ARB/05/20, the final award of 11 December 2013 ordered Romania to pay compensation for the revocation of state aid that had been found by the EU Commission to violate EU state aid prohibitions. The investors successfully challenged in the EU General Court the European Commission's decision to block the enforcement of the award (Cases T-624/15, T-694/15 and T-704/15 *Micula and Others v Commission*, ECLI EU:T:2019:423 of 18 June 2019; the appeal by the Commission is pending before the CJEU).

[59] C-402/05 P *Kadi et alii v Council and Commission*, ECLI EU:C:2008:461 of 3 September 2008.

[60] *Opinion* 2/13 (accession of the EU to the ECHR), EU:2014:2454 (18 December 2014).

[61] 'Execution of the award shall be governed by the laws concerning the execution of judgments in force in the State in whose territories such execution is sought'.

[62] Article 351 of the Treaty on the Functioning of the EU reads, *inter alia*: 'The rights and obligations arising from agreements concluded before 1January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties. To the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established'…..

[63] Case C-1/17, EU:C:2019:341 (30 April 2019).

[64] Case C-2/15, EU:C:2017:376 (16 May 2017), para. 292: 'Such a regime, which *removes disputes from the jurisdiction of the courts of the (member states)*, cannot be of a purely ancillary nature … and cannot, therefore, be established without the Member State's consent'.

UNCITRAL and ICSID institutions) will respond to the widespread criticism of traditional ISA – like the lack of an appeal mechanism, insufficient transparency and incoherence of ISA jurisprudence, inadequate independence and impartiality of arbitrators, pro-investor biases threatening the regulatory powers of host states, limiting access to justice, burdening tax-payers and undermining the legitimacy of ISA – by improving the UNCITRAL-, ICSID- and other ISA procedures and protection standards. So far, the new ICS procedures in the EU's external agreements have not been used. Adjusting the ISA provisions in the more than 3'200 existing BITs will require time, during which foreign investors are likely to engage in forum shopping and 'rule shopping' so as to maintain their past legal privileges. If economic efficiency is determined also by voluntary compliance with democratically agreed rules protecting informed preferences of citizens, the progressive replacement of FDI privileges by more inclusive FDI rules and investment court procedures protecting all affected citizen interests more comprehensively offers social, democratic and legal advantages and also 'economic efficiency' gains.

Conclusion: Constitutional Economics Requires 'Constitutionalization' of Economic Rules and Institutions

Sections I and II explained why – if economics is about the arrangements within which individuals and institutions make 'efficient choices' in response to scarcity – it is important to distinguish choices within existing constraints (as studied by ordinary economics) from choices among alternative legal and institutional constraints (as studied by constitutional and 'institutional economics'). Hence, the economic 'maximization paradigm' (e.g. underlying Pareto- and Kaldor-Hicks-efficiencies) must be complemented by 'constitutional contract/exchange paradigms' for deliberative or evolutionary choices of constraints that protect informed, individual and democratic preferences. In contrast to the focus of politics on 'winners', 'losers' and distribution of power, the exchange paradigm of constitutional economics focuses on mutual individual and collective gains enabled by constitutional cooperation improving the 'laws and institutions' of the economic-political order. Sections III-IV explained why globalization and its transformation of national into transnational PGs require extending constitutional and institutional economics to multilevel governance of transnational PGs in order to enhance the wealth of nations – not only through cooperation and division of labour among private economic actors, but also among lawmakers and governments. Efficient allocation of scarce resources and satisfaction of consumer preferences can be enhanced by both constitutional improvement of the contractarian efficiency of 'laws and institutions' (e.g. constraining coercive authority) and post-constitutional economics maximizing the available economic goods, services and resources.

Sections V-VI emphasized the realities of 'constitutional pluralism' and 'regulatory competition' among authoritarian economic systems (e.g. in China and Russia) and neo-liberal or ordo-liberal market economies committed to 'methodological individualism', 'democratic constitutionalism' and 'rational choices' by individuals and peoples. Sections VII-VIII discussed the diverse European schools of ordo-liberalism and of 'Virginia constitutional economics' influencing the progressive development of European economic constitutionalism and the ordo-liberal dimensions of the WTO legal and dispute settlement systems. Section IX explained the need for international cooperation among 'overlapping PGs regimes' by exploring the interrelationships between the WTO trading, legal and dispute settlement systems and the need for climate change mitigation through introduction of carbon taxes, border carbon adjustments, limitation of fossil fuel subsides and promotion of carbon-free 'green economies', as envisaged in the context of the 2015 Paris Agreement and the EU's 'New Green Deal'. Section X explored the contribution of private and public, national and transnational courts of justice and arbitration to reduction of transaction costs and efficient protection of transnational rule of law protecting democratic and individual preferences as expressed in mutually agreed, human and constitutional rights of citizens. The constitutional transformations of common markets (notably among the 30 EEA countries) and the regulatory challenges of globalization and climate change require reforms of international trade, investment, economic and human rights adjudication, as illustrated by the jurisprudence of the CJEU and the changing cooperation among national, regional and worldwide

jurisdictions. The ordo-liberal 'constitutional perspective' proceeds from 'methodological individualism', but acknowledges and protects the communitarian dimensions of individuals, their civil, political, economic, social and cultural rights and voluntary cooperation, and the multilevel interactions between democratic, executive and judicial governance institutions confronted with rational choices limited by scarcity of resources and respect for equal human rights and transnational rule-of-law. Ordo-liberal European economic constitutionalism differs from neo-liberal American nationalism and totalitarian Chinese state-capitalism, whose nationalist, power-oriented economic and foreign policies offer no multilateral models for efficient governance of global public goods. This regulatory competition (e.g. for attracting foreign investments to particular host countries) also explains why – in contrast to worldwide agreement on multilateral, substantive and procedural trade rules and institutions – worldwide investment agreements (like the ICSID convention) remain more focused on procedures (e.g. for the settlement of disputes) than on harmonization of bilaterally agreed 'protection standards' and investment incentives.

Dynamic constitutionalism as 'institutionalization of public reason' and 'efficiency'

Most economists emphasize that 'efficiency' – e,g. in the sense of avoiding unnecessary waste of scarce resources - must be part of social definitions of 'justice': 'no rational society can ignore the costs of its public policies… The demand for justice is not independent of its price'.[65] This article has described 'constitutionalism' as the most important 'political invention', whose importance for economics and economic policies remains unduly neglected. In his Theory of Justice (1971), Rawls describes constitutionalism as a 'four-stage sequence' based on the history of the US Constitution: reasonable citizens, after having agreed (1) on their constitutional 'principles of justice' (e.g. in the US Declaration of Independence 1776), convene (2) a constitutional convention elaborating a national Constitution providing for basic rights and legislative, executive and judicial institutions; (3) democratic legislation must progressively implement and protect the constitutional principles of justice for the benefit of citizens, and (4) the agreed constitutional and legislative rules need to be applied by administrators and judges to particular cases so as to promote rule-of-law and rule-compliance by citizens.[66] In his later book on Political Liberalism, Rawls emphasized the legitimacy challenges arising from the permanent fact of a plurality of diverse religious, philosophical and moral doctrines endorsed by citizens: the democratic exercise of power is justifiable only to the extent it remains consistent with the essential constitutional principles and institutionalizes 'public reason' supported by free and equal citizens as reasonable and rational in spite of their diverse moral beliefs.[67] My books on *International Economic Law in the 21st Century* and on *Multilevel Constitutionalism for Multilevel Governance of Public Goods* applied this Rawlsian theory of justice as fairness to multilevel governance of transnational PGs: As globalization prevents states to protect transnational PGs without (5) international law and (6) multilevel governance institutions, the national 4-stage process must become a constitutionally restrained, transnational '6-stage process' in order to protect basic human rights and agreed principles of justice in stable, well-ordered transnational societies for the benefit of 'cosmopolitan citizens'.[68] This article has

[65] R.A.Posner, The Economic Approach to Law, in: A.Ogus/C.Veljanowski (eds), *Readings in the Economics of Law and Regulation* (Oxford: Clarendon 1984), at 46.

[66] Cf. J.Rawls, *A Theory of Justice. Revised edition* (Belknap Press 1999), at 171ff, at 176: 'the four-stage sequence is a device for applying the principles of justice. This scheme is part of the theory of justice as fairness and not an account of how constitutional conventions and legislatures actually proceed. It sets out a series of point of views from which the different problems of justice are to be settled, each point of view inheriting the constraints adopted at the preceding stage.'

[67] J.Rawls, *Political Liberalism* (Columbia University Press 1993).

[68] Cf. Petersmann (n 9), at 112f, 126f, 174ff. On my use of Kantian and Rawlsian theories of justice for justifying economic constitutionalism see also: E.U.Petersmann, *International Economic Law in the 21st Century. Constitutional Pluralism and Multilevel Governance of Interdependent Public Goods* (Oxford: Hart 2012), Introduction and chapts. I-III.

explained why the 'constitutional problems' of multilevel governance of the world trading and investment systems remain under-researched by both lawyers and economists.

The historical evolution of common markets inside federal states (like Canada, Germany, Switzerland, the United States) and through European institutions (like the EU, EEA, EFTA) illustrates dynamic interactions between *internal constitutional reforms* (like EU common market law, human rights law, judicial remedies) and *external reforms of trade and investment regulations*.[69] Section X illustrated these 'constitutional dynamics' by discussing the impact of the Achmea judgment and of Opinion 1/2017 of the CJEU on the termination of BITs and of related ISA inside the EU. These *intra*-EU constitutional reforms also triggered external EU initiatives for replacing external BITs of EU member states by EU trade and investment agreements with bilateral or multilateral investment court systems. It remains too early to predict the outcomes of the ongoing multilateral negotiations on reforming UNCITRAL-, ICSID- and ECT-investment arbitration procedures. But the successful strengthening of *intra*-EU investment adjudication boosted also the ongoing negotiations for strengthening the independence, impartiality, transparency, due process, accountability and human rights dimensions of ISA in the *external* relations of the EU and EU member states. Similar 'integration spill-over dynamics' can be observed in many other areas of regional economic integration law. The relationships between private legal autonomy (e.g. for commercial arbitration), state sovereignty (e.g. for domestic enforcement of arbitration awards based on the 1958 New York Convention) and the autonomy of the EU legal and judicial systems continue being progressively 'constitutionalized' *inside* the EU (e.g. by means of EU infringement proceedings against EU member states challenging *intra*-EU BITs, EU blocking of national enforcement of ISA awards if they undermined EU competition law or other EU constitutional law principles). Reforming the EU's external trade and investment agreements and judicial remedies remains legally and politically more contested and less constitutionally restrained by human and constitutional rights of citizens. As a result, the stronger judicial protection of rule-of-law among EU member states reduces transaction and coordination costs. In the external EU relations, however, the illegal blockage of the WTO AB system signals a weakening of the WTO legal and dispute settlement system in favour of intergovernmental power politics increasing transaction and coordination costs.

Strategic constitutionalism: A research agenda

Section III explained why reforms of international trade, investment and environmental law and institutions are increasingly hampered by the conflicting value principles underlying utilitarian Anglo-Saxon neo-liberalism (e.g. promoting self-regulatory market forces privileging the *homo economicus*), constitutional European ordo-liberalism (e.g. protecting 'common market freedoms' and multilevel, constitutional rights and judicial remedies of EU citizens), and authoritarian state-capitalism (e.g. protecting totalitarian power monopolies of the communist party in China). Sections IV and V argued that this reality of 'constitutional pluralism' at national levels of governance is unlikely to disappear; it may require broader re-interpretations of WTO 'exception clauses' and, as explained in Sections VII and VIII, pragmatic adjustments of the WTO dispute settlement system in response to the US assault on the WTO Appellate Body. Section IX discussed the need for 'greening the embedded liberalism' underlying international trade, investment and environmental regulation; arguably, the 'anthropocene' – i.e. our new global context of humans having become a geophysical force provoking climate change, massive biodiversity losses and other geological changes that can no longer be prevented through intergovernmental 'management' – necessitates global constitutional approaches limiting obvious 'governance failures' so as to prevent the human destruction of our environmental system.[70] As people

[69] Cf. Hilf/Petersmann (n 17); E.U. Petersmann, *Constitutional Functions and Constitutional Problems of International Economic Law. International and Domestic Foreign Trade Law and Policy in the United States, the European Community and Switzerland* (Fribourg University Press/Boulder Publishers, 1991, re-print 2020).

[70] Cf. L. J. Kotzé, *Global Environmental Constitutionalism in the Anthropocene* (Hart 2016).

in less-developed countries risk being most adversely affected by WTO power politics and climate change,[71] all WTO member states and their citizens must defend 'public reason' and global PGs, for instance by resisting President Trump's invocation of 'America first' for justifying the US assaults on WTO law and on the Paris Agreement.[72]

Strategic constitutionalism argues that the design, interpretation and adaptation of constitutional rules should more focus on their real-world consequences (e.g. in terms of incentives for citizens, politicians, administrators, judges, enterprises) and dynamic '6-stage processes' than on the 'originalist intentions' of their founders.[73] Just as ordo-liberal constitutionalism emphasizes dynamic interactions between moral, political, economic and legal freedoms and justifies economic competition on economic and non-economic grounds,[74] so can democracy be identified with competitive government dependent on constitutional safeguards of democratic competition (e.g. promoting 'median democracy' in constitutional democracies, 'political bargain democracy' in neo-liberal democracies, multilevel constitutional democracy inside the EU). Transforming national constitutionalism protecting national PGs into multilevel constitutionalism for multilevel governance of transnational PGs raises a host of strategic policy questions, as discussed in sections I to X. For instance:

- Why are so many economic and legal textbooks neglecting the task of justifying economic law and policies in terms of 'principles of justice' even though voluntary rule-compliance also depends on perception of the rules as 'just'? Which human rights and constitutional 'principles of justice' can justify modern trade and investment regulation in 'efficient' ways that reasonable citizens can understand and support?[75]
- Can European competition law and common market principles (like free movement of persons, fundamental rights, judicial remedies) serve as models for reforming international trade, investment and environmental law beyond Europe?
- Can the EU's multilevel common market constitution remain effective without further 'constitutionalization' of the EU's monetary constitution and 'banking union'? Do the political risks of introducing 'Eurobonds' – as demanded by southern EU member states disregarding the fiscal and debt disciplines of the Lisbon Treaty (e.g. Articles 123-126 TFEU) – create such 'moral hazards' that EU citizens may lose trust in the EU constitutional law principles (like limited delegation of EU powers, national sovereignty over fiscal and debt policies, 'regulatory competition' among EU member states as constitutional safeguard against 'regulatory capture' transforming the EU into a redistributive 'transfer community' assuming EU responsibility for national governance failures without effective controls by national parliaments)?[76]

---

[71] Cf. the UN Report on 'Climate Change and Poverty', A/HRC/41/39 (25 June 2019), para. 11.

[72] Cf. E.U.Petersmann, WTO Adjudication@me.too: Are Global Public Goods like the World Trade Organization Owned by Governments or by Peoples and Citizens? in: *Journal of East Asia and International Law* 13 (2020), forthcoming.

[73] For 'law and economics' approaches to constitutionalism see Cooter (n 3) and Petersmann (n 9 and 69).

[74] E.g. as information, coordination and sanctioning mechanism enhancing individual freedom, promoting consumer welfare in terms of consumer surplus, inducing individuals to use their decentralized knowledge and limit abuses of power; cf. V.Vanberg, Consumer welfare, social welfare and economic freedom – on the normative foundations of competition policy, in: J.Drexl *et alii* (eds), *Competition Policy and the Economic Approach. Foundations and Limitations* (Elgar 2011), 44-71.

[75] Cf. my criticism of the neglect of theories of justice in most international economic law textbooks: Petersmann (n 69), at 1ff. My definition of the 'first principle of justice' in terms of Kantian and Rawlsian theories of justice also justifies a presumption of transnational economic freedoms subject to other principles of justice and human rights (cf. Petersmann, n 69, chapter III).

[76] Cf. B.Young, Is Germany's and Europe's Crisis Politics Ordo-liberal and/or Neo-liberal? in: Biebricher/ Vogelmann (n 28), 221-238.

- How can the 'constitutional problems' of the compulsory WTO dispute settlement system be reduced such as the insufficient, democratic accountability of the WTO AB for its 'judicial clarifications' of WTO rules? Does the political failure of WTO members to hold WTO jurisprudence accountable – e.g. by adopting majority decisions on authoritative interpretations of WTO rules (Article IX.2 WTO Agreement), amending WTO rules, negotiating new WTO rights and obligations, or by establishing a DSB committee of legal experts for elaborating proposals for reforming WTO jurisprudence – undermine the 'democratic legitimacy' of WTO jurisprudence based on quasi-automatic adoption of WTO panel and appellate reports?
- How much will the strengthening of the intra-EU constitutional restraints on economic adjudication of trade and investment disputes and on judicial protection of individual rights influence the ongoing negotiations on reforms of ISA procedures in the external EU relations with third states and foreign investors?

The tensions and geopolitical rivalries between American hegemonic neo-liberalism, European constitutional ordo-liberalism and China's totalitarian state-capitalism render 'constitutional' and 'institutional economics' more contested, for instance due to the lesser constitutional restraints on governmental conferral of privileges and rent-seeking interest groups in neo-liberal and state-capitalist economies than in ordo-liberal, constitutionally more restrained democracies. Yet, the current global governance crises, health pandemics and climate change make constitutional reforms of multilevel governance of PGs ever more urgent. In order to be democratically legitimate and politically supported by citizens, these reforms can no longer prioritize 'negative freedoms' and economic neo-liberalism; they must protect also universally recognized positive freedoms (like health rights and other human rights) and constitutional, democratic and environmental reforms. As criticized by economic Nobel Prize laureate Buchanan already more than 40 years ago, economists must not neglect 'the constitutional-institutional or framework requirements of an economic system',[77] just as politicians must acknowledge that transnational PGs cannot be protected without international law and multilevel governance institutions supported by all citizens (rather than only by utility-maximizing economic actors). The conflicts between rational pursuit of self-interests, legal promotion of common interests (e.g. through non-discriminatory economic and democratic competition), and reasonable protection of public interests and PGs through constitutional law and democratic regulation are at the root of why economic constitutionalism and constitutional economics are needed for rules-based, efficient responses to the knowledge problems, incentive problems, reputation and legitimacy problems of economies.[78]

[77] J.Buchanan, *Freedom in Constitutional Contract* (Texas University Press 1977), at 5.

[78] Cf. V.Vanberg, Ordnugnspolitik, the Freiburg School and the Reason of Rules, in: Freiburger Diskussionspapiere zur Ordnungsökonomik No.14/2001.