II. INTERNATIONAL LAW ENFORCEMENT IN ACTION

The case studies in this chapter compare ICs involved in economic, human rights, and mass atrocities law enforcement in diverse countries so as to underscore the altered politics dimensions across issues and contexts. For each case, what compliance required varied, so that the actor with the power to choose compliance differed. Variation in the "problem structure" of compliance affected the strategies of litigants and IC compliance partners. Remember that my goal is not to explain compliance per se, but rather to understand how pressure on governments gets raised and diffused by the actions of IC interlocutors so as to ascertain how an IC's existence and actions contribute to changes in state behavior in the direction of greater respect for international law.

7.1. "Foreign Sales Corporation"—WTO review of the United States special tax treatment for goods exported abroad

This conflict over US tax policy began in 1971 when Congress decided that it needed to create a remedy to address American businessmen's complaints about the US system of taxing profits. The nature of the United States' legal violation did not change over the thirty-three years of this dispute, nor did the global trade regime's formal sanctioning system.

What became the Foreign Sales Corporation (FSC) case began in 1971 when the United States introduced the Domestic International Sales Corporation (DISC), which allowed US companies to create a subsidiary where export earnings could escape taxation. Congress hoped that the DISC legislation would reduce the US trade deficit. From the US perspective, providing a way for multinational corporations to escape American taxes only served to moderate the disadvantages the US approach to taxation inadvertently created.[9] The crux of the issue was that Europe levels value-added tax on goods sold in its market, and thus its system of taxation does not apply to goods exported abroad. Meanwhile, the United States taxes profits. American firms have to pay both US profit taxes and European value added taxes. Even if one accepts that the European system implicitly subsidizes exports, the intent behind the European system is not to provide a subsidy for exports so much as to tax consumption. By contrast, the intent behind the American DISC system was to provide tax relief for exporters. Thus arguably the American system was more illegal than European tax rules.

9 Gary Hufbauer explains the US position: GATT rules have a territorial notion of taxation that many see as making little sense in the modern system (Hufbauer 2002, 1–4).

As soon as the United States introduced its DISC system, Europe asked for a GATT panel arguing that DISC provided American firms with an unfair trade advantage. In response, the United States brought countersuits against European taxes that it claimed provided analogous export subsidies. Under pressure from Europe, the United States allowed the DISC case to proceed to the point that US practice was declared illegal. The United States was able to win its countersuits against the European practices, though according to Robert Hudec, the legal reasoning supporting the US victories was questionable.[10] All panel rulings were released at the same time. The United States offered to have the four panel rulings accepted, which would lead to mutual nullifications and impairments and thus no authorized retaliation. Europeans refused to accept the rulings against them, and thus all the panel rulings were blocked under GATT era rules that required unanimous consent for panel reports to be adopted.

Throughout the 1970s and 1980s the United States maintained its claim that the European system was also illegal. But in the politics that followed, the United States ended up isolated, with most countries believing that the DISC policy clearly violated GATT law, while the European systems were probably legal. In 1981 GATT bodies created a compromise collective position that arguably exonerated the European taxation systems while implicitly leaving the DISC policy discredited and illegal. In this compromise, the three European panel reports were separated from the DISC report, and the United States supposedly agreed that the European tax system was acceptable. The United States later claimed that the compromise position also exonerated DISC.[11] A basic détente set in. While the United States continued to violate GATT rules, the fact that its argument was not legally tenable undermined the US Trade Representative's ability to use reforming the DISC as a bargaining chip against other countries.

From a domestic perspective, the US tax system was entirely legal. The United States Trade Representative's office surely saw the DISC law as a strategic liability, but it had no power to address the issue. Only Congress

10 Hudec surmises that either political concern about the US position or inadequacies in legal reasoning allowed for the four panel decisions. According to Hudec: "Finding the right answer to the nasty interpretative problem presented by Article XVI:4 would have required legal work of the highest order. The level of legal practice would have had to provide the panel with a broad and sophisticated exploration of the issues, the data, the possible solutions, and the ramifications of those solutions. In 1976, however, GATT litigation procedure was just beginning to scrape off the rust that had accumulated during the antilegalist period of the 1960s. It was simply not ready to operate at this level." (Hudec 1988, 1486).

11 Ibid., 1493–96.

could change the contested policy. Congress had contradictory preferences. Its members supported the GATT and the enforcement of GATT fair trade rules, and it saw the United States as largely complying with GATT rules and with the rule of law in general. But members also supported US policies that violated GATT rules.

The compulsory WTO dispute resolution system came into effect in 1994. Now it would take unanimity to reject a panel ruling. Changes in the WTO enforcement system transformed a losing international legal argument into a ticking-bomb legal violation, which Europe could unleash whenever it chose. By then the United States had replaced its DISC system with tax rebates for exports and foreign production (goods sold through a Foreign Sales Corporation) so that goods sold in Europe could escape the double taxation of the US profit tax system. But creating a discount for the part of a corporation's products that were exported still looked like an illegal export subsidy. Europe knew that the FSC policy violated WTO law. Although the new WTO system made the FSC legislation a greater political liability, the US could avoid making any changes until Europe acted. The lurking possibility that this case might be filed was not enough to stop the United States Trade Representative from bringing suits to satisfy those American exporters who disliked European Union policies involving bananas, beef with hormones, and genetically modified foods. Only after losing these cases did the European Union raise the FSC suit.[12]

When the new FSC suit appeared in the WTO system, the substantive issue remained largely the same. US firms may believe that Europe's value added tax system provides benefits for exporters, but this does not change the reality that Europe's system of consumption taxes is WTO compliant. According to Gary Hufbauer, when the WTO ruling condemned the FSC system, it "gutted the understandings that the United States had relied on for nearly two decades." A first WTO ruling left open a door for the United States to maintain the heart of its FSC system. The United States adopted modest legal reforms, which were then challenged, leading to a second WTO ruling where it became clear that if the United States did not eliminate the entire system, Europe could levy $4.03 billion a year in retaliatory sanctions.[13]

The WTO system allows the winning country to choose which products it targets for retaliation. The winning country can first create tariffs on, for instance, US automakers right before quarterly reports are due or

12 Hufbauer argues that Europe raised the case to create bargaining chips after it lost the bananas and beef hormones case, and because it anticipated losing cases involving Airbus and agricultural subsidies (Hufbauer 2002, 5).

13 (Hufbauer 2002, 5). WTO United States Tax Treatment for "Foreign Sales Corporation."

when credit agencies are making their calculations, then add tariffs on Hollywood movies, American computer products, and perhaps wine from Napa Valley, and later add tariffs on citrus products shipped from states where there are tight elections. For Europe, this award was a bargaining chip it could use in future conflicts with the United States. Europe won the right to put a 5 percent levy on American goods, rising 1 percent for every month the legal violation persisted up to a 17 percent tariff ceiling. The European Union published a target list for retaliation, making quite clear the costs of defending this subsidy for American exporters.[14] Moreover, American legal leverage vis-à-vis Europe was undermined as long as this fine existed. The United States could continue to bring and win cases against Europe, but doing so merely risked that Europe would find even more products to target as it implemented $4.03 billion worth of annual retaliation.

According to one estimate, European countries collected between $200 and $300 million in 2004 and were poised to collect another $666 million in 2005.[15] The prospect of rising retaliation ultimately changed domestic calculations by mobilizing businesses like Boeing, General Electric, and Caterpillar, which faced retaliation. With these major firms now wanting the FSC system eliminated, the political costs of changing the US tax code diminished. The American Jobs Creation Act of 2004 changed the contested US tax law while providing tax breaks to many.[16] It may be urban folklore, but the press reported that even Starbucks earned a classification as a "manufacturer" that could benefit from the tax reform.

The United States was particularly intransigent regarding the FSC case because so many American firms believe that they are unfairly disadvantaged by double taxation, yet there continues to be deep political opposition in the United States to switching from taxing profit to taxing consumption. The United States has complied more quickly with WTO rulings where far smaller sums were at stake. For example, the US government on its own volition respected the WTO's finding of a violation regarding safeguards levied on Australian and New Zealand lamb, ending the safeguard protections nine months before they were set to expire at a cost of $42.7 million.[17] Compliance was arguably easier in this case because the United States' International Trade Commission could choose to end the safeguard without congressional assent. In other words, the United States is not always reluctant to comply with WTO laws or decisions. Meanwhile, Europe's record of compliance with WTO rulings is

14 (Stancil 2005, 422).
15 Ibid., 434–35.
16 H.R. 4520, 108 Congress 2004.
17 "US ends lamb import quotas." 2001. Agra Europe, November 16, 2001, 7.

also spotty. Instead of immediately complying with the WTO's banana and beef hormones rulings, Europe brought the FSC suit so that it could counterretaliate should the United States target its products. Arguably European firms were disadvantaged by the tax-break subsidy for exports, but the impetus for the suit seems to have been annoyance and a desire to gain bargaining leverage. Thus we might conclude that the WTO system brings both incremental compliance and dueling legal suits.

7.2. "Second Use Patent"—Andean Tribunal's review of Peru's policy granting patents for new medical uses

Andean intellectual property law requires absolute novelty for inventions to garner a patent. It thus bars recognition of so-called second use patents—new patents for when a medication is found to be beneficial for a different purpose. In the 1990s, the American pharmaceutical company Pfizer discovered that its heart medication pyrazolpyrimidinones (renamed Viagra) had the side effect of treating male impotence. Latin America promised to be a lucrative market for Viagra. Notwithstanding clear Andean rules to the contrary, Pfizer filed second use patent applications in all of the Andean countries in an effort to prevent the sale of generic erectile dysfunction medications.

In Peru, the office charged with issuing patents (the National Institute for the Defense of Competition and the Protection of Intellectual Property [INDECOPI]) applied Andean law and rejected three patent applications for Viagra. A few months later, in June 1997, President Fujimori issued a decree that purported "to clarify and interpret various articles of [Andean] Decision 344."[18] Article 4 of the decree recognized that patents could be issued when there were new uses of existing drugs.[19] Immediately thereafter, Pfizer ask INDECOPI to reexamine its application to patent Viagra. Relying on the new law, the agency granted the application in January 1999. Pfizer then threatened to sue Peruvian drug companies that were manufacturing or selling generic copies of Viagra. With domestic litigation looming, the Association of Pharmaceutical Industries of National Origin (ADIFAN) filed a complaint with the Andean General Secretariat alleging that Peru had violated Andean rules requiring absolute novelty for patents. This case would not have occurred under the original Andean system, because the General Secretariat originally could

18 Supreme Decree No. 010-97-ITINCI (June 5, 1997).

19 Article 4 provided that "a distinct use included in the state of the art shall be the subject of a new patent if it complies with" the normal patent requirements of novelty, inventive step, and industrial applicability. Ibid.; see also Pascale Boulet, *Campaign for Access to Essential Medicines—Patents and Medicines in Peru* 4 (November 2001); Ena Matos Jaqui, *Las patentes de segundo uso* (undated), available at http://www.dlh.lahora.com.ec/paginas/judicial/PAGINAS/D.Autor.4.htm.