

Resolving US-European Trade Disputes Through Law:
Is the WTO Dispute Settlement Mechanism Effective?

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Thank you. It is a pleasure to be here, wintry though it is.

My topic today is Resolving US-European Trade Disputes Through Law: Is the WTO Dispute Settlement Mechanism Effective? To address it, I will first consider whether a trade dispute settlement system should be more adjudicative or negotiation-oriented, and then describe the WTO dispute settlement system, which came into operation in 1995. Then, I will consider the overall operation of that system in general, followed by a comparison of how the system has operated specifically in resolving US-EU disputes. I will then speculate on why the EU-US experience evolved as it did and consider whether there is a need either (i) for a different system for EU-US disputes or (ii) for specific changes to the WTO system.

Before describing the specifics of the WTO dispute settlement system, it is instructive to consider the history of the GATT dispute settlement system. Although viewed as relatively successful, throughout GATT's history, there was disagreement over whether its dispute settlement system should be more or less "judicial" in nature. Some argued that it should be more judicial so as to promote more precise decisions on the merits of disputes and more effective implementation of decisions. At the same time, others argued that the nature and basic philosophy of GATT dictated that the system should be used only to the extent it facilitated negotiated settlements of trade disputes.

These two conflicting viewpoints are often referred to as the "legalistic" model, which stresses adjudication, and the "pragmatic" or "anti-legalistic" model, which emphasizes negotiation and consensus. Put simply, the legalistic view was that the GATT and now the WTO Agreement are codes of conduct and embody a balance of concessions. If a Member violates the code or tips the balance, it is appropriate to penalize such behavior and put pressure on that Member to conform to the code or right the balance, if necessary by allowing the complaining Member to take offsetting countermeasures. On the other hand, the anti-legalistic position is that the agreements are not a code of conduct *per se*, but more of a commitment by the Members to deal with each other in trade matters so as to work out mutually acceptable solutions to any disagreements. Until the closing period of the Uruguay Round, the United States was generally perceived to have supported the legalistic position, while Japan and the EU were considered supporters of the opposing position.

To choose between these alternatives, it would seem to be necessary to decide: What are the goals of a trade dispute settlement system? Would they be better achieved by emphasizing adjudication or negotiation?

The first question seems easy to answer. Clearly the goal of the dispute settlement system should be to promote compliance with the agreement. Any lesser goal would have the effect of undermining the negotiated commitments and they would lose their meaning if they were not enforced. Put simply, it would make little sense to spend years negotiating

detailed rules in international trade agreements if those rules could be ignored. Would a more adjudicative system would promote greater compliance with agreements?

Critics of the adjudicative approach suggest that it will not. First, they argue that disputes in the end must always be resolved by negotiated settlement. Even after the dispute settlement mechanism has produced a decision on the merits of a case, the implementation of that decision will likely be the subject of negotiations between the contending parties as to form and timing. A more contentious, adjudicative approach, they argue, will poison the atmosphere for these negotiations and ultimately undermine the system. I tend to disagree. Emphasis on a negotiation approach is likely to result in more powerful countries dominating the process to the detriment of weaker countries and the integrity of the agreed rules. This result is more likely to poison the atmosphere in the long run than a system that only asks countries to comply with the obligations they have freely undertaken.

Second, it is argued that a more legalistic system will encourage the filing of complaints, i.e. it will promote disputes and that some of these will be what could be called "wrong" cases. A wrong case is one that may overwhelm the system because of political considerations. Country X may be violating an agreement, but it may not be able to stop because of a particular political situation. For me, such cases are likely to be rare and the system so far has had the strength to deal with them. In any event, even if compliance cannot be assured, the violator still may in a position to right the balance of concessions by taking other compensating action. And even if it cannot, the victimized party at least ought

to be authorized to suspend concessions otherwise owed to the violator in order to the right the balance.

Thus, the criticisms of the adjudicative approach do not seem to be valid. The basic question remains, however. Will the adjudicative approach lead to better compliance with agreed rules? I think so. First, an adjudicative system discourages rule violations because a potential violator knows it is likely that it will be called to account if it ignores the rules. In the negotiation model, the only detriment to the violator would be unpleasant diplomatic encounters. Second, because experience shows that dispute settlement decisions are usually implemented in the long run, more decisions -- which is a likely result of an adjudicative system -- will result in clearer definition of and closer compliance with agreed rules. Thus, a more adjudicative system will strengthen the system over time.

In any event, the results of the Uruguay Round negotiations clearly put a much more judicial-like system in place. That occurred in large part because the EU and Japan decided that a more adjudicative system would be desirable as a means of limiting the US tendency to take unilateral trade action. Their hope was that by strengthening the WTO/GATT system by making it more adjudicative and automatic, the United States would be less able to complain about the system's inadequacies and therefore less likely to act unilaterally. And in return for their agreement to the more adjudicative system, they insisted on provisions designed to prevent unilateralism. Needless to say, to the extent that the new system is ever perceived not to be effective, the philosophical debate over the desirability of an

adjudicative system is likely to resurface. And, as explained below, some would argue that may now be the case, at least in respect of EU-US difficulties in dispute settlement.

I now turn to a brief description of the WTO Dispute Settlement System

It is based on the so-called "Dispute Settlement Understanding" or simply the "DSU".

There are essentially four phases in the WTO dispute settlement process: consultations, the panel process, the appellate process and surveillance of implementation.

Phase 1 - Consultations

A WTO Member may ask for consultations with another WTO Member if the complaining Member believes that the other Member has violated a WTO agreement or otherwise nullified or impaired benefits accruing to it. The goal of the consultation stage is to enable the disputing parties to understand better the factual situation and the legal claims in respect of the dispute and to resolve the matter without further proceedings. The DSU provides that "[t]he aim of the dispute settlement mechanism is to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute and consistent with the [WTO] agreements is clearly to be preferred."

Despite the fact that the structure of consultations is undefined and there are no rules for conducting them, consultations lead to settlements (or at least the apparent abandonment of a case) in respect of about one half of consultation requests.

Phase 2 - The panel process

If consultations fail to resolve the dispute within 60 days of the request for consultations, the complaining WTO Member may request the Dispute Settlement Body (the DSB, which is the WTO organ supervising dispute settlement) to establish a panel to rule on the dispute. The DSB is required to do this, unless there is a consensus in the DSB to the contrary.

The salient features of the panel process are

- there are three-person ad hoc panels, usually current or former government officials
- the parties are supposed to agree on the panelists, but most in recent cases have been appointed by the WTO Director-General
- there are at least two hearings, with party written and oral submissions and panel questions – such that the panel is actively engaged in defining the case

If a panel finds that a WTO rule has been violated, the standard practice of panels is to recommend that the measure found to be in violation be brought into conformity with WTO rules.

After its circulation to WTO Members, the final report is referred to the DSB for formal adoption, which is to take place within 60 days unless there is a consensus not to adopt the report or an appeal of the report to the WTO Appellate Body. This so-called negative consensus rule is a fundamental change from the GATT dispute settlement system where a positive consensus was needed to adopt a panel report, thus permitting a dissatisfied losing party to block any action on the report. Now, as long as one Member wants the report adopted, it will be adopted. However, while the losing party cannot block adoption of a report, it has a right of appeal.

Phase 3 - The appellate process

The possibility of an appeal to an Appellate Body is a new feature of the WTO dispute settlement system. The Appellate Body consists of seven individuals, appointed by the DSB for four-year terms. Only one reappointment is permitted.

The Appellate Body hears appeals of panel reports in divisions of three, although its rules provide for the division hearing a case to exchange views with the other four Appellate Body members before the division finalizes its report. The Appellate Body is required to issue its report within 60 (at most 90) days from the date of the appeal, and its

report is to be adopted automatically by the DSB within 30 days, absent consensus to the contrary.

There have been 53 Appellate Body reports adopted to date. In ten cases, the panels were upheld; in two cases, they were reversed. In both of those cases, proceedings were recommenced and the complainant ultimately won. In the remaining 41 cases, the Appellate Body has modified, sometimes extensively, the panel's findings. In all but one of those 41 cases, however, the basic finding of a violation reached by the panel has been upheld, albeit sometimes to a different degree and/or on the basis of quite different reasoning.

Phase 4 - Surveillance of implementation

The final phase of the WTO dispute settlement process is the surveillance stage. This is designed to ensure that DSB recommendations (based on adopted panel/Appellate Body reports) are implemented. As noted above, if a panel finds that an agreement has been violated, it typically recommends that the Member concerned bring the offending measure into conforming with its WTO obligations.

Under the surveillance function, the offending Member is required to state its intentions with respect to implementation. If immediate implementation is impractical, a Member is to be afforded a reasonable period of time for implementation. Absent agreement, that period of time may be set by arbitration. The DSU provides that, as a

guideline for the arbitrator, the period should not exceed 15 months. The period, on average, is 8 to 9 months.

If a party fails to implement the report within the reasonable period of time, the prevailing party may request compensation. If that is not forthcoming, it may request the DSB to authorize it to suspend concessions (i.e. take retaliatory action) owed to the non-implementing party. DSB authorization is automatic, absent consensus to the contrary, subject to arbitration of the level of suspension if requested by the non-implementing Member.

If the losing party takes corrective action, but there is a dispute over whether the new measure is WTO consistent, then the current practice is to refer the matter to the original panel, which considers the new measure. It is accepted that this panel report may be appealed. At the end of this process, retaliatory action may be authorized.

It is important to note that retaliation is prospective – it starts when authorized – and is limited to offsetting the future trade effects of the contested measure.

How has the WTO dispute settlement system operated to date?

The WTO dispute settlement system has been quite active since the founding of the WTO on January 1, 1995. As of January 31, 2003, there had been 280 consultations

requests. It appears that roughly one-half of these cases were resolved by the parties or abandoned without the need for recourse to the panel process.

As of January 31, 2003, there were ten active cases. In addition, panel and/or Appellate Body reports had been adopted in 67 cases. Generally, the system has a strong overall implementation record. Of the 67 cases, in 9 cases, no implementation was required; in 10 cases the period for implementation had not been set or had not yet expired. Of the remaining 48 cases, implementation had occurred in approximately 85% of the cases. Of the 8 problematic cases, one was in Article 21.5 compliance proceedings (*EC Bed Linen*) and one was in suspension level arbitration (*Canada Dairy*).

The clear problem cases were the two Brazil/Canada aircraft disputes and three cases involving EU complaints against the United States: *FSC*, *Copyright* and *1916 Act*. While unresolved, retaliatory sanctions had not been implemented in any of these cases. The conclusion that things are working well has to be qualified. There are several cases involving the United States where it had to seek an extension of the reasonable period of time, suggesting that implementation problems will arise in those cases. Moreover, two cases involving the US/EU – Bananas and Hormones, while arguably now resolved, at least as to Bananas, took many years to solve after expiration of the reasonable period of time and did result in retaliatory sanctions. I refer them in more detail below.

Turning to the record in US-EU disputes, the US and the EU have been frequent users of the WTO dispute settlement system, especially against each other. Of the 281

consultations requests to date, 52 have involved US-EU disputes – with 26 complaints brought by the US and 26 brought by the EU. Interestingly, the US and EU were more active in requesting consultations in the early days of the WTO – of the 52 cases, 37 cases were initiated in the 1996-1999 period (or about nine per year), with only 11 cases being initiated in the last three years – 2000-2002 (or a bit fewer than 4 per year).

How have these disputes been resolved? Well, of the cases that are more than two years old, roughly one-third led to panel reports and two-thirds were settled or have remained inactive for a long period. Compared to the overall WTO record, there seems to be a somewhat higher rate of settlement.

What about those cases that result in a panel report? Two statistics stand out. First, of the total of 14 panel reports, the initial three involved cases brought by the United States against the EU; the next 11 cases were brought by the EU against the US, with one more pending. Thus, there has been a bit of imbalance in taking cases to the panel stage.

Second, compared to the overall WTO record of compliance, the record in the US/EU cases is not so good. Indeed, with the exception of the Brazil-Canada regional aircraft subsidy dispute and perhaps the pending Canada Dairy dispute, all of the major noncompliance issues in the WTO have involved EU/US cases. Of the three cases brought by the United States, two resulted in major noncompliance problems – Bananas and Hormones. In Bananas, the EU lost initially, reformed its measures, lost again and

was subjected to US retaliation. The matter was finally resolved only in 2001, more than four years after the initial adverse decision had been adopted. And even now, there is a transition period still to run before there is complete compliance.

The Hormones case presented similar problems. The EU admitted its failure to take corrective action in 1999 and has been subject to sanctions since by the United States and Canada. At the moment, the EU has recently enacted a new measure, which it claims complies with WTO rules, although the US does not agree. Thus, this case is still may be considered a compliance problem.

In respect of the EU successes against the United States, the US has failed to implement several decisions in a timely manner. The most significant case in the Foreign Sales Corporation case, where the US lost initially, reformed its measure, lost again and now is potentially subject to EU retaliation in an amount of around \$4 billion. There are several other cases where compliance is overdue or about to become so, including the US failure to repeal the 1916 Antidumping Act and the failure to amend the copyright act to require royalty payments by certain classes of retail establishments.

This overview suggests that there may be some serious problems of effectiveness at the WTO in resolving US EU disputes.

I turn now to an analysis of the EU US disputes.

I have mentioned what a few of these disputes have been about. Are there any general patterns that one can discern in these disputes? I think that several distinct phases may be discerned.

I see three phases in particular. The first phase, 1995 through 1997, was characterized by US cases against the EU, many of which could be categorized as old cases (Bananas and Hormones were difficult disputes in GATT) and Uruguay Round implementation issues, mainly involving intellectual property. The first category led to the difficult cases I mentioned above – Bananas and Hormones; the second category of cases was resolved amicably. Relatively speaking, the EU in this period was not so active in bringing cases against the US.

The second phase of US/EU dispute settlement started at the end of 1997, with a more active EU bringing cases against the United States. This phase might be characterized as EU pay-back for the US cases in respect of Bananas and Hormones. While the EU would undoubtedly take issue with that characterization, I think it is reasonable. This phase resulted in the currently unresolved US problem cases – FSC, 1916 Act and copyright. There was also an unsuccessful case brought by the EU against Section 301 of the US 1974 Trade Act, which serves as the basis for much US trade retaliation in recent years.

The third phase has been the 2000-2002 phase, which has involved mainly action commenced by the EU (8 of 11 cases) about US trade remedies (all four of the cases that

have gone to a panel). For the most part, those cases involved trade remedy relief for the steel industry.

Why these phases? Probably two reasons. First, a matter of personalities. For whatever reason, the individuals dealing with trade matters in the EU and US in the first two phases of the WTO did not get along well – Charlene Barshefsky and now Lord Brittan. I don't mean to suggest that the relationship of two individuals explains everything, but I do think it is fair to say they made compromises more difficult. In the last several years, the new individuals in charge of EU/US trade policy – Lamy and Zoellick seem to have been able to work together much better. That is not to say that disputes have disappeared, but they are managed at a lower level of conflict.

Second, it was only natural that the first phases of WTO dispute settlement would have to deal with old, contentious cases – the three most difficult cases – Bananas, Hormones and FSC – arguably fall into that category. Since then, the major cases have involved US use of trade remedies, which for the EU has been particularly troublesome in the steel industry.

The good news may be that the more recent matters may be expected to be resolved (or at least fade from view) more easily than some of the initial disputes. The various measures in favor of the steel industry will expire in due course. That said, the fact remains that there have been and remain some difficult contentious issues. That

raises the question of whether the WTO dispute settlement system needs to be changed or if the EU and US need to explore alternative ways of resolving trade disputes.

I first consider possible alternative systems for EU US disputes.

This issue has received a fair amount of attention. The three immediate past Directors-General of the WTO/GATT – Ruggiero, Sutherland and Dunkel – issued a statement after the Seattle Ministerial debacle at the end of 1999 suggesting that the contentiousness of dispute settlement process risked spilling over into negotiations and that it was a particular problem given the FSC case. Their basic theme was that the WTO and GATT before it had always relied upon US/EU leadership in negotiations, but that was being undermined by disputes. (I would note that the success of the Doha ministerial has blunted this concern.)

There were also suggestions coming from the EU/US summit process that an early warning system was needed to identify potential disputes and resolve them amicably before they grew into major problems.

While I would concede that there have been some serious problems – and I suppose that the GMO dispute may soon present a new one, overall I question whether the WTO dispute settlement process is too contentious. It may be the case that the lawyers directly involved in the disputes become so, but for the most part they are ultimately controlled by political actors.

The idea that the disputes arise without adequate warning is simply untrue. These disputes all percolate for some time before they are brought. There are numerous EU/US meetings – in Brussels, in Washington, in the WTO. The idea that the problems could be avoided by more meetings seems naïve. Rather, if anything, it would seem that history suggests that it is the individuals who attend the meetings and their willingness to compromise that is crucial.

Are the EU/US too quick to litigate? Would it be preferable to have an alternative method of resolving disputes – some sort of mediation or negotiation stage? I see little hope in such an attempt. Negotiations occur now, and at all levels. The usefulness of mediation would likely be much less in the case of the US and the EU than in the case of small countries, who may have less clear or accurate views as to their rights. The US and EU are unlikely to take the mediator seriously, in my view. They tend to have clear views of their rights and what they want.

Thus, while the current situation is not ideal, I don't see a need for the EU and the US to adopt radically new methods of resolving disputes.

Finally – what about reforms to the WTO system described above. Does the EU-US experience suggest any are needed?

For me, I think one problem stands out. There is considerable foot-dragging in some cases and the use of retaliatory sanctions seems to have been of questionable effectiveness. That raises the question of whether improvements in the remedy rules could usefully be made, especially given the Bananas/Hormones experience and the pending FSC dispute.

In considering remedies in the WTO system, it is important to recall that the existing remedies are prospective – whether in the form of compensation or retaliation. In addition, it is important to consider their two principal aims – to restore the balance of concessions that was upset when one Member violated its obligations (a temporary aim since compliance is the preferred result); and to give that Member an incentive to comply. The current problem with achieving the first aim – rebalancing – is that if retaliation is authorized, rebalancing takes place at a lower level of trade liberalization that had been agreed to. It would be desirable if a remedy could be devised that would not lead to less liberalization overall. One could consider monetary payments or requiring the payment of compensation through a reduction in other tariffs or trade restrictions maintained by the non-complying Member.

In respect of the second aim – incentive to comply – there are two issues – timing and level of compensation or retaliation. At present, because remedies are prospective, there is an incentive initially to delay the time at which point they might be implemented, such as by seeking a long reasonable period of time for compliance and then taking only limited action and forcing the victor to go through an additional panel proceeding.

Moreover, if the threat of retaliation does not work, it is possible that the actual existence of retaliation will become viewed as the status quo and a long-term solution, even though the WTO rules in theory require compliance. A preferable solution may be to create incentives for early compliance, such as by providing that any retaliation will be calculated from a date prior to the date set for implementation or by providing for increasing retaliation over time.

What about other forms of remedies beyond compensation and retaliation that might be more effective? One obvious possibility would be the payment of fines or damages. The system would have to be designed to avoid the possibility that rich Members could effectively buy their way out of obligations in a way not available to the poor Members; but that could be done. To avoid the perception that the payment of fines is simply an alternative to compliance, the fines could be assessed annually (or on some other periodic basis) and could be increased over time. Such a system could serve as a method of rebalancing if the fines are paid to the member owed compliance and could promote prompter compliance if the fines are increased over time. While a system of fines has not been seriously discussed in the GATT/WTO in the past, the US has recently negotiated two free trade agreements providing for such a remedy in certain cases.

The use of monetary compensation might well resolve at least some of the minor EU-US cases the pendency of which may otherwise over time become more troublesome issues. Thus, if the US-Eu experience suggests the need for any reform – it is in the area of remedies available in WTO dispute settlement.

In conclusion, I would say that the WTO system has worked adequately in the US/EU context. The overall number of disputes seems to have declined and the recent focus is largely on US trade remedies for steel. Those cases will probably eventually be resolved – if only through expiration of the challenged measures. Their pendency could sour relations, however, which makes reform of WTO remedies a more urgent issue. As noted above, some form of mandatory compensation might be the best solution. While more difficult cases will arise from time to time – GMOs may be next – I think the system has been able to defuse most major cases.

Thank you for your attention.