The Dispute Settlement Mechanism of the WTO: A Brief History and an Evaluation from Economic, Contractarian and Legal Perspectives

T.N.Srinivasan

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GATT and WTO

- GATT's main objective was to reduction of tariff rates and making non-tariff barriers relaxed.
- The GATT agreement of October 1947 had a very rudimentary enforcement mechanism.
- These vague procedures evolved to become more formal and legalistic over time, in particular in the Tokyo Round of multilateral trade negotiations in 1979.

- But there was a demand for a more legalistic system with set timetables for decisions.
- These demands were met in large part in the Uruguay round of agreement in 1994.
- This paper looks at the evolution of the Dispute Settlement Mechanism (DSM)in the GATT era.
- This also analyzes different perspectives through which DSM s can be viewed.

DSM in GATT and WTO

- Throughout the history of GATT the question of DSM has been ambivalent.
- There are two views: one sees the DSM as a diplomatic (and not legalistic) process while the other sees it as a legalistic process.
- The objective of the diplomatic approach is to achieve: a balanced accommodation of interests, rather than a vindication of rights in a victory versus defeat pattern.
- The objective of the legalistic approach, to achieve legal consistency, predictability and certainty'.
- The GATT system initially was more oriented towards the diplomatic approach, but over time it became more legalistic.

- The trend towards the legalistic approach cannot be explained simply by the failure of the more diplomatically oriented GATT system.
- The dissatisfaction of the European Community (EC) and the United States of America (USA) with the system and the failure to respect adverse panel reports, were primarily responsible for the legalistic character of the WTO system that emerged out of the Uruguay Round.

- It is worth noting that the charter for an International Trade Organisation TO), adopted in March 1948 at the United Nations Conference on Trade and employment in Havana, Cuba, had a legalistic DSM.
- The first working draft of the ITO Charter (in 1948) submitted by the USA outlined a three step procedure.
- Executive Board – Conference – International Court of Justice (ICJ).
- In the GATT, there was no provision for appeal to the ICJ at all. Nor is there any in the WTO.
- GATT remained fairly small until early 1960s with fewer than 30 signatory.
- The 1960s saw the membership in GATT increase to 77 in 1970, with 52 of them being developing countries.

- The change in the number and composition of membership naturally brought new issues to the fore, many of which still remain contentious.
- LDC s wanted a strong rule based system on one hand, and more freedom to comply with the rules on the other.
- The EC wanted freedom to protect its agriculture and also engage in preferential trade with its former colonies.
- The EC also pushed for a diplomatic approach to solving trade policy conflicts, thus under emphasising a legalistic adherence to rules.
- The USA, which in the 1970s pushed for a legalistic DSM, sided with the EC in its anti-legalism, thus ensuring the diplomatic approach continued to prevail until the late 1960s.

- Pressure by the USA led to the rebuilding of the GATT legal system in the 1970s.
- The core problem underlying delays and failures of implementation of panel decisions had been widely perceived to be the GATT principle of consensus decision making, which gave the defendants the ability to drag their feet at every stage of the process (Hudec, 1991, p. 54).
- The Tokyo Round Agreement produced two documents on GATT procedures:an Agreed Description of Customary Practice and an Understanding on Dispute Settlement.
- Together these two significantly improved the situation.

- Interest in the use of the GATT process had revived in the 1970s, with 32 new complaints brought before it, as compared to virtually none during 1963-1969.
- This interest intensified in the 1980s with the filing of 115 legal complaints.
- Panels that heard the disputes in 47 of the 115 complaints delivered decisions, more than in all the three previous decades. This record of success encouraged

- There was internal pressure on the US to take unilateral action.
- US used its own trade laws – particularly section 301 and super 301 of the trade act of 1974.
- This issue was resolved in the Uruguay round.
- The solution of the part of the final act embodying the results of Uruguay round and was signed in April, 1994 in Marakesh, Morocco.

DSM of the final act and GATT

- In the old GATT,there was no timetable, rulings were easier to block and many cases were dragged inconclusively.
- Under the old system rulings could only be adopted by consensus.
- Under the new system, rulings are automatically adopted unless there is a consensus to reject a ruling.

- As of April 2006, in all 343 disputes have been filed between 1995-2004, 152 cases came from developing countries, 82 by the US and 72 by the EU.
- This increasing number indicates an overload in near future.
- This shows the ineffectiveness of DSM as the legal system.
- But this is not so surprising. DSM cannot be an international analogue of a domestic system.
- There is no international body that has the international moral authority to judge the case. This led to the ineffectiveness of the DSM as a legal system.

Trade agreements and their DSM: Economic Perspectives

- The diplomatic approach came from the view that economic issues were too important to be left to the lawyers.
- But, are GATT obligations self enforcing?
- Economic models show that such agreement help nations avoid Prisoner's Dilemma type problems by prohibiting the nations from engaging in tariff war,avoiding domestic political constraints and allowing them to commit to certain domestic policies.

- The above three issues involve some kind of inefficiency arising out of externality.
- The first two of them arising from terms of trade.
- However, third issue arises from government's inability to credibly commit to a policy.

- In the GATT agreement, any renegotiation of tariffs under Articles *XXVIII and XXVIII b* is subject to the reciprocity requirement that re-negotiations maintain a general level of reciprocal and mutually advantageous concessions not less favourable to trade than that provided for in [the] agreement prior to such negotiations.
- Bagwell and Staiger show that MFN insures against the conventional erosion of benefits of concessions in an agreement through opportunistic deviation of a subset of parties at the expense of others.
- But MFN cannot eliminate opportunism fully

- However, MFN combines with reciprocity requirement will lead to a renegotiation prood agreement that is politically efficient.
- Efficient in Pareto sense – it is not possible to increase one nation's utility without harming the other.
- But the politically efficient tariff that the renegotiation proof trade agreement can sustain is not zero.
- Hence, Bagwell-Staiger theory predicts that GATT style negotiation with MFN and reciprocity is not a means for achieving a barriers-free global trading system.
- It can only ensure minimum barrier equilibrium.

- Etheir (2004) on the other hand argues that "ACTUAL MULTILATERAL TRADE AGREEMENTS DO NOT PREVENT COUNTRIES FROM TRYING TO INFLUENCE THEIR TERMS OF TRADE".
- He further argues that Bagwell and Staiger have two implications:
  1. Small countries will never sign trade agreements. If they did, they would surrender the use of trade policy for domestic objectives while receiving absolutely nothing in return.
  2. Large countries will negotiate only trade agreements that constrain terms-of-trade manipulation. Trade agreements that do not do this would, for no reason,surrender the use of trade policy for domestic objectives.
- But in reality we observe the opposite.

- Etheir's own multicountry model deliberately does away with market-power-induced terms-of-trade externalities by assuming that no country has the ability to influence world prices.
- Governments have an objective function that reflects two political externalities:
  1. Political support is more sensitive to the direct effects of government actions.
  2. Trade volumes influence political support independently from their implications for factor reward.

- Horn and Marvodis (2001) correctly points out that the sole rationale for trade agreements in Bagwell and Staiger (2002) is to address terms of trade externalities of tariffs.
- Ethier, on the other hand, focused on political externalities that do not go through terms of trade.
- In both the views DSM is self reinforcing equilibrating mechanism in the sense that short term gain from deviation is less than the loss term loss arising out of retaliatory consequences that the deviation would invoke.

Trade agreements and their DSM: Contractual Perspectives

- Schwartz and Sykes (2002) view trade agreements to be "in effect, contracts among the political actors who signed them."
- They focus on three central features of GATT/WTO
  1. rules structuring the renegotiation and modification of commitments of signatories.
  2. sanctions for breach of obligations.
  3. measurement of substantially equivalent concessions.

- In the economic perspective parties will comply if short term gains of non-compliance$<$ long term gains of compliance.
- From contractual perspective parties will comply if the benefits from compliance to the promisee $>$ costs to the promisor.
- The underlying premise is that contracts are incomplete. Hence, there will situations where deviations which are not legally punishable.
- Schwartz and Sykes view the so-called escape clause (Article XIX of GATT) as an example of efficient breach.
- It allows a signatory to raise, for example, its tariff on an import above the level at which it had previously bound when increased competition from imports threaten domestic industry.

DSM: A Legal Perspective

- Weiss (2000b) describes a three step procedure involved in the adjudication according to law
  1. Determination of the applicable law for a particular case.
  2. interpreting the rules so chosen or ascertained with respect to the present case.
  3. applying of the said rule to the case
- WTO process however involved a pre-litigation stage.

Critical legal aspects of DSM in WTO

1. Pre-Litigation
2. Standing
3. Citizen representation
4. Transparency of WTO processes
5. Remedies

Pre-litigation

- Scope of jurisdiction, due process function and litigation avoidance function.
- Due process: ensures that defendants have opportunity to prepare to defend themselves. Also, third parties may participate.
- Litigation avoidance: opportunity to the parties to settle the dispute at the consultation stage

Standing

- A DSM such as that of the WTO has to specify who has standing to bring complaints before it, magnitude of penalty etc.
- The issue of particular importance is whether private individuals have standing in the sense of having the right to petition the relevant body of the DSM if they have a stake in dispute.
- Another important question is whether WTO ruling automatically become part of domestic law or do they have to be given domestic legal status through the enactment of specific legislation incorporating the agreement.

- Whether WTO rules can be imposed on domestic law depends on several factors.
- The most basic is direct effect.
- Direct effect entitles a private person to base a legal claim directly on a WTO provision as a rule of decision.
- It is a matter of domestic constitution and not one of harmonised international law.

- For example in France, treaty rule can be applied by a French court in a dispute between private person and government.
- Moreover, in the French case the rule overrides any subsequently enacted legislative Act.
- In the USA, on the other hand, treaty provisions are given direct effect only sometimes, so that a private person is allowed to base a claim or a defence in a national court directly on the treaty rule.
- But unlike the French case,treaty rule can never override subsequent legislative acts.

- There is also a provision of indirect effect.
- This allows the use of international agreements in providing an interpretation of the domestic law.
- A broader issue than giving indirect effect is whether the decisions of foreign jurists could be invoked by domestic jurists in deciding a case before them

Citizen Representation

- Can private individuals have standing in WTO's DSM?
- One of the principles say that that WTO DSM is an inter-governmental mechanism.
- NGOs demanded a voice in cases of concern to them.
- Several environmental NGOs ?led amicus briefs with the panel hearing, the so-called Shrimp-Turtle Case

Shrimp-Turtle case

- In 1994, the WTO intervened to address member concerns regarding the import of shrimp and its impact on turtles. This became known as the Shrimp and Turtle case.
- The process of shrimp catching in some less developed countries would harm endangered species of turtle.
- US had a law that prohibited the importation of shrimp that was produced without Turtle Excluder Device (TED) technology introduced by the National Marine Fisheries Services.
- But this law only was applied to Carribean countries and not all.

- The Earth Island Institute filed a lawsuit against US Secretary of State Warren Christopher in federal court to get an embargo on all LDCs who are not catching shrimps using TED.
- But this technology was too costly to be used by fishermen from Malayasia, Pakistan and India.
- Hence, these countries filed case against the US in WTO.
- US was subsidizing TED in Carribean but not in those countries.
- This was against the non-discrimination principle of WTO.
- WTO ruled that the US can prohibit the import of non-TED shrimp but cannot discriminate between the Carribean and the Asian countries in terms of subsidizing TED technology.

- The strengthening of the DSM in the WTO relative to GATT's and the inclusion of TRIPS in the Uruguay round owe a large part to lobbying by private parties – in case of TRIPS it was by multinational drug companies.

Transparency of WTO processes

- Allowing NGOs to submit amicus briefs is not equivalent to giving them standing.
- It is argued that giving private parties a standing in DSM will make DSM transparent.
- Because currently private parties lobby their governments and governments represent their concern in DSM — this is a non-transparent mechanism.

- Article 8 on Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) requires that panels be comprised of three panellists who are governmental and/or non-governmental individuals.
- panel members have a sufficiently diverse background and wide experience, are not citizens or parties to the dispute, and are independent.
- the WTO secretariat is required to maintain an indicative list of suitable panellists and to propose nominations to the panels from its list to the parties to the dispute. Disputants can oppose the nominations only for compelling reasons

- if the parties to the dispute do not agree on panellists within 20 days after the establishment of a panel, then at the request of either party, the Director General will appoint the panels in consultation with the Chairman of the Dispute Settlement Body and chairman of the relevant Council or Committee.
- The standing Appellate Body is to be composed of seven persons, three of whom shall serve on any one case. The Dispute Settlement Body will appoint to the Appellate Body persons of recognised authority, with demonstrated expertise in law, international trade and the subject matter of agreements covered.
- Panelists meet in closed door session and maintain confidentiality.
- BY making the deliberations public the process can be made transparent.

- However, creating space for private parties in DSM cannot make the process more inclusive.
- The key issue is whether the private parties have stronger presence in their respective domestic arena.
- The author maintains that the democracy deficit issue in the WTO is fundamentally misplaced.
- They belong in the domestic political arena.

Remedies

- Can we see WTO as a supra state infringing on the power of the state?
- This issue is debated also within the USA.
- Jackson (1997) held the view that although WTO rules are not binding in a strict sense, members nevertheless are obligated legally to comply with the findings of DSM. Any failure to do so is a violation of international law.
- Bello on the other hand argued that WTO cannot force the USA to do anything.
- The USA always has the option to deviate from WTO commitments and compensate other members or suffer retaliation.

- Mavroidis (2000) made the point that effectiveness of the WTO remedies (the liability rule and expectation damage for example) depends on the persuasive power of the WTO.
- He further examines the incentives for invoking countermeasures.
- Such countermeasures are costly for the injured party. Hence it will only be imposed if the benefits from compliance is high enough.