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Dispute Settlement – Or Not?

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Abstract

In December 2019, the WTO's dispute settlement system ceased to function when the Trump administration allowed the number of Appellate body members fall below the minimum specified for the hearing of an appeal. The non-cooperation in the appointment of Appellate body members was deliberate. It was part of a wider strategy to loosen WTO constraints on US trade policy and has been a major irritant in US relations with trading partners. The incoming administration of President Biden has vowed to take a more cooperative approach to trade and dealing with the disruption to the dispute settlement system could be an important step. Dissatisfaction with the dispute settlement system is not, however, simply an artifact of the Trump administration. This paper explores the roots of US dissatisfaction with the WTOs dispute settlement system and outlines what avenues are available to deal with it. It concludes that the options are few and that instead of a reversion to a strong multilateral mechanism a return to something akin to the weaker previous GATT system may prevail.

Keywords: Appellate, Biden, disputes, dumping, negotiation, WTO

Introduction

Because of the implications of many of the legal obligations in the Uruguay Round texts, and because they were negotiated among more than 120 participating national governments, it is not surprising that one can find ambiguities, omissions and other troublesome interpretive problems in this vast treaty. For this reason, the dispute settlement process becomes crucial, since it is one of the principal means for

> resolving the inevitable differences that arise about the various legal obligations of the world trading system.
>
> John H. Jackson (1997a, p. 60)

From 1947 until 2019 the dispute settlement mechanisms established first in the General Agreement on Tariffs and Trade (GATT) and subsequently the World Trade Organization (WTO) were at the centre of the organizations' activities. The GATT/WTO has three major activities: (1) to provide a place where the Member States can undertake negotiations leading to changes in the international rules of trade and Member State's commitments; (2) to provide *report cards* on how well individual Member States are living up to their commitments and; (3) to settle disputes arising from Member State's different interpretations of the agreements. Over time, the organization has taken on other activities such as providing training so that developing countries can act more effectively within the WTO and publishing reports and guides regarding various aspects of international trade law, but the three functions remain its core activities.

The GATT had many successful *Rounds* – first in reducing the very high tariffs that existed at the time of the organization's formation (Kerr, 2000) and latterly in expanding its role in dealing with non-tariff barriers and trade distorting subsidies. The last *Round* of GATT negotiations – the Uruguay Round – included an agreement to establish the WTO. The WTO has not had the same success as the GATT as the only *Round* agreed by the Member States – the Doha Round – ended in failure. The negotiation function has limped on after the comprehensive *single undertaking* format was abandoned in favour of a piecemeal approach, which has had limited success in agreements on trade facilitation and export subsidies in agriculture (Kerr, 2014; Kerr, 2016). While the WTO still provides a forum for lesser negotiations, this function has faded with attention and energy having switched to negotiation of major preferential trade agreements such as Regional Comprehensive Economic Partnership (RCEP), a potential US-EU trade agreement, a UK-US trade agreement, etc. While the existing rules of trade remain popular with over forty countries having joined since the formation of the WTO (Kerr, 2010a), negotiation among 164 members, if nothing else, seems too cumbersome.

With the negotiation forum role less prominent, the disputes system took central place in the WTO's activities. The disputes system provides the main constraint on the use of trade policy measures by countries. United States President Donald Trump and his administration perceived the discipline imposed through the disputes system as too constraining on its use of trade policy – in particular the use of trade measures to force countries to restrain their firms from using anti-competitive strategies (Kerr, 2018a).

The election claim of President Trump was that all previous US administrations back to the negotiations to establish the GATT in the 1940s had been poorly negotiated and failed to put the interests of the US first. President Trump threatened to withdraw from the WTO but in the end did not – instead his trade official set about to loosen the constraints but leaving the multilateral system intact. It used a mechanism that was legal but not within the *Spirit of the GATT* to emasculate the disputes system (Kerr, 2019). Decision making at the WTO is by consensus – in effect meaning every country has a veto. One of the functions of the WTO that requires consensus is the appointment of new members to the Appellate Body where dispute Panel rulings can be appealed. The seven appellate judges have fixed terms and three appellate judges are needed to hear each appeal. The US refused to agree to the appointment of new Appellate judges until in December 2019 the number of judges fell below the three required to hear any appeal. At that point, without the ability to appeal Panel rulings the entire WTO disputes system became invalid in the sense that a Member State could ignore a Panel ruling that it should come into conformity with WTO rules. That does not mean that countries could not agree to follow the ruling of a Panel, or that Panels could no longer be requested, but if a country wished, it could simply ignore the ruling of a Panel. In a way, this is similar to the GATT's original disputes system where a Panel ruling had to be accepted by consensus, including the party found in violation of its GATT's commitments.

As the Trump administration leaves office to be replaced by that of President Biden, the disputes system will be on the trade agenda. The US intransigence on the appointment of Appellate judges has been one of the major irritants for US trading partners and if the new US administration wishes to rebuild relations with its allies finding a solution to the impasse over the disputes system will be important.

Whither the Disputes Mechanism of the WTO

The Trump administration lived within the letter of international trade law, not just in its strategy towards the disputes mechanism but in other aspects of its confrontational and contentious trade policy.[1] Its approach to trade policy, however, did not conform to the cooperative approach to trade relations embodied in the *Spirit of the GATT* (Kerr, 2019). As there was no change in legal status, the easiest solution to the disputes system problem would be for the Biden administration to simply *walk back* the policy of the Trump administration and begin to cooperate on appointing new Appellate judges (Cardwell and Kerr, forthcoming). The Biden administration may decide to do this but US problems with the disputes mechanism pre-date the Trump administration (Brown and Keynes, 2020). As a result, to begin cooperation on appointing new Appellate

judges, the Biden administration may wish to secure an agreement to re-negotiate the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU).

This raises the question of what the US, and other countries, might want from a revised DSU. While the US agreed, indeed promoted, the inclusion of the DSU in the Uruguay Round agenda, the operation of the disputes body in the WTO did not turn out as US trade policy experts expected. To understand why one must look to the original disputes system of the GATT.

Dispute mechanisms are very contentious because they can be viewed as impinging on a nation's sovereignty. Thus, they are subject to considerable scrutiny during their negotiation. In many cases countries prefer not to include any type of binding dispute settlement system in international agreements. For example, none of the major multilateral environment agreements (MEA) contain a dispute settlement mechanisms with real teeth – e.g. the Kyoto Accord, the Biosafety Protocol, the Convention of Trade in Endangered Species, the Paris Agreement, the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, Montreal Protocol on Substances that Deplete the Ozone Layer, etc. (Gaisford et al., 2004; Kerr and Hall, 2004). This is also true for other multilateral organization such as the World Intellectual Property Organization (WIPO).[2] Great care was taken in constructing a dispute mechanism for the GATT (Kerr, 2018b). At that time trade negotiations tended to be conducted by aristocrats or other elites – *gentlemen* – and they saw disputes being decided by negotiated compromises rather than through a legal style litigation. According to Thompson (1981, p. 469):

> When the GATT organization was first started there was considerable distrust of lawyers, for it was felt that GATT was a club inhabited by diplomats of impeccable reputation who would ensure that its affairs would be conducted with all seemly propriety. Should any unhappy differences arise they would be settled privately according to the feeling of the general consensus. … and this, together with the concept that the better solutions were to be found in the economic rather than the legalistic field, resulted in a preference for conciliation on the basis of an agreed compromise rather than a decision on a legal basis.

The dispute mechanism that arose from this philosophical lens stressed compromise among *reasonable* men (Kerr, 2018b). This may seem somewhat bizarre when viewed from the lens of the 160-plus member WTO but it should be remembered that the original GATT membership was only twenty-three. From this perspective, there was no need for a binding dispute mechanism. One important facet of the GATT was that compensation and retaliation were included from the beginning but were expected to be temporary until a country came into conformity with its GATT obligations (Brown and Keynes, 2020).

The requirement for consensus was built into the system so that when a Panel made a ruling all countries had to agree with the judgement before it could come into effect – and that included the party found not to be living up to its GATT obligations. The Panel report could be blocked at which point negotiations would begin (Brown and Keynes, 2020) – as envisioned by the framers of the GATT. The GATT system, however, also required consensus for a complaint to be put forward to a Panel. This provided cover for countries dealing domestically with particularly sensitive sectors, but without a Panel's ruling there was no basis for a negotiated settlement. The GATT system was in place and worked for almost fifty years.

By the early 1980s the disputes system designed for a small club of like-minded diplomats was feeling the strain of having to deal with an organization that had grown to 120 Member States. It was becoming increasingly legalistic in adjusting to the reality that many new members were not like-minded. There was a need to modernize and design a system that reflected the new reality of trade. As well, there was a feeling that the GATT needed to expand beyond rules for trade in goods to cover trade in services. There were also demands that there be an improved international system to protect foreign intellectual property (Kerr, 2010b).

The Uruguay Round GATT negotiations produced an agreement to establish the WTO and to revamp the disputes system – the DSU. The requirement for consensus was removed both from allowing a complaint to go forward to a Panel and from acceptance of a Panel's report. To offset the ability to block a Panel's report a new Appellate body was added so that a Member State could appeal against an adverse ruling.

According to Brown and Keynes (2020), the major contentious issue for the US with the DSU is the treatment of its contingent protection measures – in particular anti-dumping but also countervail and safeguards.[3] These are seen by the US as their major line of defense against politically difficult surges of imports and foreign competition that domestic producers find they are unable to deal with effectively.

Unfortunately, anti-dumping is fundamentally flawed, lacking in both a sound theoretical underpinning in economic theory (Kerr, 2006) and widely accepted methods for determining whether dumping is taking place, how injury is determined or how the size of anti-dumping duties are to be calculated (Kerr and Loppacher, 2004).[4] In theory, dumping is an *unfair* pricing strategy practiced by foreign firms (Kerr, 2001). The GATT definitions of dumping that were rolled into the WTO unchanged are flawed and mean that firms following pricing strategies that would be legal in importing countries can be accused of dumping (Kerr, 2006) – they are being held to a higher standard than

domestic firms. Given the poor theoretical underpinning of dumping, it is not surprising that it is challenged in the DSU.

For trade policy makers in the US dumping is simply a protectionist measure (Brown and Keynes, 2020) but it is convenient to promote the fiction that it is meant to deal with *unfair* practices of foreign firms. This fiction makes it difficult for US lawmakers to accept changes that would weaken the ability to extend protection (Kerr and Loppacher, 2004).

One of the most contentious issues is the method used by the US to calculate the margin of dumping. It uses only selected data points in a process known as *zeroing*. This method yields higher margins of dumping, and thus higher anti-dumping duties that some alternative methods of calculation used by other countries. This leads to accusations that the US method is *biased* in favour of protecting domestic industries, but the truth is that there is no generally accepted *correct* way of calculating dumping margins and anti-dumping duties. Contingent protection measures are dealt with, in the first instance, by domestic mechanisms with reviews by the WTO allowed. The domestic mechanisms have been promoted in the US as essential guardians of *fair trade*.[5] US trade policy makers and members of the US Congress see adverse judgements as attacks on near-sacred institutions and clear infringements on sovereignty. The determination of countervailing duties in cases of *unfair* subsidies suffers from some of the same calculation methods as anti-dumping duties. In their view, contingent protection measures should be free from international oversight. According to Brown and Keynes (2020, p. 27), however,

> Overall, nearly two-thirds of the 141 disputes brought against the United States between 1995 and January 19, 2017 involved its safeguards, antidumping, and countervailing duties ….
>
> Importantly, as was common for respondents in WTO cases, the United States typically lost in the cases brought against its trade remedies.

When the WTO was negotiated the US thought it had ring-fenced its domestic anti-dumping system from scrutiny through the DSU. In Article 17.6 of the Anti-Dumping Agreement, it states:

> (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. *If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned*;

> (ii) the panel shall interpret the relevant provisions of the Agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the *Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement* if it rests upon one of those permissible interpretations (emphasis added).

According to Brown and Keynes (2020, pp. 6-7):

> The broader compromise that emerged was Article 17.6 of the WTO's Antidumping Agreement. WTO adjudicators were supposed to be able to scrutinize countries' use of antidumping duties, as long as they gave deference to domestic investigating authorities. In America's eyes, that meant they were supposed to accept the investigations, facts, and decisions provided by the Department of Commerce and the US International Trade Commission (USITC) when delivering their judgments.

This was not the approach the Panels and the Appellate body chose to take, which is understandable given the complaints were most often directly against the controversial calculation method of *zeroing* and the obvious fiction of *unfair* trade. As time wore on and the judgements against the US mounted up, it is not surprising that something had to give. Given that US trade policy makers and the US Congress were unwilling, and likely unable, to change the domestic contingency protection system and no possibility that the texts of the WTO agreements could be changed, the system was simply unsustainable.[6] It was a classic case of an *unstoppable force meeting and immovable object*. All it took was the arrival of the Trump administration to set things in motion.

The trade policy functionaries chosen by President Trump, starting with Robert Lighthizer, the United States Trade Representative, were against any international constraints on the use of contingency protection measures and viewed anti-dumping and countervail as purely protectionist and necessary trade policy mechanisms. Lighthizer had spent time as a lawyer for steel industry interests. They viewed the DSU with dismay and were determined to protect their vision of US trade policy from it. One of the first indications was when the US steel industry was asking for protection during a period of significant worldwide excess capacity in steel production due to less than anticipated global economic growth. This would have been, in previous times, when anti-dumping and countervail cases would have been initiated. Instead, President Trump imposed tariffs of steel (and aluminum) on national security grounds, which led to protests from long time US allies. It is virtually impossible to successfully challenge a national security justification at the WTO (Jackson, 1997b). One can only speculate that the US did not go the route of contingency protection because they did not want to face

a DSU challenge – and to send a message that the likely outcome of a dispute was not acceptable.

The direct imposition of a wide range of tariffs on Chinese goods is more complicated. Many of the practices on Chinese firms, state owned enterprises and governments are simply not covered by WTO disciplines (Kerr, 2020a). The strategy was to use trade policy against China in a major way and force it to the bilateral bargaining table – and if it did not come to the table to threaten to hit them again. These wide-ranging tariffs are not likely WTO compliant and China, as expected, brought a case to the WTO. The US appears to have been betting that China would be forced to the bilateral negotiating table long before the case could work its way through the DSU.[7] This strategy seems to be partially vindicated given the First Stage Agreement signed between the US and China in early 2020. If the Trump administration had been returned for a second term, then without an Appellate body the US could use its contingency protection mechanism without international oversight and could impose tariffs and other trade measures on China and other countries without fear of WTO interference. Disputes would be settled through bilateral negotiations or left to fester. It would have fit with the *America First* narrative. There would still be some constraints on US trade policy in preferential trade agreements such as the United States, Mexico, Canada Agreement (USMCA) – NAFTA's replacement where the US wanted the dispute mechanism removed in the negotiations, but was unsuccessful (Kerr, 2020b).

Although the Biden administration may wish to renegotiate the role and composition of the Appellate body, or the wider DSU, there may not be an obvious way forward. Belatedly, once WTO members woke up to the fact that the Trump administration were serious about lifting what it perceived as the constraint the Appellate body imposed on the use of US trade policy, some effort was put into finding ways to reform the DSU. In October 2018, a group of twelve WTO members[8] convened a conference in Ottawa to find a way through the impasse. In November 2018, they suggested that the US complaint regarding the difficulty the Appellate body had in meeting its mandated 90 days for a ruling be solved through giving it more resources, increasing its membership and giving members longer terms. This did nothing to deal with the central US concern and was summarily dismissed by the Trump administration (Brown and Keynes, 2020). On October 15, 2018, just prior to the Appellate body ceasing to function, a *facilitator*, David Walker from New Zealand, filed a report with the WTO's General Council where relatively small procedural changes to the Appellate body's functioning were outlined.[9] They did not persuade the Trump administration to change its position and cooperate in the appointment of new Appellate body members at the last moment.

In another initiative, the so called Ottawa Group, was established to suggest solutions. The Ottawa Group's agenda was subsequently overtaken by events as the trade problems associated with the Covid-19 pandemic required urgent attention. The problems with the Appellate body were not, however, ignored. On November 23, 2020 – after the US election – WTO Deputy Director-General Alan Wolff addressed the ministers from the Ottawa Group regarding potential reforms to global trade rules over the following two years. With respect to dispute settlement, he said:

> Members can propose that the new Director General offer her good offices to bring the major interested parties together to work on a solution for dispute settlement reform.
>
> In the meantime, to protect the integrity of the dispute settlement system, and by extension, the WTO as a whole, Members could propose that access to the WTO panel system be conditioned on parties agreeing in advance to be bound by the result, either by accepting that a panel decision will be final, or through an agreed alternative appeal mechanism. In the absence of this measure, panels would in effect be issuing unauthorized advisory opinions. If a Member refused to agree to a binding outcome, it would forfeit its right to invoke the panel process in future cases. This proposal should optimally be adopted by all Members.[10]

There is not much there to inspire the Biden administration to engage in discussions regarding reform. There are other suggestions for reform being proposed by individual [11]countries and think tanks but the Ottawa Group includes a number of the major players in international trade but there does not appear to be much to show after two years and the Appellate body having ceased to function for over a year – a crisis of major proportions. It may be that once President Biden's trade team is in place, they may develop inventive proposals for reform, but that is far from certain. It may just be satisfied with the current *status quo*, and glad of the cover given by the uncooperative Trump administration in fostering the demise of the Appellate body and its constraints on US trade policy.

Conclusion

If the Biden administration does not walk back from the stance of the Trump administration and continues not to cooperate in the appointment of Appellate judges, the global trading system will continue to limp along without a fully functional disputes system. Some countries have found *work arounds* for the appeal processes. For Example, Article 25 of the DSU states:

> 1. Expeditious arbitration within the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties.
>
> 2. Except as otherwise provided in this Understanding, resort to arbitration shall be subject to mutual agreement of the parties which shall agree on the procedures to be followed. Agreements to resort to arbitration shall be notified to all Members sufficiently in advance of the actual commencement of the arbitration process.

Following this course, Canada and the EU reached an interim arrangement as laid out below:

> In view of these extraordinary circumstances, envisage resorting to the following interim arrangement:
>
> 1. Canada and the European Union indicate their intention to resort to arbitration under Article 25 of the DSU as an interim appeal arbitration procedure (hereafter the "appeal arbitration procedure"), if the Appellate Body is not able to hear appeals of panel reports in any future dispute between Canada and the European Union due to an insufficient number of its members. In such cases Canada and the European Union will not pursue appeals under Articles 16.4 and 17 of the DSU.
>
> 2. Under the appeal arbitration procedure Canada and the European Union intend to replicate as closely as possible all substantive and procedural aspects as well as the practice of Appellate Review pursuant to Article 17 of the DSU including the provision of appropriate administrative and legal support to the arbitrators by the Appellate Body Secretariat.
>
> 3. In particular, Canada and the European Union envisage that, under the appeal arbitration procedure, appeals will be heard by three former members of the Appellate Body, serving as arbitrators pursuant to Article 25 of the DSU. The arbitrators will be selected by the Director General from the pool of available former members of the Appellate Body, based on the same principles and methods that apply to form a division of the Appellate Body under Article 17.1 of the DSU and Rule 6(2) of the Working Procedures for Appellate Review. However, two nationals of the same Member may not serve on the same case.[12]

This model, now the Multi-Party Interim Appeal Arbitration Arrangement (MPIA), had 24 members by July 31, 2020.[13] These members account for a significant proportion of non-US trade activity. The MPIA has not, however, yet been fully tested in an acrimonious dispute. As it only replaces one appeal body with another, it does not deal

with the substance of the US complaint against the DSU – interference with US contingency protection rulings.

If the MPIA proves to be a success, other WTO members may well join. This would leave US trade policy not being constrained by the DSU, and in a position roughly equivalent to the pre-WTO dispute system whereby it could be faced with adverse Panel rulings that it could ignore. This would, however, mean that disputes remain unresolved and left to fester, which could have negative implications for wider aspects of international relations where the US might need cooperation from other countries. To prevent this, Panel rulings could, as in the past, be a starting point for negotiations. Given the size of the US economy, it will always be in a strong bargaining position.

This outcome would leave the US somewhat isolated in the world. It would also further weaken the WTO both because its relevance has been reduced and because the US could not take a leadership role in trying to move the organization forward. The latter has been important in the evolution of the *rules based system of international trade* since its inception in the 1940s. It is unfortunate that the US trade policy establishment and those with vested interests are wedded to the fiction that anti-dumping has something to do with *unfair trade*. Hence, from the US perspective it, and other aspects of the US contingent protection, must be defended against being weakened through interference from international institutions.[14] It may be that the use of a binding disputes system will be viewed from a historical perspective as a twenty-five year un-successful experiment.

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ENDNOTES

[1] This included the imposition of tariffs on steel and aluminum on national security grounds (Kerr, 2018a) and the imposition of tariffs on a wide range of Chinese goods (Kerr, 2019).

[2] The absence of a disputes system was one of the major reasons for including the TRIPS agreement when the WTO was formed and why cross-agreement retaliation was included in the new binding DSU of the WTO (Yampoin and Kerr, 1998; Gaisford et al., 2002).

[3] The other often voiced complaints such as the inability of the Appellate body to reach judgements in the 90 days specified in the DSU and members of the Appellate body staying beyond their specified terms to finish particular appeals, while not trivial are relatively minor.

[4] It also leads to rent seeking and gaming of the system. See Mahbobi and Kerr (2012) and Viju and Kerr (2014).

[5] Anti-dumping has been compared to the Hans Christian Anderson *Fairy Tale* known as *The Emperors New Clothes*. According to Kerr and Loppacher (2004, p. 211): "Dumping is the international commercial policy equivalent of the invisible suit. As in Andersen's story where the courtiers and other hangers-on embellished the invisible suit with all manner of stylish attributes, dumping has been endowed with all manner of trappings including a WTO code, prestigious national tribunals, complex rules and procedures and quasi-scientific guidelines for determining injury and calculating dumping margins. As in the procession where the emperor

chooses to show off his new suit, various international trade functionaries go through elaborate charades to give anti-dumping actions the proper degree of pomp and circumstance."

[6] According to Brown and Keynes (2006, p. 21): One important contributor to the collapse of the Appellate Body is that the WTO lacked a functioning legislative body. No rules could be added when countries recognized unforeseen gaps in WTO legal provisions. No legislative fixes could be made by negotiators to clarify rules when WTO adjudicators inevitably made errors. The result was an Appellate Body put under unrealistic pressure to resolve ambiguities without stepping over political red lines.

[7] They may also have been betting that the dispute system would cease to function when the number of Appellant judges fell below the mandated number needed for an appeal.

[8] Mexico, Singapore, Iceland, South Korea, Australia, Switzerland, New Zealand, Norway, India, Canada, China and the European Union. This sub-grouping of influential and interested WTO Member States is reminiscent of the discredited *Green Room* processes that were used to move negotiations forward when negotiating with 100-plus members was seen by some as too cumbersome (Kerr, 2002). Of course, the US was conspicuous by its absence from the group.

[9] WTO legal document WT/GC/W/752, 15 October 2019.

[10] WTO (2020).

[11] The Ottawa Group is currently comprised of Australia, Brazil, Canada, Chile, the European Union, Japan, Kenya, Mexico, New Zealand, Norway, Singapore, South Korea, and Switzerland.

[12] Canada and the European Union (2019

[13] Australia; Benin; Brazil; Canada; China; Chile; Colombia; Costa Rica; Ecuador; the European Union; Guatemala; Hong Kong; Iceland; Mexico; Montenegro; New Zealand; Nicaragua; Norway; Pakistan; Singapore; Switzerland; Ukraine; and Uruguay.

[14] Countries entering into future preferential trade agreements with the US should pay particular attention to the dispute settlement mechanisms that they include.