RESEARCH SEMINAR IN INTERNATIONAL ECONOMICS

Gerald R. Ford School of Public Policy
The University of Michigan
Ann Arbor, Michigan 48109-3091

Discussion Paper No. 566

A Review of Charan Devereaux,
Robert Lawrence, and Michael D. Watkins,
Case Studies in US Trade Negotiation:
Making the Rules and Resolving Disputes

Robert M Stern
University of Michigan

September 2, 2007

Recent RSIE Discussion Papers are available on the World Wide Web at:
http://www.fordschool.umich.edu/rsie/workingpapers/wp.html

Robert M. Stern*

Case Studies in US Trade Negotiation: Making the Rules, Vol. 1, and Resolving Disputes, Vol 2, by Charan Devereaux, Robert Lawrence, and Michael D. Watkins. (Peter G. Peterson Institute for International Economics 2006) are outstanding contributions that provide a magnificent depth of understanding of how U.S. trade policies and related initiatives are designed, negotiated, and implemented and how issues of dispute settlement of concern to the United States in the World Trade Organization (WTO) have been addressed and the efforts that have been made in seeking their resolution.

1. Introduction

Volume 1, Making the Rules, covers: trade-related aspects of intellectual property rights (TRIPS); the multilateral agreement on investment (MAI); fast track/trade promotion authority; the 1999 US-China bilateral agreement and the battle for permanent normal trade relations (PNTR); and the US-EU Mutual Recognition Agreements. The dispute settlement cases in Volume 2, Resolving Disputes, include: US-EU trade in hormone-treated beef; the EU banana regime; Kodak v. Fuji; US steel actions; Brazil’s WTO cotton case; and the US-EU GMO dispute on agricultural biotechnology. The material in the two volumes is organized in the form of case studies developed at the Harvard University’s John F. Kennedy School of Government (KSG) and used for instructional purposes.

2. Making the Rules

Each of the cases in Volume 1 is preceded by a discussion of the coverage of trade agreements, that is, whether the focus should be narrowly concentrated on trade-related issues such as tariffs and quantitative restrictions or be more broadly concentrated on the rules governing trade such as investment policy, competition policy, regulatory policies, or labor and environmental standards. Also discussed is how deeply trade agreements should reach beyond national boundaries and into the domestic economy and whether non-discrimination and transparency are to be sought in individual nations or whether there should be complete harmonization of policies across countries. The enforcement of trade agreements is another issue of importance that requires rules and procedures for resolving inter-country disputes that may arise. Further, the circumstances of developing countries may require special attention in trade agreements as to whether these countries may merit special and differential treatment in complying with the provisions of the agreements, including preferential trading arrangements. A final consideration is that trade agreements will affect governance domestically as well as relationships between countries. Volume 1 further provides an illuminating conceptual framework designed to enhance the understanding of the processes of negotiation and the strategies that the parties involved may employ.
The cases included in Volume 1 all deal with the policies, politics, and processes used in making rules to govern trade. Following discussion of the different aspects of the individual trade agreements just noted, each chapter is organized in a case format that traces in detail the background of the issues and the different phases of the negotiating process. What is remarkable about the cases is that they bring to life how the trade agreements unfolded politically in terms of the role of the different interest groups and government authorities. This is done based on personal interviews of key actors and documentation of the negotiating process based to a large extent on news reports and published statements of government officials and major stakeholders. Each chapter’s case concludes with a negotiation analysis based on the conceptual framework of the negotiation processes and strategies referred to above. What then can be learned from the individual cases presented?

2.1 The TRIPS Agreement

The TRIPS agreement was negotiated during the Uruguay Round of multilateral trade negotiations (1986-94) with the intensive lobbying efforts especially by U.S. multinational firms in the pharmaceutical, software, and entertainment industries. The TRIPS agreement was designed to protect intellectual property rights primarily for the benefit of the advanced countries and possibly to the detriment of low-income developing countries. The TRIPS agreement was therefore a major departure from the principles of trade liberalization based on the General Agreement on Tariffs and Trade (GATT). TRIPS caused a backlash as concerns were raised that low-income developing countries would be unable to afford the essential medicines needed to treat such endemic diseases as HIV/AIDS, malaria, and tuberculosis. This led to negotiation of special measures at the 2001 WTO ministerial meeting in Doha and subsequently to help low-income countries obtain access to medicines.

2.2 Multilateral Agreement on Investment

As mentioned, the GATT system was focused on the reduction and removal of trade barriers. While an agreement on trade-related investment measures (TRIMS) had been negotiated during the Uruguay Round, it is noteworthy that there were no multilateral rules or agreements covering foreign direct investment (FDI) more broadly. An effort was made therefore to negotiate a multilateral agreement on investment (MAI) under the auspices of the Organization for Economic Cooperation and Development (OECD). What is noteworthy is that the OECD consists largely of high-income countries and is primarily an advisory body without enforcement powers. The idea was that if the OECD members could agree on the principles of an MAI, developing countries could then be induced to join. It turned out however that there was widespread opposition to an MAI by a large number of non-governmental organizations and many developing countries. Also, some high-income countries backed away from the MAI when they realized that some of its investment provisions might be a significant intrusion on their national sovereignty. As a consequence, many countries have negotiated bilateral investment treaties that deal with important issues and represent less of a threat to sovereignty.
2.3 Fast track/Trade Promotion

Fast track/trade promotion authority has been a cornerstone of U.S. trade negotiations since 1974. The president is given authority to negotiate trade agreements, and the Congress can only vote yes-or-no without any amendments or changes once an agreement has been submitted. This authority grew out of a situation in which the Congress opposed some of the concessions that had been negotiated in the Kennedy Round of GATT negotiations in the 1960s and mandated some changes to be made. As a result, it became clear that other countries would not enter into trade negotiations with the United States if there was some likelihood that the U.S. Congress were able to withdraw or revise the negotiations. Congressional opposition to fast track authority was built up in the early 1990s when the United States entered into negotiations with Mexico and Canada for a North American Free Trade Agreement (NAFTA). There was a fear that U.S. workers would be displaced by low-wage Mexican workers. It was only when President Clinton opted to negotiate side agreements on labor and the environment that the NAFTA was approved by a very small margin in the Congress in 1994. Afterwards, the fast track authority lapsed, and it was restored only in 2002 and renamed trade promotion authority at a time when the Bush Administration had majorities in both houses of Congress. It is noteworthy that the president’s trade promotion authority expired on June 30, 2007, and there is a question of when and under what conditions it might be revived with the Democrats in the majority in the Congress and with a Democrat possibly elected as president in November 2008.

2.4 China’s WTO Accession and Permanent Normal Trade Relations

China became a member of the WTO in December 2001. Although China was not previously a member of the WTO, the United States had granted it most-favored-nation (MFN) trade status in 1979, thus enabling China to avoid having to pay the much higher U.S. import duties that dated back to the 1930s. Nonetheless, U.S. law mandated an annual Congressional review of China’s trade status, and this provided Congress an opportunity to call attention to alleged human rights abuses in China, to express concern over national security vis-à-vis China and its policies towards Taiwan, and to criticize China’s policies that were allegedly responsible for the U.S. bilateral trade deficit. Since China was in any case to become a WTO member, the issue was that the United States had to give up its annual review and to grant China permanent normal trade relations (PNTR). It was only with a vigorous public relations campaign by the Clinton Administration and the support of the U.S. business community that enough votes were obtained to support PNTR for China and overcome the opposition of some members of Congress and organized labor.

The controversy over granting PNTR to China is pertinent to the present situation regarding Russia’s accession to WTO membership. As in the case of China, the United States has granted MFN status to Russia. But Russia technically remains subject to a U.S. Cold War trade provision known as Jackson-Vanik, which links the trade status of many communist or formerly communist countries to their human rights and emigration policies. As a fellow WTO member, the United States would therefore be required to lift
that provision and permanently provide Russia the same degree of market access it provides every other WTO member. PNTR for Russia has been held up for some years as Russia has been accused of numerous violations of intellectual property rights and the failure to apply effective science-based sanitary and phytosanitary (SPS) measures for a number of agricultural products. Criticisms have also been made of Russia’s industrial subsidies and pricing of energy products. While bilateral negotiations have been underway for some time on these issues, the granting of PNTR to Russia has yet to be addressed by the U.S. Congress. It is likely accordingly that there will be considerable discussion and debate on the issues in the near future, and it will remain for a post-Bush administration to decide whether and how PNTR is to be supported politically with respect to Russia.

2.5 US/EU Mutual Recognition Agreements

The US-EU mutual recognition agreements (MRAs) refer to agreements covering bilateral inspection, testing, and certification for a variety of traded products, including medical devices, pharmaceuticals, recreational craft, telecommunications, electromagnetic compatibility (EMC) services, and electrical equipment. Negotiations on MRAs, which were completed in 1998, were designed to eliminate red tape and duplication of product testing and standardization with the objective of lowering costs for the sectors involved. What is interesting about MRAs is that their negotiation took place outside of the WTO and involved national regulatory agencies as well as or in lieu of trade agencies. It was also the case that representatives from business firms played important roles in the negotiations under the auspices of the Transatlantic Business Dialog (TABD). The negotiation of MRAs was thus decidedly different than negotiating changes in tariffs and non-tariff barriers. Much can be learned from this case therefore that may prove useful in the current EU-US trans-Atlantic negotiations that were launched in 2007 with the support of the German Prime Minister, Angela Merkel. Sectoral agreements to be negotiated include automobiles, financial markets, anti-trust/competition law, chemicals, accounting, and pharmaceuticals.

The cases in Volume 1 thus cover a variety of interesting and important negotiations on trade and related agreements. These cases provide useful insights and understanding of the economic and political complexities of the important issues involved and are therefore of great value to trade specialists. They may also provide a template for related negotiations that are now in progress or that will begin in the near future.

3. Resolving Disputes

With the advent of the WTO in January 1995, a new system for resolving disputes was created. It was designed to strengthen the system and to facilitate its operation by imposing time lines and procedures for the presentation, adjudication, and settlement of cases. The introductory chapter summarizes the six cases of dispute settlement to be covered and presents a brief and informative survey of the GATT system and the foundation of the WTO during the Uruguay Round of multilateral trade negotiations (1986-94). It then analyzes the structural, political, and psychological barriers that may
arise in negotiating the resolution of disputes and the design of alternative dispute resolution systems. A contrast is drawn between the GATT system of dispute resolution in which diplomacy played a central role and the WTO system that is much more formalized and based on principles of jurisprudence. Some important features of the WTO system include the role of precedents in adjudicating cases, the discretion that some countries exercise in complying with rulings, the limits placed on private counsel in presenting cases, and the inability to force compliance with rulings. It is also noted that countries may seek to “game” the system by intentionally breaching their WTO commitments for domestic political reasons by delaying the implementation of new legislation or the introduction of adjustment-assistance programs. There may also be cases in which the objective is to challenge ambiguous trade rules and policies. Finally, for strategic reasons, WTO member countries may form coalitions in bringing cases.

Each case presented is prefaced by a discussion of the historical context of the dispute involved and the events leading up to the filing of the official dispute in the WTO. At the end of each chapter, there is an analysis that summarizes the main features and outcome of the case.

3.1 Hormone-Treated Beef

The case of hormone-treated beef had its origin in the EU ban on beef using growth-promoting hormones, including imports from the United States. The United States viewed the EU action as protectionist and designed to protect the EU beef market by unsupported scientific claims about the detrimental health effects on consumers. For its part, the EU argued, according to the precautionary principle, that health issues should be decided in response to the interests of its citizens. The United States filed a formal complaint against the EU in April 1996, and its position was later upheld by the WTO on the grounds that the EU had violated the WTO sanitary and phytosanitary (SPS) agreement. Nonetheless, the EU chose not to respond, on the grounds that it could prohibit or restrict products that were suspected, but not proven to be harmful. The United States then chose to impose sanctions on imports from the EU in the form of tariffs on particular products of key interest to some individual EU member countries. While the EU has made some changes in policies permitting the use of beef hormones, its ban and the U.S. retaliatory tariffs remain in place. This case thus illustrates the difficulty in using the WTO dispute settlement mechanism when health and safety concerns are at issue and the parties differ in their assessment of the risks involved.

3.2 The EU Banana Regime

The banana dispute is particularly interesting because it was orchestrated by the Office of the US Trade Representative on the initiative of the Chiquita and Dole corporations who had major interests in investments in banana production in Central and South America. When the EU moved to a Single Market in the early 1990s, it revised its quota regime on banana imports to expand the benefit to former colonies in the Africa/Caribbean/Pacific (ACP) region to the detriment of bananas produced by the U.S. multinationals and other producers not covered by the ACP preferences. There is evidence that the Chiquita...
Corporation was deeply involved in influencing the USTR action through the political contributions that were made to both political parties. The United States was joined by some other WTO members in this action, and the WTO ruled against the EU quota arrangements. The EU was slow to respond to the unfavorable ruling, and this led the United States to impose retaliatory tariffs, which remained in place pending a new system of import tariffs that the EU has developed that permits greater imports from producers outside the ACP grouping. What is striking about this case is that the United States has virtually no domestic production of bananas but was nonetheless able to use its influence on behalf of some influential U.S. multinational corporations and at the same time to help reduce the discriminatory effects of the EU banana import regime.

3.3 Kodak-Fuji Film

The Kodak-Fuji photographic film dispute was initiated in late 1996 by Kodak’s alleged difficulties in penetrating the Japanese market in which Fuji had the predominant share. At issue was the extent to which the Japanese Fair Trade Commission applied its regulations of the domestic market for films to benefit Fuji and to limit the competition of foreign competitors like Kodak. The Kodak case was also based on the claim that there were a variety of informal trade barriers that prevented their expansion in the Japanese film market. The WTO later essentially denied all of Kodak’s allegations and ruled in favor of Fuji. The Kodak-Fuji dispute is interesting because it followed along the same lines as a number of previous disputes that the United States had pursued vis-à-vis Japan on a bilateral basis under existing U.S. law. That is, under Section 301 of the U.S. Trade Act, the United States could bring unilateral actions against trading partners that were allegedly harming U.S. commercial. With the advent of the WTO, such unilateral actions were no longer possible since they could now be challenged in the new WTO dispute settlement mechanism.

3.4 US Steel Safeguards Tariffs

In March 2002, the Bush Administration imposed safeguards tariffs on some types of imported steel. This was in response to the intense lobbying pressures of the domestic steel producers and union representatives to deal with the problems posed by the alleged surge of imported steel resulting from the foreign financial crises of the late 1990s. The facts of this case were in dispute, and there was no clear evidence of substantial injury for the steel firms and workers involved. Yet the action was taken even though the Bush Administration knew that it would be challenged in the WTO, which turned out to be the case as the EU filed an action challenging the U.S. import tariffs. The rationale for the Bush Administration appears to have been that, while WTO-inconsistent, the imposition of the safeguards tariffs would buy time for the aid to benefit the U.S. steel producers and workers. This is because of the various steps involved in implementing a dispute settlement action. In any event, the WTO ruled in favor of the EU, and the Bush Administration removed the tariffs in the face of potential EU retaliation. This case thus illustrates how a country can “game” the WTO dispute settlement system at least for a while, but, in the final analysis the WTO system becomes effective.
Brazil brought a case against the United States in September 2002 challenging the U.S. agricultural subsidies on cotton that allegedly reduced the world price considerably. Drawing a line between subsidies that may be “trade distorting” and other subsidies is one of the most vexed issues in international trade relations. There is greatest agreement on direct export subsidies, which are widely seen to be a form of reverse tariff. They are prohibited on manufactures and, since the Uruguay Round, they are seen as negotiable concessions on agricultural products. In agricultural trade, the attempt was made during the Uruguay Round to distinguish between subsidies that were “trade distorting” and other subsidies. Since countries agreed to place caps on their subsidization of exports and other actionable subsidies, the classification of subsidies into the different categories became operationally important. The dispute about cotton subsidies reveals where the WTO Dispute Settlement Body (DSB) draws this particular line.

The DSB found that certain U.S. domestic cotton support programs could be considered as subsidies that might violate commitments under WTO Agreements. One such program consisted of direct payments to farmers, although these were not related to prices or production. The DSB, however, noted that payments were conditional on farmers not growing certain alternative crops (and it thus interfered with market signals). Countercyclical payments to farmers were another such program: these had been introduced in the late 1990s when world cotton prices fell heavily. They were intended as a form of income support, but the DSB ruled that they were an actionable subsidy because the base price in the program was high in relation to world prices.

The reasoning of the DSB in the cotton case appears applicable to several other crops of major exporting countries, particularly the United States. Thus, the DSB rulings could place significant restrictions on the domestic agricultural programs that major exporters are able to pursue while remaining compliant with WTO Agreements. It seems very probable that these restrictions are greater than what countries assumed at the time that they negotiated the Agreements. It is also true, however, that at least in the case of U.S cotton, the problem stems partially from a shift in U.S. domestic agricultural policy since the time of the Uruguay Round negotiations. This was evident in the 2002 Farm Bill, which formally incorporated a partial reversion to price support programs.

The broader issue is that the rulings of the DSB may, in the eyes of many, upset the balance of concessions and obligations that countries agreed to in the Uruguay Round. Rulings that are perceived to alter this balance significantly strike at the principle of reciprocity on which trade negotiations depend. It could be said that the DSB has tended to hand down rulings that are on the side of the economic angels, not on the side of the political realists who actually negotiated the Agreements. What appeared to guide the DSB in deciding whether or not disputes were trade distorting was a model of a freely competitive market. Not for the first time, however, this model sometimes clashed with the political realities that negotiators had to contend with in formulating multilateral trade agreements.
Brazil also brought a case on sugar against the EU. Both the sugar and cotton cases were brought by Brazil as part of a strategy to press the EU and the US to reform their agricultural policies in the context of the Doha Round negotiations. The EU, which was in the process of reforming its sugar regime, stated that it would comply with the recommendations of the DSB. In the case of cotton, the DSB authorized Brazil to take retaliatory action against the US for failure to comply with major parts of its recommendations. However, in agreement with the US, Brazil suspended action, pending the outcome of the Doha Round negotiations.

The Brazil cotton and sugar rulings seem to take the DSB beyond its proper function, which is to preserve and protect the balance of concessions and the supporting rules governing agricultural policies that had been negotiated among members in the Uruguay Round. It will be interesting therefore to see what future dispute settlement actions agricultural producing countries might take and how the United States and other developed countries may be required to make changes in their domestic agricultural support programs.

3.6 Genetically Modified Crops

Beginning especially in the 1990s, the production of genetically modified (GM) crops, particularly corn and soybeans, was greatly expanded in the United States. The U.S. regulatory system did not distinguish between GM and non-GM crops. But this was not the case in the EU in which a separate regulatory approach for GM crops was adopted and a moratorium was placed on new GM products in 1998 to the apparent detriment of U.S. exporters. As a consequence, the U.S. brought an action against the EU on the grounds that the EU had violated the WTO sanitary and phytosanitary (SPS) agreement that had been negotiated during the Uruguay Round and that required that the determination of risk for designated products should be science based. The WTO upheld the U.S. position in early 2006. But the EU position is that it can use the precautionary principle to safeguard the health of its consuming public, pending additional and more authoritative research. The issue here thus parallels the beef-hormone case noted above with regard to the differences between the U.S. and EU regulatory policies on food products.

3.7 Issues of Fairness in WTO Dispute Settlement

The multilateral system of agreements that governs trade relations among the member countries of the WTO rests mainly on recognition of mutual advantage. The agreements overcome the Prisoner’s Dilemma that faces states in their relations with each other. States enter into the agreements because they trust that others will also comply with their terms. This implies that states regard the system of agreements as broadly fair; otherwise, they would have an incentive not to comply. Of course, in relations between the strong and the weak, the exercise of power may also be influential in inducing the weak to comply. Both cooperation for mutual advantage and the exercise of hegemonic power are thus at work.

1The discussion that follows is adapted from Brown and Stern (2007)
The perception of fairness evidently plays some role in sustaining the trading system, and it is this role that accords such importance to the dispute settlement process. It is not only that the process provides a channel through which irksome disputes between individual countries may be resolved. Of much broader importance is the fact that, over time, the process of dispute settlement may either confirm or diminish members’ confidence that the system as a whole is functioning as it should. It may or may not reassure countries that the mutually advantageous arrangements to which they have subscribed remain fully respected.

This places a heavy burden on the Dispute Settlement Body, its Panels and Appellate Board. They are expected to become the repository of what members collectively believe to be the norms and rules of the system; their envisaged duty is to interpret the collective view of what is fair as embodied in the agreements that member countries have negotiated and agreed to. It is one condition that the process itself should be seen to be fair: the adjudicators in the process should act impartially, not favoring one country over another; and the parties to a dispute should have equal opportunity to present their cases. Much more difficult to fulfill, however, is the obligation of the Body to interpret and apply the agreements of the WTO fairly in all cases.

Most of the agreements of the WTO spell out the obligations of the member states in considerable detail. They identify criteria by which to assess whether a particular measure of a member is in compliance with the agreement or constitutes a violation. For example, the Subsidies and Countervailing Measures Agreement notes that, for a subsidy to be in violation of the Agreement, it must be specific, be a financial contribution, confer a benefit, derive from a government or its agencies, and cause material injury to the industry of the complainant country or serious prejudice to its interests. Even when carefully crafted, however, the texts of agreements cannot be expected to match all the highly specific circumstances found in individual cases. Nor can they indicate all the factual evidence that may be necessary to apply the rules to a case. Moreover, inherent in the text may be ambiguities in language that allow for different interpretations. Further, the particular circumstances surrounding a dispute may not have been envisaged at the time when the agreement was drafted, and may thus be only tangentially covered or not covered at all. The adjudicators in the process thus exercise considerable discretion in the interpretation and application of the agreements. Whether they exercise that power in line with the collective view of fairness affects confidence in the trading system as a whole.

This is in line with game theoretical experiments, like ultimatum games, which show the importance of fairness in the context of negotiations. One explanation why fair offers are made in the context of negotiations is the expected utility hypothesis: self interested proposers make fair offers because they fear that unfair offers will be rejected. In the normative hypothesis, proposers make fair offers because they are motivated by concerns about acting fairly. Fairness for them rests on a belief in reciprocity.

3.8 Strains within the System
There appears to be a broadly based consensus among trade economists and lawyers that the dispute settlement process has worked quite well since its inception in 1995. This is an important indicator of the health of the global trading system as a whole. It tells us that member countries are not only abiding by the DB rulings, but that they are willingly conforming to the rules of the WTO system as a whole. In this sense, the dispute settlement process is a cornerstone of the system. So long as disputes are, for the most part, seen to be settled fairly, the system retains the confidence of its members.

However, there are strains within the dispute settlement process that could constitute systemic threats. These have emerged out of the content of some of the disputes or from the dispute settlement process itself. Some of the major sources that have emerged to date include:

- Interpreting ambiguities in particular WTO agreements, which for example may lead to divergent views about fair competition and, especially, where the line should be drawn between prohibited or actionable subsidies and other subsidies.

- The accommodation of large and unforeseen changes in domestic economic or political circumstances through safeguards or anti-dumping

- The boundary between national social preferences and WTO rules

- Gaming of the dispute settlement process to press for the reform of agreements or to delay compliance with DB rulings

- Resort to authorized trade sanctions that provoke tit-for-tat reactions and unproductively worsen trade relations.

3.9 Conclusions

The dispute settlement cases included in Volume 2 provide evidence of the various strains to the system. The beef-hormone and GM products cases show how difficult it may be to deal with differences between the EU and US with regard to national social preferences and WTO rules. These cases also demonstrate how the resort to trade sanctions may be counter productive and worsen trade relations. The Kodak-Fuji film case raises issues of the interpretation and implementation of competition policies that may differ between nations. The banana case reflects the problems in dealing with trade preferences as compared to MFN tariff treatment, which is a pillar of the WTO system. Finally, the US steel safeguards tariffs and the Brazilian cotton cases are examples of how nations may “game” the dispute settlement process.

There are many additional dispute settlement cases involving WTO members besides those chosen to illustrate U.S. experiences in Volume 2 that are of interest and importance. There are fortunately some excellent sources of information on the cases available from websites maintained by the WTO (WTO.org), World Bank (WorldBank.org), and WorldTradeLaw.net.
*Stern: University of Michigan, Ann Arbor

Reference