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### **Issues of Fairness in Dispute Settlement**

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## **Issues of Fairness in Dispute Settlement**

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### **Abstract**

We first discuss what fairness may mean in the context of the dispute settlement process, noting the crucial relation between fairness in dispute settlement and the functioning of the trading system as a whole. We explore this relation further through an analysis of three main groups of dispute settlement cases. These are: cases that turn around the question of defining fair competition; cases that arise from the use of contingency measures; and cases that draw the boundaries between domestic regulatory measures and the trade-related norms and rules of the WTO. There follows an analysis of experience with compliance and with the use of counter measures in various cases. Finally, taking together the rulings of the Dispute Settlement Body and the procedures for compliance and the use of counter measures, we conclude that while the present dispute settlement process serves to protect the fairness of the trading system as a whole, there are some aspects of dispute settlement that remain problematic from the standpoint of fairness.

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# **Issues of Fairness in WTO Dispute Settlement<sup>1</sup>**

**Andrew G. Brown and Robert M. Stern**

## **I. Introduction**

We begin from the premise that ideas of fairness play some part in shaping the multilateral trading system. We derive this from the fact that the reciprocal exchange of rights and obligations has historically been at the core of the GATT/WTO system founded by the industrial countries. Among these countries, or coalitions of these countries, all with significant economic power, reciprocity has assured a rough equivalence in perceived net benefits and therefore has seemed fair. As more developing countries have joined the system, however, the asymmetries in power have widened, and the cooperation of many countries has depended less on reciprocal exchanges among equal partners than on the desire of weaker countries to participate in the global trading system on acceptable terms. Still, so long as the leading powers, especially the United States, have sought to gain the voluntary cooperation of others rather than to impose its own will, some account has had to be taken of what others consider fair.

It is because the notion of fairness plays some part in sustaining the trading system that the dispute settlement process acquires importance. It represents the process that provides a channel through which disputes between individual countries may be resolved, or at least prevented from descending into trade wars. More generally, it is needed to sustain trust in the system of rights and obligations. It should reassure members

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<sup>1</sup> We wish to thank James Hartigan and Elizabeth Teague for their helpful comments on an earlier version of our paper.

that the mutually advantageous arrangements to which they have subscribed remain respected.<sup>2</sup> Thus, the process is expected to serve as the impartial expositor of what members collectively believe to be the norms and rules of the system; its envisaged duty is to interpret and apply the view of what is fair as embodied in the agreements that member countries have negotiated.

For the most part, we do not ask whether the rules of the GATT/WTO that the Dispute Settlement Body (DSB) is called upon to administer, are themselves fair. These are reached by consensus and there are many different opinions as to whether or not particular rules are fair. These affect assessments of DSB rulings, a fact that we cannot ignore. However, our main focus is on the narrower question of whether the arrangements for settling disputes under these rules raise issues of fairness.

This breaks down into two parts. The first is whether the process itself is equally accessible to all members and is seen as impartial. The second is whether the adjudicators interpret and apply the agreements of the WTO fairly in all, or nearly all, cases. In reviewing the performance of the Dispute Settlement Body (DSB), which is carried out very largely by its subsidiary components, the panels and the Appellate Body, it is the second part that we concentrate on here. However, we would not want to underplay the importance of the first condition. If the way in which individuals assess the fairness of national courts is anything to go by, it is the accessibility and impartiality of the process that, more than anything, persuades people to believe whether or not legal outcomes are

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<sup>2</sup> Some economists interpret the function of the dispute settlement process quite differently, casting it in terms only of its economic rationale. They see it as a means of rebalancing trade relations so as to eliminate inefficiencies caused by protectionist measures and thereby to maximize national income (Bagwell and Staiger, 1999)

fair.<sup>3</sup> The existing WTO procedures are not without their defects, and a number of valid criticisms have been voiced.<sup>4</sup> While most participants have appeared to believe that the established process meets high standards of impartiality, the question of accessibility raises serious doubts. Equal accessibility to the dispute settlement process clearly exists in name. As a practical matter, however, member countries differ widely in their capacity to use the process effectively. Such use requires that a member government has a body of trade lawyers, economists, and diplomats who have experience with the process and who can call upon a network of informed persons in government departments and in private industry. The rational use of limited professional resources militates against the creation of such capacity in smaller and poorer countries. Moreover, in many developing countries – both large and small – the emergence of a formal legal system supported by a body of judges and lawyers who administer and practice commercial law, is a development of only the last one or two generations. For such reasons, the richer, industrial countries are at an advantage in acquiring the expertise necessary to utilize the process advantageously.<sup>5</sup>

On the second condition of the fair interpretation and application of the WTO agreements, it is a common opinion that the DSB has performed its duties with creditable success most of the time. The Dispute Settlement Understanding enjoins the DSB not “to add to or diminish the rights and obligations” provided in the agreements, and the latter,

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<sup>3</sup> Social psychologists have found that how people assess the justice of the procedures heavily influences their readiness to accept the legal outcomes. Their judgment about whether the legal authorities have acted fairly are multifaceted and include such factors as their assessment of whether authorities were motivated to be fair, whether they were honest, whether they had ethical standards, whether they acted in a biased way, and whether adequate opportunities for representation were provided. See Tyler (1988) for a review.

<sup>4</sup> For an informative summary and commentary of reforms proposed officially during the Doha Development Round negotiations, see Mexico (2007). See also Hoekman and Mavroidis (2000).

<sup>5</sup> For a sociological analysis of why cases do, or do not, get submitted to the DSB – including a critique of the presumption of economic rationality – see Conti (2008).

through its panels and Appellate Body, has clearly endeavored to stick to its last.<sup>6</sup> If some have found particular rulings of the DSB to be unfair, the problem may as readily lie in the WTO agreements themselves as in the DSB's deliberations. This said, however, the record of the DSB in resolving disputes has certainly not been above criticism even though the source of its deficiencies may not have necessarily been of its own making. It is an open question, for instance, whether some kinds of disputes, which have broad economic or political ramifications, can be resolved at all through the distinctly rigid and legalistic dispute settlement process of the WTO. Moreover, the adjudicators in the dispute settlement process – the members of the panels and the Appellate Body – exercise considerable discretion in the interpretation and application of the agreements. Even where carefully crafted, the texts of the WTO agreements cannot be expected to describe all the highly specific circumstances found in individual cases. Moreover, most agreements contain inconsistencies and ambiguities in language. Indeed, the language of agreements has sometimes been deliberately left vague in order to facilitate the conclusion of negotiations. Further, the interpretations placed on the rules and on the factual evidence depend on the beliefs and the expertise of the members of the panels and of the Appellate Body.<sup>7</sup> Both their normative beliefs about the economic system and their technical understanding of the economic consequences of trade-related measures affect their interpretations. For these reasons, it is well to ask whether the DSB always make judgments in line with the collective view of fairness.

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<sup>6</sup> The sensitivity of governments on this point explains why precedent has not formally become part of WTO jurisprudence. For the DSB to build up a body of precedents would be seen as an infringement of the sovereign rights of members to negotiate their international rights and obligations.

<sup>7</sup> While the members of the Appellate body are distinguished jurists appointed for a (renewable) four-year term, panelists are selected on a case-by-case basis and vary widely in experience and background.

In this chapter, we attempt to evaluate the rulings and recommendations that the DSB has made up to mid-2007. Our underlying interest is not in the outcome of specific cases but in whether the dispute settlement process has been contributing effectively to the preservation of trust in the multilateral trading system as a whole. To do so, we have reviewed the hundred or so cases on which the DSB, through the panels and the Appellate Body, has made rulings and recommendations since the Dispute Settlement Understanding (DSU) came into force in January 1995. (See Table 1) From these, we have selected a number of cases that we believe to illustrate the directions that the DSB has taken and the difficulties that the process has encountered. We make no attempt to provide a full account of all the legal, economic and political facets of each case, and we do not quote chapter and verse of all the specific GATT/WTO articles quoted in individual cases. However, we do provide the WTO dispute settlement case numbers for those who might want to consult the DSB reports themselves (which are available on the WTO website). Complainants in many cases cite several GATT/WTO articles that the respondent has allegedly failed to comply with, but we restrict ourselves to what we regard as the key issues in each case.

**Table 1. Dispute Settlement Body: Reports Adopted, 1995-2007**

Total, 1995-2007	
Panel reports adopted	108
Appeals notified (excluding Article 21.5)	75
Appellate Body reports adopted	68
Compliance Panel reports adopted (Article 21.5)	22
Appeals notified (Article 21.5)	14
Appellate Body reports adopted (Article 21.5)	14

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Notes: Data for 2007 end in 10 December 2007. Article 21.5 of the Dispute Settlement Understanding provides that, if a complainant believes that the ruling and recommendations of the Dispute Settlement Body are not being complied with, it may request the Body, preferably through the original panel, to review compliance by the respondent.

Source: Adapted and updated from Wilson (2006).

## **II. Fairness in Trade Relations**

Before we proceed any further, we should attempt to clarify what we mean by fairness. It is an elusive concept.<sup>8</sup> We know that it is a characteristic of relations among individuals and groups, but that these relations take many forms. We can offer no single definition of fairness that fits all occasions. However, most of us recognize intuitively what fairness means when we are confronted by particular sets of relations. In the context of the multilateral trading system, governments have codified their appropriate conduct in

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<sup>8</sup> The classic analysis of fairness is Rawls (1971). For a recent alternative view, see de Jasay (2006).

a number of agreements, and from these agreements, we can identify a few generalized sets of trade relations. Within each of these, we find that there is broad agreement, or fairly broad agreement, about what constitutes fairness.

The most elementary of these relations is how each government treats the products of another country at the point of entry in comparison with the products of third countries. Fairness is recognized to demand non-discrimination unless governments have collectively agreed that the criterion may be waived under certain specified circumstances. Another relation is that of a government to its own and to foreign producers within its domestic market; and in this situation, we generally recognize the national treatment of firms – another expression of non-discrimination – as our definition of fairness. A more complex relationship is how each government affects the market behavior of its own producers compared with how other governments affect theirs. The definition of fairness in this circumstance turns on our conception of fair competition, and there is less wholehearted agreement on this score.<sup>9</sup> Broadly, two views vie with each other. In the dominant view, governments should allow prices in a freely competitive market to determine outcomes for producers; there should ideally be an integrated world market in which producers from different countries compete with each other within the same institutional and regulatory framework. In the other view, governments may legitimately give domestic producers preferential treatment in order to promote national development. In this latter interpretation, equity qualifies the idea of fair competition. Fairness is not realized if account is not taken of the wide differences in income and

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<sup>9</sup> For an interesting exchange of views on fairness in the U.S. context, see Ikenson and Lighthizer (2007).

wealth that exist among countries; equality of opportunity exists only formally if some lack the capacity to exploit the opportunity.<sup>10</sup>

Yet another set of circumstances that confront governments in their trade relations arises when any government feels obliged to defend its producers from import surges or from competition that it deems politically disruptive. Action against such competition is often rationalized as a defense against “unfair trade.” Such interventions – the use of trade remedy measures – will appear arbitrary to other governments and they only become acceptable if all are likewise free to act in similar circumstances. Fairness can only be approximated through agreement on these circumstances. However, if some governments exercise their freedom to act arbitrarily much more than others, that behavior is not likely to be considered fair by most people.

Finally, there are situations in which governments seek to override the obligations that they have accepted in their commercial relations with others because these clash with their social preferences. No one questions the freedom of governments to pursue their own policies in regard to domestic matters, but there are circumstances in which these may harm the trading interests of other countries. The protocol developed in the GATT/WTO to deal with these circumstances is that governments should first voluntarily agree on those national policies that may override the trading interests of other countries. When these exceptions are invoked, interventions in trade are accepted as fair. But when there is no prior voluntary agreement, the interventions are widely seen as unfair.

Needless to say, these general ideas about what constitutes fairness in trade relations do not provide any well defined or objective set of yardsticks. Nor are they

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<sup>10</sup> There is, further, a moral obligation to act justly toward the less fortunate. For a fuller exposition on the concept of fairness as applied to trade relations, see Brown and Stern (2007).

applicable to every specific circumstance. There are, moreover, valid differences of views about the appropriate definition of fairness to apply in particular circumstances. Despite these difficulties, the issue of fairness is present in most cases and it is answered in one way or another. It merits inclusion in an analysis of disputes.

### **III. Interpretation and Application of the WTO Rules**

We have grouped the dispute cases that we have studied into three main clusters:

- 1) disputes that center around the ideas of non-discrimination and fair competition. These include cases that invoke the WTO rules relating to non-discrimination, national treatment, and subsidies. Also included is the rare case alleging restrictive business practices.
- 2) disputes that concern the use of contingent trade remedy measures employed to deal with unforeseeable changes in economic or political circumstances. These include anti-dumping and countervailing duties, and safeguard measures. (Both anti-dumping and countervailing duties could formally be included in the first cluster as measures concerned with fair competition. But it seems more realistic to treat them separately since governments can independently introduce them and since, especially in the instance of anti-dumping measures, political expediency rather than the any firm idea of fair competition appears to dominate their use.)
- 3) disputes that concern the boundary between WTO rules and social preferences in such matters as health and safety standards, public morals and the environment.

While not all cases fit neatly into these three clusters, most are captured. The first two clusters have accounted for the majority of cases, with disputes about subsidies and anti-dumping duties being the leading issues. Compared with developing countries, industrialized countries have been decidedly the more active participants in the dispute settlement process, both as complainants and as respondents. The European Communities (EC) and the United States by themselves have accounted for more than a quarter of all complaints, and their practices have been challenged still more frequently. (Horn and Mavroidis, 2006)

### **Non-Discrimination, National Treatment and Fair Competition.**

The ideas of non-discrimination, national treatment, and fair competition have permeated much of the rule making in the GATT/WTO, and they underlie the criteria followed by the DSB in much of its adjudication. The implicit economic model is that of a freely competitive international economy where prices are not altered by governmental intervention. In so far as this applies, fairness equates with efficiency as defined in mainstream economics. However, the oldest expressions of fairness in trade relation are non-discrimination and national treatment, and these derive from a long history that predates the articulation of any specific economic model. The DSB has been quite rigorous in its application of these bedrock principles, and when countries have challenged practices accepted in the past as exceptions to the principles, it has tended to rule in their favor. This has sometimes raised questions about whether the ruling has resolved the dispute in a fair way.

### *Non-discrimination*

In contributing to the preservation of trust in the GATT/WTO system of rules, the DSB is subject to at least one major limitation. It can pass judgment on an alleged misconduct only if an actual case has been presented to it. In regard to the principle of non-discrimination, this is by far the most frequent apparent infringement of the principle in recent years that has been occasioned by the proliferation of free trade agreements (FTAs). One might therefore have expected that this would have generated numerous complaints to be considered by the DSB. But this has not been the case. In one sense, this may have been fortunate for the DSB since both the GATT and the WTO have been singularly unsuccessful in establishing criteria for assessing the consistency of FTAs with their rules.<sup>11</sup> More important, the anomalous situation reminds us that the DSB cannot resolve inconsistencies –and therefore possible causes of unfairness – that are inherent in GATT/WTO rules and practices.<sup>12</sup>

One of the few cases that addressed this issue was a complaint brought by India against Turkey (DS 34). It alleged that Turkey was implementing regulations that not only introduced new quantitative restrictions on imports of textiles and clothing but also discriminated against India's exports. Turkey's defense was that it was in the process of establishing a customs union (CU) with the European Communities (EC) and that, as part of this process, it was obliged to conform its regime for textile and clothing imports to

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<sup>11</sup> The ambiguity began early. The agreements establishing the European Economic Community were never submitted to the GATT for assessment of their consistency with the rules. Indeed, only one agreement has been declared consistent with GATT/WTO rules – the Czech-Slovak agreement.

<sup>12</sup> In view of the absence of formal challenges, we may ask, like Sherlock Holmes, why the dog did not bark in the night. The fact is that nearly all members of the WTO have had a direct interest in the definition of acceptable FTAs since they themselves are almost all parties to one or more such arrangements. There has apparently been a reluctance to challenge these arrangements in order to determine the circumstances in which non-discrimination should be upheld.

that of the EC. The DSB ruled that the entry of Turkey into a CU did not exempt it from its obligation to conform to WTO rules. In introducing new quantitative restrictions and in applying them in a discriminatory way, Turkey was therefore in violation of these rules. (In this case, the DSB also gave precedence to the principle of non-discrimination over other international obligations of a member country.)

The GATT/WTO rules made an explicit exception to non-discrimination with the introduction of the Generalized System of Preferences (GSP); these preferences were expressly permitted in the GATT under its Enabling Clause. As the preferences granted under the GSP are determined by individual importing countries and are not part of any international commitment under the GATT/WTO, they are less subject to multilateral discipline. However, the DSB has placed some restrictions on the freedom of action of individual countries to broaden the use of these preferences. In a case brought against the EC, India complained that the tariff preferences granted by the EC under its Special Arrangements to Combat Drug Production and Trafficking were inconsistent with non-discrimination. (DS 246) The EC treated these preferences, which were rewards for efforts to curtail drug production and trade, as part of its GSP scheme. The DSB ruled that these preferences could not be so justified and were therefore in violation of the principle of non-discrimination.

Some members have also appealed to the principle of non-discrimination in challenging waivers granted to member countries in the past for political or historical reasons. Undoubtedly, the best-known case on this score is the banana dispute between the EC on the one hand and the United States and some Latin American countries on the other. (DS 27) This arose out of the long standing preferential arrangements that EC

member states have had with African, Caribbean and Pacific (ACP) countries under the Lomé Conventions. These Conventions provided for non-reciprocal preferential arrangements in line with the Enabling Clause of the GATT. In fact, before the WTO was established, the EC had sought and been granted a waiver from GATT on the application of non-discrimination to its trade with the ACP countries.<sup>13</sup>

The event that triggered the banana dispute was the drive by the EC in the late 1980s and early 1990s to establish a Single Market within its borders. As part of that program, it drew up a common regime for bananas in 1993. Previously, each member country had pursued its own policy. In Germany and the Scandinavian countries, there was free trade or virtually free trade in bananas, and much of their imports came from Latin American countries. In some other EC countries, quotas and licensing arrangements favored imports from ACP countries. Under the new EC-wide regime, preferential treatment was accorded to imports from the ACP countries. In economic terms, the new regime brought about a redistribution of gains in the banana trade. The new regime favored the EC distributors and, to some extent, the ACP producers.<sup>14</sup> This change was at the expense of consumers in the EC, of Latin American producers, and of particular multinational corporations in the United States and Latin America that were distributors in the EC.

When the banana dispute came before the DSB, it ruled that most of the quota and licensing arrangements established by the EC under its new regime were not consistent

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<sup>13</sup> The EC believed that this legitimized its preferences to ACP countries. Officials in the Office of the U.S. Trade Representative, while “willing to concede that the waiver sanctioned the tariff on Latin American imports... insisted that it left many additional trade violations unresolved.” (Devereux et al., 2006, p. 113)

<sup>14</sup> A World Bank study concluded that most of the excess profits arising from the quota system flowed not to the Caribbean producers but to the EC distributors who bought and marketed the bananas. (Borrell, 1994)

with its obligations to respect non-discrimination and national treatment. In effect, the DSB did not question the waiver granted to the EC – it could accord a preferential tariff to the ACP countries – but it required that the system of quotas and licenses be as consistent as possible with the rule of non-discrimination. Even the allocation by the EC of specific quotas among individual countries within the ACP group was, for instance, a violation of non-discrimination. (As will be discussed later, EC compliance with the ruling presented substantial difficulties)

In sum, the DSB itself has held closely to the principle of non-discrimination in its rulings. This obviously does not mean that, from a wider viewpoint, non-discrimination has been strictly observed in international trade relations. As noted, the trend has been toward the multiplication of preferential trading arrangements, justified mainly as FTAs. As a consequence, the non-discrimination rule, which was long a primary expression of fairness in international trade relations, has been losing its strength and clarity.

There is, moreover, still greater ambivalence about the fairness of the GATT/WTO system of rules when the concept is qualified by the notion of equity. Where new preferential arrangements by one major trading nation have adversely affected other large traders (by causing trade diversion), the latter have been able, for the most part, to offset the adverse effects by negotiating parallel FTAs themselves. Thus, it has tended to be poorer, third countries that have experienced the adverse consequences of these discriminatory arrangements. At the same time, the EC's preferential arrangements with ACP countries have been challenged in the WTO. Partly as a consequence, the EC has proposed to ACP countries that they forego their existing

preferential arrangements with it – which, in a recognition of their need for development, were based on non-reciprocity – and that the arrangements be converted into reciprocal FTAs consistent with WTO rules. These inconsistent trends seem inequitable to many.

It is difficult to say therefore that, in the multilateral trading system operating under GATT/WTO rules, non-discrimination, as an expression of fairness, has been firmly upheld. The fault, however, has not lain with the DSB.

### *National Treatment*

Application of the national treatment rule appears to have been generally quite clear, and not many disputes have arisen on this score. Disputes have focused on domestic regulations that, intentionally or not, have differentiated between domestic and imported products. For instance, cases were brought against Chile, Japan and South Korea on the grounds that their internal taxes on liquor discriminated in favor of domestic products through regulatory differentiation such as the alcoholic content of the liquor. (DS 8,10,11,75, 84, 87,110) In these cases, the DSB found that the imported liquors were, in fact, “like products” that competed directly with domestic products, and that the tax differentiation was therefore inconsistent with the national treatment rule. In the same vein, the DSB found that a soft drink tax and a distribution tax that were imposed by Mexico on imported sweeteners, soft drinks and syrups, were inconsistent with national treatment. (DS 308) These appear to be fair applications of the rule.

Some developed country members have invoked the national treatment provision in quite another context. They have complained that certain emerging countries, in pursuing industrial policies that lay down conditions on foreign owned enterprises to utilize locally produced components or to meet certain export requirements, have violated

the provision. In complaints brought against India by the EC and the U.S., for instance, Indian performance requirements in the automobile industry were argued to be inconsistent with national treatment as well as with the import licensing rules and TRIMS. (DS 146, 175) In line with the rules as they stand, the DSB found in favor of the complainants. From the viewpoint of fairness, however, many would argue that the rules fail to take account of equity. Poor countries seeking to rise out of poverty are intent on promoting the rapid indigenous development of new industry, and that legitimizes the use of the disputed measures as exceptions to the national treatment rule. This is an instance where the dominant norm of fairness hews too closely to the economists' static definition of efficiency as the optimal allocation of resources. A broader conception of fairness that was qualified by equity would recognize the relevance of a more growth-oriented model in which increasing returns played a central role. The same issue arises in a case relating to the Indonesian automobile industry, which is discussed below in the section on subsidies (DS 54,55,59, 64)

### *Subsidies*

Throughout the history of the GATT/WTO, subsidies have figured prominently among the allegations of unfair trade. International agreement on what constitutes unfair subsidies, however, has been slow to emerge. Some progress was made with the adoption of the Subsidy Code during the Tokyo Round. A much larger advance was made with the negotiation of the Subsidies and Countervailing Measures Agreement (SCM) during the Uruguay Round.

The SCM Agreement defined a subsidy in two ways: as a financial contribution by a government or a public body; and as any form of income or price support affecting

imports or exports that conferred a benefit. It drew a distinction between those subsidies that are of no concern to other countries and other subsidies that are prohibited or “actionable” because they directly affect trade relations; and they confine the latter to those that apply to individual industries or enterprises. Most of the disputes about subsidies over the last ten years or so have, in fact, related to export subsidies. The SCM Agreement was quite explicit on this score: it prohibited export subsidies of non-agricultural products. In addition, the Agricultural Agreement placed limits on their use in exports of agricultural products. A number of the disputes about subsidies have turned on the appropriate definition of the terms in these agreements, and in clarifying these terms, the DSB has played an influential role in shaping the position of the WTO on subsidies.

The interpretation of the definition of subsidies by the SCM has been quite expansive – with implications that may have surprised the original drafters. This has been true particularly of national regulations affecting agricultural products. A fairly straightforward case was that brought by New Zealand and the United States against Canada on exported dairy products. (DS103, 113) Since Canada’s official milk marketing arrangements provided for the sale of milk to export processors at below cost, the DSB deemed that, although no financial payment took place, a subsidy was being given. A somewhat more complex case was that brought against the EC on the export subsidization of sugar. (DS 265, 266, 283) Under the EC regime regulating the production and sale of sugar, beet farmers were free to produce and sell sugar beyond their production quotas provided the sale was to export processors only (at unregulated prices). Although the EC made no payment to producers or processors and did not

regulate the prices of raw or refined sugar, the DSB nonetheless ruled that the sugar exports were subsidized. It reasoned that the exports were cross-subsidized by the high prices received by producers for their sales in the domestic market. Producers were able to cover their fixed costs from their domestic sales and only had to cover their variable costs in order to benefit from their export sales. This implied that any products sold on the world market might be deemed to be subsidized if they benefited from domestic agricultural support programs, perhaps not something that the original drafters intended. Indeed, the EC observed to the Appellate Body that the finding in this case “blurs the distinction between domestic support and export subsidies.”<sup>15</sup>

In the upland cotton subsidy case brought against the United States by Brazil, the DSB went in the same direction. (DS 267) In effect, it questioned the consistency of some domestic agricultural support programs with WTO rules. Central to the dispute were two support programs. One consisted of direct payments to farmers that were not related to prices or production but which the DSB nonetheless found to be actionable subsidies because the farmers receiving the payments were restricted in the alternative uses to which they could put their land (thus indirectly affecting prices and production). The other was the counter-cyclical payments that were introduced in the late 1990s when cotton prices fell. Although intended solely as support for farm incomes, the DSB noted that the base price in the program was well above world market prices, thus affecting world prices and making the payments actionable subsidies. Further, the DSB found that, in suppressing world prices, the U.S. programs caused “serious prejudice” to the interests of the complainant, namely, Brazil. In this particular case, what gave rise to the dispute

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<sup>15</sup> The Appellate Body asserted that its interpretation was based on the specific facts and circumstances of the sugar case and in particular that the sugar had to be exported. (Powell and Schmitz, 2005, p. 37)

was not so much a failure on the part of the original drafters of the Uruguay Round agreements to appreciate their implications as a shift in U.S. agricultural policies since the completion of the Round. With the collapse of cotton prices in the late 1990s, the balance of political forces had moved toward a partial reinstatement of the old policy of price supports, bringing support policy into conflict with WTO agreements accepted in the early 1990s.<sup>16</sup>

Analysis of the evidence rather than interpretation of the rules has been of primary importance in many cases. For instance, an important condition that the DSB has stipulated in its definition of export subsidies is that there should be a demonstrable link between the payment of a subsidy and actual export performance. The legal and institutional channels through which payments are made have therefore had to be studied. In a case brought by the EC against South Korea on the subsidization of commercial vessels, for instance, the complaint was that certain government agencies provided preferential financial terms to capital goods exporters. (DS 273) The DSB noted, however, that there was no “mandate” requiring these agencies to provide export subsidies, and it ruled that only certain of their loans and guarantees could be identified as directly linked to export performance.

Appraisal of the evidence can demand careful and detailed economic analysis of local circumstances. It may not be easy, for instance, to determine whether payments made by a government were actually on terms below market rates and therefore constituted subsidies. Making fair comparisons of publicly and privately provided finance has been important in the cases brought by Canada against Brazil and Brazil against

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<sup>16</sup> Canada has recently requested formation of a panel to settle a dispute about U.S. corn subsidies. Other cases may be in the wings, awaiting the outcome of the Doha Development Round.

Canada on regional aircraft. (DS 46, 70, 71, 222) Both countries are leading manufacturers of regional aircraft, have provided active governmental support to their manufacturers, and are close competitors. On both sides, the allegation was that financial arrangements made by governmental agencies in support of exports constituted prohibited export subsidies. In one phase of this long running dispute, it was asserted that the Export Development Corporation (EDC) of Canada provided finance on terms more favorable than the private market. The DSB rejected this view, however, on the grounds that the EDC was able to provide highly favorable terms partly because it had acquired substantial expertise in this segment of the financial market and partly because its large portfolio allowed it to diversify its risks. Further, it pointed to evidence of the competitiveness of the EDC; its net interest margin was better than that of some of the commercial banks.

On the Brazilian side, the initial complaint was that the government subsidized export financing through an interest-equalization account. (Brazil did not deny that this constituted a subsidy but argued that “payments are permitted in so far as they are not used to secure a material advantage in the field of export credit terms.”) The DSB rejected this reasoning, stating that the intention of the SCM Agreement was to impose a discipline on “subsidies which distort international trade.”) In subsequent presentations, the focus shifted from broad complaints about the activities of governmental agencies to an analysis of the sources of financing in specific contracts negotiated with individual purchasers. Clearly, the DSB has required considerable data and analysis – some of which has been withheld on grounds of commercial sensitivity – in order to make informed judgments. Yet there may be no clear yardstick of fairness in such cases since

specific circumstances keep changing and plausible alternative assessments are always possible.

As well as the factual evidence, the more theoretical assumptions underlying the economic or financial analysis may also affect the rulings of the DSB. In assessing the evidence in specific cases, the DSB has been guided, unsurprisingly, by the more conventionally accepted assumptions. The case brought by the EC against the United States on the Foreign Sales Corporation (and subsequent) legislation illustrates the role that such conventional beliefs may play in the interpretation and application of the rules.

(DS108) The dispute raised the question whether certain national tax rebates or exemptions constituted export subsidies and therefore gave rise to unfair competition. Historically, some national tax measures have long been recognized as placing domestic producers or exporters at an unfair disadvantage in international trade. A manufacturer paying a sales tax on his product would, for instance, be at a competitive disadvantage if he were required to pay the same tax on his exports of the product; and it has been customary to exempt exports or to rebate the tax. Conversely, if imports did not attract the tax, domestic producers would be disadvantaged; and again, it has been customary to adjust border taxes to ensure national treatment of imported products. In brief, WTO rules have recognized indirect taxes as adjustable at the border. On the other hand, direct taxes like corporate taxes have remained outside the scope of the rules.

When the EC countries began to introduce value added taxes, these were treated as indirect taxes, an approach that was formally recognized in the Subsidy Code negotiated during the Tokyo Round in the 1970s. However, to U.S. producers and exporters, not working within a value-added tax system, it appeared that the European

exporters received a tax rebate on their exports while U.S. exports to the EC were subject to an additional tax. After the Tokyo Round, the United States introduced the Foreign Sales Corporation (FSC) legislation, which gave American producers a measure of tax relief on their exports. Exporters were permitted to set up foreign sales corporations through which their export earnings were channeled, and they were allowed to defer taxes on a portion of these earnings (Since deferment was for a number of years during which interest could be earned on the deferred taxes, the arrangement amounted to tax exemption). After the adoption of the SCM Agreement, however, the EC challenged the legislation and the DSB ruled that, by the terms of the SCM Agreement, the U.S. tax relief fitted the definition of a prohibited export subsidy: revenue was foregone by the government, a benefit was conferred on the exporter, and the subsidy was contingent on export performance. The United States abandoned the practice after first attempting unsuccessfully to comply through modification of the legislation.

It has been trenchantly argued (Hufbauer, 2002) that the conventional view of taxes on which this ruling was based rests on weak economic analysis. In simple theory, the burden of an indirect tax falls wholly on the consumers who purchase the taxed product; unlike a direct tax, it does not affect production costs and the competitiveness of firms. In the case of a value added tax, however, its incidence depends on several characteristics of the market and of the tax itself. Producers may find it difficult to pass on the tax and its incidence may fall mainly on their earnings – on the incomes of land, labor and capital – and would therefore constitute a direct tax.<sup>17</sup> Thus, the distinction

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<sup>17</sup> As Hufbauer observes, one of the characteristics that makes this more likely is whether or not adjustments are made at the border; a tax at the border would shift the incidence toward the income earners.

between rebates of direct taxes on export earnings and rebates of value added taxes on exported products may be more blurred than conventionally assumed.<sup>18</sup>

The particular economic analysis brought to bear on the evidence may clearly affect the rulings of the DSB. We may quote another, more extreme case on this score – one that concerned, not the subsidization of exports, but of domestic production in competition with imports. This was the case brought against Indonesia regarding certain measures affecting domestic car and car part production. (DS 54, 55, 59, 64) Indonesia gave exemptions or rebates on import duties and sales taxes to companies that met certain local content requirements as well as to cars or car parts manufactured by Indonesian companies elsewhere and imported into Indonesia. The DSB found that the measures contravened several WTO rules, including non-discrimination, national treatment, and TRIMS. It also found that, under the terms of the SCM Agreement, the subsidies to domestic industry constituted actionable subsidies because they caused “serious prejudice” to the interests of the EC as an exporter. Thus, the ruling placed a restriction on Indonesian industrial policy, bearing out the criticism of many that the WTO rules and their interpretation were hostile to some of the developmental measures of poor countries. As in the case against India discussed in the section on national treatment., it appears that the economic model implicit in this judgment is one of comparative statics, not of economic growth. Had the judgment been backed by a more growth-oriented analysis,

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<sup>18</sup> As Hufbauer himself notes, the economic logic critical of the accepted convention can be taken even further. As others have argued, it does not matter in the end whether or not the tax policy subsidizes exports. In a regime of freely floating exchange rates, any advantage that a subsidizing country may obtain will be washed away by the effect of an improving trade balance in causing the currency to appreciate. However, as we know, this process takes time and, moreover, other forces affecting the capital account may cause contrary movements in the exchange rate. The link is abstruse and uncertain. In the meantime, exporters are grumbling about the tax advantage of competitors and, in their world of more partial analysis, see the governmentally engineered tax advantage as unfair. It is with this more immediate world of national sentiment that the formal trading system must cope.

where development is seen as a succession of innovative investments that are actively supported by public policy interventions, it might well have been different. However, the DSB was probably reluctant to ask whether a subsidy was consistent with a member's development needs. The DSB panel in the case of Brazil's export subsidies of regional aircraft had noted that such was "an inquiry of a peculiarly economic and political nature, and notably ill-suited to a review by a panel whose function is fundamentally legal." (DS 46)

In the various subsidy cases brought before the DSB, there has evidently been scope for differences of opinion about the fairness of its specific rulings. While the DSB has interpreted the definition of subsidies quite broadly, it has certainly remained within the terms of the SCM Agreement. However, in the analysis of the evidence in specific cases, there has been room for differences of opinion, deriving particularly from the assumptions underlying the economic reasoning. In assessing fairness, we have to recognize, therefore, that different but equally defensible constructions can be put upon the evidence.

### *Restrictive Business Practices*

Restrictive business practices are also widely seen as another source of unfair competition. While there is no multilateral agreement under the WTO that covers these practices, they have been indirectly challenged through the dispute settlement process. The closest to a direct challenge came in the Kodak-Fuji complaint that the United States brought against Japan. (DS 44) The complaint was that governmental measures and business practices in Japan impeded foreign competition in the market for photographic film. Three sets of measures were criticized: distribution measures that allegedly created

a market structure that prevented the access of foreign producers to traditional distribution channels; restrictions on the operation of large retail stores that allegedly prevented the growth of alternative distribution channels; and measures that restricted the use of sales-promotion techniques. Thus, the complaint was, in essence, directed at alleged deficiencies in Japanese competition policy.

In the absence of WTO rules relating to restrictive business practices, the complainant made the broad argument that its benefits under the WTO Agreements were being nullified or impaired by the measures (Article XXIII of GATT), and in addition, that the Japanese distribution measures violated the national treatment provision. Some have said that, in this case, the United States was testing the boundaries of WTO jurisprudence. The nullification or impairment clause in the GATT provides a possible means of challenging measures of trading partners that are not specifically covered in the existing agreements; it accommodates “non-violation” complaints.

In the event, the DSB did not accept such a broad interpretation of the nullification or impairment clause. Nor did it directly address the absence of competition rules in the WTO. The DSB judged that the United States had failed to demonstrate that the Japanese measures had actually nullified or impaired its benefits under the WTO or that the measure conflicted with the national treatment provision. It thus assessed the complaint against the terms of the existing agreements, and did not pass judgment on national laws or regulations that lay outside these agreements. To have done so would have been unfair since members of the WTO had not consented to any rules in the field of competition policy.

The story was quite different in the complaint brought by the United States against Mexico on telecommunications services. (DS 204) The complaint was that Mexico maintained anti-competitive and discriminatory measures, tolerated certain market barriers employed in the private sector, and failed to take the needed regulatory measures. Since the matter concerned a service industry, the rules of the General Agreement on Trade in Services (GATS) applied, and it contains provisions that specifically relate to the measures being complained about. The DSB found that the measures were in violation of the GATS.

### **Contingent Trade Remedy Measures and WTO Rules**

Our second cluster of disputes concerns contingent trade remedy measures. Three types of measures are provided for in the WTO Agreement: anti-dumping, countervailing, and safeguards measures. A WTO member is authorized, when certain contingencies are fulfilled, to impose such measures that might otherwise be inconsistent with the WTO Agreement. That is, under Article VI of the GATT 1994 and the Uruguay Round Anti-Dumping Agreement, anti-dumping duties can be imposed on a non-MFN basis on a producer or exporter and at levels in excess of WTO bindings in cases in which “dumped” imports cause or threaten “material” injury to a domestic industry. Under GATT Article VI and the Uruguay Round Agreement on Subsidies and Countervailing Measures (SCM), countervailing duties can be used to offset a subsidy that benefits export producers and that is found to cause or threaten “material” injury to a domestic industry. Safeguards measures can be imposed in excess of bound rates or equivalent quantitative restrictions under GATT Article XIX and the WTO Agreement on Safeguards in the event of unforeseen developments in which imports cause or threaten

“serious” injury to a domestic industry. Each type of contingent measure is subject to review at specified times. There is a “sunset” clause in the Anti-dumping and SCM Agreements that specifies that the measures should be terminated not later than five years after their imposition or the date of their most recent review, subject to determination that the expiration of the measures might likely lead to a continuation or recurrence of the injury involved. Safeguards are not to remain in effect for longer than four years although exceptions can be made for measures for up to eight years,

What distinguishes contingent trade remedies is that they are imposed initially by the importing country and without any form of advance authorization. As a consequence, as Kreier notes (2005, p. 48), the discipline of dispute settlement in these cases tends to focus on the *processes* by which the determination of the trade remedy is carried out by the national authorities. For anti-dumping and countervailing measures, this involves (p.49): “...the process by which investigations are initiated, transparency, due process and participatory rights of interested parties, public notice and explanation of determinations and judicial review.” Similar, though less detailed provisions, apply to safeguards. Dispute settlement panels thus are not initial finders of fact, but rather are mainly concerned with how the investigations have been carried out.

### *Anti-Dumping*

In commenting on the rulings and recommendations of the DSB throughout this paper, our primary interest has been to ask whether the DSB has interpreted and applied the rules of the WTO fairly. The underlying assumption is that the rules themselves are accepted as reflecting a broad consensus about fair conduct in trade relations. As regards the Anti-Dumping Agreement, however, it is stretching belief to say that the anti-

dumping practices allowed by the WTO rules are widely regarded as fair; they have been the subject of unrelenting criticism, particularly from economists. Anti-dumping provisions had been incorporated in the trade laws of a number of industrial countries long before WW2 and the anti-dumping rules of GATT and the WTO have largely been built around such legislation. The formal justification for the national laws has been the need for measures to counter “unfair trade” practices. However, the central criterion of “unfair trade” employed in the legislation is that the export price of a product is below the “normal” price in the home country; if this causes injury or threat of injury to producers in the importing country, it becomes the basis for justifying an anti-dumping duty.

There are many reasons why the export price may be below the “normal” price (which include the method of how these prices are measured) and a divergence may not be indicative of an “unfair trade” practice. The pricing strategies of firms within countries often use below-cost pricing for specific product lines, and the practice is regarded as quite consistent with national competition laws. It is only when an exporting firm operates from a “sanctuary” home market – one so protected that the firm can sell at a higher price at home – that the case for “unfair trade” can be argued. Such conditions are probably quite uncommon. Where they do not prevail, anti-dumping measures become no more than politically expedient measures to protect producers in the importing country.

Given the nature of the WTO rules, its dispute settlement process is severely limited in its ability to make rulings and recommendations that would be widely regarded as fair. It is confined to assessing whether national practices are consistent with the WTO rules, particularly in regard to the procedures and methodologies used by governments in arriving at decisions on the application of anti-dumping duties.

Since the inception of the WTO, 62 complaints about anti-dumping measures have been referred to the Dispute Settlement Body. Respondents have been equally divided between industrial countries on the one hand and emerging market economies/developing countries on the other. The majority of cases against the latter have been settled through consultations or there was no settlement notified to the WTO. In contrast, many of the cases involving the EC and United States have been much more drawn out through time in the panel and appellate process and in the implementation of the decisions handed down. The different experiences suggest that the anti-dumping issues involving the EC and United States may be more complex, politically more sensitive, subject to different legal interpretations or given to delays in changing national laws and institutional practices to conform to WTO anti-dumping regulations. Yet the evidence suggests that the EC and United States have finally responded when they are found in violation of WTO regulations.

Among the most troublesome cases that have resulted in protracted litigation are those involving the use of “zeroing” in calculating dumping margins, conflicts posed by U.S. laws, implementation of sunset reviews, and special circumstances in dispute settlement arising from the North American Free Trade Agreement (NAFTA).

“Zeroing” is a patently unfair practice used by some governments in determining anti-dumping duties. In the case brought by India against anti-dumping duties in the EC on bed linen, the practice was challenged. (DS141) It involves the establishment of a set of categories in the product under question. Within each category, a weighted average normal value is calculated by reference to home-country sales, third-country sales, or a constructed value. This normal value is then compared with a weighted average export

price for that category. If the normal value is higher, the difference is treated as a positive dumping margin, that is, the goods are being exported at less than their normal value. If the normal value is lower than the export price, a negative dumping margin would exist. However, under EC practice, in calculating a total weighted average for all categories of the product under investigation, the negative dumping margins are changed to zero. As a result, the calculated dumping margin may be significantly overstated. The DSB ruled against the EC and in favor of India in this case. The U.S. has also been challenged successfully in a number of cases for its use of “zeroing.” (DS282, 294, 322, 325, 239).<sup>19</sup>

The consistency of national legislation with WTO rules has been another source of complaints. One such complaint was brought by the EC and Japan against the U.S. (DS 136,162) This sought to invalidate the 1916 Act of the U.S., which was an antitrust-based statute that addressed foreign-based predatory pricing (i.e., dumping) and made it a criminal offense that could result in the imposition of fines or imprisonment or recovery of treble damages. The United States argued that the 1916 Act was an internal matter, and that it targeted predatory pricing more broadly, requiring that there be an intent to destroy, injure, or prevent the establishment of a U.S. industry, or to restrain or monopolize trade. However, the DSB ruled that the Act violated the pertinent provisions of the GATT/WTO anti-dumping agreements. The U.S. subsequently repealed the 1916 Act in December 2004.

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<sup>19</sup> See Ikenson (2005, esp. p. 10-11), for an illustration of how antidumping margins can be inflated using zeroing, and (pp. 20-21) for a discussion of some of the WTO cases challenging the U.S. Import Administration’s (IA) use of zeroing. He notes that the IA “...is adamantly opposed to changing its zeroing practice...,” presumably “...to serve its mission of safeguarding American industries and jobs.”

Several countries challenged another piece of U.S. legislation, best known as the Byrd Amendment. (DS 217, 234). This complaint was lodged against the *Continued Dumping and Subsidy Offset Act of 2000*. This act changed the disposition of funds raised from duties on imports that the U.S. government determined to be dumped domestically. Prior to the Act, those funds were incorporated into the U.S. budget. The Act specified that the funds be distributed to the U.S. companies that filed pricing complaints. This meant that non-U.S. firms allegedly engaged in dumping could be fined and the funds given to the U.S. companies that made the complaint initially. The duties could no longer be ostensibly argued as restoring fair price competition and, indeed, they provided firms with a monetary incentive to initiate anti-dumping cases. The Byrd Amendment was ruled to be illegal in 2002. Following the imposition of sanctions on imports of selected U.S. goods by some of the complainants, the Byrd Amendment was repealed in January 2006, although the Act's provisions were to remain place until October 1, 2007 and the funds could continue to be redirected to the U.S. filing companies during this time.

As noted, according to the Anti-dumping Agreement, measures should be terminated not later than five years after their imposition or the date of their most recent review, subject to determination that the expiration of the measures might likely lead to a continuation or recurrence of the injury involved. There have been several cases in which the implementation of the U.S. sunset procedures has been challenged. (DS281, 282, 244, 99, 268, 89, 225, 262).<sup>20</sup>

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<sup>20</sup> Ikenson (2005, p. 21) suggests that the U.S. Import Administration (IA) has been reluctant to bring U.S. sunset policy into conformity with the WTO Anti-dumping Agreement, and that the IA "...has turned what should be a temporary remedial measure into permanent protection."

In at least two cases, differences in the dispute settlement mechanisms of the WTO and NAFTA have created some confusion and conflicts in coverage and interpretations. The U.S.-Canadian softwood lumber dispute is discussed more fully in a later section but we may note here that, in addition to countervailing duties, the U.S. imposed anti-dumping duties on Canadian lumber. Canada challenged both the countervailing duties and the anti-dumping duties under Chapter 19 of NAFTA and in dispute settlement proceedings in the WTO. Canadian producers also filed claims against the U.S. government under the investor-state dispute settlement provisions of Chapter 11 of NAFTA. This extensive litigation resulted in a state of confusion. That is, on November 15, 2005, a WTO panel *accepted* a U.S. finding that Canadian imports of softwood lumber threatened to cause material injury to U.S. firms. But, on August 10, 2005, a NAFTA Extraordinary Challenge Committee had confirmed an earlier NAFTA (Chapter 19) panel conclusion that did not support a finding of threat of material injury. The situation was further complicated by the claim filed under Chapter 11 of NAFTA. In the end, the lumber dispute, as we note later, was settled bilaterally.

A dispute between Mexico and the U.S. took much the same character. The issue was an anti-dumping duty imposed by Mexico on imports from the U.S. of high-fructose corn syrup. (DS 101, 132). Each government had filed trade dispute cases before NAFTA and the WTO challenging the other's handling of the dispute. Again, in the end, the dispute was resolved bilaterally.

In the context of a discussion of fairness in dispute settlement, it is worth noting that two different dispute settlement bodies may arrive at opposite rulings on the same legal claims. How far this may be due to differences in the texts of the relevant

agreements or in procedures or in the assessments of the evidence, we do not know. It does appear, however, that once a dispute settlement procedure has been initiated in either NAFTA or the WTO, one or the other forum is thereby excluded from further examining the issues at stake and there may be no interaction between them.

More generally, the most we can say about the fairness of the WTO dispute settlement process in the area of anti-dumping measures, is in applying the Anti-dumping Agreement, the DSB has worked to remove some of the most egregiously unfair national practices.

### *Countervailing Duties*

The Subsidies and Countervailing Measures Agreement requires that, before imposing a countervailing duty, member countries must undertake investigations that meet certain conditions: There must be sufficient evidence of the existence of a subsidy, of injury to the domestic industry, and of a causal link between the subsidized imports and the injury. Some of the key issues have been documented in the *European Journal of International Law* by Trachtman (2007) and others.

In one case of definition of a subsidy, Canada complained that the U.S. charged a countervailing duty on certain products on the grounds that Canada had imposed an export restraint on a product that was used in the production of the exported products. (DS 194). The reasoning of the U.S. was that the restraint depressed the domestic price of the product and thus subsidized the exported products. The DSB panel, however, was of the opinion that the export restraint did not constitute a financial contribution and therefore did not qualify as a subsidy within the meaning of the SCM Agreement. (For other reasons, however, the DSB did not rule on this case.) In another such case of rule

interpretation, the EC complained that, in a sunset review of a countervailing duty on certain steel products, the U.S. had failed to apply a *de minimis* standard as required by the SCM Agreement. (DS 213). The interpretation of the DSB was that the Agreement did not require application of the standard.

Complaints about the imposition of countervailing duties have more often challenged the evidence presented in support of the duty. In at least two cases, the issue was whether, on privatization of a state-owned company, some part of the subsidies formerly granted to the state-owned company had been passed through to the new private firm. In the case of the countervailing duties imposed by the U.S. on certain steel products from the UK, the DSB ruled that the privatization extinguished the subsidy; the privatization had been carried out at arm's length and at fair market prices. (DS138) The conclusion was similar in a comparable case brought against the U.S. by the EC. (DS 212)

Two complaints brought by South Korea against the U.S. and the EC concerned the imposition of countervailing duties on dynamic random access memory semiconductors or chips. (DS296, 299) While approached differently by the DSB panels, the two cases turned similarly on whether the analysis of the factual evidence justified the duties. In both cases, the DSB found that a subsidy existed but that the analysis had failed to establish a link between the subsidized imports and injury to the domestic industry.

In the long running dispute between Canada and the U.S. on softwood lumber that we have already mentioned, Canada initiated several complaints concerning the countervailing duties imposed by the U.S. (DS 236, 247, 257, 264, 277, 311) These cases dealt with different methodological and procedural aspects of the U.S. determination of

the duties. In DS 257, for example, the DSB concluded that it was unable to determine whether the U.S. had correctly assessed the benefit accruing to Canadian industry from the recognized subsidy. The issue was how to treat a subsidy on primary goods that was passed on to further stages of processing. The DSB ruled in this case that a pass-through analysis was required in connection with sales of logs by tenured harvesters to unrelated sawmills. In DS 277, the DSB found that the U.S. had failed to demonstrate that the rise in imports was “substantial” or that there was a causal link between the imports and injury to the domestic industry. These cases were overtaken by events when, in October 2006, as discussed later, Canada and the U.S. signed a comprehensive bilateral agreement on softwood lumber that closed the dispute.

These cases in countervailing measures are a sub-category of the cases on subsidies and, for the viewpoint of fairness, much the same can be said about them. The issue of fairness has turned, for the most part, on the analysis of the evidence, and there has been room for differences of opinion about whether the evidence has been sufficiently or correctly assessed.

### *Safeguards*

Safeguards measures differ from anti-dumping or countervailing measures in that they are not justified as a response to “unfair trade.” These measures, which may take the form of increased tariffs or quotas, are designed to deal with unforeseen import surges resulting from earlier trade concessions that can be demonstrated to have “caused” serious injury in the importing country. They are intended to allow time for adjustment by an industry to a new trading situation. The justification of safeguards measures, which are permitted under Article XIX of the GATT and the Uruguay Round Agreement on

Safeguards, is consequently expected to meet a higher standard (particularly of injury) than in the case of the other measures. Safeguards measures are also applied on an MFN basis on all imports of like products; and there may be compensation measures that are applied under special circumstances to exporting countries that are harmed by the imposition of safeguards.

Since 1995, there have been 31 safeguards actions filed in dispute settlement. Of these, 16 have been the subject of DSB reports (eight of these were complainant cases involved in settling the U.S. steel safeguards dispute). As with other measures, our particular interest is in whether the DSB – through its panels and Appellate body – has interpreted and applied the rules fairly. In the case of safeguards measures, however, the language of the GATT Article and the Safeguards Agreement leaves notably large uncertainties about what the rules are. Sykes (2003) and Trachtman (2007, pp. 20-24) have noted a number of difficult interpretative issues that have arisen. Sykes has discussed these issues in the context of specific cases that have reached the Appellate Body of the DSB.

One source of difficulty is that, in accordance with GATT Article XIX, member countries may introduce safeguard measures to counter a larger than expected rise in imports if it takes place “as a result of unforeseen developments and of the effects of the obligations incurred” by a member, but it is unclear what constitute “unforeseen developments” and which obligations are relevant. Even though the Safeguards Agreement does not contain such language, the Appellate Body ruled in a case brought against South Korea relating to safeguard measures on imports of cotton and dairy products that the phrases remained a binding obligation. (DS98) Similar rulings were

made in cases against Argentina on footwear (DS121), and against the U.S. on lamb meat (DS178). Sykes notes that the Appellate Body has not offered any meaningful guidance on how countries can satisfy the outmoded Article XIX requirements.

There is also a problem of measurement in defining what constitutes an import surge, which arose in the just mentioned case against Argentina. Sykes again notes that the Appellate Body has not provided guidance on the baseline to be used in measuring the “increased quantities”.

There is a further problem in the definition of “serious injury.” Sykes notes that the Appellate Body has not defined “serious injury” with any precision, and has referred to the text of the Safeguard Agreement that states that “...the competent authorities shall evaluate all relevant factors of an objective and quantifiable nature having a bearing on the situation of that industry....”. Thus, in the Argentina footwear case and in the case against the U.S. on wheat gluten (DS166), the Appellate Body found that the safeguard measures implemented had not met the “all relevant factors” requirement. More broadly, the Appellate Body has ruled that serious injury should reflect “significant overall impairment,” a condition that was found to be lacking in the Argentine footwear and the U.S. frozen lamb meat cases.

The causal relationship between increased quantities of imports and serious injury has figured in several cases. It can be very difficult to determine the causes of injury to an industry since there may be other factors, such as changes in demand patterns rather than increased imports, that give rise to serious injury. In the aforementioned cases of Argentine footwear, U.S. frozen lamb meat and wheat gluten, as well as the case against the U.S. on carbon quality line pipes (DS202), the Appellate Body did not address the

conceptual issues involved in treating imports as a causal variable. Sykes thus concludes that: "...the Appellate Body offers no coherent guidance as to when safeguards are permissible and when they are not."<sup>21</sup>

The case against the U.S. on steel safeguards warrants separate attention. (DS248,249,250,251,252,253,254,258,259) This case involved 10 safeguard measures that were applied and that were challenged by Brazil, China, European Communities, Japan, Korea, New Zealand, Norway, and Switzerland, with several additional countries requesting third-party representation. The Appellate Body ruled that all of the measures were inconsistent with U.S. obligations under Article XIX and the Safeguards Agreement, and all of the claims were consolidated. This case has been discussed at length in Devereaux et al. (2006, Vol. 2), who note that the steel safeguards tariffs were imposed 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. 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. It turned out that the Bush Administration removed the tariffs in the face of potential retaliation especially by the

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<sup>21</sup> See Irwin (2003) for a review of WTO decisions involving causation and injury attribution in U.S. escape clause cases and for a methodology for attributing injury to various factors that could be used to enable U.S. safeguards decisions to conform to the requirements specified in the WTO Safeguards Agreement.

European Communities. 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.

The WTO safeguards cases are significant in so far as practically every safeguards measure that has been challenged in the panel/Appellate Body process has been overturned. WTO member countries may thus be at a loss when it comes to designing safeguards actions that can meet panel/Appellate Body approval. What is needed therefore is recognition of this impasse and efforts to design guidelines and criteria that WTO members can attempt to follow without encountering the dead ends that they have experienced thus far.<sup>22</sup> If WTO member countries are reluctant to use safeguard measures for fear of their being overturned, it is quite likely that they may resort to other trade-remedy measures, in particular anti-dumping actions that do not have the same constraints as safeguard measures.<sup>23</sup> It is also possible that countries may decide to game the system to gain time in protecting domestic industries along the same lines as in the U.S. steel safeguards case noted above.

The vagueness in the rules relating to safeguards measures leaves open the question of whether the DSB has interpreted and applied the rules fairly.

### National Preferences and WTO Rules

Another cluster of dispute cases arises from disagreements about how WTO rules should be reconciled with the many non-commercial regulations that nations apply domestically. While these regulations may impinge on external trade and affect the

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<sup>22</sup> For suggested actions, see Sykes (2003, 2004) and for a critique of Sykes’s views, Jones (2004).

<sup>23</sup> For an analysis along these lines, see Bown (2002).

interests of trading partners, they also express social preferences that governments may view as overriding commercial concerns. This was recognized when the GATT was first drawn up in 1947. Members have always understood that they may claim exemption for their GATT/WTO obligations on certain non-commercial grounds – the most relevant in the present context being the protection of public morals, of the environment, and of the life and health of humans, animals, and plants. At the same time, they have been concerned that trading partners should not exploit such exemptions as a means of evading their trade obligations. The DSB has sometimes been called upon to define more precisely where the line lies between national preferences and WTO obligations.

The DSB has insisted that it does not question the right of members to determine their own domestic policies in these matters. However, it has usually maintained that, in application of these policies, members should respect the WTO rules about non-discrimination and national treatment. A recent example is in the case brought against the United States by Antigua and Baruda in regard to gambling and betting services. (DS 258) The complaint arose out of restrictions that the United States had imposed on internet gambling. The DSB found that, while the United States was certainly not barred from implementing measures that were deemed “necessary to protect public morals or to maintain public order,” it was obliged to do so in a way that was consistent with its obligations under the WTO. The DSB noted that the commitments made in regard to these services by the United States under the GATS Agreement provided for full market access. Moreover, the U.S. regulations permitted certain exceptions like interstate bets on horseracing and remote gambling conducted by Native American tribal entities, and these were not consistent with the obligation to apply measures in a non-discriminatory way.

Similar reasoning was applied in a complaint against the United States that its environmental regulations discriminated against imports of gasoline from Brazil and Venezuela. (DS 2,4) Regulations adopted by the United States to implement a 1990 amendment to its Clean Air Act required domestic producers and importers of gasoline to meet certain standards that would reduce vehicle emissions of toxic air pollutants and ozone-forming compounds in the most air-polluted areas of the country. The regulations called for the establishment of certain baselines regarding the quality of the gasoline produced in 1990. The complaint was that the method used to determine baselines had the effect of discriminating against imported supplies. The DSB did not question the right of the United States to take measures to control air pollution. Clean air was an “exhaustible natural resource” whose protection justified an exception from WTO obligations. However, the DSB found that the measure violated WTO obligations because it was applied in a way that resulted in “unjustifiable discrimination” against imports from Brazil and Venezuela. Accordingly, it constituted “a disguised restriction of international trade” (the language in the chapeau to Article XX of GATT on general exceptions).

These cases were relatively straightforward applications of the idea of fairness expressed in non-discrimination and national treatment. In the more famous shrimp/sea turtle case brought by the United States against Thailand, the DSB entered more difficult terrain. (DS 58) The case raised the question whether national regulations could override WTO obligations when the issue at stake was production methods used in foreign countries; this appeared to be unfair since it implied that the national preferences of one country could override those of another country.

The specific issue was a U.S. prohibition of shrimp imports from countries where the method of fishing endangered sea turtles since sea turtles were a protected species in the United States. As a general position, the DSB explicitly accepted that the international trading system should be wholly consistent with sustainable development. In this particular case, the United States could rightly seek an exception from its WTO obligations on the grounds that it was protecting an “exhaustible natural resource” (even though the resource being protected was beyond its territorial waters). However, the DSB questioned the U.S. regulation because it prescribed that domestic and foreign shrimpers had to use a particular production method – nets with a turtle extruder device – as a condition of being certified as suppliers to the U.S. market. This method of implementing the regulation was deemed to be both arbitrary and discriminatory, and was therefore – as in the other environmental cases – in violation of WTO rules.

The DSB, however, went further, addressing the issue of the national preferences of one country overriding those of another. It stated that, as a condition of claiming an exception from WTO obligations, the United States should make good faith efforts to negotiate a bilateral or multilateral environmental agreement (MEA) that would protect sea turtles. In stipulating this condition, the DSB was apparently seeking a justification for encroachment on the sovereignty of the shrimp-exporting members. It found grounds in the text of the Marrakech Decision that established the WTO Committee on Trade and the Environment. The DSB maintained that trade-related measures not based on international consensus were not the “...most appropriate means of enforcing environmental measures” ... and could lead to the “...imposition of unwanted constraints

on the multilateral trading system.”<sup>24</sup> In principle, the expression of national preferences in a multilateral environmental agreement made the decision fair in the sense that all the trading partners had voluntarily consented to the action.

These interpretations of the rules as they relate to environmental measures have been careful to respect the ability of each member country to decide its own standards. However, when disputes have concerned exceptions to WTO obligations on the grounds of protecting human, animal or plant life and health, the same has not been so. In these disputes, the DSB has been guided by a distinctly more stringent set of rules. Before national regulations for the protection of human, animal or plant life and health may qualify as a legitimate exception to WTO obligations, they must clear the hurdle set in the Sanitary and Phytosanitary Agreement (SPS). It specifies that the need for regulation has to be justified by the scientific evidence, including an adequate assessment of risk. Members are expected to assess risk on the basis of the scientific evidence – as well as of other factors – while determining for themselves the level of risk that is acceptable. The Agreement, however, urges members to make use, so far as possible, of common international standards.<sup>25</sup>

A complaint brought by the United States against Japan illustrates the application of the main terms of the SPS Agreement. (DS 245) The complaint concerned the quarantine restrictions that Japan imposed on imported apples to protect against the introduction of a disease known as fire blight. The DSB found that the restrictions were

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<sup>24</sup> The DSB later found the United States to be in compliance after it had taken several steps. Besides providing technical assistance to foreign shrimpers, the United States modified its regulations to remove reference to a specific production method and to make its certification process non-discriminatory; and it initiated good faith efforts to negotiate bilateral or multilateral environmental agreements to protect sea turtles.

<sup>25</sup> Defining such standards is the work of the international Codex Alimentarius Commission, a scientific committee of FAO/WHO that assists it.

maintained in the absence of sufficient scientific evidence of their need. In addition, the DSB held that Japan had not undertaken an adequate risk assessment. Further, Japan could not defend the restrictions on the grounds that they were provisionally necessary because the scientific evidence presently available was insufficient. (Japan complied with the ruling by introducing less rigorous standards.)

The complaint by Canada about Australia's prohibition of certain salmon imports was similar in key respects. (DS18) The DSB again found that the scientific evidence in support of the need for restrictions was insufficient and that an appropriate risk assessment had not been made. Further, it found that arbitrary and unjustifiable distinctions were made in different salmon products to which the restrictions applied. Australia stated that it would comply with the rulings. However, though the case was first adjudicated in 1998, there has as yet been no satisfactory resolution. Australia has made successive adjustments to its regulations, but these have not been deemed sufficient by Canada or the DSB. There apparently remain differences of views between the Canadian and Australian authorities on a valid interpretation of the scientific evidence.

In both the Japanese and Australian cases, the application of the rules by the DSB appeared straightforward. It judged the scientific evidence insufficient and the assessment of risk inadequate. In the well-known hormone-fed beef case, however, the uncertainties surrounding scientific evidence came very much to the fore. The complaint brought by the United States and Canada was that the EC imposed a ban on imports of hormone-fed beef. (DS 26, 48) The import prohibition was an extension of an internal ban that the EC had introduced in 1989 on the use of growth-promoting hormones in fattening cattle. If the DSB had taken the same approach as in the environmental cases, this fact would have

been highly relevant since the key question would have been whether the regulations discriminated between domestic and imported products. However, the rules relevant to this case were those embodied in the SPS Agreement. While the Agreement stated that a higher standard than the international standard was permissible, there had to be some scientific evidence to justify it. In the event, the DSB focused on whether the assessment of the health risk associated with the use of the hormones was adequate; and it judged that this was not so. Therefore, the EC import prohibition was in violation of its WTO obligations. (We return to the subsequent history of this case in the section on compliance.)

At the heart of this dispute have been the different views on the assessment of risk that the complainants and respondent held (and still hold). The United States has taken the position that hormone-fed beef, which had been on the North American market for a number of years, should be deemed to be virtually risk free so long as there was no evidence to the contrary. The EC has taken the more cautious view that a new product should be assumed to be unsafe until all reasonable concerns about its safety had been proven false. Known as the precautionary principle, this latter view has wide application in the EC.<sup>26</sup> One possible contributory explanation for this divergence in risk assessment derives from the difference in political structures of the EC and the United States. The

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<sup>26</sup> In defining the precautionary principle, the EC has stated that the introduction of new products or processes is subject to review in “cases where scientific evidence is insufficient, inconclusive, or uncertain and preliminary scientific evaluation indicates that there are reasonable grounds for concern that the potential dangerous effects on the environment, human, animal or plant life, may be inconsistent with the high level of protection chosen by the EU.” (Quoted in Rifkin, 2004, p. 327)

EC allows lobbies representing consumer safety and environmental interests greater political influence while producers' lobbies hold greater sway in the United States.<sup>27</sup>

The same clash over risk assessment arose in the dispute over bio-technical products. The complaint (DS 291, 292, 293) made by the United States and others was that the EC was unreasonably delaying the importation of genetically modified (GM) products and had, in effect, imposed a moratorium on them. Public concern in EC countries about the possible environmental impact of introducing genetically modified organisms (GMOs) as well as of the possible harmful effects of GM foods on human health, had led the European Council in 1990 to introduce a complicated approval process before any GM crop or GM food could be sold on the market. In 1997, the regulations were further tightened, provoking the complaint. The DSB found that the de facto moratorium was in violation of the SPS Agreement; it was unreasonably delaying approvals. Interestingly enough, the DSB did not pass judgment on "whether biotech products in general are safe or not," instead stating only that the EC was engaging in procedural delay. (The EC stated that it would comply with the findings of the DSB and was given until November 2007 to do so.)

In both the beef hormone and GM organisms cases, the DSB has evidently been reluctant to pass any judgment itself on the scientific evaluations. The SPS Agreement, however, sought to reduce the abuse of health and safety regulations as a protectionist device by invoking scientific evidence as a more objective criterion for their justification. The problem is that risk assessment is an important element in the scientific evidence and

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<sup>27</sup> The clash in viewpoint about the assessment of risk has surfaced in other international bodies. The Codex Alimentarius Commission adopted the U.S. approach. On the other hand, the UN Protocol on Bio-Safety (the Cartagena Protocol) recognized the precautionary principle: a "lack of scientific certainty" could justify a refusal to allow the importation of genetically modified organisms. (Article 10)

that necessarily contains a subjective component. In a world where technological innovations are many and rapid, where there are consequences for human life, and the ecology and the larger natural environment are not readily foreseen, different degrees of risk assessment may be equally rational. From the viewpoint of fairness, it is difficult to say whether the rulings of the DSB were fair. On the SPS Agreement itself, it can be argued that, if its intent was to prevent protectionist abuse of health regulations while respecting national preferences, the rulings appear unfair. Accepting a more literal interpretation of the Agreement, however, the panels and the Appellate Body stayed within its terms and, in that sense, acted fairly. However, the crux of the matter in both cases was the assessment of the scientific evidence and the associated risk, and on these scores, there was room for differences in assessments that could all be defended as reasonable. It is not possible to express a consensus view of what is fair.

#### **IV. Compliance with DSB Rulings and Recommendations**

In assessing the fairness of the dispute settlement process, we also have to consider the record of members in complying with the rulings of the DSB. If we believe that the DSB has ruled fairly in most disputes and if members have complied with the rulings in a timely way, then the dispute settlement process as a whole has been operating fairly. In fact, the record of compliance has so far been good. Between 1995 and March 2007, the DSB ruled on 109 dispute cases, and it found violations of WTO rules in nearly 90 per cent of these cases. (Wilson, 2007). Almost all members declared their intention to comply with the rulings, and most did so within a reasonable time. In a number of cases, however, the complainant challenged the corrective action taken by the violating member as insufficient, and this set off a further lengthy round of adjudication. (Such delay could

cause considerable financial loss to the complainant and be a source of unfairness). When the violating members have sooner or later brought their laws and regulations into conformity with the DSB findings, the disputes have been settled.

Not all disputes that have come before the panels or the Appellate Body of the DSB have been successfully resolved by their rulings. In a few cases, the parties to the dispute have finally taken the matter out of the WTO process and resolved it through bilateral negotiation. In others, the complainant has felt compelled to resort to counter measures in order to induce compliance. Up to March 2007, the DSB has authorized the complainants in some eight cases to take counter measures in the form of withdrawal of concessions; and in five of these cases, the countermeasures were implemented. While, as discussed in the next section, the countermeasures can be seen as a deterrent to “cheating”, the need to resort to these measures may also be symptomatic of an honest reluctance on the part of the violator to comply. This would suggest that some disputes might not be expeditiously or fairly resolved within the rigid legalistic framework established by the Dispute Settlement Understanding. Compliance with the terms of the DSB rulings, however fair they appear to be within the restricted remit of the DSB, may not always seem fair when seen in a broader context.

One dispute that the DSB was not able to resolve through conclusive rulings and that was eventually settled through bilateral negotiation, was that between Canada and the United States on softwood lumber. (DS 257, 277) The background to the case was that the effects of Canadian imports on the U.S. lumber industry had long been a source of political concern in the United States, and various measures had been taken over the years to restrict competition. After the WTO rules had come into force, the U.S. imposed

countervailing duties (and later, anti-dumping duties). At the core of the U.S. case was the stumpage fees paid by Canadian sawmills for lumber. Since the timberland was mostly publicly owned, the fees were paid to the government, and, it was argued, since these were below market rates, they constituted a subsidy. Canada challenged the U.S. action both in the WTO and in NAFTA. In the WTO, Canada brought two main cases against the United States. One contested the U.S. claim that Canadian lumber exports were subsidized and caused injury to the U.S. industry (thereby qualifying as an actionable subsidy.) The other challenged the methodological and factual grounds that the United States used in assessing the duties. While the DSB accepted the U.S. arguments that production was subsidized, it failed to determine whether there was also injury to the U.S. industry. It also found merit in the Canadian criticisms of U.S. methodology but, after the United States had modified its approach, ruled that on this score the United States was in compliance with WTO requirements. Over the four years of the formal dispute, however, the verbal exchanges between Canada and the U.S. had become increasingly acrimonious and were souring broader political and economic relations. After it had become a source of political embarrassment to both governments, the dispute was finally settled through bilateral negotiations. Under the Softwood Lumber Agreement, Canada undertook to impose an export tax, optionally combined with export quotas, in the event that prices fell below a specified level, and the United States agreed to revoke the existing countervailing and anti-dumping duty orders and to refund duty deposits held by the U.S. customs authorities. Though the agreed solution was not necessarily consistent with WTO rules, it was at least regarded as sufficiently fair to restore good relations between the trading partners.

Resolution of the banana dispute between the EC and the United States was similar. (DS 27) It will be recalled that, as discussed earlier, the DSB had been insistent on as close adherence as possible to non-discrimination in the preferential access that the EC accorded the banana producers of the ACP countries. The EC, however, faced substantial difficulties in devising a revised regime that was acceptable to all its member governments, to the EC banana distributors, and to the ACP banana producing countries, while also meeting the conditions laid down by the DSB. On the other side, the EC's long delay in moving toward compliance provoked the United States into seeking approval for, and introducing, counter measures.

In the end, the dispute was settled in 2001 – at least for the time being – through bilateral negotiations. The violator and the complainant bargained with each other to arrive at a distribution of benefits from the revised regime that both found politically acceptable. The EC undertook to introduce a tariff-quota regime for non-ACP suppliers under which licenses would be granted according to historical shares in the EC market – and this favored the traditional U.S. multinational distributor. At the same time, the United States agreed that the EC could set aside a proportion of licenses for “newcomers” – and these included non-traditional EC distributors. Though the outcome in the banana dispute was consistent with DSB rulings, it could not have been determined by the DSB. What triggered the negotiated settlement was the mounting fear of an appreciable worsening in trade relations between the two major traders. The U.S. Congress was threatening to call upon the U.S. administration to rotate the products subject to retaliation on a six-monthly basis.<sup>28</sup> Such action might have provoked the EC to put into

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<sup>28</sup> In 2000, the U.S. Congress passed a trade bill that included the so-called carousel provision.

effect the counter measures it had been authorized to apply in the FSC case but had so far refrained from acting upon.<sup>29</sup>

The continuing nature of some disputes – usually rooted in a lasting political need to defend highly valued constituent interests – suggests that they may not always lend them to resolution through the formal, semi-legal process of the Dispute Settlement Understanding. When one or both parties are reluctant to abandon practices that may violate the rules, they may resort to the dispute settlement process, less to seek a resolution, than to defend their competing positions. The cases brought by Canada and Brazil against each other with regard to the export subsidization of regional aircraft took on some of this coloration. (DS 46, 70, 71, 222) The DSB found that both provided prohibited export subsidies to their manufacturers. Both modified their regulations and financial practices, and both thereafter challenged whether the other was yet complying with the WTO rules. At one stage, both governments were authorized to use counter measures against the other.

The history of these cases is one in which the DSB has been called upon to make repeated judgments about whether the successive arrangements for financing exports constituted prohibited subsidies. Both parties have seen the actions of the other as commercially unfair. The legalistic interplay, however, has not appeared to resolve the dispute; it has been no substitute for a more pragmatic understanding between the two governments on what constitutes mutually acceptable financial relations that each government may have with its producers. A similar pattern of behavior could appear in

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<sup>29</sup>We should note that the dispute was revived in 2005 when the EC proposed to introduce new MFN tariffs and new quotas for ACP countries. In 2007, in response to requests from Ecuador and the United States, the DSB agreed to consider again whether the new EC regime was in conformity with its rulings.

the recently initiated Boeing-Airbus cases brought by the EC and the United States against each other on the same issue of subsidies to a key export industry. (DS 316, 317)

A more intractable reason for the failure of the dispute settlement process to resolve a dispute is when both parties apply quite different conceptions of fairness to the case. That is, the ruling of the DSB may conflict with strongly held social preferences on the part of the violator. This has been at work in the hormone-fed beef case (DS 26, 48). As discussed earlier, the DSB found in favor of the United States and Canada and against the EC in its banning of the importation of hormone-fed beef. Following the failure of the EC to comply, the United States and Canada in 1999 put into effect duly authorized counter measures. In 2003, the EC returned to the DSB arguing that these measures should be lifted as it was now in compliance with the DSB rulings (DS 320, 321) It claimed that the ban on five of the six hormones used in fattening cattle was “provisional” pending further scientific research, a designation that was consistent with the SPS Agreement; and it stated that its ban on the sixth hormone – oestradiol 17 beta – had been made permanent, since a group of scientists had concluded that the hormone was potentially a carcinogen.<sup>30</sup> At the time of writing, the case is still under adjudication. At the root of the EC position is a conception of fairness holding that every person should be free to act provided the action does not harm anyone else. The conception applied by Canada and the U.S. is that everyone is bound by the “rules of the game” as embodied in the negotiated agreements of the GATT/ WTO.

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<sup>30</sup> The EC argued that one reason why the DSB had found it to be non-compliant was that it had failed to carry out a risk assessment within the meaning of Articles 5.1 and 5.2 of the SPS Agreement. It stated that an assessment had now been done by an independent scientific committee whose findings indicated that hormones posed a risk to consumers.

What do we infer from the several cases that we have just reviewed? Not all disputes can be resolved within the rather rigid, semi-legalistic framework of the DSU. In some, a more fruitful path is bilateral negotiations because these are not confined to the question of conformity with specific rules but can encompass broader concerns; and the resolution of the dispute may consequently be fairer. In others, disagreement about interpretation of the rules may be so profound that no resolution is possible, and the complainant is left with the only recourse of imposing counter measures.

## **V. The Use of Counter Measures**

In most cases, as we have already noted, countries have complied in a timely way with the rulings of the DSB. In our view, they have generally done so in order to preserve their reputation as reliable trading partners. As with participants in national markets, they recognize the value for long-lasting commercial relations of mutual trust exercised within a framework of common rules of conduct. Of course, there are always the possible participants who seek to advance their interest at the expense of others by disobeying the rules, and so countries have invariably wanted to threaten retaliatory measures in order to deter such transgressors. Under the GATT regime, retaliatory measures could nominally be authorized but, as the alleged violator of a rule could veto their use, they were never actually employed. Despite this fact, according to Hudec (2002), the record of compliance during the GATT years from 1947 to 1994 was rather good. In the Dispute Settlement Understanding (DSU) of the WTO, the scope for use of counter measures was nevertheless strengthened. Violators could no longer block the authorization of counter measures. Since 1994, as just noted, the DSB has authorized the use of such measures in

several cases. It is an open question whether the greater use of such measures has enhanced the fairness of the dispute settlement process.

Under the terms of the DSU, authorized counter measures may take the form of the withdrawal of concessions unless the complainant has agreed to accept compensation. Almost all complainants have opted for the withdrawal of concessions. On the face of it, these should work in favor of inducing compliance, at least so long as the complainant is not a small country and the violator is a large country. Provided the products affected are chosen with care so that the incidence of the measure falls heavily on politically articulate producers or consumers in the violating country, internal pressure may be brought on its government to comply. At least in the hormone-fed beef case, however, the counter measures have evidently failed to weaken the reluctance of the violator to comply with the DSB ruling. In other cases that we have reviewed where the withdrawal of concessions has been authorized, it is difficult to say how influential the threat of withdrawal or actual withdrawal has been in advancing compliance. In the banana and FSC disputes, the actual or threatened withdrawal may well have reinforced more general concerns about national reputation in abiding by the WTO agreements. However, as noted earlier, the fear of both the EC and the United States that the use of counter measures was deteriorating into a tit-for-tat game of retaliation and counter retaliation may have been more influential than the counter measures themselves in bringing about compliance.

In one respect, a larger role for counter measures to induce compliance with the rules clearly makes for greater unfairness in the dispute settlement process. Developing countries have long pointed out that when the complainant is a small country and the

violator is large, familiar counter measures like raising tariffs on imports from the violating country may have little or no effect on the latter's behavior. Again, there is a bias in the process that works against small countries. This said, however, we should note that, in some circumstances, it may be possible for a small country to punch above its weight. In its case against the United States on on-line gambling, Antigua and Baruda proposed to rescind their commitments under the TRIPS Agreement to recognize U.S. trademarks and copyrights; and this could make Antigua and Baruda a safe haven for copiers of motion pictures and software.<sup>31</sup> The United States has objected to this proposed measure and the issue is, at the time of writing, in the hands of an arbitrator.

It is unfortunate that counter measures are so often cast in the role of a punishment intended to deter non-compliance. The Dispute Settlement Understanding is itself not explicit about the purpose of these measures; it only describes them as temporary measures applied in the expectation of full compliance. However, the DSB has been more forthcoming. In one case, it noted that "there is nothing (in the relevant provisions of the DSU) that could be read as justification for counter measures of a punitive nature." (DS 27) Fairness would probably be better served if countermeasures were seen in a different light.

Some scholars have argued that the set of WTO agreements can appropriately be seen as a contract among members in which each accepts a balance of rights and obligations.<sup>32</sup> Like most contracts, however, it is incomplete in the sense that there are many uncertainties about future circumstances that cannot be spelled out at the time when

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<sup>31</sup> The EC and Japan joined Antigua and Baruda in pressing the case against the United States, but they later withdrew their support after the United States offered them concessions in other service sectors. (*Financial Times*, December 18, 2007)

<sup>32</sup> For a full exposition of this approach, see Schwartz and Sykes (2002).

the contract is drawn up. In the theory of contracts, if one party to a contract comes to find a particular obligation too onerous and if the cost of compliance is greater than the benefit to the other party, it may propose an efficient breach of contract, offering full compensation for the lost benefit. In the WTO, such compensation – whether in the form of a financial payment or a revision of concessions – can be seen as restoring the balance between rights and obligations that members negotiated in the first place. This view of counter measures introduces some flexibility into the obligation of compliance; these measures can be seen as compensation for efficient breaches of contract and as a deterrent only to inefficient breaches.

## **VI. Conclusions**

We have asked whether the dispute settlement process in the WTO has so far operated fairly. In so doing, we have – for the most part – not taken up the issue of whether the GATT/WTO rules applied in the dispute settlement process are themselves fair, though views on the rules must necessarily affect assessments of the outcomes from WTO dispute settlement.

Since there are no objective criteria for assessing fairness, there is no unequivocal answer to our question. However, there are some widely accepted principles applied in international trade relations that express ideas of fairness, and these have enabled us at least to make some partial assessments.

We have noted that two questions can be asked. One is whether the procedures followed throughout the settlement of a dispute assure equal treatment to all parties, both powerful and weak. In some important respects, the procedures do meet this condition; for instance, no doubt has been raised about the impartiality of the persons appointed to

adjudicate in dispute settlement cases. There are, however, two major weaknesses. First, effective participation of countries in the dispute settlement process demands a body of legal, diplomatic and economic expertise in trade law that only large countries with long traditions in commercial law are well endowed with; and they are better able to press complaints or to defend themselves against alleged violations. Second, the use of countermeasures to induce compliance with WTO rules may be ineffective when employed by small and poor countries against their much larger trading partners.

The second question, to which we have devoted most of our attention, is whether the panels and Appellate Body of the DSB have been able to interpret and apply the rules in ways that are widely regarded as fair. As just stated, we can give no conclusive answer. In some cases, the conformity of the rulings with widely accepted principles of fairness that are applied in international trade has been obvious. In many cases, however, while some ideas of fairness (and perhaps conflicting ideas like equality of opportunity and equitable distribution of the benefits) may have lain behind the judicial reasoning, it is far from clear how any assessment could be made that might claim some objectivity. However, our review of individual cases suggests some observations that appear relevant to any assessment of fairness in the dispute settlement process. We list the most salient points below.

The panels and Appellate Body of the DSB have done much to define and clarify what constitutes fair competition, especially with regard to subsidies. In their rulings on a number of cases, they have identified the kinds of governmental measures that give rise to subsidies and that may generate unfair competition. The more difficult task, however, has often been, not the identification of a subsidy, but the analysis of the evidence to

establish the presence of a causal link between the subsidy and, say, export performance or injury caused to another member's industry through the depression of world prices. The rigor of the analysis, the assumptions, the methodology, and the normative and causal beliefs of the adjudicators may all be open to challenge and raise questions about the fairness of the ruling.

As noted, the DSB cannot compensate for any unfairness inherent in the GATT/WTO rules themselves. In dealing with anti-dumping cases, the panels and Appellate Body have been successful in eliminating some of the more egregious national laws or practices that have appeared inconsistent with the WTO Agreement on anti-dumping measures. However, they have necessarily accepted the restrictions imposed by the Agreement on their capacity to assess the underlying rationale of anti-dumping measures or their consistency with the spirit of other GATT/WTO agreements.

As others have observed, it is a weakness of the WTO dispute settlement process that there is no effective legislative mechanism through which agreements can be modified in the light of accumulating juridical experience with individual cases. Since the DSB is enjoined not to add to, or subtract from, these agreements, its panels and Appellate Body are faced with a predicament when textual ambiguities need to be clarified, especially when these hide what many members may regard as policy issues. The analysis of Sykes ( 2003 ) in regard to the Agreement on Safeguards Measures illustrates just such a situation. One consequence is that the effectiveness of the Agreement is emasculated.

Experience with the dispute settlement process since 1995 has shown that, while the DSB has successfully brought most disputes to an end through the compliance of

parties to the GATT/WTO rules, this has not always been so. In a few cases, a settlement regarded as fair by both parties has been beyond the ability of the DSB to achieve through its rulings and recommendations; its realization has required negotiations between the parties on a fair distribution of the benefits. Further, in one or two cases where national preferences have conflicted with the rules, members have chosen to accept the imposition of countermeasures rather than to comply. It would be reasonable to view the countermeasures, not as a penalty intended to induce compliance, but as compensation for a breach of contract.

The borderline between member's obligations under the GATT/WTO Agreements and their own national preferences is an uncertain one. In principle, members recognize the rights of individual countries to override their obligations in certain areas such as public morals or health. However, if the assertion of national preferences is not to be exploited for protectionist purposes, a borderline has to be clearly demarcated. Particularly in view of rising global concerns about the environment, this may well become an increasingly sensitive issue. In this regard, the DSB was pointing in the right direction when it opined that the precondition for action by any one country that adversely affected the trade of others, should be the existence of a multilateral or bilateral environmental agreement.

It is beyond the scope of our present effort to suggest or devise changes in the dispute settlement process that would deal with the various strains noted. So, we leave the unresolved issues to be addressed for a future occasion and for other specialists to consider.

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