UNICE

THE VOICE OF BUSINESS IN EUROPE

31 May 2001

UPDATE OF UNICE DISCUSSION PAPER

ON WTO DISPUTE SETTLEMENT SYSTEM

EXECUTIVE SUMMARY

On the whole, the European business community considers the WTO Dispute Settlement System ("DSU") a success. The DSU provides security and predictability to the multilateral system and is key to preserving the rights and obligations of WTO members.

Effective compliance with the WTO Agreements is essential to reap the benefits of trade liberalisation. This UNICE Discussion Paper considers the challenge of how to deal effectively with non-compliance. It discusses how retaliation aggravates trade tensions. It supports the European Union's action against the US Carousel Legislation in the WTO. As it is business which in practice pays the price in cases of retaliation, the paper also considers how to transfer the financial burden of retaliation away from business.

Where disputes arise, prompt settlement is essential. Compliance is the only option to provide an adequate remedy for the breach of WTO obligations. In cases where implementation is not possible, WTO members should look for alternatives which open borders instead of closing them. Compensation is only a second-best alternative since it involves measures in areas unrelated to the subject of the dispute. Recent high profile cases have demonstrated that retaliation (the suspension of concessions) is not an effective solution. European business therefore favours greater emphasis on compliance with WTO obligations, bilateral consultations and prompt implementation of DSU panel rulings.

Further improvements to the DSU are proposed in Part Two of the paper. The issues of avoiding disputes, sequencing, transparency and a standing panel body to hear disputes are considered.

UNICE would like to pursue this discussion with all interested parties on this important issue for business. The views expressed in this discussion paper might be complemented and updated as the debate develops.

Union of Industrial and Employers' Confederations of Europe – Union des Confédérations de l'Industrie et des Employeurs d'Europe
Rue Joseph II 40/Bte 4 - B-1000 Brussels - VAT BE 536.059.612 - Tel. +32(0)2 237.65.11 - Fax +32(0)2 231.14.45 - E-mail: main@unice.be - Website: //www.unice.org

UNICE

THE VOICE OF BUSINESS IN EUROPE

31 May 2001

UNICE DISCUSSION PAPER

ON WTO DISPUTE SETTLEMENT SYSTEM[1]

INTRODUCTION

Effective compliance with the obligations embodied in the WTO Agreements is essential to increasing the overall gains from reciprocal trade liberalisation. Where disputes arise concerning these obligations, European business believes that prompt settlement of these situations is essential, following the principles laid down in article 3 of the Dispute Settlement Understanding ("DSU"). **Compliance is the only option to provide an adequate remedy** for the breach of WTO obligations, since it involves measures relating directly to the subject matter of the dispute. Compensation, in the form of additional tariff reductions may result in more open trade but remains only a second-best alternative since it involves measures in areas which are unrelated to the subject of the dispute. Recent high profile cases have demonstrated that retaliation, namely the suspension of concessions, is not an effective solution, because it results in less open trade and is contrary to the basic principles of trade liberalisation. European business favours a hierarchical approach which places greater emphasis on compliance with WTO obligations, bilateral consultations and prompt implementation of DSU panel rulings rather than retaliation, which is the worst alternative as it injures business and has proved ineffective in compelling compliance. This hierarchy is addressed in Part One of this paper.

The DSU is the central element in providing security and predictability to the multilateral system and is key to preserving the rights and obligations of the WTO members under the covered agreements. On the whole, the European business community considers the WTO dispute settlement system a success and notes that, by enforcing rules and commitments, it has ensured real market-opening. Between January 1995 and July 1999, 214 cases were initiated. The WTO has been able to handle the increasing number of cases with overall satisfactory results. The Appellate Body of the WTO has a double task of settling disputes promptly and interpreting WTO law. With its well-reasoned decisions the Appellate Body has succeeded in striking the delicate balance between this double task and the sovereign power of the WTO members to make WTO law.

The European business community welcomes the continuing transition from a power-oriented system towards a true rules-based system and views the DSU as an essential element of this transition. It is in the interests of all WTO members to eliminate from dispute

(1) This paper builds on the Preliminary UNICE Position of 1 October 1999

settlement all remaining aspects of the old power-oriented system. Further improvements to the DSU are proposed in Part Two of this paper.

PART ONE

1. Faithful Implementation

Under the GATT there were several instances where dispute settlement became blocked in politically sensitive cases. This occurred through the blocking of the adoption of panel reports. The WTO has solved this particular problem with the creation of a binding dispute settlement system. However, practical experience with WTO Dispute Settlement shows that blockages for political reasons still exist. Out of societal concerns, a certain number of WTO members may find themselves compelled not to apply WTO rules. These same members may even be prepared to pay the price of non-compliance whatever the measures which might eventually be adopted. Today WTO members can no longer block the adoption of the panel report but they can block implementation. Consequently, blockages can now occur at a later stage than they did previously under the GATT.

The challenge of how to deal effectively with non-compliance therefore remains. The DSU in theory gives WTO members a choice between implementing the panel ruling, agreeing compensation or facing WTO-legal retaliatory action in the form of a suspension of concessions as provided in DSU Article 22(1). However, these alternatives to implementation are no substitute for compliance with the WTO obligations on which the DSU has adjudicated. Indeed, in the case of a resort to suspension of concessions, practical experience shows that this does not necessarily compel implementation. On the contrary, governments may consider the issue is solved since the price of non-compliance is paid by business.

The potential alternatives to implementation were elaborated in order to compel reluctant WTO members to implement DSU rulings faithfully. In reality, however, these choices undermine the basic concept of equal treatment for WTO members. The WTO dispute settlement system should protect weak and strong members alike. Given this choice, strong and rich countries are able to refuse to implement WTO-rulings and absorb the consequent cost, whilst poor and weak countries have no alternative but to implement, since they are less able to afford compensation or withstand retaliatory action. For reasons of equity, therefore, the system must be devised so as to bring all WTO members into compliance with their international obligations.

2. Retaliation is mercantilistic, injures the innocent and aggravates trade tensions

Nullification and impairment of WTO concessions results in reduced market access opportunities than originally envisaged. In case of non-implementation of a dispute settlement ruling the WTO system allows for suspension of concessions by the injured WTO member. The overall outcome of this development consists in a higher level of protection because one wrong (violation of WTO obligations) is cured with another wrong (suspension of concession). Such mercantilist remedy is contrary to the basic idea of the WTO, namely to liberalise trade, and to provide transparent and predictable conditions for business.

Retaliation inevitably injures innocent third parties, however tightly it may be confined to the same sector pursuant to DSU article 22(3)(a). European businesses are currently paying the price for the European Union's unwillingness or inability to bring its Banana Regulation or its ban on hormone-treated beef into compliance with its WTO obligations. These innocent third parties do not have the power to force their governments into compliance: experience shows that once a scapegoat has been found, no political expediency is felt to change the non-compliant provisions. At least two European companies have complained against the Council of the European Union in the European Court of Justice for damages resulting from retaliatory actions taken by the United States against the European Union because of its non-compliance with WTO obligations. European business supports these complaints and hopes that the European Court of Justice will recognise that the European Union should not inflict damage on its corporate citizens by not complying with its international obligations.

Resort to retaliation also has dangerous side effects as can be witnessed with the flawed concept of rotation of sanctions commonly called carouselling. The US legislation on carouselling was generated out of a frustration at the failure of retaliation to force compliance. Its biggest fault from a legal perspective is that it would result in an additional financial impact beyond that which is authorised by the WTO. This would constitute an element of penalty which is foreign to the WTO dispute settlement system; retaliation was agreed only as a mechanism to rebalance concessions but not as punishment. The concept of carouselling is also flawed because it is increasingly difficult in a globalised and interdependent market to select targets for retaliation which do not result in injury to the businesses located in the state selecting the targets. This phenomenon will only increase in the future as the process of global market integration proceeds. The theory behind retaliation is predicated on the expectation that retaliation will bring pressure to bear on governments to implement, and that part of that pressure will come from business which is injured by the retaliation. Practical experience shows that this expectation is not fulfilled. Indeed it risks undermining the support of the business community for the DSU. Moreover, retaliation has a further negative effect of aggravating the political climate and adding to trade tensions without improving the chances of settlement. As European Business believes the US carousel legislation to be incompatible with the WTO rules, it supports the European Union's action against it in the WTO.

Retaliation can also have a chilling effect on the negotiation of compensation. So far the WTO members involved in dispute settlement have moved too quickly to retaliation and spent insufficient time trying to negotiate compensation. Some WTO members appear to see suspension of concessions as easier to obtain than a compensation agreement with the non-compliant country.

3. A Hierarchy favouring Implementation

Given the deficiencies of giving preference to retaliation as a means of ensuring compliance, European business suggests that WTO members follow a hierarchy of measures which places greater emphasis on compliance with WTO obligations, on bilateral consultations and prompt implementation of DSU panel rulings rather than retaliation.

A clearer focus on implementation will not only reinforce existing rights and obligations but will enhance the willingness of parties to enter into new commitments because it provides better assurances that contracting parties will receive what they bargain for. The need for better assurances is of particular interest to developing countries at this time; one reason for their hesitation to embrace a new round of multilateral negotiations is their concern that obligations assumed by developed countries in areas of special export interest for them, will not be respected. European business shares these concerns and believes that a better focus on implementation can best be achieved through a hierarchy of measures. In this way the rules-based system of the WTO works to eliminate and not to perpetuate inequalities when it comes to compliance with the law.

With the objective of providing better assurances regarding implementation, the following hierarchy of measures could be envisaged

3.1. *Full Use of the Settlement Possibilities Provided in the DSU*

Industry is fully aware of the challenges raised by difficult cases and the need to come to bilateral settlements or other alternatives. The parties to disputes often do not use all the possibilities provided for by the DSU to come to mutually acceptable solutions. Despite the affirmation in DSU article 4, WTO members regrettably appear reluctant to favour bilateral settlements. European business recommends that WTO members place more emphasis on using all the possibilities of the DSU to settle disputes bilaterally including good offices, conciliation and mediation pursuant to DSU article 5.

European business considers that an unduly legalistic approach tends to overlook the fact that the central aim of the DSU is the search for compromise and the re-establishment of the balance of concessions, before the legal procedures take effect. All WTO members should therefore take full advantage of these possibilities and not view them as merely an intermediate step in a total dispute settlement process. Parties to disputes too often shun using the WTO Director General in an *ex officio* capacity to provide good offices, conciliation or mediation pursuant to DSU Article 5.6.

3.2. *Open Borders, Do Not Close Them*

Dispute settlement cases which have resulted in retaliatory action in the form of a suspension of concessions undermine the fundamental objective of trade liberalisation because they result in less open trade. In cases where implementation is not possible, WTO members should look for alternatives which open borders instead of closing them.

One alternative would be concessions by the non-compliant country chosen by the injured country. To be most effective whilst maintaining their multilateral character, the concessions chosen should be highly focussed.

In this case the injured member country would choose the sectors in which the non-compliant country should make concessions up to the amount of the nullification and impairment, and would try to obtain agreement from the non-compliant country. The agreement reached would be applied on a provisional basis until the non-compliant country had implemented the WTO-ruling. This measure is already possible, yet WTO members do not use it, because they fear that they will not achieve agreement and because retaliatory measures are easier to obtain. As it would result in provisional market openings it is preferable to retaliation which simply reduces market access.

3.3. *Retaliatory Measures Should be the last resort*

European Business reminds governments of the obligation in article 3.7 of the DSU that the last resort is the suspension of concessions on a discriminatory basis. This remedy should in future be used only if none of the above-mentioned measures works to assure compliance or a new balance of concessions.

3.4. *Transferring the financial impact*

In practice, it is business which currently pays the price for a WTO member's unwillingness or inability to bring its legislation into compliance with its WTO obligations. In such situations there should be a mechanism for transferring the whole (or the major part) of the financial burden of retaliation for non-compliance away from business and onto the WTO Members. Consequently, in cases where the member is unable, for whatever reason, to bring its law into compliance, the nation as a whole should pay the price and not only a few innocent parties. This would have the equitable effect of distributing the cost of non-compliance across society at large thus avoiding the iniquitous targeting of innocent parties.

Transferring the financial impact could be achieved through a range of measures. One possibility would be that national law establishes a right to compensation from the state in cases where there is a loss suffered due to non-compliance by that state with its WTO obligations. In these situations, the state (or its agencies (ECAs)) should be held liable for losses due to non-compliance.

A further alternative which could be envisioned would be a payment of compensation to the injured WTO member in the amount of the nullification or impairment suffered by that member. A national parliament might accept this liability and allocate a budget line to make a financial contribution to the injured country for so long as the nullification or impairment continues. A yearly budget line covering WTO nullification and impairment-payments might also become an incentive for the national Parliament to bring its law into compliance.

PART TWO: Further improvements to the DSU

4. Dispute Prevention.

All WTO Members should ensure that their laws and regulations are compatible with their obligations under the WTO agreements. To help avoid disputes from arising, and to provide an early warning of potential issues, governments should systematically assess draft legislation to check whether it might have the effect of breaching WTO obligations, in which case the draft should be adapted to remove the WTO inconsistency. This system would fit in with current efforts to provide an early warning of potential disputes before they become damaging. A trade policy assessment would allow for open and informed debate. European business therefore encourages a process by which it is ensured that national legislation is assessed and specifically analysed with respect to its WTO compatibility.

5. Sequencing

Legal uncertainty has arisen in relation to the correct sequence of steps to be taken in the case where a member disagrees that another member's remedial actions are adequate to achieve compliance with WTO rules. There have been a number of creative interpretations in particular DSU cases, and an attempt has been made to cover the issue by the proposal tabled during the Third WTO Ministerial Meeting, which would introduce an article 21 *bis*, to the DSU to deal specifically with Determination of Compliance. European business would welcome the introduction of legal certainty to this important area of procedure and supports a solution which clearly designates a competent panel to rule expeditiously on compliance, followed by arbitration on the amount due.

6. Transparency

Transparency should be improved throughout the dispute settlement process. Efforts to make the dispute settlement more transparent and to allow interested parties further and more efficient access to the available information on the dispute in question are to be welcomed not least because the more legalistic the process becomes the more transparent it has to be. This includes publishing the findings of the panel expeditiously and making the appellate stage proceedings public. In the case of bilateral settlement of disputes the terms of such agreements should be notified to all WTO members. Greater public insight and awareness of the issues surrounding particular dispute settlement cases might also generate additional incentives to governments to accelerate moves to bring about compliance.

7. Standing Panel Body

European business supports the idea of establishing a standing panel body of independent experts knowledgeable in WTO matters to decide WTO cases at first instance. Members of this body should be experts from government or other interested parties, such as business, who are knowledgeable in WTO related issues. A standing panel body of some 20-30 people would provide continuity and should rule on questions of interpretation in order to promote consistency of legal reasoning and continuity, thus alleviating the task of the Appellate Body to some extent. It would have all the functions of the present panels and in

particular decide on the timeframe relating to implementation, rule on control of correct implementation and take decisions on the amount of compensation due.

A standing panel body should be able to decide all WTO panel cases and would soon develop sufficient authority so that the tendency to appeal many cases could potentially be reduced, thus helping to reduce the heavy workload of the appellate body.

Conclusion

UNICE would like to pursue this discussion with all interested parties on this important issue for business. The views expressed in this discussion paper might be complemented and updated as the debate develops.

_____