

## Transatlantic Trade Conflicts and GATT/WTO Dispute Settlement

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## 1. Introduction

The story of dispute settlement at the World Trade Organization (WTO) is, in large part, the story of the transatlantic relationship between the United States (US) and European Community (EC).<sup>1</sup> *Primus inter pares* at the WTO, the US and EC together accounted for fully 38 percent of global merchandise trade in 2000, more than the ten next largest trading economies combined (WTO 2001, 22).<sup>2</sup> Not surprisingly, US-EC disputes set the tone in the global economy more generally, notably on the eve of the Doha round. Focusing on this salient dyad, observers on both sides of the Atlantic place a good deal of faith in the dispute settlement reforms ushered in by the Uruguay Round and embodied in the WTO's Dispute Settlement Understanding (DSU). Indeed, it is widely argued that these reforms have dramatically increased the WTO's capacity to resolve disputes, compared to the practices under the General Agreement on Tariffs and Trade (GATT). Have the reforms of the DSU, in fact, improved the outcomes of US-EC disputes?

With a WTO dispute settlement record of seven plus years now available, we find that the data so far belie the conventional wisdom. At first blush, US-EC disputes appear to have ended with the defendant making the desired policy changes more frequently under the WTO than under GATT, although it is important to note that both systems have been highly efficacious overall, notwithstanding the limitations of international adjudication (Helfer and Slaughter 1997). On closer inspection, however, the WTO's superior track record is not attributable to dispute settlement reforms *per se*. Rather, we find that the apparent success in resolving US-EC disputes since 1995 is due largely to the expansion of the WTO's scope in new areas, notably intellectual property (IP) and traded services. In fact, the new dispute settlement system has struggled to induce the defendant in US-EC disputes to liberalize where it counts most: namely,

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<sup>1</sup> The fifteen members of the European Union (EU) identify their collective organization as the European Community (or Communities, to be precise) at the WTO.

in the “highest-stakes” cases. Likewise, when GATT-era cases pitting the US and EC against each other have recurred under the WTO, the institution, despite its greater clarity of law, has fared little better than its predecessor in resolving transatlantic disputes.

More interesting still, the pattern of transatlantic dispute outcomes across stages of escalation remains much the same as it did under GATT. That is, *early settlement* continues to be a pillar of the system, even though compliance with rulings is no more frequent. We thus argue that, in light of the track record to date, procedural legal reforms *per se* have not improved the outcomes of US-EC disputes. If, as we speculate below, the more legalistic WTO process may actually hinder pre-ruling bargaining, then the efficacy of US-EC dispute settlement may be at greater risk now than in the GATT era, since the institution appears to depend even more on early settlement for the vast majority of its successful outcomes.

The paper is in five sections. Section 1 surveys key dispute settlement reforms ushered in by the WTO, and elaborates how these likely influence US-EC disputes. Section 2 reports new data on all US-EC disputes at the WTO thus far, and offers a simple contrast with comparable GATT disputes. Section 3 empirically tests our argument that the WTO’s (nominally) better record in resolving US-EC disputes owes to factors other than the legal reforms embodied in the DSU *per se*. Section 4 interprets these results and discusses their implications.

## **1. The WTO Dispute Settlement Mechanism**

Observers have long marveled that GATT dispute settlement worked at all, never mind that it worked quite well (Hudec 1993). First codified in a small annex to the 1979 Understanding on Dispute Settlement on customary practices, and played out by different rules across the different covered agreements (notably the Tokyo Round codes), GATT dispute settlement lacked not only

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<sup>2</sup> And this figure excludes intra-EC trade.

“teeth,” but a consistent set of rules more generally. Against this backdrop, the DSU has been heralded as a significant step forward in institutional design (see Petersmann 1997; Steger and Hainsworth 1998; Horn and Mavroidis 2001), complementing the WTO’s greater clarity of law. Indeed, Palmeter (2000, 468) describes the DSU as “perhaps the most significant achievement of the Uruguay Round negotiations, establishing what may be the most developed dispute settlement system in any existing treaty regime.” By almost any metric, it would be difficult to argue otherwise: stricter timelines, the right to a panel (carried over from the 1989 Dispute Settlement Procedures Improvements), automatic adoption of reports (except by “negative consensus”), and review by a permanently-constituted Appellate Body (AB) are among the most salient provisions of the integrated DSU which appear to fill in where GATT had seemed to fall so terribly short. The question, though, is how these reforms influence the litigation of disputes, particularly those involving the US and EC.

First, speedier procedures with stricter time limits are thought to boost confidence in the DSU by delivering “justice” more promptly, and by beating various unilateral measures to the punch, notably US Section 301, which worked on a notoriously faster clock than did GATT. Second, the right to a panel removes the possibility that a defendant can block or considerably delay a case from being heard, a tactic that was widely viewed as the *sine qua non* of GATT power politics. Third, standard terms of reference, and the automatic adoption of reports, lend greater legal coherence to the system as a whole, and obviate the threat of a unilateral “veto” by a recalcitrant defendant (Palmeter and Mavroidis 1998). Fourth, the potential for review by the AB promises more consistency across rulings and a better-informed body of case law with which to reason through the merits of a dispute *ex ante* (Howse 2000). Taken together, these reforms are expected to promote more liberalization by errant defendants in a timely manner, thereby

restraining US resort to extra-legal enforcement through “aggressive unilateralism” (Busch 2000a; Reinhardt 2001).

The conventional wisdom is probably right about the benefits of many of the most salient of these reforms, including negative consensus and the formation of the standing AB. However, a more balanced assessment is necessary. To that end, we note that the legal reforms of the DSU may actually *raise* the transaction costs inherent in settling disputes by affording opportunities for longer delays, increasing incentives for foot-dragging in litigation, and motivating defendants to delay concessions (Shoyer 1998; Reinhardt 2002). Granted, each separate stage of the process now operates according to a tighter timeline, but this fact is overwhelmed by the new possibility—indeed, the inevitability<sup>3</sup>—of successive rounds of litigation in the same dispute, culminating in up to 15 months’ grace period for implementation,<sup>4</sup> the possibility of an Article 21.5 panel review (and possibly appeal), additional litigation or negotiations over “sequencing” with respect to Article 22, and ultimately arbitration over the amount and form of retaliation. Put simply, a determined defendant can wring at least three years of delays from the system before facing definitive legal condemnation, enough time for “temporary” measures—such as the March 2002 US steel safeguards—to wreak sustained havoc without possibility for retroactive compensation (Mavroidis 2000; Pauwelyn 2000). Further, the added stages of litigation, tight enforcement of terms of reference, the legal disincentives for disclosure, and the rules on standing, all serve to put the onus on disputants and third parties to legally mobilize as soon as possible in order to avoid losses on technicalities (i.e., having the panel or AB deem a certain argument outside its terms of reference) later on.

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<sup>3</sup> Of the eleven initial panel reports in the dataset of completed US-EC WTO cases below, only *Section 301* and *US Copyright Act* were not appealed. And in the latter case, no fewer than three separate arbitrations were invoked, under Articles 23.1(c), 25, and 22.6, governing the “reasonable period of time” for implementation, the level of nullification or impairment, and the level of retaliation.

From the outset of a dispute, concern for post-ruling delays, in particular, has the effect of undermining early settlement (e.g., Stewart and Burr 1998, 514). This is especially true if the rush to litigation draws in third parties or additional disputants, whose involvement has been shown to reduce the prospects for concessions by a defendant (Busch 2000b; see also below). At the conclusion of a dispute, the DSU's superior enforcement power is also vastly overstated in relation to GATT; the hurdle in this regard has never been obtaining legal authorization *per se* (Hudec 1999, 9-10; Mavroidis 2000; Valles and McGivern 2000; Reinhardt 2001), but rather mustering the market power and political will to retaliate. In this sense, as Pauwelyn (2000, 338) astutely observes, "[t]he 'legalization' of disputes under the WTO stops, in effect, roughly where noncompliance starts." Taken together, these factors lead us to expect that transatlantic disputes under the WTO are *no more or less likely* to end with concessions (i.e., policies aimed at market-liberalization on the part of the defendant) than those brought under GATT. The one exception should be areas where explicit obligations did not previously exist—i.e., IP and traded services—where we can expect WTO disputes to fare better than their counterparts under GATT, simply because of clearer disciplines.<sup>5</sup>

## **2. A First Cut at the US-EC WTO Dispute Record**

To empirically assess the DSU's track record, we assemble a dataset of 85 concluded transatlantic<sup>6</sup> trade disputes filed under GATT/WTO procedures from 1960 through 2001. Of

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<sup>4</sup> The grace period in *Australia—Salmon* was eight months, but generally it has been much longer.

<sup>5</sup> Though less frequent, GATT disputes over IP or traded services did occur, resulting uniformly in negligible change from the status quo ante, e.g., in the US-initiated 1989-1993 *Transfrontier Television* consultations and in the EC's 1987 *Aramid Fibres* complaint.

<sup>6</sup> "Transatlantic" for these purposes denotes cases in which the disputants included the US, on one side, and the EC or an EC member state, on the other side.

these, 53 were brought under GATT, 32 under the WTO.<sup>7</sup> The first and most obvious question is simply, “What is a dispute?” Like Hudec (1993), we only count complaints in which formal GATT/WTO proceedings were explicitly invoked, i.e., naming defendants and alleging the infringement of specific legal rights, most often in the form of an initial “request for consultations.” We eliminate redundancy in the list of cases to avoid double-counting, following the approach of Horn, Nordström, and Mavroidis (1999). Specifically, in some cases, the US has filed on essentially identical issues several times against one or more EC members, plus the EC itself (e.g., GATT’s *Transfrontier Television* and *Income Tax Practices* cases; and, under the WTO, *Customs Classification*, DS62, 67, and 68; *Certain Income Tax Measures*, DS127-131; and *Flight Management Systems*, DS172, 173). We count each of these as just one dispute. Similarly, we drop *Bananas III* (DS16, late September 1995) because it was reworked and re-filed as *Bananas IV* (DS27, early February 1996) before any action could be taken.

In order to compare the efficacy of GATT and the WTO in inducing concessions by defendants, we need to control for the differing legal dispositions of each case. Hence we identify the stage reached and the direction of rulings for all disputes. Of the 85 US-EC disputes in our dataset, a panel was established in 43 cases (29 of 53 GATT complaints and 14 of 32 WTO complaints). Of those 43 panels, 36 issued substantive reports, which were appealed in 9 of the 11 WTO cases. Thus a large majority—58 percent—of US-EC disputes have been resolved or dropped in consultations, or during panel deliberations. This percentage speaks to the importance of early settlement under the WTO, and is entirely in keeping with figures drawn from empirical work looking at all GATT-era disputes (Busch and Reinhardt 2000, 2002).

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<sup>7</sup> Our dataset does not include another eleven GATT disputes with missing outcome information as well as eight WTO disputes still underway. However, it *does* include tentative codings for four WTO disputes with manifest but still potentially reversible outcomes: *Foreign Sales Corporations* (DS108), *Anti-Dumping Act of 1916* (DS136), *US Copyright Act* (DS160), and *Section 211* (DS176).

In terms of the direction of any decisions rendered, we code the initial panel report, or the AB report, if appealed, according to whether it substantially favored the complainant, was mixed, or favored the defendant. Of the 36 rulings, 22 favored the complainant, 7 were mixed, and 7 found for the defendant. This “pro-plaintiff bias” also accords with previous studies of the GATT years for all disputants, not just the US and EC (Reinhardt 2001).

Finally, we follow Hudec (1993) in defining outcomes as the policy result of a dispute, rather than the nature of a ruling *per se* (see Busch and Reinhardt 2002, 470). In other words, the main question is whether the defendant liberalized the disputed trade policy practice(s), conceding to some or all of the complainant’s demands, and not simply whether a ruling (if there was one) favored one side or the other. Using a measure that has meaning at each stage of dispute settlement, from consultations to an AB verdict, we code outcomes according to whether substantial, partial, or no concessions were made with regard to the contested trade measure(s). While such an approach has been used to study GATT disputes (Hudec 1993; Busch 2000b; Reinhardt 2001), this paper is the first to systematically characterize WTO outcomes in the same way. By way of illustration, *Hormones* (DS26) scores as “no concessions,” and *Duties on Imports of Grains* (DS13) ended with “full concessions.” *Bananas* (DS27) is perhaps the most difficult case to score; we give it a “partial concessions” outcome due to the long delay before settlement, the multi-year time frame allowed for implementation afterwards, and the incomplete relaxation of the discriminatory barriers in any case. Of the 85 US-EC GATT/WTO disputes, 49% ended with substantial concessions, 20% ended with partial concessions, and 31% with no concessions.

With these data in hand, we can now contrast GATT and WTO dispute outcomes. As a first cut, consider Table 1, which provides a simple tabulation of the level of concessions achieved in



US-EC disputes under the two regimes. Just 21 of 53 GATT-era conflicts (40%) ended with substantial liberalization by the defendant, while fully 21 of 32 WTO cases (66%) ended that way. This difference is statistically significant. Undeniably, the US and EC appear to have made more concessions to each other in disputes under the WTO than they did under GATT. But is this improvement in transatlantic trade tensions attributable to dispute settlement reform *per se*, or to something else?

[insert Table 1 about here]

### **3. A Second Cut at the US-EC WTO Dispute Record**

The better WTO dispute settlement record is even more impressive when we consider two differences in the kinds of cases filed under this institution, and its predecessor. As noted above, defendants are least likely to concede in multilateral disputes, perhaps because they have more trade at stake, or because coordination of deals is necessarily more complex. Interestingly, far more US-EC conflicts under the WTO have involved multiple parties (66%) than under GATT (43%). In addition, while the attachment of a “non-violation nullification or impairment” claim at the end of a long list of violation arguments has often been the mark of either poor legal merits or poor strategy (the “kitchen sink” approach),<sup>8</sup> it is more common in US-EC conflicts under the WTO (in 44 percent of the complaints) than under GATT (30 percent). For these reasons, we would expect WTO disputes to end with fewer, not more, concessions, and yet the opposite is true.

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<sup>8</sup> In the absence of a violation finding, a successful nonviolation claim requires very strong and detailed evidence, which complainants are often unable to provide.

Nonetheless, we conjecture that the marked WTO improvement cannot be attributed to the increased legalism of the system *per se*. Most obviously, the WTO's expanded scope has made disputes successful where they were not before, especially in IP and traded services (Hoekman and Kostecki 2001, 79). Better outcomes in these areas would be expected even in the total absence of dispute settlement reforms. Rigorous statistical analysis bears out this contention. Furthermore, if the reforms have worked, they should yield successful outcomes even in the highest-stakes disputes. They have not. A related test of the efficacy of reform concerns GATT disputes that have recurred under the WTO. Looking case by case, we find that, on the whole, such disputes have fared no better than they did under GATT. Finally, if these dispute settlement reforms have accomplished anything, they should have improved the level of compliance with rulings. The data suggest otherwise. Accordingly, we submit that the frequency of early settlement in WTO disputes is probably driven not by any improved threat of enforcement *per se*, but by diplomacy and, perhaps, the normative weight of the institution, as it arguably was under GATT (Hudec 1987; Reinhardt 2001; Busch and Reinhardt 2002).

### *3.1 Controlling for Scope Expansion*

The WTO extended its reach into intellectual property and services trade through the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) and the General Agreement on Trade in Services (GATS), respectively. As a result, the WTO has rendered more disputes “actionable” under the single integrated DSU. This is not to say that disputes in IP and traded services eluded GATT, for in fact GATT handled a small but highly contentious set of

cases touching on these areas, with little effect on the status quo.<sup>9</sup> For its part, the WTO has adjudicated nine US-EC disputes in IP and traded services, as listed in Table 2.

[insert Table 2 about here]

A close look at these IP and traded services disputes is revealing. In particular, five of these nine cases are US complaints designed to speed up domestic legislation implementing TRIPs by individual EC member states (Portugal, Denmark, Sweden, Ireland, and Greece). It can be argued that these cases were far less acrimonious than most, because the TRIPs commitment was of recent vintage and the desire to comply was already manifest through proposed domestic legislation. Indeed, panel establishment and litigation never occurred in these five disputes. Not surprisingly, as Table 2 indicates, all five of these US-EC disputes ended with full concessions. The defendant fully, or at least partially, conceded in the other four IP and traded services disputes under the WTO as well, mostly prior to a panel ruling. This is not to suggest that IP and traded services disputes *per se* are easy to resolve. On the contrary, IP cases, in particular, are widely viewed as being among the most technical, and difficult, requiring a considerable outlay of resources on the part of the disputants and the WTO. Further, we are not arguing that the weaknesses on IP associated with US intransigence in the GATT-era *Aramid Fibres* and *Spring Assemblies* disputes (see notes 5 and 9) were fully corrected by TRIPs; the still-unfinished EC WTO complaint on the same US statute (*Section 337*, DS186) disconfirms this notion. Rather, the point is that TRIPs and GATS have induced, probably on a one-time basis, a special set of disputes distinguished by their direct relationship to these recent commitments, and are thus

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<sup>9</sup> E.g., see note 4. Neither did the US or EC budge as defendants in IP/services complaints brought by third parties under GATT, e.g., *Austria v. Germany Truck Traffic Restrictions* (1990) and *Canada v. US Spring Assemblies*

ready-made for full concessions. Put more simply, better dispute settlement procedures *per se* did not force the defendant's hand in these cases.

After controlling for the improved dispute outcomes achieved through this expansion of scope, does the more legalistic WTO dispute system still perform better than GATT? To find out, we use the technique of multivariate regression to model the probability that the defendant makes concessions in these US-EC disputes (see Table 3). This time-honored method allows us to quantify the independent impact of one variable (the DSU reforms) while controlling for the effect of other variables (e.g., scope expansion). The dependent, or outcome, variable is the level of concessions the defendant makes in each of the 85 cases: none, partial, or full concessions.<sup>10</sup> To explain the level of concessions, we include a dummy variable reflecting whether the case was brought under GATT versus WTO procedures (the shaded row in Table 3). A separate dummy variable identifies just those WTO-era cases on IP or traded services issues (i.e., coded one for the 9 cases in Table 2, and 0 otherwise). If our explanation is right, the WTO variable should not be significantly different from zero (showing no difference between GATT and WTO overall), while the dummy for WTO-era IP or traded services disputes should be significant and positive. To make sure our estimates for these two variables are not driven by other important features of each dispute, the model also controls for whether a panel was established, the direction of a subsequent panel or AB report (if any), whether the US was the complainant, whether the dispute concerned an agricultural product, whether it was "multilateral" (i.e., with several disputants or third parties), and whether it centered on strictly discriminatory measures or covered "sensitive" issues like health and safety (SPS) or cultural matters. The results in Table 3

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(1981).

<sup>10</sup> Hence we use a particular form of multivariate regression known as *ordered probit*.

indicate that the model fits the data adequately, correctly predicting about two-thirds of these dispute outcomes.

[insert Table 3 about here]

The main point to flag in Table 3 is that our hypotheses appear correct. Namely, while the variable for WTO disputes involving IP and traded services is positively signed and statistically significant, the WTO variable itself (shaded) is not significantly different from zero. The model indicates that, holding all other variables at their sample means, a dispute over IP or traded services is 43 percent more likely to end with full concessions by the defendant under the WTO than it was under GATT. Yet the probability of concessions by defendants is *no more likely* now than under GATT, when one considers areas outside of IP and services trade.<sup>11</sup> Keep in mind that this result accounts for the differing legal dispositions of each case.

The regression provides a number of other interesting quantitative findings. Specifically, defendants are 22 percent *less* likely to concede in multilateral as opposed to purely bilateral disputes; 43 percent *less* likely to concede in SPS or cultural cases; yet 33 percent *more* likely to concede in cases involving purely discriminatory measures; and 24 percent *more* likely to concede in agricultural cases. Even more important for the argument in section 3.4 below, we find that in these 85 GATT/WTO US-EC cases, the defendant is much more likely to concede in advance of ruling, rather than after, regardless of the ruling's direction. In particular, a ruling for the defendant reduces the probability of full concessions by about 63 percent; a mixed ruling by 43 percent; and even a ruling for the *complainant* cuts the chances of concessions by roughly 25

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<sup>11</sup> The coefficient of *WTO Case* in Table 3 is positive but hardly larger than its standard error, so we cannot with statistical confidence reject the very likely possibility the WTO has had no effect whatsoever.

percent. Clearly, where the US and EC litigate to a verdict, concessions in transatlantic disputes are *less* likely.

### 3.2 The WTO's Poor Record in High Stakes Disputes

For many observers, the true measure of the success of a dispute settlement mechanism is how it handles the “toughest” cases. Hence we categorize the WTO-era transatlantic disputes according to their approximate monetary and political stakes, either low/medium or high. A “low” or “medium” score applies when a dispute affects less than \$50 million (or \$150 million, respectively) of annual trade (e.g., *Poultry Products*, DS100), or if the broader potential ramifications of the disputed policy are not in practice realized by virtue of the defendant’s restraint from the start (e.g., *Cuban Liberty and Solidarity Act*, DS38). Fully 25 of the 32 WTO-era US-EC conflicts fall into these two categories. A “high” score indicates annual affected trade levels or authorized retaliation levels above \$150 million and/or intense perceived significance for the future of WTO dispute settlement or the US-EC trading relationship. Table 4 lists these 7 cases.

[insert Table 4 about here]

If the DSU reforms have improved US-EC dispute outcomes, then we ought to find that the defendant has made substantial concessions in at least a few of these highest-stakes cases. After all, these cases matter most for the WTO dispute settlement regime by definition. The record in Table 4 is, however, rather poor, albeit somewhat tentative. The defendant fully conceded to the complainant’s demands in just 2 of the 7 cases so far, with a partial victory in one more. What is

more, these three instances of concessions were largely driven by factors outside the dispute settlement system. For example, in the *Customs Classification* (DS62, 67, 68) case, the EC ultimately eliminated tariffs entirely on local area network (LAN) products, effectively reversing the reclassification which had prompted the US complaint. But this action resulted from the multilateral Information Technology Agreement (and was thereby compensated with additional US concessions), not from the US litigation, which in any case was rejected by the Appellate Body (GAO 2000, 73-74).

The *Bananas* (DS16, 27) settlement, as announced in April 2001, delays true “tariffication” of the quotas for five years and retains significant preferences for the ACP producers, to their great satisfaction.<sup>12</sup> Coming after nearly ten years of deadlock and bankruptcy for a leading US-owned exporting firm (Chiquita), this outcome can only be classified as a partial victory for the US. Insiders also frankly admit that the primary impetus for settlement was the EC’s desire to remove obstacles to the imminent Doha round, not from the WTO legal condemnation.

In the third case, *Import Measures on Certain Products* (DS165), premature US retaliation on the *Bananas* dispute was at issue. Though the preliminary sanctions were judged illegitimate, the AB approved the substitute measures in place by the time of its report. Hence, just as in *Customs Classification* above, the defendant’s concessions once again were not motivated by WTO legal action. The US withdrew the retaliation only because of the nominal settlement by the EC on the *Bananas* case—no more than a technical success, if that, for the WTO.<sup>13</sup> The clear failure on *Hormones* (DS26) and the apparent (but perhaps still reversible) deadlocks on *Foreign*

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<sup>12</sup> E.g., see remarks in *Financial Times* (12 April 2001); *Business and Industry* (13 April 2001).

<sup>13</sup> To be fair, one could use the same reasoning to argue that the lack of US concessions in *Section 301* (DS152) should not count as a failure for the WTO dispute settlement system, since the ruling upheld the legality of the US statute.

*Sales Corporations* (DS108) and *Anti-Dumping Act of 1916* (DS136) testify that defendants still do not concede where it counts most for the regime.

### 3.3 *Déjà Vu All Over Again*

Another benchmark against which the DSU's mettle might be assessed concerns those GATT cases that have recurred under the WTO. If the DSU is truly an improvement over the GATT system, then it should have induced better outcomes in those disputes that repeated across these two regimes, providing for a "second kick at the can." What does the record show?

Consider the 1972-1984 *Domestic International Sales Corporation (DISC)* and the 1997-2002 *Foreign Sales Corporations (FSC)* complaints by the EC against US tax practices that subsidize exports, along with the accompanying counter-complaints by the US against alleged similar EC member state subsidies. The GATT-era *DISC* ruling, which the parties blocked from adoption for many years, is legendary for its "faulty reasoning" (Jackson 1978, 781), and the dozen years before settlement speak poorly for GATT's efficacy as well (Hudec 1993, 59-100). The relative rapidity, legal professionalism, and lack of veto of the WTO rulings on the EC's 1997 successor suit against the 1984 law implementing the *DISC* settlement, *FSC*, make the WTO shine in comparison.

But in other ways the WTO record in *FSC* is no better. WTO legalism has allowed the EC to force the issue, so that it now confronts the necessity to retaliate with a "nuclear weapon"<sup>14</sup> (from 1 to 4 billion dollars of sanctions per year), a desperately costly proposition for both disputants. The EC's recent appeasing statements contrast sharply with those on lower-stakes cases against the US, indicating a recognition that a settlement, even one that provides just a fiction of

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<sup>14</sup> The term is US Trade Representative Robert Zoellick's (*International Trade Reporter*, 17 May 2001, 778).



compliance, may be preferred.<sup>15</sup> (In this respect the EC faces the same situation as Canada did once retaliation against Brazilian aircraft subsidies was authorized in the *Export Financing Programme* case, DS46.) The WTO panel missed a reasonable opportunity to forge an opening for a compromise, one more acceptable to the US Congress, by treating the case as linked to the earlier *DISC* settlement. The *DISC* settlement may have achieved little, but at least it defused a contentious issue that could have had negative effects for the regime. What counts most, of course, is that the WTO dispute has not induced any more change from the status quo US policy than the GATT complaint did, despite the clearest legal rulings the institution could produce. Thus, here the WTO exhibits little improvement.

*Hormones*, *Harbor Maintenance*, and *Bananas* offer comparable testimony. The EC blocked a US panel request in the 1987 *Animal Hormones Directive* complaint, and in reprisal the US blocked the EC's request for a panel to rule against the subsequent unilateral US retaliation (Hudec 1993, 545, 574-575). Under the WTO procedures, unlike under GATT, the EC has been unable to block definitive legal condemnation of its policy, but the US has once again retaliated and the EC ban remains in place, just as before. Similarly, the EC has twice disputed the US policy of taxing shipping to pay for harbor maintenance (constituting an effective import tax), once in 1992 (*Harbor Maintenance Fees*) and again in 1998 (*Harbor Maintenance Tax*, DS118). Neither case was brought before a panel. While the Clinton administration proposed a change that may have satisfied the EC, the necessary legislation was not passed. The best hope for change in the status quo lies now in US domestic litigation, not in WTO action. Furthermore, in the two GATT complaints against the banana import regimes of the EC and its member states, the EC blocked adoption of not one but two adverse panel reports in 1993 and 1994. The DSB

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<sup>15</sup> For instance, an anonymous European Commission official has suggested that compensation rather than strict compliance might be acceptable in the *FSC* case, saying, "[we want] to avoid this issue becoming a major dispute"

of course succeeded in adopting the WTO *Bananas* reports, but as noted earlier, the ultimate concessions by the EC leave much to be desired in extent and timeliness, and are probably attributable to other factors in any case. Déjà vu, to be sure. Thus it would be hard to argue that the WTO is succeeding where GATT once failed, in these recurrent cases.

### *3.4 The Successes Occur as Early Settlement, not Compliance with Rulings*

One commonly held view in the literature is that the success of early settlement under GATT is increasingly less evident under the WTO, especially in consultations (Wethington 2000, 587). While bargaining “in the shadow of the law” proved efficacious under GATT’s more diplomatic system, the argument is that the DSU’s reforms may have made litigation attractive, motivating complainants to push for a definitive verdict. As evidence, many observers point not only to the caseload at the panel stage, but the frequency of appeals to the AB. We show elsewhere (Busch and Reinhardt 2000) that the proportion of cases “paneled” differs little across the GATT/WTO years, and that the WTO’s greater caseload reflects growth in the institution’s membership and volume of world trade. In terms of the transatlantic relationship in particular, early settlement is perhaps more important than ever, a point quite evident in Figure 1, which graphs the level of concessions achieved in WTO disputes ending at various stages of escalation.

[insert Figure 1 about here]

The first point to make about US-EC disputes is that this dyad has tended to settle early at the GATT/WTO, with the defendant offering concessions in advance of a ruling 58% of the time. In the WTO years, this percentage stands at 66% (21 of 32 disputes). The more telling question, of

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(*Financial Times*, 15 January 2002).

course, is whether early settlement produces positive results. Of this there can be no doubt. The data tell a remarkable story: of the 21 US-EC disputes ending in *full* concessions at the WTO, 16 were resolved in advance of a panel ruling. If we set a lower bar and examine disputes in which *any* concessions were offered, the data favor early settlement by a margin of 17 to 7. In short, it is only a slight exaggeration to suggest that all of the “real action” in US-EC disputes is in early settlement.

The obvious retort to this would be that early settlement is, itself, a reflection of the reforms ushered in by the DSU. In other words, the propensity to settle early simply reflects the logic of bargaining in the shadow of “strong” law, in that defendants plead good cases and complainants withdraw weak ones (Jackson 2000, 179). This would be convincing, were it not for the fact that the data are at odds with this logic. The key to this hypothesis would necessarily be that enforcement of compliance *ex post* is driving early settlement *ex ante*, and yet there is no evidence that compliance is in any way more likely under the WTO than under GATT.

Consider Figure 2, which compares the level of concessions by the defendant in GATT versus the WTO, depending on the direction of the panel (or, if appropriate, AB) ruling. Under GATT, a ruling for the complainant resulted in full concessions 63 percent of the time (10 of 16 cases); under the WTO, facing an adverse ruling, the defendant has fully conceded just 33 percent of the time (2 of 6 disputes).<sup>16</sup> Granted, with only 6 WTO rulings unambiguously against the defendant, we cannot compare the regimes yet with statistical confidence, but so far the WTO is actually inducing *less* compliance with adverse rulings, in US-EC disputes. Hence, because compliance is still as significant a problem (if not more), the WTO’s increased legalism

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<sup>16</sup> *Bananas, Hormones, FSC*, and *Anti-Dumping Act of 1916* are the four WTO cases with no or partial compliance by this reckoning.

is probably not responsible for the regime's continuing dependence on early settlement for most of its *successful* dispute outcomes.

[insert Figure 2 about here]

However, could the WTO's legalism have improved upon GATT at least in the *easier* cases, if not in the most difficult transatlantic conflicts? If so, the infrequency of compliance does not necessarily mean dispute settlement efficacy has not increased, because higher-stakes cases may disproportionately go to panels and beyond. The fact that all 7 of the highest-stakes conflicts in Table 4 witnessed rulings is certainly consistent with this explanation. Nonetheless, we argue this interpretation of the evidence misses the point, for three reasons. First, quite a few WTO disputes have ended with no or limited concessions by the defendant *without* being brought before a panel. For instance, in *Flight Management Systems* (DS172), the US objected to a one-time \$25 million subsidy by France to Sextant Avionique, a supplier of avionics for Airbus, but the dispute died on the table. Just because a dispute involves small stakes, or does not continue through the litigation process, does not mean it will end with concessions by the defendant.

Second, if procedural reforms have induced more early settlement because they darken the "shadow of the law" in anticipation (Jackson 2000, 174), why do complainants sometimes fail to pressure defendants with the threat of a ruling, even in promising cases? The defendant failed to fully concede in *Harbor Maintenance Tax* (DS118) and *Trademarks and Geographical Indications* (DS174), but no panel request was made. Two ongoing disputes (thus not in our dataset) stand out in this regard. Of the 14 concluded US-EC WTO cases that went before a panel, the median delay between the request of consultations and panel establishment was just 5

months. But the EC has not made a panel request in *Section 337* (DS186) and *Section 306* (“Carousel Retaliation”, DS200), even 27 and 22 months, respectively, since the complaints were filed. If improved legalism is indeed responsible for early settlement, the EC seems to have missed a golden opportunity to use the threat of a ruling to leverage concessions from the US.

Third, if the most vaunted procedural reforms — namely, removing the defendant’s veto — have made early settlement more likely (at least in the easier cases), then we would expect much less early settlement under the GATT rules, where defendants could block the adoption of reports and even panel establishment. Yet early settlement was a hallmark of the GATT era (Busch and Reinhardt 2000; Reinhardt 2001). Clearly the normative power of a GATT ruling, regardless of its legal adoption, was most important (Hudec 1999). Successes in the form of early settlement in the WTO era are probably driven by the same dynamic.

#### **4. Implications and Conclusions**

Long admired for its more legalistic design, the WTO’s DSU has been heralded as a big step forward in dispute settlement. Indeed, many observers hold to the view that the DSU may well be the most significant outcome of the Uruguay Round, distinguishing the WTO more generally. We dissent from this view, arguing instead that the diplomacy of GATT is alive, but perhaps not well, at the WTO. Let us be clear on this point: we are encouraged by the pattern of concessions we observe in US-EC disputes, notably with regard to early settlement, but find that the DSU’s reforms *per se* have not helped in this regard, and may ultimately hurt. We see these reforms lending to an overly litigious approach to dispute settlement, depriving the system of its greatest strength for managing transatlantic conflicts: namely, diplomacy. The fault lies not in the WTO

itself, but in the membership's zealous drive to litigate, rather than confront the domestic politics of protectionism.

The empirical tests reported above are not exhaustive, but they are critical. We examined the implications of the DSU's greater scope, the stakes of the US-EC disputes under the WTO, and the institution's handling of cases that repeated from the GATT era. Our results suggest that the main contribution of the DSU is that it has grown to include IP and traded services, but that even here, the data speak more to the kind of disputes arising under TRIPs and GATS than they do to the workings of these agreements *per se*. More to the point, the vast majority of US-EC disputes under TRIPs to date have centered on the phase-in of commitments that were already in progress. Thus, while we concur that the DSU's coverage of IP and traded services is, in fact, a significant improvement, the hardest test cases under TRIPs and GATS are likely still to come.

Our findings suggest, more provocatively, that the WTO has fared little better than GATT in its handling of high-stakes US-EC disputes, or GATT-era cases that have resurfaced since 1995. These strike us as obvious benchmarks against which to assess the workings of the DSU, and yet the data belie conventional wisdom: the DSU boasts a poor track record in resolving high stakes US-EC disputes, and has hardly proved effective when given a second "kick at the can" in those disputes that have repeated from the GATT era.

The issue of early settlement under the WTO is more interesting still. The expectation is that we should see more early settlement under the WTO, since disputants have incentive to plead out a case in the shadow of strong law. If such a pattern was, in fact, evident, we could trace it to the DSU's legal reforms *per se* by looking for greater *ex post* compliance with panel and AB rulings. We find no such evidence. On the one hand, this leads us to marvel that early settlement, while not more evident under the WTO, remains a pillar of the system, much as it was under GATT.

As US Trade Representative Robert Zoellick said in a speech to the European Parliament, “We must be more creative in settling bilateral disputes.... Litigation is not always the solution for solving every problem” (*International Trade Reporter*, 17 May 2001, 778). On the other hand, a statement like Zoellick’s may be easy when one is the legal loser (*FSC* in this case), but restraint is difficult when the opportunity presents itself to begin a successful retaliatory lawsuit. We see reason to fear that early settlement—still the regime’s main avenue for achieving successful dispute resolution—may be jeopardized by the DSU’s enhanced legalism. Mike Moore (2000) is certainly correct in pointing out that “settlement...is the key principle,” without which “it would be virtually impossible to maintain the delicate balance of international rights and obligations.”

Unlike other observers, we do *not* recommend turning back the clock on the WTO in pursuit of more diplomatic times (Barfield 2001). Rather, we propose three ways to enhance the DSU’s efficacy: (1) resist the temptation to increase transparency in the consultation stage; (2) formalize the 21*bis* “solution” to the sequencing problem; and (3) institute retroactive damages. First, calls to make the consultation stage more transparent, by giving the public more access or by bringing the panel into the process (Parlin 2000), are mistaken. Theory makes it clear that disputants will not “deal” if offers made in pre-trial discovery can be introduced as evidence before a judge or a jury (see Daughety and Reinganum 1995). Greater transparency, by raising “audience costs” in negotiations (Fearon 1997), would have this effect. Along these lines, evidence from the GATT years (Busch 2000b) suggests that highly democratic pairs of states are more likely to settle early in consultations, likely because governments enjoy far more latitude in relation to their industrial constituents to strike deals at this stage of dispute settlement. The case studies in this volume are instructive in examining how disputants approach consultations, and why, at times, they seem to be pro forma, whereas at other times, they facilitate concessions in the shadow of the law.

Second, disagreement over the sequencing of Articles 21.5 and 22 in the wake of a ruling has been a source of uncertainty and foot-dragging. And while the disputants in several cases to date have reached informal agreement on sequencing (Valles and McGivern 2000), formalizing this is likely to build confidence in the dispute settlement system. Indeed, a number of countries are of the view that Article 21*bis* (WT/MIN(99)/8; TN/DS/W/1) would streamline litigation in the post-verdict phase of a dispute by requiring a compliance panel in advance of an arbitration panel, for example, and clarifying the appeals process with respect to 21.5 panels, in particular. Several of the case studies in this volume offer a window on how disputants regard the post-verdict phase of dispute settlement, suggesting how this procedural reform might induce more settlement *ex ante*.

Third, it is well known that the DSU is about compliance with obligations, not retaliation, let alone retroactive damages. This means that there is ample room for a defendant to benefit from a protectionist measure for years while a case is heard, without fear that an arbitration panel would hold it accountable for its pre-ruling actions. We concur with a growing number of scholars who favor retroactive damages (Mavroidis 2000; Pauwelyn 2000) as a way to curb the temptation for governments to act on domestic demands for protection, reaping electoral returns while awaiting a negative ruling at the WTO. The case studies in this volume highlight how compensation may influence the calculus of disputants, and by extension how retroactive damages might shape the way cases are litigated, if at all.

This paper offers some new empirical insights into the transatlantic relationship at the WTO, but its greatest service may be in raising questions not only about these bilateral disputes, but the functioning of the dispute settlement system more generally. Several questions stand out. Most obviously, are transatlantic disputes representative? Or is this bilateral relationship *sui generis*? Is the WTO system more effective than GATT in deterring violations from arising? And related



to this, has the increasing legalism in dispute settlement procedures affected states' propensity to file meritorious WTO suits? More generally, how does the existence of other dispute resolution fora, notably under regional trade agreements, influence the efficacy of the WTO system? And how are dispute settlement outcomes related to the broader context of WTO negotiations? These and other questions merit close scrutiny as the WTO turns a reflective eye on the DSU on the eve of the Doha round.

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**Table 1. US-EC Dispute Outcomes under GATT and the WTO**

Period		Level of Concessions			Total
		None	Partial	Full	
Period	GATT (1960-1994)	18	14	21	53
	WTO (1995-)	8	3	21	32
	Total	26	17	42	85

$$\chi^2(2) = 6.15, p = 0.046$$

**Table 2. US-EC IP and Services Disputes under the WTO**

DS	Start	Compl/Def	Title	End	Level of Concessions
37	30-Apr-1996	US/PT	Patent Protection Under the Industrial Property Act	1996	Full
80	2-May-1997	US/BE	Measures Affecting Commercial Telephone Directory Services	1998	Full
83	14-May-1997	US/DK	Measures Affecting the Enforcement of Intellectual Property Rights	2001	Full
86	28-May-1997	US/SE	Measures Affecting the Enforcement of Intellectual Property Rights	1998	Full
82,115	14-May-1997	US/EC,IE	Measures Affecting the Grant of Copyright and of Neighboring Rights	1998	Full
124,125	30-Apr-1998	US/EC,GR	Enforcement of Intellectual Property Rights For Motion Pictures and Television Programs	2001	Full
160	26-Jan-1999	EC/US	Section 110(5) of the US Copyright Act ("Irish Music")	2002*	Partial*
174	1-Jun-1999	US/EC	Protection of Trademarks and Geographical Indications for Agricultural Products	2002*	Partial*
176	8-Jul-1999	EC/US	Section 211 Omnibus Appropriations Act ("Havana Club")	2002*	Full*

\* denotes cases with apparent but still tentative policy outcomes.

**Table 3. Ordered Probit Model of 85 US-EC GATT/WTO Dispute Outcomes, 1960-2001**

Dependent Variable: Level of Concessions	Coefficient	Robust Standard Error
Intercept 1	0.179	0.351
Intercept 2	0.884 <sup>**</sup>	0.351
Panel Established	2.048 <sup>**</sup>	0.799
Ruling for Complainant	-1.306 <sup>*</sup>	0.790
Mixed ruling	-1.719 <sup>*</sup>	0.881
Ruling for Defendant	-2.351 <sup>**</sup>	0.952
Complainant is US	-0.018	0.339
WTO Case	0.472	0.394
IP or Services WTO Case	1.419 <sup>**</sup>	0.599
Agriculture	0.620 <sup>*</sup>	0.332
Multilateral Case	-0.563 <sup>*</sup>	0.296
Discriminatory Measure	0.873 <sup>**</sup>	0.340
SPS or Cultural Case	-1.681 <sup>*</sup>	0.848
Number of Observations	85 (53 GATT, 32 WTO)	
Model $\chi^2$	32.34 <sup>**</sup> , 11 d.o.f.	
Pseudo- $R^2$	0.195	
Percent Correctly Predicted	64.7	

<sup>\*</sup> denotes one-tailed  $p < 0.05$ ; <sup>\*\*</sup>,  $p < 0.01$ .

**Table 4. High Stakes US-EC WTO Disputes**

DS	Start	Compl/Def	Title	End	Level of Concessions
26	25-Apr-1996	US/EC	Measures Affecting Meat and Meat Products ("Hormones")	1999	None
27 (16)	5-Feb-1996	US/EC	Import Regime for Bananas	2001	Partial
62,67,68	8-Nov-1996	US/EC,UK,IE	Customs Classification of Certain Computer Equipment	1998	Full
108	18-Nov-1997	EC/US	Tax Treatment For Foreign Sales Corporations	2002*	None*
136	9-Jun-1998	EC/US	Anti-Dumping Act of 1916	2002*	None*
152	25-Nov-1998	EC/US	Sections 301-310 of the Trade Act of 1974 ("Section 301")	2000	None
165	4-Mar-1999	EC/US	Import Measures on Certain Products from the European Communities	2001	Full

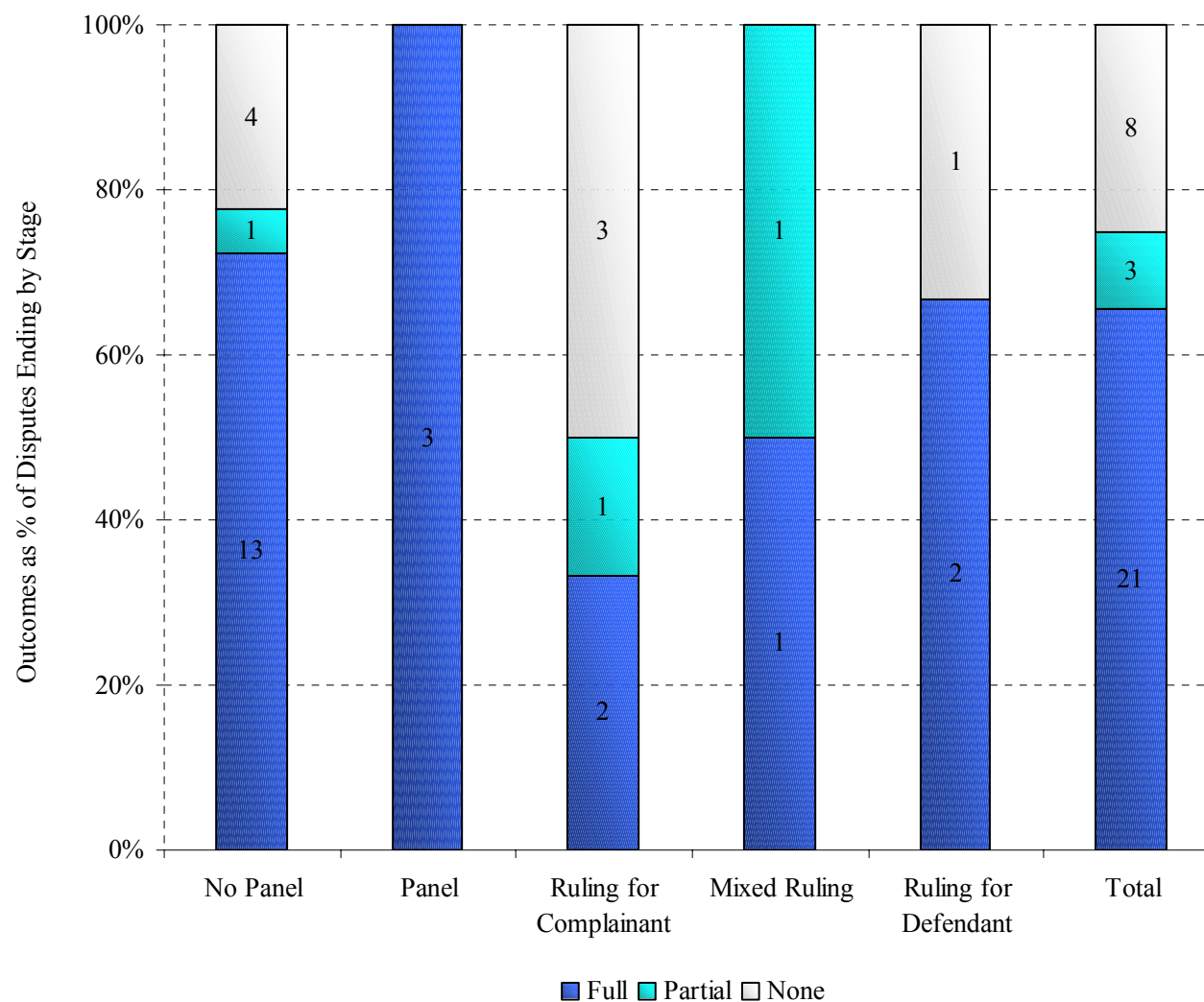
\* denotes cases with apparent but still tentative policy outcomes.

**Table 5. US-EC WTO Dispute Outcomes by Stakes**

		Level of Concessions			Total
		None	Partial	Full	
Stakes	Low/Medium	4	2	19	25
	High	4	1	2	7
	Total	8	3	21	32

Note: Fisher's exact test yields  $p = 0.037$ .

**Figure 1. Early Settlement: The Level of Concessions in US-EC WTO Disputes Ending at Different Stages of Escalation**



NOTE: Darker blue area represents percent of cases ending at the given stage (e.g., prior to panel establishment) in which defendant fully concedes. Numbers in bars denote the actual number of cases in each subcategory; the total is 32. The listed ruling direction is that of the Appellate Body, not the panel, in appealed cases.

**Figure 2. Compliance: Level of Concessions by Ruling Direction under GATT and WTO, for US-EC Disputes**

