THE POLITICAL ECONOMY
OF
LITIGATION AND SETTLEMENT AT THE WTO

Andrew T. Guzman*
Boalt Hall School of Law
University of California at Berkeley
guzman@law.berkeley.edu

8/1/2003

* Assistant Professor of Law, Boalt Hall School of Law, University of California at Berkeley. I owe thanks to Jeff Atik, Chris Busch, Stephen Choi, Bob Cooter, Bill Dodge, Aaron Edlin, Jesse Fried, Larry Karp, Christopher Kutz, Mitch Polinsky, Kal Raustiala, Beth Simmons, Paul Stephan, Alan Sykes, Joel Trachtman, John Yoo, and participants at the Bay Area Group of Law and Economics Meeting, May 2002 for helpful comments. Special thanks to Jeannie Sears and Nicholas James. Ranah Esmaili, Jennie Wang and Ryan Waterman provided outstanding research assistance.
Abstract

In 1995, following the Uruguay Round of trade talks, the World Trade Organization (WTO) came into being. Included in the infrastructure of the WTO was a mandatory dispute resolution system known as the Dispute Settlement Understanding (DSU). From its inception in 1995 through June 2003, the DSU handled 323 cases and affected the content of international trade obligations.

Despite its central role in the trading system, however, we are only just beginning to understand how the DSU affects state behavior and litigation patterns. Of particular note, we do not have a coherent model of litigation and settlement at the WTO that can explain why some cases settle while others do not. This paper provides such a model.

In the domestic context, models of litigation and settlement turn on informational asymmetries. At the WTO, however, the informational assumptions required to explain the observed pattern of settlement are unrealistic, so an alternative approach must be explored. The relevant costs and benefits for a state involved in WTO litigation are political in nature. As such, benefits enjoyed by one party are unlikely to equal the costs borne by the other. This is true of both the impact of a panel ruling, and the impact of the delay that is built into the WTO system. Both of these factors affect the payoffs received by a state's political leaders. This paper shows how these asymmetric political payoffs affect the pool of cases that proceeds to a panel. Of the 108 cases that have generated a panel ruling, 93% have resulted in a complainant win. Combining this remarkably high win rate with the theory developed in this article allows us to draw inferences about the political costs and benefits facing states as they decide whether to settle or proceed to a panel.
THE POLITICAL ECONOMY OF LITIGATION AND SETTLEMENT AT THE WTO

I. Introduction....................................................................................................................1
II. Asymmetric Information............................................................................................. 3
   A. The Asymmetric Information Model ..................................................................... 3
   B. Why Asymmetric Information fails at the WTO .................................................... 5
III. Asymmetric Payoffs..................................................................................................... 7
   A. The Theory of Asymmetric Payoffs ..................................................................... 7
   B. The Model............................................................................................................. 10
IV. The Political Economy of WTO Litigation .............................................................. 12
   A. Drawing Inferences from the Evidence ................................................................. 12
   B. Payoffs and Delay at the WTO: Lessons Learned................................................ 13
      1. Political Costs and Benefits of Settlement ......................................................... 14
      2. The Impact of Delay .......................................................................................... 16
   C. Political and Reputational Costs of Filing a Case ................................................ 19
V. Conclusion ................................................................................................................... 19
I. INTRODUCTION

No aspect of the World Trade Organization (WTO) system has received more attention than its dispute resolution provisions. When the organization was established, it was hoped that these new provisions would increase compliance with WTO obligations and improve the functioning of the international trading system. Among other changes to the pre-WTO regime, the architects of the Dispute Settlement Understanding (DSU) created a mandatory system of dispute resolution with fewer opportunities for delay than had existed under the General Agreement on Tariffs and Trade (GATT). They also eliminated the ability of the losing party to veto the adoption of panel reports. These new rules have been celebrated for bringing more law and less politics into international trade.

Because the DSU’s procedures are unique, and because they are so young, our understanding of how the DSU impacts state behavior remains incomplete. The good news is that the WTO maintains and provides easy access to data on all WTO cases. For those interested in considering the pre-WTO GATT system, published data collected by scholars – most notably Robert Hudec – are available on that period as well.

Several scholars have taken advantage of the available data to conduct empirical inquiries into the GATT, the WTO, and the dispute resolution process, including the question of why and when cases settle rather than proceed to a panel. These studies

---

1 The procedures governing dispute settlement are contained in the Dispute Settlement Understanding (“DSU”). See, e.g., Monika Butler & Heinz Hauser, The WTO Dispute Settlement System: A First Assessment from an Economic Perspective, 16 J. L. Econ. & Org. 503, 504 (2000) (“During its first five years a large number of cases made [the DSU] by far the most active part of the new international trade organization.”).


3 These data are available at the WTO website, www.wto.org. More precisely, they can be found at http://www.wto.org/english/tratop_e/dispu_e/dispu_e.htm.


contribute a great deal to our understanding of litigation at the WTO, but we still do not have a satisfactory theoretical apparatus with which to study the subject. This paper provides such an apparatus.

Though there exists a large and sophisticated literature on the litigation and settlement of domestic legal disputes, the institutional features of the WTO do not line up well with the assumptions of that literature. This article advances an alternative and more suitable model of litigation and settlement. Among the features of WTO litigation that make it distinct from most domestic litigation is the fact that the litigants are states, not private parties. As a result, the payoffs that concern them are not simply monetary transfers, but rather a more complex set of political payoffs. A good deal of what drives litigation and settlement turns on the fact that these payoffs are asymmetric.

The paper demonstrates that asymmetric payoffs can generate a selection effect in which pro-defendant and pro-complainant cases settle at different rates. Because the payoffs in question are political and because they do not take the form of damage payments or any other sort of transfer, they are likely to be asymmetric. We cannot, however, as a matter of theory, identify the relative magnitudes of the political payoffs received by each of the parties to a dispute, so we cannot predict which cases will settle and which will go to a panel.

Once the theory of asymmetric payoffs is established, however, the empirical evidence on litigation and settlement clarifies the relative magnitudes of the payoffs received. Specifically, the theory predicts that pro-complainant cases will fail to settle if the political payoffs from litigation (as opposed to settlement) received by complainants are systematically larger than those received by the defendant. If the payoffs to defendants are larger than those to complainants, pro-complainant cases settle more easily than pro-defendant cases.

The data on litigation and settlement show that, from the entry into force of the WTO and the DSU until June 2003, a total of 108 panel rulings have been issued. All data used in this paper have been taken from information on the WTO website, http://www.wto.org and http://www.worldtradelaw.net.
these, 100 or 93%, have represented a victory for the complainant.\textsuperscript{10} Since the establishment of the WTO, then, the complainant has won virtually every case that has reached the panel stage.\textsuperscript{11} Such a high rate of complainant victories suggests that litigation yields larger payoffs to the complainant than to the defendant.\textsuperscript{12}

The Article proceeds as follows. Part II explains why theories of asymmetric information – the dominant approach to litigation and settlement in domestic law – fail to explain the behavior of WTO cases. Part III presents the model of asymmetric payoffs. Part IV discusses the political economy of litigation and settlement at the WTO, and concludes that the data, coupled with the theory, help us understand the magnitudes of the political payoffs received by the parties.

II. ASYMMETRIC INFORMATION

A. The Asymmetric Information Model

The simplest model of litigation and settlement assumes zero transaction costs, complete information, and positive costs associated with trial. Under these assumptions, it is well-established that every case will settle prior to trial because settlement saves litigation costs.\textsuperscript{13} In reality, of course, some cases find their way to trial,\textsuperscript{14} and the usual explanation for the failure to settle relies on the presence of asymmetric information.\textsuperscript{15}

\textsuperscript{10} For our purposes, a case is a complainant victory if the panel finds that some practice of the defendant is in violation of its WTO obligations. Though the complainant may not win every claim, it remains appropriate to classify a case as a complainant victory if, as a result of the case, the defendant is expected to change its behavior.

\textsuperscript{11} I am not the first to notice this empirical regularity. See Paul B. Stephan, Sheriff or Prisoner? The United States and the World Trade Organization, 1 Chi. J. Int'l L. 49, 52 (2000) (noting that complainants won 22 of the first 25 cases to be resolved by a WTO panel). To my knowledge, this paper is the first to offer an explanation for this high complainant win rate. Similar surprising results were generated by the GATT dispute settlement process between 1948 and 1989. Robert Hudec carried out a careful analysis of all the cases filed during this period and found that of the 207 complaints, 88 or 43% led to a ruling by a panel or the plenary assembly. Of the 88 panel rulings, 68 or 77% led to a ruling in favor of the complainant. Hudec, supra note 3.

\textsuperscript{12} In all, a total of 323 cases have been filed at the WTO since its inception in 1995. Of these, approximately 33% proceed to a panel and produce a ruling. The precise percentage of cases that go to a panel varies somewhat from one report to another, depending on how active cases are defined. Some cases have not yet reached the point at which they can be said to have settled or gone to a panel. To calculate the percentage of settling cases, therefore, one should omit these cases. The 33% figure used above is calculated by excluding all cases that remain active. Data used here and throughout the paper include all cases through June 2003. Studies that report a lower percentage of empanelled cases typically include those that have not reached the end of the consultations and, therefore, may yet proceed to a panel. See, e.g., Marc L. Busch & Eric Reinhardt, Testing International Trade Law: Empirical Studies of GATT/WTO Dispute Settlement, mimeo (2000), table 3 (reporting that 33.5% of cases lead to a panel ruling).

\textsuperscript{13} See William Landes, An Economic Analysis of the Courts, 14 J. L. & Econ. 61 (1971).
Informational models assume that one of the parties to a dispute may be better informed than the other. Suppose, for example, that the defendant knows the probability of plaintiff victory at trial. The plaintiff, on the other hand, knows only the probability distribution of winning. The plaintiff makes a take it or leave it offer to the defendant. The defendant, who has better information than the plaintiff, is able to determine whether the offer is better or worse than what the defendant can expect at trial and accepts offers that provide more than the expected judgment while rejecting those that provide less. In particular, defendants are less likely to settle cases that they expect to win at trial, leading to a high win rate for defendants. Of course the same argument can be made with an assumption that the complainant has better information than the defendant. The general result, then, is that cases in which the better-informed party is likely to win at trial are less likely to settle, so the cases that go to trial are disproportionately won by the well-informed party.

To predict the observed rate of complainant wins at the WTO, however, we would have to assume that, in most cases, the complainant is well-informed relative to the defendant. An understanding of the way in which litigation works at the WTO, however, reveals that this assumption is implausible.


15 Some of the literature divides the existing models into two separate categories. The first is the asymmetric information category, developed primarily in Lucian A. Bebchuk, Litigation and Settlement Under Imperfect Information, 15 RAND J. ECON. 404 (1984). The second is the divergent expectations model developed in George L. Priest & Benjamin Klein, The Selection of Cases for Litigation, 13 J. LEGAL STUD. 1 (1984). The divergent expectations model, however, can be shown to represent a special case of the asymmetric information model. See Steven Shavell, Any Frequency of Plaintiff Victory at Trial is Possible, 25 J. LEGAL STUD. 493 (1996). See also John Gould, The Economics of Legal Conflicts, 2 J. LEGAL STUD. 279 (1973); William M. Landes, An Economic Analysis of the Courts, 14 J. LAW & ECON. 61 (1971) (providing early models of litigation and settlement).

16 In a more general model one can give each party a 50% chance (or some other probability) of being able to make the final offer. This would not affect the results.

17 See Bebchuk, supra note 15.

18 Notice that the theory of litigation and settlement makes it clear that even if a system is biased toward plaintiffs, one would not expect more plaintiff victories at trial. Cases in which the outcome is clear to the parties in advance will settle, and only cases in which there is some difference in information between the parties will go to a panel. At the WTO, if panels have a pro-complainant bias, complainants will fare better overall, but the set of cases that are heard by a panel will change so that, even with the bias, there will be both pro-defendant and pro-complainant cases presented.

19 The asymmetric information model is also difficult to reconcile with the combination of a low settlement rate and high complainant win rate. Approximately 33% cases at the WTO proceed to the panel stage and 93% of these cases lead to a victory for the complainant. The number for cases that proceed to the panel stage is calculated using the methodology in note 12: excluding active cases that are
B. Why Asymmetric Information fails at the WTO

To see why it is unlikely that complainants are systematically better informed than defendants, notice first that the complainant must demonstrate that the defendant’s practices constitute a violation of its obligations under the WTO – placing the informational burden on the complainant.\(^{20}\) One would normally think that the defendant has the informational advantage because the key information in the case – the practice of the defendant – relates to the defendant’s own conduct.\(^{21}\) The defendant is even more likely to have an informational advantage because, unlike the domestic court system, the DSU does not provide “discovery” procedures for the complainant. Rather, the complainant must pursue its case with whatever information it can gather on its own.\(^{22}\)

If complainants do not have an informational advantage, one might imagine that the complainants themselves are simply more savvy players in the system, allowing them to, for example, anticipate panel decisions more accurately, an ability which would have the same effect on the win rate as the above informational asymmetries. At the WTO, however a small group of states account for the majority of both complainants and defendants at the WTO. For example, the United States, the EC, Canada, and Japan – represent 52% of all defendants and 54% of all complainants.\(^{23}\) The most frequent participants, therefore, find themselves on both sides of disputes – ruling out the

less than three years old. The asymmetric information model predicts that the win rate for the better-informed party will approach 100% as the adjudication rate approaches zero. Comparing WTO figures with those available for domestic disputes, one can see that the WTO cases feature a more one-sided win rate and a higher rate of adjudication than most categories of domestic disputes. See supra note 14. Though this comparison is admittedly crude, it is suggestive that something else explains the high complainant win rate.

\(^{20}\) A dispute might also involve a “non-violation nullification and impairment.” In that case, the complainant must demonstrate that a “benefit accruing to it directly or indirectly under this Agreement is being nullified or impaired . . . as the result of the application of another contracting party of any measure, whether or not it conflicts with the provisions of this Agreement.” GATT XXIII(1)(b). Even in these cases, however, it is difficult to see why the complainant would have better information regarding the disputed practices and the harm they cause than the defendant.

\(^{21}\) See Bebchuk, supra note 15; Joel Waldfogel, Reconciling Asymmetric Information and Divergent Expectations Theories of Litigation, 41 J. Law & Econ. 451, 458 (1998).

\(^{22}\) Robert Hudec, The New WTO Dispute Settlement Procedure: An Overview of the First Three Years, 8 Minn. J. Global Trade 1, 39 (“Governments do not have the powers of discovery to obtain information from opposing parties, and so often they can only offer undocumented surmise.”). But see Argentina-Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items: Report of the Panel, WT/DS56/R (Nov. 25, 1997) ¶ 6.40 (stating that a party is “obligated to provide the tribunal with relevant documents which are in its sole possession. This obligation does not arise until the claimant has done its best to secure evidence and has actually produced some prima facie evidence in support of its case. It should be stressed, however, that ‘discovery’ of documents, in its common law system sense, is not available in international procedures.”).

\(^{23}\) The United States represents 23% of all complainants and 28% of all defendants, the EC represents 21% of all complainants and 16% of all defendants, Canada represents 7% of all complainants and 4% of all defendants, and Japan represents 3% of all complainants and 4% of all defendants. The inclusion of Brazil and India would account for 66% of all complainants and defendants. Brazil and India were complainants more often than they were defendants.
possibility that complainant states are systematically better able to operate within the dispute resolution system.

One might also suspect that developing countries (LDCs) tend to be less well-informed than their developed country counterparts, either due to a lack of resources or because LDCs are less frequent participants in the dispute settlement process. If LDCs tend to be defendants while developed countries tend to be complainants, this might contribute to an explanation of the complainant win rate. Table I presents the breakdown of cases according to the developmental status of the parties.24

Table I: Complainants and Defendants

<table>
<thead>
<tr>
<th>Complainant</th>
<th>Defendant</th>
<th>Number of Cases</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>More Developed</td>
<td>More Developed</td>
<td>118</td>
<td>37</td>
</tr>
<tr>
<td>More Developed</td>
<td>Developing</td>
<td>78</td>
<td>24</td>
</tr>
<tr>
<td>Developing</td>
<td>More Developed</td>
<td>75</td>
<td>23</td>
</tr>
<tr>
<td>Developing</td>
<td>Developing</td>
<td>52</td>
<td>16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>323</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Though LDCs are defendants more often than they are complainants,25 Table I does not suggest that the high win rate for complainants is explained by informational differences between LDCs and developed states. There are only 78 cases (24% of the total) in which the defendant is a developing country and the complainant is a developed country. Something else must explain the high complainant win rate in the other cases. In addition, if the overall win rate were driven by the informational disadvantages of developing countries, we would expect them to fare less well before the panel than developed countries. The data indicate that this is not the case. LDCs have won 95% of the cases in which they were complainants, while developed countries have won only 91%.

Another potential source of asymmetric information relates to the quality of the legal representation provided to the parties. If complainants’ lawyers are more informed or more skilled than defendants’ lawyers, complainants may have an advantage in settlement negotiations. This could conceivably lead to settlement in cases that would otherwise lead to a defendant victory at trial. As discussed above, however, the parties involved in litigation before the WTO play the role of complainant in some cases and defendant in others, making it unlikely that the lawyers for the complainant are systematically more capable than those for the defendant.

Because we reject the assumption that the complainant is better informed than the defendant, we also reject the asymmetric information model as an explanation of the complainant win rate. A different model of litigation and settlement at the WTO is

---

24 The developed and less developed categories used herein are those of the World Bank and can be found at http://www.worldbank.org/data/databytopic/class.htm#Definitions_of_groups.
25 As Table I shows, LDCs have been defendants in 130 cases and complainants in 127 cases.
needed. The next Part examines how asymmetries in the payoffs from a panel ruling and asymmetries in the costs of delay – contribute to an explanation of the complainant win rate.

III. ASYMMETRIC PAYOFFS

A. The Theory of Asymmetric Payoffs

For present purposes, the key features distinguishing the WTO from domestic litigation are that settlements and panel rulings at the WTO are political in nature and the payoffs to decision makers are not zero-sum. In the domestic context, both settlements and judgments are normally accomplished through the payment of money from one party to the other, ensuring that what is gained by one is lost by the other. This is even true with respect to the costs of delay in litigation. In a domestic case, a defendant who is engaged in an illegal act that harms the plaintiff, and who continues that act prior to a court judgment will normally have to compensate the plaintiff in the form of damages. By continuing its activity until a judgment is reached, the defendant incurs additional liability equal to the increased loss suffered by the plaintiff.

In inter-state litigation at the WTO, on the other hand, damages do not have this zero-sum character. States do not generally settle their disputes through cash payments, and the WTO does not compel payment from the loser of a case to the winner. Indeed, the WTO dispute resolution system does not provide for any compensatory damages at all. After a loss before a panel or appellate panel, the defendant is expected to end the disputed practice but is not liable for its past conduct. It is true that the winning party can request permission to impose economic sanctions – in the form of a suspension of concessions previously granted to the defendant – if a losing party refuses to bring its 26 One might believe that one of the significant features of the WTO dispute settlement process is a pro-trade or pro-complainant bias. Whether such a bias exists, of course, depends in part on one’s interpretation of the WTO Agreements and one’s view of the proper role of panels. This Article takes no position on the question of whether panels are biased. It is not necessary to take such a position because the decision of whether or not to bring a case is made in the shadow of the panel procedures. If panels are biased, would-be complainants and defendants know this and can adjust their negotiations accordingly. One would expect different cases to reach the panel stage (as more relatively pro-complainant cases settle and more relatively pro-defendant cases go to a panel), but would not expect the rate of complainant wins to increase.

27 See Butler & Hauser, supra note 1, at 512.
29 See DSU art. 21(3, 5). The outcome of some disputes may require a government to implement certain measures, such as establishing an intellectual property regime that is consistent with the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs). This is not conceptually different from a requirement to end a practice. One can simply think of it as a requirement that the state end its violation of its WTO obligations.
actions into compliance.\textsuperscript{30} These sanctions, however, are strictly prospective, and are only intended to provide an incentive for the defendant to bring its actions into compliance, not to compensate for past losses.\textsuperscript{31} Accordingly, the value of suspended concessions cannot be greater than the loss suffered as a result of the ongoing violation.\textsuperscript{32}

The WTO ruling, therefore, serves as a form of injunction that calls on losing defendants to bring their practices into compliance. This ruling generates payoffs for the parties, but there is no reason to think that the benefits enjoyed by the complainant are equal in magnitude to the losses of the defendant. Even if one considers only the economic costs and benefits involved in a case before the WTO, they are not zero-sum in character. Indeed, it is easy to imagine a case in which the economic welfare of both countries improves as a result of a complainant victory. For example, if a violative practice impedes trade and the ruling requires that the defendant remove the practice, this represents a liberalization of trade that will provide an economic gain to every state.

From the point of view of states, of course, it is the political costs and benefits felt by decision makers that matters. Interest groups that favor a practice, for example, may withdraw their support from politicians that agree to terminate that practice. These political effects are likely to be felt in both defendant and complainant states, but the political impact in one state is not tied to costs and benefits felt in the other state, making it unlikely that the political payoffs are symmetric.

Like panel decisions, settlement agreements at the WTO lead to outcomes that are generally not zero-sum. Unlike domestic settlements, negotiated settlements at the WTO are not normally structured around monetary payments from one party to the other.\textsuperscript{33} Rather than cash transfers, settlements may involve, for example, a partial rather than complete removal of the disputed measure, or perhaps removal of the measure combined with concessions in other policy areas.\textsuperscript{34} This outcome, like a panel ruling,

\textsuperscript{30} See DSU art. 22.

\textsuperscript{31} “[N]either compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements.” DSU 22.1. See Joost Pauwelyn, Enforcement and Countermeasures in the WTO: Rules Are Rules – Toward a More Collective Approach, 94 Am. J. Int’l L. 335, 346 (2000). Despite the fact that the text of the GATT/WTO Agreements have never provided for retrospective damages, and despite the fact that the overwhelming majority of panels have limited compensation to prospective relief, a few panels have made retrospective awards. See New Zealand – Imports of Electrical Transformers from Finland, BISD 32S/55-70 (Jul. 18, 1995); United States Countervailing Duties Fresh, Chilled and Frozen Pork from Canada, BISD 388/30-47 (Jul. 11, 1991).

\textsuperscript{32} “The level of suspension of concessions or other obligations authorized by the Dispute Settlement Body (DSB) shall be equivalent to the level of the nullification or impairment.” DSU art. 22.4.

\textsuperscript{33} The reason that states are reluctant to enter into cash transfers is not well understood, but the claim seems to be true as an observational matter. For some speculation on why states might behave this way, see Andrew T. Guzman, The Cost of Credibility: Explaining Resistance to Inter-State Dispute Resolution Mechanisms, 31 Journal of Legal Studies 303 (2002).

\textsuperscript{34} Though it is not typical for states to provide explicit concessions in unrelated areas in order to settle a WTO case, it seems likely that such concessions are sometimes made in an implicit and undocumented fashion.
generates political costs and benefits for the leaders in each state, and these costs and benefits are likely to be asymmetric.35

To see why payoff asymmetries offer a potential explanation of the complainant win rate, consider the following simple numerical example. The next section of the paper offers a more formal and general presentation of the results.

Imagine that a complainant, C, brings a case against a defendant, D, alleging that some activity of the defendant is a violation of its WTO obligations. Assume that both parties have full information. When the parties enter into settlement negotiations, they do so in the shadow of the ultimate payoffs they would receive should a panel decide the case. If D were to win at the panel stage, the status quo would endure and D would be able to maintain the disputed activity. If D wins, then, each party receives a payoff of zero.36 If C wins, however, we assume that D would be required to end the disputed activity.37 The resulting payoffs to the parties might be asymmetric for any number of reasons. To cite just one example, the activity in question might be less politically salient in D than it is in C. A measure that affects the importation of coffee into the United States, for instance, may have larger political implications in a small, coffee-producing state than in the United States.

Now observe how the asymmetric payoffs affect the settlement range. Suppose that victory at the WTO yields a political payoff to C in the amount of 150 and losing before a panel imposes a cost of 50 on D. To determine the settlement range, we first identify the minimum settlement offer that each party would accept rather than proceeding to the panel. Let p represent the probability that C will win at the panel stage. In order to isolate the effect of the asymmetric payoffs, it is assumed that both parties know the value of p. Finally, assume that it will cost each party 45 in additional fees if the case proceeds to a panel.

C will settle if and only if the settlement exceeds its expected return from the panel (150p) minus C's expected litigation costs (45), 150p – 45. D, on the other hand, agrees to settle if and only if the settlement is smaller than D’s costs of going to a panel: 50p + 45.38 Comparing the two states’ willingness to settle, it is clear that a necessary

---

35 Here we are only considering the costs and benefits to the decision makers. Many of the practices that are disputed at the WTO are actually harmful to the defendant as well as the complainant. The relevant question for our purposes, however, concerns the political costs and benefits of an action. When the WTO requires that a state change its conduct, therefore, we will consider this to represent a loss to the state – meaning that it is a loss in the eyes of the state’s decision makers.

36 The assumption that payoffs are zero in the event of a defendant victory is simply a normalization of the payoffs and is not necessary for the analysis.

37 Under the DSU, there is no immediate sanction if D does not end the disputed activity. D could, for example, appeal the ruling to the appellate panel. DSU art. 16(4). Even after an appeal, if D refuses to comply, C must request permission to impose sanctions on D. DSU art. 22. Nevertheless, we assume for simplicity that a loss before the panel causes D to end the activity. The model could easily be extended to account for the fact that D can resist compliance even after a loss at the panel stage.

38 We assume both states are risk-neutral. We also assume that the settlement can be treated as a cash payment that has equal value to both sides. This need not be true, and may not be realistic, but it simplifies the example. A more complex modeling of the settlement is possible without affecting the results.
condition for there to be a settlement is that $150p - 45 \leq 50p + 45$. That is, the minimum that $C$ will accept must be less than the maximum that $D$ is willing to pay. Simplifying this expression yields: $100p \leq 90$. Notice that as $p$, the probability of a victory for $C$, gets larger, the settlement range (i.e., the difference between $150p - 45$ and $50p + 45$) shrinks and, most importantly, when the value of $p$ crosses a certain threshold (here, $9/10$), the settlement range disappears altogether. This means that if $C$’s probability of winning exceeds a certain level, no settlement is possible and the case proceeds to a panel. If $C$’s probability of winning is below the threshold there is at least some possibility of a settlement, and the more that probability falls, the larger the settlement range. The result is that the cases which find their way to the panel stage are those with the highest probability of a complainant victory.

**B. The Model**

This section demonstrates, in a general setting, how asymmetric payoffs and delay can affect settlement and explain the observed rate of complainant victories at the panel stage.\(^{39}\) Assume that the complainant has a probability, $\rho$, of winning a case before a panel, and that this probability is common knowledge.\(^{40}\) If the complainant wins, it earns a positive payoff of $J_C^C$, while the defendant loses $J_D^C$. If the defendant wins before the panel, on the other hand, the complainant earns $J_C^D$ while the defendant loses $J_D^D$.\(^{41}\) The parties also care about the costs of pursuing the case at the panel stage. Let $C_C$ and $C_D$ represent the litigation costs borne by the parties when the case goes before a panel, $C_C, C_D > 0$. To take into account the impact of delay, if the complainant wins before the panel, let $\Delta_C^C$ represent its loss due to delay, and let $\Delta_D^C$ be the gain $D$ enjoys as a result of delay. If the defendant wins the cost of delay to the complainant is $\Delta_C^D$ and the gain to the defendant is $\Delta_D^D$.\(^{42}\) Finally, let $S$ denote the value transferred from the defendant to the complainant in the event of a settlement.\(^{43}\)

---

\(^{39}\) The numerical example in the prior section discussed only asymmetric payoffs resulting from a panel ruling. The formal model also includes asymmetric payoffs resulting from delay.

\(^{40}\) This informational assumption, though made to ensure a tractable model, is probably a realistic one. See Eric Reinhardt, Adjudication without Enforcement in GATT Disputes, 45 J. Conflict Resolution 174, 180 (2001) (“[T]he ruling is just a formality whose likely content the disputants could often agree on in advance.”)

\(^{41}\) Thus, the payoff to the parties are $J^i$, $i, j = \{C, D\}$, where $i$ indexes the party receiving the payoff and $j$ indexes the winner before the panel.

\(^{42}\) One could model the litigation costs and delay with a single variable, but it is more convenient for our purposes to treat them as separate variables with litigation costs, $C_p$ representing costs directly related to the pursuit of the case (e.g., lawyers’ fees), while $\Delta^i$ represents the political costs and benefit associated with the failure to resolve the dispute and the defendant’s continued use of the disputed measure.

\(^{43}\) Like the payoffs from a panel, the settlement cost to the defendant need not be equal to the benefit felt by the complainant. Nevertheless, for expositional purposes it is assumed that there is a single settlement value that is paid by the defendant and received by the complainant. One could carry out a similar, though more complex, analysis to reach the same conclusions under an assumption that the settlement costs are not zero-sum.
Using this notation, and recognizing that the complainant will settle a case if and only if the amount it receives from a settlement is at least as large as its expected return should the case go before a panel, the complainant will settle if and only if:

\[ S \geq \rho J_C^C + (1 - \rho) J_D^D - C_C - \rho \Delta_C^C - (1 - \rho) \Delta_C^D \]  

(1)

Similarly, the defendant will only settle the case if the settlement amount that it must pay is less than or equal to what it expects to pay should the case go before a panel:44

\[ S \leq \rho J_D^C + (1 - \rho) J_D^D + C_D - \rho \Delta_D^C - (1 - \rho) \Delta_D^D \]  

(2)

We normalize the model such that \( J_C^D = J_D^D = 0 \), meaning that we treat a defendant victory at trial as the status quo, against which other outcomes are measured.45 This normalization also implies that \( \Delta_D^D = \Delta_C^D = 0 \). That is, if the defendant wins, delay imposes no costs on the complainant and delivers no benefit to the defendant beyond that provided by the status quo.

Combining expressions (1) and (2), and adjusting our notation for the costs of delay, settlement is possible if and only if:

\[ \rho J_D^C + C_D - \rho \Delta_D^C \geq S \geq \rho J_C^C - C_C - \rho \Delta_C^C \]

Simplifying, there is a positive settlement range if and only if:

\[ 0 \leq \rho (J_D^C - J_C^C) + (C_D + C_C) + \rho (\Delta_C^C - \Delta_D^C) \]  

(3)

Notice that the right-hand side of this expression yields the size of the settlement range.

Expression (3) reveals how each of the variables at issue affects settlement. Most obviously, the settlement range and, therefore, the probability of settlement increases with the total costs of litigation \( (C_D + C_C) \). This is to be expected because higher litigation costs offer the litigants larger gains from settlement.

The other factors in settlement, according to expression (3), are the interaction of the payoffs \( (J^i) \) and delay \( (\Delta^i) \) with the probability of a complainant victory \( (\rho) \). Specifically, an increase in \( \rho \) (signifying an increased chance of a plaintiff victory before the panel) reduces the settlement range and, therefore, the probability of settlement if:

\[ J_D^C - J_C^C < 0 \]

and

\[ \Delta_C^C - \Delta_D^C < 0 \]

Focusing on the payoff terms, if \( J_D^C - J_C^C < 0 \), pro-defendant cases tend to settle and pro-complainant cases tend to go to a panel. If \( J_D^C - J_C^C > 0 \), pro-complainant cases

---

44 The \( \Delta_i \) term represents a benefit to the defendant in the event of litigation, so settlement is less likely as it gets larger.

45 Although the model does not require that we restrict the values of \( J_C^D \) and \( J_D^D \), normalizing \( J_C^D \) and \( J_D^D \) makes it likely that \( J_C^C > 0 \) and \( J_D^C < 0 \), meaning that decision makers in both states do better when they win the case then when they lose.
tend to settle while pro-defendant cases tend to go to a panel. Thus the impact of the probability of a complainant victory on the selection effect in settlement depends on the relative sizes of $J^C_C$ and $J^D_D$. The delay terms work in much the same way. Pro-complainant cases are more likely to settle than pro-defendant cases if $\Delta^C_C - \Delta^D_D > 0$. If $\Delta^C_C - \Delta^D_D < 0$, the opposite is true.

To understand the intuition behind this result, consider the position of the parties as they attempt to negotiate a settlement. Imagine that a victory for the complainant will yield it a large payoff, but that the same outcome will generate only a small loss for the defendant. Under these assumptions, the defendant is willing to pay only a small amount to settle the case and avoid the risk of a plaintiff victory, while the complainant demands a relatively large payment in exchange for giving up the possibility of winning at the panel stage. As the probability of a complainant victory ($\rho$) increases, the impact of the difference in payoffs grows, as is clear from expression (3) above. Thus, the disputes in which the complainant is most likely to win are the least likely to settle. As a result, we expect the complainant to win a high percentage of the cases that proceed to a panel. If, instead, we assume that a complainant victory would yield a small payoff to the complainant but impose a large cost on the defendant, the opposite result would emerge – settlement would be more likely as $\rho$ got larger.

IV. THE POLITICAL ECONOMY OF WTO LITIGATION

A. Drawing Inferences from the Evidence

No amount of theoretical analysis can tell us whether the political costs and benefits of litigation are greater for the defendant or the complainant. Combining the above theory with the available data, however, allows us to draw inferences about the political economy at work. The key piece of data for our purposes is the complainant win rate. Of the 108 cases decided by a WTO panel through June 2003, 100, or 93%, were won by the complainant.

As already mentioned, the right-hand side of expression (3) represents the size of the settlement range. To consider the political economy inferences that might be drawn from the data, it is convenient to restate (3) as:

$$0 < \rho [ (J^D_D - \Delta^C_D) - (J^C_C - \Delta^C_C) ] + (C_D + C_C)$$

From expression (4) it is clear that an increase in the probability that the complainant will win before a panel (an increase in $\rho$) reduces the size of the settlement range.
range if and only if the political payoffs from a complainant victory plus the impact of delay are larger for the defendant than for the complainant:

\[(J_D^C - \Delta_D^C) - (J_C^C - \Delta_C^C) < 0 \quad (5)\]

If expression (5) is satisfied, the settlement range gets smaller as the probability of a complainant victory rises – implying that, all else equal, pro-complainant cases should go to a panel more often than pro-defendant cases. If, on the other hand, expression (5) is not satisfied, pro-complainant cases should settle more easily than pro-defendant cases.

The observed pattern of settlement at the WTO offers clues about the relative magnitudes of these variables. Most importantly, that virtually all cases that proceed to a panel are pro-complainant cases suggests that for most cases:

\[(J_D^C - \Delta_D^C) < (J_C^C - \Delta_C^C) \quad (6)\]

To understand the intuition behind this result, keep in mind that the left-hand side of (6) represents the loss to the defendant of losing at the panel stage and the right-hand side represents the gain to the complainant from the same panel decision. When the defendant loses before a panel (rather than settling earlier) it faces a loss of $J_D^C$ and a gain of $\Delta_D^C$ while the complainant faces a gain of $J_C^C$ and a loss of $\Delta_C^C$. When deciding whether to settle or litigate, the parties will prefer to go to a panel if the total payoff from doing so is greater than zero. This means we must compare the loss to the defendant to the gains of the complainant – which is just what expression (6) does.

The fact that the litigated cases are pro-complainant cases, then, suggests that for most cases filed at the WTO, the costs of litigation borne by the defendant are smaller than the benefits to the complainant.48

**B. Payoffs and Delay at the WTO: Lessons Learned**

This section discusses some of the conclusions that can be drawn about the political economy that is at work at the WTO and presents some plausible reasons why

---

48 Notice that there is nothing significant about the fact that the returns to litigation are labeled costs for the defendant and benefits for the complainant. The defendant may receive a higher payoff by going to a panel (in which case the left-hand side of expression (6) will be less than zero), and the complainant may receive a higher payoff by settling (in which case the right-hand side of expression (6) will be less than zero).
complainants win 93% of the cases decided by a panel.\textsuperscript{49} That is, it offers potential explanations for why, in pro-complainant cases, the political economy works in such a way as to make it worthwhile, in at least a significant number of cases, for the parties to go to a panel. In pro-defendant cases, on the other hand, the political economy favors settlement.

Before proceeding, however, it is important to observe from expression (4) that we cannot distinguish, as a theoretical matter, between the impact of delay and the payoffs received as a result of a judgment, unless we assume that transaction costs are low. If transaction costs are sufficiently low, the results are not driven by delay at all and it is the political impact of a panel ruling that explains our results. Even if transaction costs are not low, delay does not by itself result in litigation. If the parties to a dispute prefer delay to a quick settlement, they can still choose to settle immediately before a panel rules on the issue. There is, however, little evidence that parties to a dispute settle at the last possible moment in WTO litigation. If the parties were motivated by a desire for delay and nothing else, and if they could settle at any time, we would expect many settlements to take place after the establishment of a panel but before the panel ruling. In fact, only 10 cases settled in this time period, from which it can reasonably be inferred that either the parties are motivated by more than just delay or for some reason the parties cannot get the benefits of delay without proceeding to the panel stage.\textsuperscript{50} The more reasonable perspective, then, is that delay and the impact of a panel ruling both play some role, but we cannot separate their effects.

1. Political Costs and Benefits of Settlement

When a dispute fails to settle, the parties’ political leaders face domestic consequences. It is sometimes argued, for example, that the government of a defendant whose citizens support a challenged policy is better off going before a panel rather than settling. It is claimed that any benefits from a negotiated settlement are unlikely to offset the political cost of giving in to foreign pressures. In addition, if the defendant loses before the panel, politicians can blame the WTO for the need to change policies, thereby reducing the political harm to themselves.\textsuperscript{51} The argument, then, is that pro-complainant cases fail to settle because the defendant prefers to lose rather than agree to a settlement that includes an end to the disputed measures. A complainant that expects to win before

\textsuperscript{49} These explanations are described as “plausible” because they cannot be proven true and even if they are true may not represent the only relevant factors.

\textsuperscript{50} One possibility is that by going to a panel the parties get further delay because there is the possibility of an appeal. As a practical matter, however, this seems like it would be of modest value since the delay imposed by an appeal is supposed to be quite short. The Appellate Body (AB) is, as a general rule, expected to circulate its report no more than 60 days from when a party notifies the AB of its decision to appeal. DSU art. 17.5. The AB then adopts the report unless the DSB decided by consensus not to do so within 30 days of the report’s circulation. DSU art. 17.14. The total delay generated by the appeal, then, should not exceed 90 days.

\textsuperscript{51} See Marc L. Busch & Eric Reinhardt, Bargaining In The Shadow Of The Law: Early Settlement In GATT/WTO Disputes, 24 Fordham Int’l L.J. 158, 165 (2000) (stating that a “ruling may enable the defendant’s executive to “tie hands,” making concessions more politically palatable by citing the need to be a ‘good citizen’ of GATT/WTO.”).
the panel, on the other hand, can claim the political benefits of victory before its domestic audience, and therefore prefers to go before the panel. These costs are said to be present only in pro-complainant cases because in pro-defendant cases the defendant can negotiate a settlement in which the disputed practice is retained.

Suppose, for example, that an anti-dumping measure adopted by the defendant and supported by that country’s steel lobby is in dispute. Assume that both the steel lobby and the parties to the litigation understand that the defendant has only a slight chance of victory at the panel stage. There may exist a settlement that would make both countries better off but that will never be reached because the gains go to groups that are less influential than the steel lobby. Though the defendant would generate a higher level of overall welfare for its residents by settling, its political leaders, responding to interest group pressures, prefer to face a panel proceeding. If the political economy described here is typical, defendants will resist settlement even when they are likely to lose at the panel stage.

On the other hand, one can construct an analogous account of why a complainant state might prefer to proceed to a panel, even when it stands to lose the case. In the above example, for instance, the complainant may have brought the case in response to pressure from its own steel lobby,\(^\text{52}\) and it may pay a large political cost if it reaches a settlement that does not include an end to the disputed measure. If the defendant has the stronger case, the complainant may nevertheless prefer to go to the panel stage rather than accept a settlement that does not put an end to the practice. As long as there is a chance of victory, the steel lobby may demand that the complainant take the case to a panel rather than agree to end the practice through a settlement. Taken by itself, then, the theoretical claim that defendants refuse to settle pro-complainant cases is unsatisfactory because it takes into account only one state’s political economy.

The theory developed in this paper tells us that the relative payoffs of the parties can generate a selection effect that determines the complainant win rate. This theory, combined with the observed complainant win rate suggests that the defendant may indeed be able to shift the blame for an unpopular policy change to the WTO and thereby minimize the political damage to themselves while complainants may be indifferent between settlement and litigation.\(^\text{53}\) Perhaps complainants will suffer the same political damage from a loss before the panel as it does from a settlement on the same terms. Though this claim (at least with respect to the defendants ability to shift the blame to the WTO) can be found in the literature on international trade, as discussed above,\(^\text{54}\) this article is the first to provide it with a theoretical foundation. Even with these theoretical underpinnings, however, it is important to note that this represents just one of many possible explanations of the observed complainant win rate.

---

\(^\text{52}\) Indeed, one would expect cases to be filed precisely because there is interest group pressure to do so. One would then expect this pressure to influence the settlement decision of the complainant.

\(^\text{53}\) In this context a policy change may be “unpopular” because it is opposed by a powerful interest group.

\(^\text{54}\) See Part IV.B.1.
An alternative explanation is that defendants are indifferent between a settlement and a panel victory while complainants get substantial benefits from a panel victory that they do not capture with a settlement. Complainants may, for example, seek a reputation for toughness in litigation at the WTO in the hope that this can generate greater concessions in future disputes (including disputes that are settled before they find their way to the WTO). Or perhaps domestic interest groups provide large rewards to leaders who manage to open foreign markets.

The above stories concentrate on why litigating a pro-complainant case increases the joint payoff of the parties. Other explanations might focus instead on why pro-defendant cases are likely to settle. For example, it may be that a loss before a WTO panel carries with it a large reputational cost for complainants because it signals that the state is willing to bring meritless suits at the WTO. It may also be that a loss for defendants carries little reputational penalty because as long as they remove the measure as required by the DSU, they are deemed to be behaving in good faith. All of the above stories provide possible explanations as to why pro-complainant cases tend to go to a panel while pro-defendant cases typically settle. Indeed, more than one of the scenarios could be true at any given time.

2. The Impact of Delay

The DSU features a series of procedural rules intended to prevent excessive footdragging by either party. Despite these provisions there remain significant opportunities for delay. From the defendant’s perspective, delay is desirable – all else equal – because WTO rules permit the defendant to maintain the disputed practice as long as the case is ongoing. The defendant’s political leaders, therefore, can continue to receive political and economic rents from the activity. There is no offsetting cost because the WTO does not require losing defendants to pay damages for violative activities. From the complainant’s perspective, on the other hand, delay is undesirable because the complainant continues to suffer harm without compensation. Whether delay has a positive or negative impact on the total welfare of the parties’ leaders depends on whether the benefits of delay are larger for decision makers in the defendant state than are the costs imposed on decision makers in the complainant state. In terms of expression (3), settlement is more likely when \( \rho(\Delta_C^C - \Delta_D^C) \) is large and positive.

Once again, because we are considering political payoffs, there is no reason to expect symmetry in the costs and benefits faced by the parties. The payoffs from delay may be asymmetric for any number of reasons. For example, the affected interest groups in the defendant state may be more powerful than their counterparts in the complainant state. Standard public choice theory would then predict a political benefit to the defendant state that exceeds the cost to the complainant state. Alternatively, asymmetric payoffs may exist because interest groups in both states are imperfectly informed about

\[ \text{See DSU art. 4-22.} \]
\[ \text{See infra note 60 (describing some of the potential sources of delay under the DSU).} \]
\[ \text{Obviously, economic payoffs are also relevant here. When I say we are interested in political payoffs, I mean to include the political valuation of economic payoffs.} \]
the status of negotiations. Political leaders in, say, the complainant state, can blame the defendant for a refusal to settle and the associated delay. Though such claims cannot be verified by local interest groups, they may provide some political cover to the complainant’s decision makers, especially since dispute settlement proceedings are largely carried out behind closed doors.58 Furthermore, in a democratic system, politicians may have short horizons – further increasing the value of delay to defendants. Imagine, for example, a political leader facing an upcoming election. Settlement might disappoint an important interest group and reduce the leader’s chances of reelection. By refusing to settle, the leader may be able to extend the case beyond the election date, allowing her to retain the support of the interest group at a critical time.

Having discussed the role of delay in general terms, the question remains how the relative costs and benefits of delay impact the likelihood of settlement, and how they might help explain the observed complainant win rate. One possibility is that barriers to trade are common in industries in decline, and these industries place a high value on delay. Delay may give the industry time to restructure or the opportunity to continue to use excess capacity, both of which imply a high return on lobbying efforts. If a challenged measure exists for the protection of an industry in decline, then, the defendant’s leaders may be able to earn significant political rents by refusing to settle. If the same industry is expanding in the complainant state, delay may impose only modest costs because the industry may already be at capacity and need time to increase it or they may have other markets to pursue. If so, the return from political lobbying may be relatively low, and they may be willing to live with a delay in the case.

Another reason why defendants may care more about delay than complainants is that they enjoy all the benefits from the action, whereas the harm may be felt by many states. If the complainant wants to reach a settlement and bring the activity to an end faster than is possible with a panel, it must pay the defendant enough to offset the total benefit the defendant enjoys from delay. Even if all affected states are parties in the formal dispute and present at the negotiating table, they face a free-rider problem when they attempt to arrive at appropriate compensation for the defendant.

If delay plays an important role in settlement decisions, one might wonder why, in pro-complainant cases that fail to settle, we do not observe settlements that consist of a promise by the defendant to end the disputed practice after a delay that approximates: (i) the time it would take a panel (or an appellate panel) to rule in favor of the complainant; (ii) the additional time imposed by an appeal; and (iii) the further delay between such a ruling and the time at which the defendant would have to end the practice.59 A settlement of this sort might achieve the same objectives as proceeding with litigation, while avoiding the associated costs. Though such settlements may indeed take place at

---

58 In a model with rational actors, the interest groups realize that they may be fooled, but cannot distinguish the cases in which their own leaders are responsible for the failure to settle and the cases in which the other states are responsible. Thus, if the complainant’s decision makers proceed to a panel rather than settle, the affected interest groups cannot determine whether or not there was a good faith effort to settle the dispute.

59 See DSU art. 21.3.
the WTO, they carry costs likely to limit their frequency. One problem with this sort of a settlement relates to the credibility of the promises being made. An agreement to withdraw a measure in the future is significantly less credible than a commitment to withdraw it immediately because the relevant economic and political situation of a state may change over time, causing the defendant to rethink its promise. It is also possible that with the passage of time governments may change, putting the commitment in further jeopardy. A settlement of this sort could easily require a delay of two to three years, and given the timing of elections in most democratic states, it is easy to see why a promise to withdraw a measure that far into the future may lack credibility.

Even if the parties reach a settlement that incorporates delay, the complainant is unlikely to terminate the dispute because doing so would surrender its leverage against the defendant. There is little to stop a defendant from making a disingenuous promise to end the practice and then, once the dispute has been withdrawn, simply ignoring its prior promise. True, there may be some political and reputational costs, but the defendant may be willing to bear these costs in order to retain the measure.

A clever complainant that reaches a settlement to be implemented only after a delay, then, will prefer to continue the case until the time for action by the defendant arrives. That is, rather than end the case and hope that the defendant honors its promise, the parties could simply allow the case to lie “dormant” until the complainant is satisfied that the defendant will do as promised. If such settlements take place, one would expect to see cases that go for long periods without any action and are then “settled.” One might also expect some number that are dormant and then restarted – these would represent cases in which the defendant failed to take action to the satisfaction of the complainant. In fact, examples of both of these phenomena can be found at the WTO.

---

60 The DSU states that the panel’s work should be done within six months, and “[i]n no case should the period from the establishment of the panel to the circulation of the report to the Members exceed nine months.” DSU art. 12(9). The panel report then must be adopted by the DSB within 60 days unless one of the parties has notified the DSB of its intention to appeal prior to this time. DSU art. 16(4). If there is an appeal, as there usually is, it is to be completed within 60 days, and “[i]n no case shall the proceedings exceed 90 days.” DSU art. 17(5). The appellate report is adopted by the DSB 30 days after its circulation unless there is a consensus against adoption. DSU art. 17(14). Finally, a losing defendant has “a reasonable period of time” to implement the recommendations of the DSB. DSU art. 21(3). This reasonable period of time is defined in article 21(3) of DSU, and should normally be less than 15 months. From an empirical perspective, it is not possible to reliably identify the time from panel formation to implementation because it is difficult to distinguish actual implementation from other forms of negotiated settlement between the parties. We can, however, identify the time between when a panel is requested until the appellate report is issued. For cases that have generated an appellate ruling, the average time from panel request to appellate ruling is 541 days (approximately 18 months). Adding 15 months to this figure generates a period of 32 months. Even this series of delays does not exhaust the possibilities for the defendant. If a defendant claims to have complied with an appellate panel ruling, but in fact has not done so (for example, a defendant might make a bad faith effort to comply), the complainant must resort to article 21.5 of the DSU, which provides for the use of the DSU procedures in the event that there is “disagreement as to the existence of consistency with a covered agreement of measures taken to comply with the recommendations and rulings.” DSU art. 21.5.
C. Political and Reputational Costs of Filing a Case

There is another possible explanation of the high complainant win rate that is worth mentioning. If the pool of cases filed at the WTO is itself heavily pro-complainant, a high rate of complainant wins at the panel stage is unremarkable. The puzzle, then, would be to explain why the filed cases are overwhelmingly pro-complainant. One possible theory is that there is a political cost associated with bringing a case – even when the case has merit.

One could imagine, for example, a complaint leading to worsening of trade relations between states, and running the risk of retaliation either within or outside the WTO. To explain the data with this theory, one must assume that the reputational harm from bringing a case is large enough relative to the potential benefits (including an end to the disputed measures) that cases are only brought when victory is assured and the benefits from victory are substantial. If this explanation is correct, it suggests that the DSU has failed to take the politics out of the dispute resolution process.

This explanation, however, is difficult to square with the observation that the large majority of decided cases are then appealed. If bringing a case generates friction between the states, one would expect that prolonging the case would do the same. Once the panel ruled in favor of the complainant, one would expect the defendant to respect that decision rather than continue the conflict.

This hypothesis is also unable to explain why filed cases settle as often as they do. If the political costs of bringing a case are very high, we would expect such cases to be filed only when no settlement is possible. That is, if it is the filing that triggers the political costs, the parties should enter into extensive negotiations prior to the filing. Only when every effort at settling has been exhausted would the case be filed. This would generate a low settlement rate because the only cases filed would be those where no negotiated outcome is possible – causing virtually every filed case to go to a panel. Though the settlement rate at the WTO is considerably lower than what is seen in domestic systems, it remains higher than what one might anticipate if all filed cases were pro-complainant cases.

V. CONCLUSION

The WTO’s regulation of international trade stands as one of the great examples of international cooperation. One of the central pillars of the organization is its dispute settlement mechanism. Despite the institution’s importance, scholars have no more than a crude understanding of how the DSU affects state behavior.

This article contributes to our understanding of the DSU and the WTO by providing a model of litigation and settlement suited to the particular institutional characteristics of the WTO. Unlike domestic litigation, the payoffs from WTO litigation

---

61 Of the 108 cases decided by a panel, 77 or 71% have been appealed.
are political and not zero-sum. These facts influence state decisions about whether or not to settle a case. Of particular interest is the political impact of going to a panel at the WTO and the political costs and benefits of the delays associated with proceeding to a panel.

With the model in hand, it is possible to draw inferences from the existing data on litigation and settlement. Most interestingly, the high complainant win rate suggests that the political costs of delay and a judgment before a panel are normally smaller for the defendant than the corresponding benefits to the complainant. One of the questions left for future work is identifying precisely why it is that the political costs and benefits behave in this way.