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Trade Policy Analyses

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The Cordell Hull Institute held a one-day Trade Policy Roundtable on December 4, 2001 to discss strengthening the ILO's role in promoting core labor standards.

The meeting was held at Arnold & Porter, attorneys-at-law in Washington, DC. Pictured above is the well of the firms building.

Reproduced opposite is the text of a paper presented by **Gary Horlick** (above).

About the Author

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He previously served as head of the US Department of Commerce Import Administration, where he was responsible for the administration of US

WOULD TRADE SANCTIONS WORK?

Confusing Trade Sanctions with Trade Remedies

Gary N. Horlick

IN ALL THE TALK of using the World Trade Organization's dispute-settlement procedures to enforce internationally recognized labor standards there has hardly been any discussion of whether that course of action could possibly be effective. Would such "trade sanctions" in the WTO system actually work? This chapter addresses the key legal aspect of the question. Before getting to it, however, a more general look at the political economy of trade sanctions in the context of labor relations is warranted.

In a study for the Brookings Institution, Theodore Moran has reviewed a wide range of options for securing adherence to core labor standards, particularly with respect to foreign direct investment.[1] He has explored how a WTO-based enforcement mechanism might be designed to work without threatening the interests of workers in developing economies or inviting capture by protectionist interests in industrialized countries? Earlier in the study, he discusses the difficulties in determining what constitute actionable violations in the treatment of workers, as well as other risks to the international trading system that could result from bringing labor issues into the WTO's activities. These difficulties cannot be easily wished away.[2]

Punishment for violations of core labor standards would have to be limited to individual plants or companies. It could not be applied to an entire export-processing zone (EPZ), nor to all the EPZs in a country or, for that matter, to a list of export items of the country in question, affecting the whole economy.

Even a narrowly defined WTO enforcement mechanism would have drawbacks. A means of enforcement that levied trade sanctions or fines (financial sanctions) against violators on a plant-by-plant or a firm-by-firm basis would risk punishing the victims. Penalties imposed on the offenders might force the workers who were being abused either to be laid off or even to lose their jobs permanently.

antidumping and countervailing duty laws.

In addition, he served as International Trade Counsel to the US Senate Committee on Finance.

Mr Horlick was the first chairman of the World Trade Organization's Permanent Group of Experts on subsidies. He was the highest ranked trade lawyer in the world in the 2004 and 2005 *Who's Who of International Trade and Customs Lawyers*.

About the Meeting

In November 2001, the International Labor Organization approved the establishment of a World Commission on the Social Dimension of Globalization, but its Director-General was requested to consult further on the Commission's parameters, terms of reference and membership.

To discuss the trade-related aspects of the ILO initiative, the Cordell Hull Institute convened in Washington on December 4 a roundtable meeting of specialists on trade, labor and development. Thirty five participated in the meeting where several presentations were made on the question of enforceable labor standards in trade agreements.

Other Speakers

In addition to Mr Horlick, other speakers included: **William D. Rogers**, Partner, Arnold & Porter, and Vice Chairman, Kissinger Associates, Washington, DC; **Jagdish Bhagwati**, Columbia University, New York, NY and Council on Foreign Relations, New York, NY; **Jeffrey Lang**, Partner,

Far worse consequences could ensue if a WTO allowed trade sanctions to be imposed more broadly. Firms that observed good labor standards would be punished collectively along with firms that did not. Ones that engaged in higher-skilled operations would be punished collectively along with firms that engaged in lower-skilled operations. Producers affiliated with multinational enterprises, based in other countries, would be punished collectively along with developing-country sub-contractors.

Moran points out that, in a rapidly integrating world economy, the huge and growing number of firms engaged in foreign direct investment, and the mixture of firms that export high-skill products and firms that export low-skill products, with all those in between, constitute the most powerful force for steadily improving worker-management relations in host economies. Thus a broad enforcement mechanism could be enormously counter-productive to progress in the treatment of workers in developing countries. Consider just three possible outcomes:

First, the effort to correct abuses at the low-skill end of foreign direct investment activities could undermine the efforts of host countries to promote development away from low-skill activities and towards high-skill ones.

Second, a broad enforcement mechanism could be captured by a wide array of interests in importing [industrialized] countries, not only firms and workers producing textiles and footwear but also firms and workers producing transport equipment, electrical and electronic products, industrial machinery and other high-skill, "high-tech" products.

Third, a wide-ranging enforcement mechanism could undermine the principal reason why international producers and retailers like to ensure that their suppliers conform to good labor practices, namely the assurance of uninterrupted purchases from those that comply.

Experience with the labor "side letters" to the North American Free Trade Agreement (NAFTA) and the Chile-Canada Free Trade Agreement suggests that national sensitivities over how to define adequate worker treatment, and how to determine adequate enforcement of labor statutes, would plague the construction of even a narrowly-defined WTO enforcement mechanism. So in the end Moran focuses on other options and concludes in favor of voluntary labor standards.[3]

PROBLEMS WITH WTO COMPLIANCE

The crown jewel of the Uruguay Round negotiations of 1986-94, which led to the WTO coming into being in 1995, is the Dispute Settlement Understanding (DSU).[4] The DSU, it is generally argued, brings quasi-juridical order to the maintenance of the

Wilmer Cutler & Pickering, Washington, DC, former Deputy U.S. Trade Representative; **Herwig Schlogl**, Deputy Secretary-General of the OECD, Paris, France.

Other speakers were **Daniel W. Drezner**, assistant professor of political science, University of Chicago, Illinois; **Gerard Depayre**, Deputy Head of Mission, Delegation of the European Commission, former Deputy Director-General of External Relations, European Commission; **John M. Weekes**, Chairman, Global Trade Practice, APCO Worldwide, Geneva, former Canadian Ambassador to the WTO, and Chairman of the WTO General Council.

Trade Policy Roundtable

The Cordell Hull Institute's Trade Policy Roundtable is sponsored by seven international law firms in Washington, DC: Akin Gump Strauss Hauer & Feld, Arnold & Porter, Hogan & Hartson, O'Melveny & Myers, Sidley Austin Brown & Wood, Steptoe & Johnson and Wilmer Cutler & Pickering.

multilateral trading system, whose legal foundation, from 1948 through 1994, was the General Agreement on Tariffs and Trade (GATT). Several recent cases, however, have highlighted structural tensions in the WTO dispute-settlement process that could gradually undermine many of the substantive obligations contained in the Uruguay Round agreements that constitute the WTO system. The problems can be classed in three dovetailing categories: (i) a lack of incentives for swift compliance, (ii) a lack of viable alternatives to trade sanctions or "remedies", the WTO-preferred term, and (iii) a lack of consideration of the impact of the remedies on private actors.

The first two are carrot-and-stick problems. They highlight the need for further streamlining the DSU process, beyond even the recent proposals by some member countries.[5] Effective reform will require members to rethink the timelines of the dispute-settlement process and ensure that governments that forestall compliance feel the true cost of the delay. The third problem is a prospective one. It cautions us against forgetting the vital need for flexibility in an inter-governmental organization with such a large and diverse membership as the WTO. Not only must these problems be addressed but the tensions between them must also be reconciled before the DSU can fully underpin the WTO agreements.

NO INCENTIVES FOR SWIFT COMPLIANCE

The first problem, the lack of incentives for swift compliance, can be seen by tracking the progress of a case along the existing DSU timeline. Assuming, charitably, that the losing member country finds out on the day when the Appellate Body's decision is released that it has been acting inconsistently with a WTO agreement, with internationally agreed rules, it has already spent at least fifteen months in the state of inconsistency, but probably more since it would be unlikely for a member to request consultations on the first day of existence of an inconsistent measure. Yet, even with all appeals exhausted, the only incentive to comply is enlightened (or diplomatic) self-interest, because the DSU allows a cost-free opportunity to delay compliance for several months.

Steps in the Delay Game

The first step in the delay game is to seek arbitration as to the length of the "reasonable period of time" for compliance. In practice that can delay matters for two months after the Appellate Body's decision. In the *Beef Hormones* case, for instance, dealing with the complaint of the United States against the European Union, the report of the Appellate Body was adopted on 19 February 1998.[6] On 16 April, the European Union requested that the reasonable time for implementation of the recommendations be determined by arbitration, pursuant to DSU Article 21.3(c).[7] In any arbitration the losing member country has every incentive to ask for the longest possible "reasonable" period of time. Fifteen

months is "normally" considered reasonable. This panel, whose report was circulated on 29 May 1998, set the period of implementation at fifteen months from the date of the adoption of reports.[8] At the end of the reasonable period of time, in May 1999, the European Union had still not brought its beef import ban into compliance and so the United States requested authorization to suspend tariff concessions.[9]

The losing member can further stall retaliation for more months in arbitration over the amount of the retaliation. In the *Beef Hormones* case the European Union did just that and the matter was referred to arbitration, pursuant to DSU Article 22.6.[10] The arbitrator finally ruled on the amount of the retaliation in July 1999.[11] Thus the retaliatory tariffs authorized against the European Union by the WTO in this case did not finally come into effect until 29 July 1999.[12]

An optimistic reading of the outcome in the long-running *Bananas* case, concerned with the European Union's regime for the importation, sale and distribution of bananas,[13] is that retaliation can take effect while the losing member country works to bring its laws into compliance. The *Australian Leather* case, however, suggests that a decision as to the adequacy of compliance (even without recourse to arbitration as to the amount of retaliation) can drag a proceeding out for another year. In that case, the Dispute Settlement Body (DSB) adopted the report of the panel on 16 June 1999.[14] When Australia announced its compliance on 17 September 1999[15] that in effect prevented the implementation of retaliation while the United States challenged the compliance, which it did on 4 October 1999.[16] The DSB recalled the original panel and finally adopted its report on 11 February 2000, twenty days after the report was circulated.[17] Had both parties not foresworn an appeal of the compliance ruling, the issue could have gone on for even more months.

Thus it seems that each new modification, whether in good faith or bad, potentially extends the period of cost-free non-compliance. Indeed, the irresistibility of the temptation to delay in this manner was made clear by a U.S. reversal of position. In the *Bananas* case, the United States argued vociferously that Article 21.5 arbitration as to the reality of compliance could not delay retaliation – authorized by DSU Article 22.6 – for failure to comply. Yet as soon as the good faith of U.S. compliance with the panel ruling on its anti-dumping rules was challenged,[18] the United States reversed course and insisted that retaliation be postponed for as long as the Article 21.5 arbitration, and presumably an appeal against that arbitration, was ongoing.[19]

Absence of Retroactive Measures

The time value of the money saved by stalling retaliation is reinforced by the absence, to date, of retroactive remedies in WTO

practice.[20] Recently, though, the panel in the *Australian Leather* case recognized that, unless the remedy for a one-time subsidy was retroactive, there would be no repayment and thus no withdrawal of a benefit disbursed before a panel recommendation to withdraw the subsidy. The governments involved in that dispute had disagreed over how to calculate the prospective portion of the subsidy, but firmly insisted that GATT/WTO custom and the DSU itself did not permit the levying of retroactive remedies. Both parties, however, had agreed in advance to waive an appeal, thus freeing the panel to declare itself not limited by the particular arguments of the parties, to reject any distinction between retroactive and prospective (noting logically that once any part of a one-time grant must be repaid, the remedy has a retroactive effect) and to order full repayment of the subsidy.[21]

The interpretation in the *Australian Leather* case, however, was linked to the language of the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). Thus, in situations where an inconsistent measure can be effectively withdrawn without retroactive effect, governments will probably continue to resist backwards-reaching remedies. Each member country lives in a glass house and is unlikely to request a remedy that could later be turned against it. Yet this logic of mutually assured destruction with respect to remedies, in which no member will be the first to seek fully retroactive remedies, allows cynical or desperate governments to maintain unfair trade practices knowing that, even after years of avoidance of effective WTO discipline, no retroactive remedy will be demanded. In the meantime, some domestic industry could well gain a cost-free (or at worst interest-free) competitive edge.

Where there is no retroactive remedy, it is difficult for a government to refuse to pursue the entire range of delay tactics when pressured by domestic interest groups that have a stake in maintaining protection. Assuming a measure exists because someone had enough political clout to get it passed, that same someone will probably fight for its survival. In many cases, even if a government, and hence the domestic interest group, comes out a technical loser, it may already be a market winner because of the effects of its temporary cost-free unfair competitive advantage. In today's fast-paced market, where product cycles are often only months long and brand loyalty develops in weeks, even a month or so of help can make a difference.

INADEQUANCY OF NON-COMPLIANCE

Not only are there no carrots or sticks creating an incentive for swift compliance. There is no satisfactory remedial option either. The DSU holds out the options of compensation or retaliation (limited to suspension of WTO "concessions"). At best, both are ineffective; and, when effective, they may undermine the logic of the system they are meant to enforce.

First of all, then, the temporary compensation envisaged by DSU Article 22.1 has, in theory, an effective role to play as a carrot to speed the compliance process along. In practice, though, the WTO is generous enough about allowing a "reasonable" period for compliance that any such temporary compensation will be rare indeed. If a member really intends to change an offending practice, it will have plenty of cost-free time to do so.

Secondly, as a source of discomfort, compensation is extremely unlikely to be a "burr under the saddle", irritating enough to push the losing member country towards compliance. Almost by definition, the compensation that the losing member chooses is less painful than compliance.[22] Granted, the WTO drafters intended compensation to be a compromise mechanism, to be used as a last resort to keep the full team on the field by allowing a member to play with one arm tied behind its back, rather than ejecting it from the game if the pain of compliance made it politically infeasible for that member to stop playing offside immediately. The problem is that the cost of compensation is often not levied on those who are maintaining the pressure to break the rules. It is the member's arm that is punished when it is the foot that keeps fouling. Unless compliance truly makes the offending actors feel the cost of their inconsistency, it cannot be seen as an honest "last resort" alternative for democratic governments, beset by immovable domestic interest groups.

Finally, as a long-term solution, compensation arguably has the value of lowering some trade barriers, presuming that the winning party insists on a level of "compensation" deeper than simply lowering duties from "bound" rates down to "applied" rates. In the final analysis, though, there remains an ongoing state of suspension of WTO obligations (the inconsistency with WTO rules found by the panel) as between at least two member countries, which, if repeated enough times, could eventually undermine the universality of the obligations.

Drawbacks of Retaliatory Measures

Retaliation (higher trade barriers) is even more problematic as a remedy for violations of WTO rules. Simply put, the purpose of the WTO is not to impose 100 percent duties on importers of Roquefort cheese, or on other innocent bystanders. To begin with, retaliation – like compensation – is generally ineffective in terms of teaching specific interest groups the true cost of their protectionism, for it is often imposed on activities in the economy unrelated to those that benefit from the WTO inconsistency. The unconvincing record of retaliatory measures in the GATT/WTO system demonstrates the ineffectiveness of retaliation as a stick. For example, the only GATT-authorized retaliation, which was by the Netherlands against the United States away back in 1951-52,[23] was never in fact applied and certainly had no influence on compliance.

The retaliatory measures imposed, with at least implicit GATT acquiescence, aptly illustrate the danger that retaliation, in the absence of carousel-like changes, can create a vested interest in the maintenance of those duties. At least one of the Chicken War tariffs placed on a variety of European products by the United States in the early 1960s, the 25 percent duty on trucks, is still in effect (and on a most-favored-nation basis at that). A further danger is that where retaliation fails to exact compliance, there exists, as with long-term compensation, a state of suspended obligation. Whereas compensation leaves only the original inconsistency lingering on, retaliation raises new trade barriers, threatening the progress of liberalization and the integrity of the fundamental principles of free trade. While the retaliatory tariffs imposed by the United States in the *Beef Hormones* case have raised barriers that had taken a lot of work to lower, the European Union is no closer to bringing its beef import ban into conformity with the WTO agreement it has been violating.

Another problem with retaliation in the form of suspension of tariff concessions is that it raises the cost of the injured member country's purchases (even where those same goods could be supplied internally under tariff protections). Historically, the larger and stronger members have been less likely to notice this effect, but it has made the retaliatory suspension of tariff concessions especially unattractive to the smaller and poorer countries authorized to retaliate against a member on whom it relied for imports. In the *Bananas* case, the recent authorization of Ecuador to retaliate against the European Union by suspending certain intellectual property rights (and therefore paying less for certain forms of intellectual property) lowers rather than raises Ecuador's costs – making retaliation a dangerously attractive option, rather than a last resort.

While retaliatory tariffs may have been logical (if not perfectly so) in a GATT system based on the assumption that the predominant barriers would be tariffs, they are outdated in the WTO system where the liberalization of most tariff barriers may be presumed. Prohibitive tariffs are dinosaurs, but when revived as retaliatory measures, and allowed to stampede through the existing structure, they can be incredibly destructive.

Although retaliatory tariffs may have been the only acceptable sticks in a world of formal national-sovereignty boundaries, recent experiments suggest that, as markets are opened and become global, notions of national sovereignty are on the whole becoming less rigid. With respect to NAFTA, for example, consider Canada's commitment in the side agreement on the environment, which precludes retaliatory tariffs against Canadian exports, but allows for financial enforcement assessments against the Canadian Government to be enforceable in Canadian courts.[24] As jurisdictions become an increasingly fluid concept, it becomes

possible to imagine new, more targeted approaches to achieving compliance with WTO rules.

Allow the Winner to Chose Compensation?

One intriguing proposal, advanced by Joost Paulwyn of the WTO Secretariat's Legal Affairs Division, is that the winning member country be allowed to choose the loser's trade compensation (subject to arbitration as to the amount) or that the loser pay monetary damages to the damaged foreign industry.[25] Other possibilities include limiting access by non-complying member countries to the dispute-settlement mechanism, or such "nuclear deterrents" as depriving the non-complying member of it's parking spaces at the WTO building! The key is to find remedies that lead to compliance and also limit the incentives to delay. For example, while one cannot eliminate a parking space retroactive to the DSB adoption of the initial panel or Appellate Body report, one could extend the effectiveness of the "No Parking" sign for the corresponding number of days. More seriously, in the case of monetary fines or damages, interest could run from some prior date. The possibility of interim relief should also be considered as a way to limit the amount of cost-free delay a member can exploit.[26] While these may be considered radical thoughts by traditionalists, it barely begins to skim the surface of useful alternatives.

IMPACT OF REMEDIES ON PRIVATE ACTORS

Thus the first two deficiencies, the incentives to delay compliance and the inadequacy of the remedies for non-compliance (the problems of inefficient carrots and sticks), militate in favor of increased procedural rigor. The lack of effective carrots and sticks is not simply a drafter's error. It serves a very important purpose of accommodating governments under great pressure from constituents feeling the pain of compliance. The DSU states that compliance is its primary goal. Compensation is currently designed to appease injured member countries when a violator cannot immediately comply with a DSU ruling. Compensation, however, should not be considered as working only at inter-governmental level, but also as a palliative at a private level, because uncompensated domestic constituencies – those injured by the violation and those injured by the remedy – can hamstring even the most committed liberal-trade-minded governments. Thus the attempt to fix compliance problems calls for more thought to be given to ways to mitigate the effects of trade liberalization on private entities.

One effect of the current DSU procedure is the burden that the opportunity for cost-free delay can put on individual entities injured by the underlying violation. The longer an inconsistent measure remains in place, the greater the disadvantage of non-benefiting private parties in the global marketplace. Also, where

governments will only demand prospective compliance, certain injuries due to unfair, even blatantly illegal trade barriers will never be remedied.

Timely compliance, however, jostles private entities that previously benefited from the protectionist measure, a tax on the public at large. Even small, straightforward and "normal" WTO-legal tariffs are phased out over as much as *eighteen years* in some free trade areas. Yet when a tariff is found to be illegal by the DSU, a country has, on average, *fifteen months* in which to remove it. From the perspective of private entities previously receiving protection, the period of cost-free delay is the only chance they have, as they perceive it, to adjust to the new market conditions. Only a fluid compliance mechanism can allow for this extra time and, also, for the possibility of negotiating a compensatory lowering of alternative barriers to further extend the phase-out period, affording previously shielded domestic Industries a chance to prepare to compete in the liberalized market.[27]

The question of effective compliance is even more complicated when the removal of protection, or support, will destroy the affected domestic producer, delay or no. In the *Australian Leather* case, the Government of Australia argued that retroactive repayment of the subsidy (and not even all of the economic benefit of the subsidy, at that) by the subsidized producer would put it (and its employees) out of business at once.[28] Could the WTO drafters have intended such a result? The consequences that attend the failure of an industry may be too harsh, after years and years of protection, for a society to bear. Furthermore, in the case of repayment of a subsidy, as in the *Australian Leather* situation, where the WTO effectively reached directly into the pockets of a private entity, it will be all too tempting for private entities to save themselves by rejecting the authority of the inter-governmental organization to make such demands. This puts national governments in an awkward position and quite possibly creates unintended private rights of actions as between a government and its citizens. Such problems are greater than what cost-free delay and negotiated extensions can solve.

Compliance is not the only DSU action that affects private actors. Retaliation can have a similar impact on private entities, whether they are European exporters of Roquefort cheese or cashmere sweaters, or are American small businessmen specializing in the import of products from a specific country. Even some of the above-mentioned proposals to replace retaliation – allowing the winning member country to choose the tariffs that are to be lowered as compensation – could have the same effect.

How, then, to reconcile the pressing need for streamlined, effective enforcement of DSU decisions with the realities of the effects of the transition on private entities? And is it necessary to think about these problems at an inter-governmental level? In legal

terms, the obligations under the WTO are among governments, not private enterprises. One could argue that such concerns about individuals ought to be addressed by domestic social-welfare programs. Given the ineffectiveness of some such programs, combined with the moral and political imperative that the WTO respect individual concerns, some thought needs to be given in the Doha Round negotiations to ensure that WTO obligations are fulfilled without wreaking havoc on the private sector. This may be particularly important in poor and developing countries where the industries affected by violations and remedies are fragile or dependent on a few markets.[29]

One possibility would be to continue to formalize the enforcement process, but build compensatory assistance for private entities (in the form of time, money or adjustment assistance) into the panel recommendations. Many economists would argue that a part of the answer is to find a way to induce the adjustment process in the economies of member countries to function more autonomously and smoothly. WTO officials must be cautious about appearing to be world governors trying to legislate for a global citizenry, but they cannot remain blind to the reality that the effectiveness of the organization depends on popular support.

While effective sticks and carrots may seem to require that the DSU move in the opposite direction of effective consideration for private entities, it may be that in many cases, attending to the effects of panel decisions on individuals will ease the pressure those injured individuals put on member governments to resist compliance.[30] The tension between increasing juridical formality and increasing flexibility in the face of popular resistance may be resolved in practice if the DSU considers compensation as part of, rather than an alternative to, bringing about compliance with WTO rules.

EVOLUTION OF "WTO SANCTIONS"

At the start of a new century, the WTO dispute-settlement procedure is widely perceived to be working well,[31] even if there is room for improvement. The procedure was not devised during the Uruguay Round negotiations alone, but was the product of two decades of analysis, experience and consultations – by no means confined to negotiators, also involving legal scholars and practitioners and trade-policy specialists in the private sector. Therefore those closely involved in the workings of the WTO system can be expected to resist the efforts of others, in separate if related fields, to use the dispute-settlement procedure to secure adherence to non-trade standards that interest them – and need to be pursued in other international forums.

The WTO dispute-settlement procedure has evolved over a long period. Recalling its evolution, at least in part, may help to convey the subtleties entailed and why care has to be taken not to push it

too far. Maintaining an open trading system, providing a stable institutional environment for the conduct of international trade and investment, requires an effective process for containing and settling disputes among and between governments. Since governments view economic problems from different perspectives, there is always a risk of miscalculation when they make decisions on trade-policy issues, which means there is a fairly constant level of conflict that must be continuously constrained and resolved in order to avert the deterioration of international trade relations.

It would be very hard to manage that constant risk of conflict if each potentially disruptive issue had to be addressed on an *ad hoc* basis. Accordingly, the process of liberalizing trade and investment requires "rules of the game", defined and established in advance so that governments can anticipate conflicts and resolve them according to standards that are accepted internationally as legitimate. In today's continuously integrating, growing and increasingly competitive world economy, with governments faced all the time with demands for trade-distorting measures to assist domestic producers, the importance of maintaining a framework of internationally agreed rules cannot be overstated.

In establishing after World War II a rules-based international economic order, which consists of two sets of rules, one for trade and one for payments, governments negotiated the GATT to serve as the institutional framework for restoring some semblance of stability to international commerce. The GATT contained a code of relatively detailed rules governing use of the major instruments of trade policy. Over the years, it developed a variety of procedures for applying those rules to particular problems, including a procedure for third-party adjudication of complaints by one government against another. Those rules and procedures served governments well during the first two decades of the GATT's existence, providing the legal framework for the substantial reduction of conventional tariffs and, too, for the progressive dismantling of the extraordinary trade restrictions that were erected during the interwar period and in order to cope with wartime dislocations.

In the 1970s there was growing concern that the rules and procedures of the GATT were losing their credibility – that governments were not adhering to GATT rules as closely as they once did, that enforcement procedures had become ineffective and that the GATT framework as a whole was not keeping abreast of developments in the world economy, particularly in the field of trade policy. These concerns came to the fore prior to the Tokyo Round negotiations of 1973-79 in the course of much public debate.

1. From the outset, then, the Tokyo Round agenda contained a fairly substantial commitment to substantive reform. The centerpiece was a commitment to negotiate "codes of conduct" on some of the non-tariff measures, matters not adequately covered by GATT rules – such as subsidies, public procurement policies and

practices, technical standards for industrial products and customs valuation. (A "safeguards" code, dealing emergency action against sudden surges of imports of particular products causing "serious injury" to domestic industries, was not achieved).[32]

2. On the second aspect of reform, improvement of the dispute-settlement procedure moved more slowly, but there was a broad consensus that something had to be done. Most early proposals for codes on non-tariff measures included special dispute-settlement procedures, reflecting a judgment that the new rules could not merely be committed to the GATT's existing procedures for rule enforcement, but an agreed program of reform was slow to emerge.

In the end, the Tokyo Round negotiations yielded codes of conduct on several categories of non-tariff intervention in the market process, but adherence to them was a matter of choice. Member countries were not required to sign the codes and most didn't. Each of them had a dispute-settlement procedure of its own, for the reason mentioned above, and that further complicated the problem of securing adherence to GATT rules as a whole. One of the objectives of the subsequent Uruguay Round negotiations of 1986-94 was an integrated dispute-settlement procedure, strengthened by tighter schedules, all of which was achieved.

Problems and Goals of Dispute Settlement

In spite of its procedural nature, dispute settlement is of central importance to the further development of the multilateral trading system, for on their own new and better rules will not necessarily result in increased government compliance. In the 1970s and early 1980s, the climate of substantial non-compliance with specific rules made governments dubious about the credibility of the rules in general, which meant they were hesitant about making difficult decisions bearing on their compliance with the rules without an assurance that the rules would be brought to bear on other governments, especially on those of the major trading powers.

When governments are left to judge compliance among themselves, without the intervention of some "higher authority", the pressures for compliance tend to vary according to the relative power of the governments involved, creating an inequitable situation in which the rules bind the weak but not the strong. Consequently, if revised substantive rules are to be effective and equitable, they have to be accompanied by procedures that ensure reliable and even-handed pressures for compliance. For many governments, satisfactory reform of the dispute-settlement procedures during both the Tokyo Round and Uruguay Round negotiations was a *sine qua non* of their input in substantive reform. In a study in 1978, the leading legal scholar on dispute settlement, Robert E. Hudec, identified two principal causes of the problem with GATT dispute settlement:[33]

(a) One cause was the breakdown in the substantive consensus underlying key GATT rules, which led some governments to resist the enforcement of them, for generally speaking the rules were no longer seen to be valid.

(b) The other cause was the transformation in the composition of the GATT system's membership, shifting from being a large number of independent, de-centralized countries to being dominated by two large trading blocs, the European Community and the United States. Thus in the large entities, there was more skepticism about the need for third-party dispute settlement; and in the rest there was more resistance to the loose and informal procedures of the GATT dispute-settlement machinery back then.

These causes suggest, as Professor Hudec pointed out, that three considerations have to be taken into account in strengthening the dispute-settlement procedure and securing compliance with findings. Those considerations still apply:

First is the need for third-party adjudication itself to be considered in the light of the doubts about the composition of the WTO system's membership. Adjudication procedures are the cornerstone of enforcement procedures. Their credibility is important to the credibility of internationally agreed rules and procedures in the internal decision making of governments. After all, if the major trading powers do not follow WTO rules and procedures, why should smaller countries?

Second, it may be that the dispute-settlement procedure cannot be strengthened much further, and applied more effectively, without adherence to fundamental principles and rules more clearly by the "majors", which in the past has caused the governments of many smaller countries to resist adjudication. Extending dispute-settlement procedures to new and revised rules may be possible, but it would need to be accompanied by improved compliance with respect to issues of interest to smaller countries, facilitating a further strengthening of the dispute-settlement procedure across the board.

Third, in the Uruguay Round negotiations the dispute-settlement procedure acquired greater authority and rigor, but that may need to be extended further to deal with the more unruly and contentious environment of the WTO system, particularly with respect to new issues. The panel procedure, which is well suited to adjudicating on compliance with trade rules, has been enhanced by giving it a more permanent institutional structure and upgrading the prestige and independence of the panel members through the appointment of "outsiders" who are experts in international trade policy. Procedures on the day-to-day operation of the complaints mechanism have been tightened to remove the opportunities for substantial delay and obstruction.

The **mockingbird** is the state bird of Tennessee. Cordell Hull represented a district of Tennessee in the Congress of the United States, and was elected a senator from there, before becoming U.S. Secretary of State (1933-44).

Trade Policy Analyses

Papers in the online series, *Trade Policy Analyses*, are published by the Cordell Hull Institute, which is a non-profit organization incorporated in Washington, DC, and is tax exempt under Section 501(c)(3) of the Internal Revenue Code.

The Institute's purpose is to promote independent analysis and public discussion of issues in international economic relations.

The interpretations and conclusions in its

The coercive sanctions" employed by the WTO dispute-settlement procedure badly need rethinking. The purpose of the WTO is to not to raise U.S. tariffs on French cheese. Public international law offers many alternatives. Some of those alternatives should be added to the menu. As discussed above, there is also a need to secure quicker compliance with the findings of dispute-settlement panels. The revisions arising from the 1998-99 review of the DSU, cited earlier, foreshadow the establishment of compliance panels, made up of the original panel or Appellate Body members, to deal with disputes over the WTO consistency of revised laws, as well as a clarification of the process for authorizing retaliation.

Finally, it might be noted that Robert Hudec concluded, after his exhaustive analysis a generation ago, that in due course a more productive way to increase the coercive force of internationally agreed trade rules would be to seek their enactment in the *domestic legislation* of the member countries.

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[1] Theodore H. Moran, *Beyond Sweatshops: Foreign Direct Investment and Globalization in Developing Countries* (Washington, DC: Brookings Institution, 2002).

[2] *Ibid.*, ch. 4.

[3] Moran, "Sweatshops, Foreign Direct Investment and the Globalization of Industry", a paper presented at the meeting of the Cordell Hull Institute's Trade Policy Roundtable in Washington, DC, on 4 December 2001.

[4] The next four sections of this chapter (all but the last) are based on Gary N. Horlick, "Problems with the Compliance Structure of the WTO Dispute Resolution Process", in Daniel L.M. Kennedy and James D. Southwick (eds), *The Political Economy of International Trade Law*, Essays in Honour of Robert E. Hudec (Cambridge, UK, and New York: Cambridge University Press, 2002).

[5] A proposal to begin the DSU reform process was initiated, but stalled, at the third WTO Ministerial Conference, held in Seattle in December 1999. See *Proposed Amendment to the Dispute Settlement Understanding*, WT/MIN(99)/8, WTO Secretariat, Geneva, 22 November 1999. The proposed revisions would have established compliance panels, made up of the original panel or Appellate Body members, to deal with disputes over the WTO consistency of revised laws. It also clarified the process for authorizing retaliation.

At the fourth WTO Ministerial Conference, held in Doha in November 2001, the ministers agreed to "negotiations on improvements and clarifications of the Dispute Settlement Understanding … based on work done thus far, as well as additional proposals by Members", to be completed by May 2003. See the Doha Ministerial Declaration adopted on 14 November 2001, WT/MIN/(01)/DEC/1. One coming issue is the "sequencing of retaliation".

[6] *European Communities: Measures Concerning Meat and Meat Products (Hormones)*, Report of the Appellate Body, WT/DS26/AB/R, WT/DS48/AB/R (16 January 1998); *EC: Measures Concerning Meat and Meat Products (Hormones)*, Action by the DSB (19 February 1998).

[7] *European Communities: Measures Concerning Meat and Meat Products (Hormones), Surveillance of Implementation of Recommendations and Rulings, Request for Arbitration by the European Communities*, WT/DS26/14 (16 April 1998).

[8] *European Communities: Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States*, Arbitration under Article 21.3 of the Understanding on Rules and Procedures in the Settlement of Disputes, WT/DS26/15 (29 May 1998).

[9] *European Communities: Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States*, Recourse by the United States to Article 22.2 of the Dispute Settlement Understanding, WT/DS28/19 (18 May 1999).

[10] *European Communities: Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States*, Request for Arbitration under Article 22.6 of the Dispute Settlement Understanding, WT/DS26/20 (6 June 1999).

[11] *European Communities: Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States, Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU*, Decision by the Arbitrator, WT/DS26/ARB (12 July 1999).

[12] *Implementation of WTO Recommendations Concerning EC Measures Concerning Meat and Meat Products (Hormones)*, 64 Fed. Reg. 40,638-41 (published 27 July 1999).

[13] *European Communities: Regime for the Importation, Sale and Distribution of Bananas.*

[14] *Australia: Subsidies Provided to Producers and Exporters of Automotive Leather*, Report of the Panel, WT/DS126/R (25 May 1999) and Action by the Dispute Settlement Body, WT/DS125/5 (18 June 1999).

[15] *Australia: Subsidies Provided to Producers and Exporters of Automotive Leather*, Status Report by Australia, WT/DS126/7 (2 September 1999).

[16] *Australia: Subsidies Provided to Producers and Exporters of Automotive Leather, Recourse by the United States to Article 21.5 of the Dispute Settlement Understanding*, WT/DS126/8 (4 October 1999).

[17] *Australia: Subsidies Provided to Producers and Exporters of Automotive Leather, Recourse to Article 21.5 of the Dispute Settlement Understanding*, Report of the Panel, WT/DS126/RW (21 January 2000).

[18] These cases are reviewed in Lewis E. Leibowitz, *Safety Valve or Flash Point? The Worsening Conflict between U.S. Trade Laws and WTO Rules* (Washington, DC: Center for Trade Policy Studies, Cato Institute, 2001).

[19] "WTO Panel to Review U.S. Compliance With Ruling on AD Rules", *Inside U.S. Trade*, Washington, DC, 28 April 2000.

[20] Note, however, that GATT panels have ordered retroactive remedies in anti-dumping and countervailing duty cases: "Dispute Settlement New Zealand: Imports of Electrical Transformers from Finland" (18 July 1995), *Basic Instruments and Selected Documents*, hereinafter cited as *BISD*, 32nd Supplement, pp. 55-70; "United States Countervailing Duties – Fresh, Chilled and Frozen Pork from Canada" (11 July 1991), *BISD*, 38th Supplement, pp. 30-47; and "Canadian Countervailing Duties on Grain Corn From the United States" (26 March 1992), *BISD*, 39th Supplement , pp. 411-36.

[21] Ironically, it did so without requiring repayment with interest, effectively allowing an interest-free loan in the amount of the subsidy – a preferential loan contingent on export, which is itself a prohibited export subsidy.

[22] One could envisage scenarios down the road where compensation – even as chosen by the loser – may actually be a desirable remedy for inconsistency with obsolete obligations.

[23] Discussed in Kenneth W. Dam, *The GATT: Law and International Economic Organization* (Chicago and London: University of Chicago Press, 1970), p. 366.

[24] North American Agreement on Environmental Cooperation, Article 34.5b and Annex 34. See also Canada-Chile Agreement on Environmental Cooperation, Article 33.5b, Article 35, and Annex 33 (creating a similar financial enforcement mechanism, enforceable in the courts of each jurisdiction).

[25] Joost Pauwelyn, "Enforcement and Countermeasures in the WTO: Rules Are Rules –Toward a More Collective Approach", *American Journal of International Law*, Washington, DC, Vol. 94, No. __, 2000, pp. 335 and 346. Even Pauwelyn does not go so far as to advocate compensation (monetary or otherwise) for damage prior to or during the dispute-settlement process.

[26] See Georges A. Cavalier, "A Call for Interim Relief at the WTO Level: Dispute Settlement and International Trade Diplomacy", *World Competition*, Geneva, Vol. 22, No. 3, 1999, pp. 103-39.

[27] *Japan: Taxes on Alcoholic Beverages*, Arbitration under Article 21.3(c) of the Dispute Settlement Understanding, Award of the Arbitrator, WT/DS8/15 (2 February 1997); *Japan: Taxes on Alcoholic Beverages*, Mutually Acceptable Solution on Modalities of Implementation, WT/DS8/19 (12 January 1998).

[28] While the Government of Australia launched this argument on behalf of a private enterprise, the argument was also self-serving in that the ultimate cost of the repayment fell to the government itself, for the Australian Government had initially extended a loan to the affected company in order to cover the repayment of the subsidy. The panel, ironically, found the loan to be a part of the same transaction, nullifying the repayment and arguably suggesting that governments could not assume the burden of the repayment. In fact, however, the panel was quite careful not to rule broadly on the validity of such government loans, presumably recognizing that governments will have to find some way to ease the cost of repayment of subsidies if future decisions continue to require full repayment.

[29] Bernard M. Hoekman and Petros C. Mavroidis, "Enforcing Multilateral Commitments: Dispute Settlement and Developing Countries", paper presented at a conference in Geneva on Developing Countries in a Millennium Round, convened by the WTO and the World Bank, on 20-21 September 1999, p. 30.

[30] It has been argued that the DSU serves as a scapegoat, so that governments under excessive political pressure not to liberalize trade barriers can say to their constituents, "The DSU made me do it." While this tactic may work for governments facing only superficial resistance, any deeply running popular sentiment could react with a vocal backlash against an "undemocratic supranational tyrant" – even if it is neither undemocratic, nor supranational, nor a tyrant.

[31] Such was the conclusion of the 1998-99 review of the DSU, according to William J. Davey, who was the Director of the Legal Affairs Division, WTO Secretariat, at the time. See his paper, "Strengthening the WTO Dispute Settlement Process and its Mediation Provision", presented at a meeting of the Cordell Hull Institute's Trade Policy Roundtable, Washington, DC, 1 May 2001.

[32] A more general commitment was made to consider the claim of developing countries for "special and differential" treatment in the administration of GATT rules.

[33] Robert E. Hudec, *Adjudication of International Trade Disputes*, Thames Essay No. 16 (London: Trade Policy Research Centre, 1978).