Testimony of

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Good morning, Mr. Chairman and Members of the Subcommittee. I should like to submit the following article as my testimony. It deals directly with the subject of the hearing this morning.

"WTO Dispute Settlement System in Need of Change." *Intereconomics: Review of European Economic Policy* 37.3 (2002): 131-135.

Ironically, the United States and the European Union are victims of too much substantive success in multilateral trade negotiations, combined with overreaching in the area of dispute resolution. As unlikely as that proposition sounds, it is a highly plausible explanation of the most important conflicts that have beset trade relations between the two trade superpowers since the creation of the World Trade Organization in 1995. To understand how this occurred, a brief history of the GATT/WTO system is in order.

"Diplomatic" vs. "Legalistic" Approach

Throughout the history of the postwar multilateral trading system, presided over first by the General Agreement on Tariffs and Trade and since 1995 by the new WTO, two distinct theories regarding the settlement of trade disputes have competed for dominance. On one side are the "pragmatists" who argue for a "diplomatic" approach that stresses conciliation and problem-solving over legal precision. This view of dispute resolution was generally espoused by Europeans; and as late as the 1980s, a Swiss GATT Director General stated: "GATT cannot be a world trade court. Conciliation is our priority: it is not our job to determine who is right and wrong." On the other side were the "legalists" or "rules-oriented" proponents who hold that legally binding rules will produce more certainty, predictability and fairness for all GATT/WTO member states. US trade policymakers and scholars, particularly, have championed this approach.

Though the system today retains some blend of the diplomatic and legalistic philosophies,

decisions taken during the Uruguay Round (1986-1994) marked a clear shift toward a more judicialized, legally binding dispute settlement system. The most far-reaching change on the dispute settlement process was the introduction of "automaticity," whereby decisions by WTO panels or the Appellate Body will stand unless there is a consensus (virtual unanimity) among WTO members against the panel or Appellate Body decision. Given the extreme difficulty of amending or interpreting WTO rules (requirement of consensus or three-fourths majority), de facto the new system gives final say to these judicial bodies.

Given the imbalance between the very efficient, binding judicial system and the inefficient, cumbersome rulemaking apparatus, there is the danger - already identified by a number of WTO scholars - that WTO member states will increasingly look to the judicial system to "create" new law or amend existing laws. As Marco Bronckers, a leading European legal scholar has written: "Governments may too easily think that progress can be made in the WTO through enforcement; that litigation is a more convenient way to resolve difficult issues than an open exchange at the negotiating table. That is troubling because it undermines democratic control over international cooperation and rule-making ..."

Further, the mindset of the new legal culture is at odds with diplomatic accommodation. Professor J.H.H. Weiler, a strong advocate of the new system, has candidly admitted that though the rule of law is supposed to be dispassionate and objective, when two parties both believe that the law is on their side and litigate, "then it becomes a profession of passion, of rhetoric, of a desire to win... all inimical to compromise." Likewise, though legal professionals should act objectively on the merits of a case, in reality they are (like other professionals) "people with ambition, with a search for job satisfaction." Thus, according to Weiler: " 'We can win in court' becomes in the hands of all too many lawyers an almost automatic trigger to 'we should bring the case.' " The bottom line regarding the old system of consultation and conciliation, as one US trade lawyer has pointed out, is that it "has disappeared as a meaningful step in the process. To consult openly is to risk your country's case as an advocate, as any admission is going to be used against you. Only consult seriously if you wish to confess judgment and make amends that is the lesson of the DSU."

The triumph of binding legalism came just at the time when the results of the Uruguay Round had vastly expanded the substantive reach of the international trade regime. New rules in the area of health and safety, and for the services industries - banks, insurance companies, telecommunications and the Internet, energy services and transportation, for example - meant that the multilateral trading system would be asked to deal with complex issues that go deep into the economic and social structures of its member states. In addition, a wholly new regime for intellectual property was established, at a time of great ferment within individual nations over challenges to intellectual property emerging from new technologies such as software and biotechnology. Sylvia Ostry, a former Canadian trade negotiator now at the University of Toronto, has described the resulting new model: "The degree of obtrusiveness into domestic sovereignty bears little resemblance to the shallow integration of the GATT with its focus on border issues . . . The WTO has shifted from the GATT model of negative regulation--what governments must not do--to positive regulation, or what governments must do."

Unsustainable Dispute Settlement System

As the two leading superpowers of trade, the United States and Europe constitute the

indispensable central core of the multilateral trading system. And the seeming intractability of an increasing number of disputes between the two WTO leaders is a harbinger of greater systemic problems. Specifically, in a recent book, I have argued that the new WTO dispute settlement system is unsustainable, both politically and substantively.' It is not sustainable politically because the constitutional flaw stemming from the imbalance between the powerful judicial system and the weak and ineffective rulemaking procedures will, over time, create major questions of democratic legitimacy. In retrospect, it was relatively easy to rebut charges of democratic illegitimacy against the delegates to Seattle in 1999: they were appointed officials of (mostly) democratic governments. It will be another thing, however, to defend the actions of WTO judicial bodies when it is alleged that they are "legislating" new rights and obligations through judicial interpretation.

Substantively, there are two problems. First, even with the best of wills, panels and the Appellate Body face a daunting task in interpreting the underlying text and rules because, as even defenders of the new system admit, they contain numerous gaps and ambiguities, lacunae, and contradictory language that papers over basic policy differences among negotiators. More fundamentally, there is no consensus in a number of instances on the complex regulatory issues posed in such areas as services regulation, health and food safety, and national intellectual property regimes.

The Beef Hormones Case

For the purposes of this essay, two major WTO judicial confrontations between the US and the EU illustrate the political and the substantive conundrums engendered by the new system. The first is the well known Beef Hormones Case, which remains a standoff with Europe continuing to pay over $100 million in compensation for refusing to abide by a WTO ruling. There could be no better example of the folly of a promise of a legally "correct" decision in a program area than this case. Underlying the complicated facts of the dispute is a fundamental disagreement about how societies should handle risk. The EU is moving inexorably toward an expansive interpretation of the "cautionary principle," whereby nations can ban the import of goods with minimal (or no) scientific evidence. The US (and some other nations) are moving in the other direction - toward mandating credible scientific data before allowing trade restrictions. WTO rules seem to point to at least minimal scientific justification, and assume that invocation of the "precautionary principle" will be temporary, pending additional data.

When confronted with such dissonances, the Appellate Body produced a decision laced with a hodgepodge of creative, yet unintegrated rationales. It upheld the need for scientific evidence, while undercutting that mandate by allowing socioeconomic arguments (including public opinion) to rank with science in determining import policy. It denied the EU's contention that the "precautionary principle" had reached the status of customary international law at this time - a truly radical assertion - but held out the possibility that in the future the situation might change. (Subsequently, the EU compounded the problem by flouting the clear statement in WTO rules that the "precautionary principle" can only be utilized "provisionally" and temporarily; in effect, it defended an invocation virtually in perpetuity.) Whatever the specific outcome in each of these questions, the debate centered on issues that potentially altered the rights and obligations of WTO members--and thus should not have been confined to the single discretion of WTO judicial bodies.

The FSC Cases

The equally famous FSC cases concerning alleged WTO-illegal tax subsidies for US exporters is another illustration of both the incapacity of the Dispute Settlement Understanding to deal with a complex international economic issue (international taxation) and the dangerous consequences of pronouncing on highly charged political issues. (It should be noted that the author is a strong opponent of any subsidies for exporters and would abolish as corporate welfare such US programs as those administered by the US Export-import Bank and OPIC. The issue here, however, relates to WTO rules and adjudication--and not the wrongheadedness of export subsidies.)

Fundamentally, the issues in these cases stem from differing national approaches in taxing foreign source income of corporations. The United States generally uses a so-called worldwide system of taxation - that is, it taxes income of a person or corporation regardless of where the income is earned. European nations in general utilize the so-called territorial system under which countries tax all income within their border but do not tax income earned abroad. Conflicts have arisen for three decades as the United States has attempted to level the playing-field and replicate some part of the European foreign source income exemption. Suits and countersuits were launched in the 1970s under the old GATT. A standoff ensued when both the European (at least for several countries) and the US international tax system were found in violation of existing trade rules. In 1981, a political "Understanding," ratified by the GATT General Council, was reached that agreed that with respect to these cases "and in general, " economic processes, including transaction involving exported goods, need not be taxed by the exporting country. Fifteen years later, in a fit of pique and after much negotiating water had flowed over the dam, the EU challenged the then existing US export credit regime.

Brushing past ample legal authority to uphold the validity of the 1981 Agreement, a WTO panel and the Appellate Body upheld the EU challenge. The US Congress then revised the export tax regime, only to have a panel and the Appellate Body once again find for the Europeans. In this last case, the Appellate Body put forward a standard that assumed the possibility of a "bright line" between foreign and domestic income - and struck down the US law for establishing formulas that partially mixed the two. As the US trade and tax expert, Gary Hufbauer, has stated, this interpretation could only have been advanced by a "firstyear law student . . . with only limited knowledge of tax law."

To conclude this section, these cases (and others that could be cited) illustrate the twin dangers inherent in the mindset of the panels and the Appellate Body that is, incautious incursions into highly volatile political areas such as food safety and international taxation, combined with a determination to provide a legally "correct" answer to all questions, even when it means--as with the FSC decisions--that they will be forced to venture into complex substantive areas beyond their competence.

What is to be Done?

The aim of the following recommendations for change in the WTO's dispute settlement system is: (1) to reintroduce some elements of the older GATT diplomatic approach, with an emphasis on mediation and conciliation rather than legal fiats; and (2) to rein in the judicial bodies and thereby lessen both sovereignty and legitimacy concerns. The recommendations are

complementary but independent - that is, the WTO could adopt them singly or in some combination.

1. *A Safety Valve: Mediation, Conciliation and Arbitration*: Under this proposal, the WTO Director General or, alternatively a Committee of the WTO Dispute Settlement Body, would be empowered to step in and direct the contending WTO members to settle their differences through bilateral negotiations, mediation or arbitration by an outside party. Such action would be taken in situations where, in the judgment of the Director General or the Committee, the highly divisive political nature of the contest would permanently damage the WTO, or where clearly the underlying text masked deep substantive divisions between WTO members.

2. *A Blocking Mechanism*: The goal of this proposal is to redress the current imbalance between the highly efficient dispute settlement system and the inefficient, ineffective consensus-plagued rulemaking process. At any time, at least one third of the members of the WTO Dispute Settlement Body, constituting at least one quarter of trade among WTO members, disagreed with a judicial decision, that decision would be set aside until the issue could be negotiated out in the WTO General Council, or as part of an overall round of trade negotiations.

In addition, two less radical changes should be considered. They would constitute new guidelines for future panels and the Appellate Body.

1. *Non liquet Doctrine*: This legal term literally means "it is not clear." Given the widespread agreement that WTO texts are replete with lacunae and contradictory provisions, and given that questions concerning the legitimacy of judicial decisions are magnified at the international level, the panels and the Appellate Body should be instructed to utilize this doctrine much more frequently - and throw the decision back to the WTO General Council or to trade round negotiations. Critics of non liquet have argued that it is prohibited because international law is necessarily "complete," or that it is the duty of judges to step in and fill gaps, particularly in contentious areas. WTO rules, by common consent, are certainly not "complete" and arguments for "gap-- filling" by judges reflect a dangerous - even antidemocratic - myopia.

2. *Political Question Doctrine*: Alternatively, the WTO could adopt a variation of the so-called "political issue doctrine," developed by the US Supreme Court. The doctrine is meant to provide a means for the judiciary to avoid decisions that have deeply divisive political ramifications and thus, in the opinion of the court, should be settled through more traditional democratic processes, involving both the legislature and the executive. Once again, if such a doctrine is deemed important for preserving checks and balances at the national level, an even more cogent argument can be advanced for its introduction in international law - where the sources of legitimacy of judicial bodies are much weaker than within democratically constructed nation states.

In summary, the proposition advanced here is that heading off corrosive conflicts between the US and the EU in the future will necessitate reform of the international trading rules that have enmeshed--and indeed entrapped--both trading superpowers.

Note

[1] Claude Barfield: *Free Trade, Sovereignty, Democracy: The Future of the World Trade Organization,* Washington, D.C. 2001, AEI Press.