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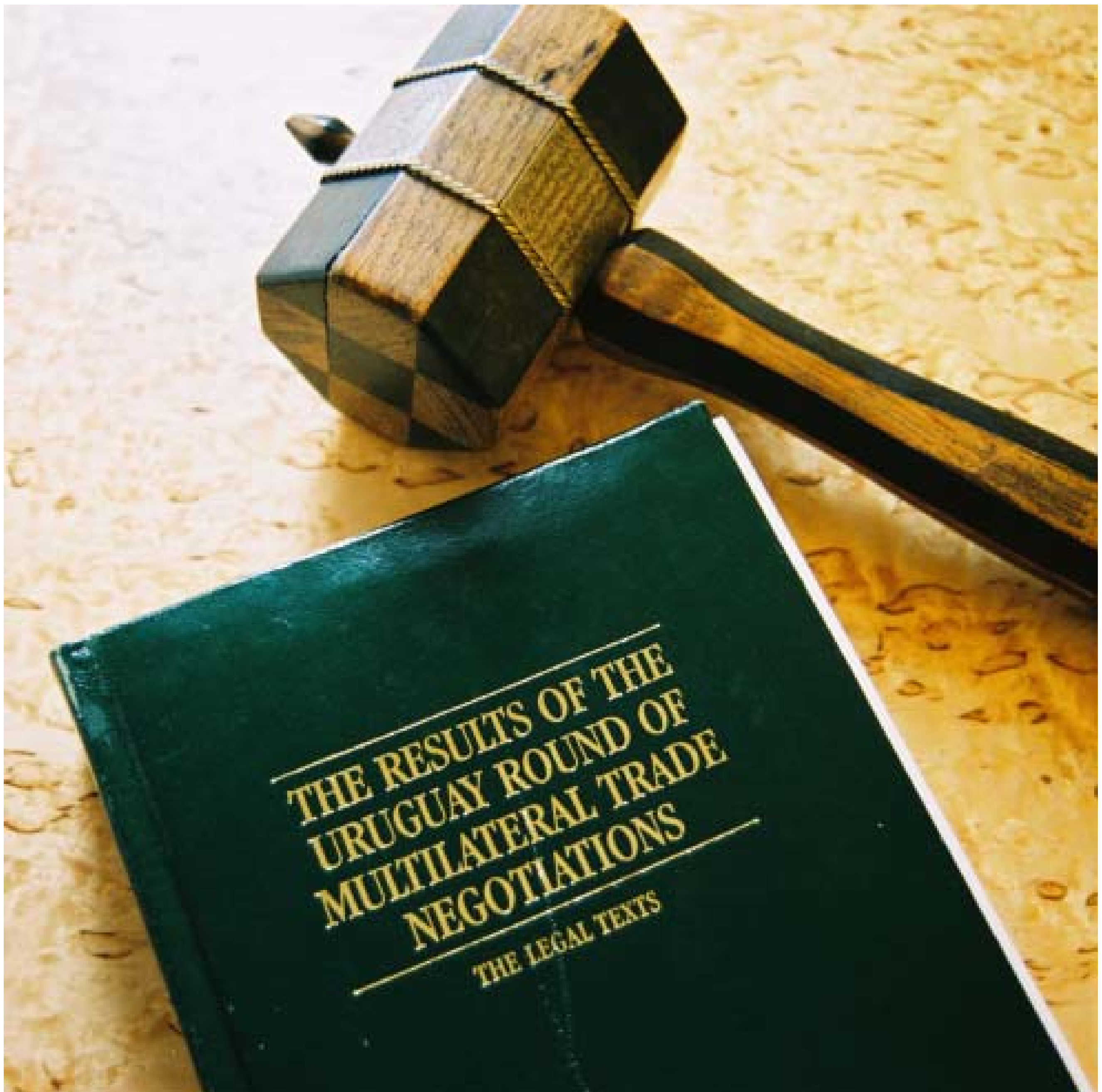
Trade brief on...

The WTO Dispute Settlement



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The WTO Dispute Settlement Mechanism and Developing Countries[1]

Developing countries need access to foreign markets if they are to reap the benefits of globalization. Multilateral negotiations under the World Trade Organization (WTO) play a pivotal role in facilitating market access.[2] Yet, throughout the global economy, pressures for protectionism abound, threatening to roll back these gains. As a result, the WTO's dispute settlement mechanism is widely seen as one of the most critical – and successful – features of the trade regime. Using this mechanism, WTO member-states can shine the spotlight of international legal scrutiny on the protectionist practices of their trading partners. This rule-of-law system is especially important for developing countries, which typically lack the market size to exert much influence through more power-oriented trade diplomacy. Indeed, some poorer countries have used the WTO dispute settlement system to great effect, proving the system's worth from a development perspective.[3] Nonetheless, the technical and legal complexity of this regime makes it difficult for other developing countries to effectively use the system, many of which have never filed a WTO dispute, despite having repeated grounds to do so. In this issues brief, we elaborate this point by describing: (a) how WTO dispute settlement works; (b) the prospective benefits and hurdles to effective use of the regime by developing countries; and (c) some potential directions for technical assistance and capacity-building, focusing on WTO dispute settlement, in particular.

1. How WTO Dispute Settlement Works

A WTO dispute proceeds through three main stages: consultation; formal litigation; and, if necessary, implementation (figure 1). All disputes start with a request for consultations, in which the member government bringing the case

[1] This note was written by Marc L. Busch, Associate Professor, Queen's School of Business, Queen's University, Kingston, Ontario, Canada and Eric Reinhardt, Associate Professor, Department of Political Science, Emory University, Atlanta, Georgia, USA, February 2004.

[2] For example, the largest developed countries have tended to reserve their deepest concessions on agriculture, a sector of central interest to many developing country exporters, for the multilateral forum, not bilateral trade agreements.

[3] Of course, some developing countries also have access to dispute settlement procedures in preferential trade agreements. Such bilateral or regional mechanisms, however, have yielded fewer benefits in practice. This is because they cover fewer partners, and often do not have the same in-depth coverage of areas that are especially salient for developing countries, like agriculture.

to the WTO (*the complainant*) sets out its objections to the trade measure(s) of another member government (*the defendant*). The two sides are then required to consult for 60 days with the goal of negotiating a mutually satisfactory solution to the dispute. Interestingly, a large proportion of cases are successfully resolved during consultations; 46% of all disputes brought to the WTO end at this stage, and three-quarters of those yield at least partial concessions from the defendant.[4]

If consultations do not result in a mutually satisfactory solution, the complainant can request a panel proceeding, marking the start of the formal litigation stage. Panels are comprised of three to five persons with a background in trade law, agreed to by the parties on a case-by-case basis. There are typically two rounds of testimony, including from other countries (*third parties*) that notify the WTO of a "substantial" interest in the case. The panel then circulates an "interim report," offering both sides an opportunity to comment and seek clarification. The complainant and defendant can still negotiate a settlement at this point. In fact, another 13% of all cases end at this stage *before* a ruling is rendered. If not, the panel issues its final report, which is then adopted by the WTO, unless one of two things happens. First, the two sides can agree *not* to adopt the panel report for whatever reason, although to date this has not happened. Second, one or both sides (but not third parties) can appeal the panel's report, which happens frequently (i.e., in 73% of panel rulings).

The Appellate Body (AB) handles these appeals. Unlike panels, the AB is a standing body of jurists which is designed to ensure greater consistency across its rulings. The AB is tasked with hearing testimony from the parties, and any third parties, on how the panel may have erred in its legal reasoning. The AB can uphold or overturn the panel in whole or in part, and its decision is final. If this verdict favors the defendant, the case typically ends. If this verdict, instead, favors the complainant, the dispute may proceed to the implementation stage.

When a defendant is ruled against, the panel and (or) AB calls for it to bring its measures into accordance with its WTO obligations. What this means in practice is, itself, often contested. If the complainant feels that the defendant has not taken appropriate steps, it can subsequently request a "compliance" panel. This panel, which is often comprised of the original panel members, must determine whether the defendant's efforts have, in fact, brought its measure(s) into compliance. If not – a judgment the defendant can appeal to the AB – the complainant can request a second panel to set the level at which it can "retaliate" against the defendant. This typically involves imposing tariffs on the defendant's exports. It is essential to note two things about retaliation. First, requests for authorization to retaliate are rare. Indeed, complainants have asked for authorization to retaliate in just seven of the hundreds of cases handled by the WTO. Second, it is up to the complainant, and not the WTO, to follow through on this

[4] This and all subsequently cited figures on WTO dispute participation, escalation, and outcomes, are derived from the dataset on WTO disputes maintained by the authors, as updated and reported most recently in Busch and Reinhardt (2003). Full definitions of the means of counting disputes and coding outcomes are in Busch and Reinhardt (2002).

authorization to retaliate, and this is rarer still. Of the six requests authorized to date (the seventh is pending at the time of this writing), complainants have retaliated in only three cases.

What is remarkable is that, despite its blend of law and politics, the system works, and works quite well. In fact, two-thirds of the disputes brought for adjudication in Geneva are resolved to the full satisfaction of the complainant. But is this true for all members? In particular, is the system useful for developing countries, most notably in disputes against developed countries? The answer is clearly "yes," although more can be done to help developing countries make better use of the system.

2. WTO Dispute Settlement from a Development Perspective

Trade liberalization promises considerable returns, but comes with risks. One such risk is the possibility that a foreign government will succumb to lobbying by its own domestic producers and grant them protection. This can undermine a developing country's interest in reallocating resources to the affected export sector, since poor countries tend to have fewer alternative export markets, and fewer export goods. As a result, the mere anticipation of such protectionism can deter or dilute much-needed trade reform in developing countries. The WTO dispute settlement system can help insure against this risk by maintaining market access once it is won, thereby encouraging developing countries to embark on an open-trade growth strategy.

The conventional wisdom, of course, is that developing countries face substantial hurdles in using WTO dispute settlement.[5] Foremost among these is their lack of market size with which to credibly threaten retaliation for noncompliance. In other words, the concern is that even with a legal victory in hand, a developing country may not be able to compel the defendant to liberalize, since its threat to retaliate lacks credibility. This may deter developing countries from filing complaints in the first place. A developing country might also be reluctant to initiate a dispute because of fears of reprisals, such as the suspension of foreign aid or unilateral trade preferences.

In addition to these difficulties, which in fact are true for small *developed* countries as well, developing countries face a unique problem: the lack of legal capacity. To take full advantage of WTO law, developing countries need the facility to aggressively pursue their rights in the increasingly complex legal trade regime. For such capacity, a country must have several things. It needs experienced trade lawyers to litigate a case, but also seasoned politicians and bureaucrats to decide whether it is worth litigating a case, which is arguably the most critical stage of the process. It needs a staff to monitor trade practices abroad, but also the domestic institutions necessary to participate in international negotiations on complex issues, like health and safety standards, which figure so prominently on the WTO's agenda. The truth of the matter is that many developing countries lack even a single full-time WTO representa-

[5] Hoekman and Mavroidis (2000).

tive, let alone the necessary dedicated trade negotiation bureaucracy at home.

With these obstacles in mind, it might seem that developing countries stand to benefit little from WTO dispute settlement. But this is far from true. Poorer complainants have filed and won concessions from large industrialized states in a wide variety of disputes, with millions of dollars at stake. These cases have involved exports of underwear (Costa Rica v. US), shrimp (Thailand and Pakistan v. US), wool shirts (India v. US), gasoline (Venezuela and Brazil v. US), sardines (Peru v. European Communities) and poultry (Brazil v. European Communities), among other products.

Why, despite their lack of a credible threat to retaliate, have these developing countries succeeded in making effective use of WTO dispute settlement? The reason is that these complainants, like their wealthier counterparts, have benefited from the fact that defendants worry about the normative condemnation that goes along with a legal defeat, rather than threats of direct retaliation per se. In other words, defendants prefer to avoid being found "noncompliant" because such a label may damage their prospects of gaining compliance when they, in turn, file as complainants. In this way, defendant governments may value the integrity of the multilateral trade regime over the outcome of a single case. This means that poor complainants can use legal victories at the WTO to weigh in on the domestic political debates over free trade within defendant countries, as they look to gain market access. In short, the effectiveness of WTO dispute settlement derives more from these intangibles than from trade sanctions, which are rare, and which could never have been a credible factor in the dozens of cases in which wealthy defendants have conceded to poor complainants.

Viewed from this perspective, the emphasis on retaliation at the WTO is misplaced. While it is true that larger countries can more credibly threaten to retaliate, threats of retaliation are not the key to the system. As Robert Hudec explained, other provisions of the WTO "make legal complaints *without retaliation* quite a bit more effective than they were" under GATT. He further observed that the inability of poor countries to retaliate "is a problem, but it is a separate problem that has nothing to do with the utility of the dispute settlement procedure for a developing country complainant."[6] The evidence, to which we now turn, bears out Hudec's discerning insight.

In looking at the evidence, the first thing to note is that most WTO disputes are among a few members that account for the bulk of international trade, most notably the US and Europe. By comparison, developing countries have had little experience with dispute settlement. But, as Table 1 indicates, this disparity is largely explained by differences in trade volumes. Consistent with this explanation, a few developing countries, such as Brazil and India, have launched a relatively large number of disputes, while others, like China, are increasingly active in dispute settlement as third parties, seeking to gain experience with the system.

[6] Hudec (2002), p. 84. Emphasis added.

Table 1. WTO Dispute Participation by Members' Level of Development

Member Income Category	Number of WTO Members	Number of WTO Disputes as Complainant	Number of WTO Disputes as Defendant	Percent of WTO Members' Total Exports
Low	44 (34%)	20 (7%)	20 (7%)	3.8%
Lower-Middle	33 (26%)	48 (17%)	35 (12%)	12.4%
Upper-Middle	26 (20%)	35 (12%)	46 (16%)	10.2%
High	26 (20%)	183 (64%)	185 (65%)	73.6%
Total	129 (100%)	286 (100%)	286 (100%)	100%

Note: Dispute counts include all filed from 1995 through the end of 2002. Trade figures are from 2000 and count both goods and services but only external trade in the case of the European Community (EC). World Bank country classifications for 2002 are used. The "Number of WTO Members" column reports the 2002 figure and does not include the 15 members of the EC, as apart from the EC itself. Sixteen of the 20 "low income" complaints were filed by India alone; the other four were initiated by Indonesia and Pakistan.
Sources: World Bank (2003); Busch and Reinhardt (2003).

Nonetheless, the record of dispute outcomes testifies to the acuteness of the legal capacity problem for the smaller and poorer countries in the developing world. Table 2 displays the data on dispute outcomes since 1995. To be sure, despite their weak market power, the poorest complainants have nonetheless managed to get larger defendants to concede fully in over 40% of their cases. Yet their developed counterparts gain full concessions in nearly three-quarters of their complaints. As we show in a recent study (Busch and Reinhardt 2003), this is not just an artefact of differences in economic size. Rather, while the system is clearly working for all complainants, it is working better for those with the know-how and savvy to take maximum advantage of the legal opportunities the system affords.

Table 2. WTO Dispute Outcomes by Complainant's Level of Development

Complainant's Income Category	Level of Concessions: None	Partial	Full	Total
Low and Lower-Middle	8 (29%)	8 (29%)	12 (43%)	28
Upper-Middle	4 (27%)	3 (20%)	8 (53%)	15
High	20 (18%)	10 (9%)	82 (73%)	112
Total	32	21	102	155

Note: Row percentages shown in parentheses. The table includes all WTO disputes begun from 1995 through 2000 and concluded by early 2003. Too few disputes with low income complainants occurred in this period for them to be counted separately. The association here is statistically significant (c^2=11.96, 4 d.o.f., *p*=0.02).
Sources: World Bank (2003); Busch and Reinhardt (2003).

This is not to say that the legal decisions handed down by the WTO are *politically* biased against developing countries. Far from it. Developing countries, as it turns out, are no less likely to win a ruling than wealthier complainants.[7] Moreover, defendants are just as likely to comply with a ruling won by a developing country as they are with a ruling won by a wealthier complainant.

Rather, the problem is that developing countries are far less likely than richer ones to induce a settlement *before* a ruling is issued. In other words, wealthier countries tend to resolve their disputes through negotiation, either in consultations or at the panel stage before a verdict, whereas poorer complainants are unable to get complainants to offer substantial concessions at these points in the process. In trade disputes between the United States and the European Union, for example, all cases yielding concessions have ended before the panel rules. In short, the benefits of adjudication disproportionately happen before formal litigation is complete, and often before it even commences. This is why it is especially important for developing countries to close the gap in "early settlement."

3. Priorities for Capacity-Building and Technical Assistance on Dispute Settlement

There are several priorities for capacity-building and technical assistance. First, developing countries need more access to information on the WTO-legality of the measures employed by their major trade partners. This information is vital not just in thinking about *how* to prosecute a case, but *whether* to prosecute a case. Institutions like the Agency for International Trade Information and Cooperation offer assistance to developing countries in interpreting trends in the global economy, and the Advisory Centre on WTO Law provides subsidized legal assistance. To close the early settlement gap, developing countries need to bridge the important contributions of these and other institutions, particularly with respect to evaluating the merits of a case *before* it is filed in Geneva, and articulating a negotiating strategy to win concessions *before* a legal verdict is issued. The long-term goal, of course, is to build-up this expertise in the capitals of developing countries, but in the short-term the focus might be on funding institutions like the Advisory Centre to increase staff and tackle this broader mandate, or develop others to fill this role.

Second, developing countries also require assistance monitoring compliance with the WTO verdicts that they win. Both domestic and foreign trade associations and consumer groups can play a key role in this respect. Indeed, these organizations have strong incentive to keep track of protectionist practices on behalf of their constituents, and often have information that governments need to monitor compliance. The challenge for developing countries is not only to sponsor domestic trade associations and consumer groups, but to forge contacts with foreign ones. Peru, for example, was assisted by a British consumer group in challenging Europe's trade restrictions on sardines, an ally that will prove crucial in monitoring future

[7] Both groups win rulings about 60% of the time, with only a little variation from that figure depending on how you define the "development" categories.

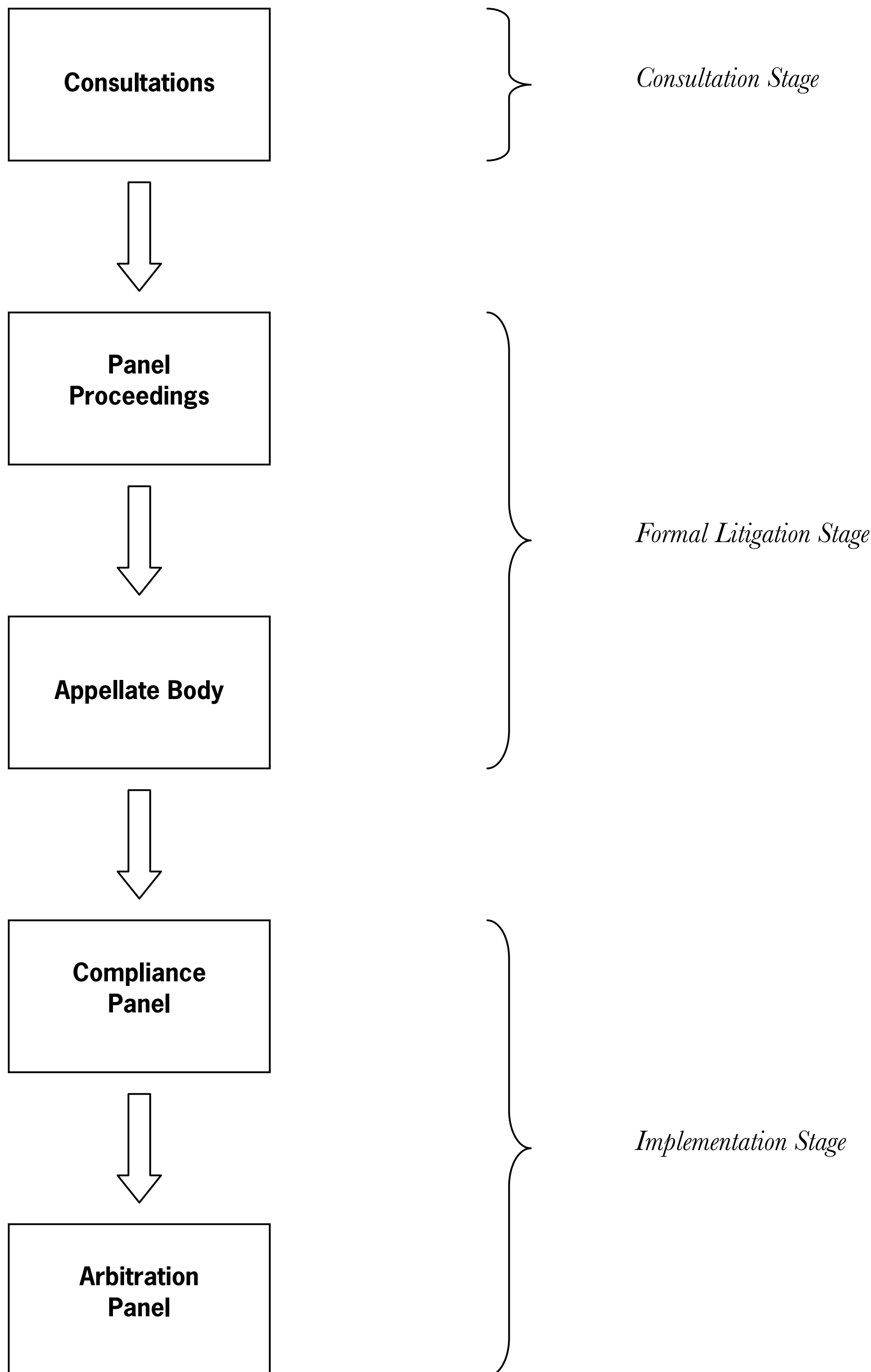
compliance.[8] Forging alliances with foreign trade associations and consumer groups is also a highly cost-effective strategies for making better use of WTO dispute settlement, since resources are shared across a wide variety of organizations with local expertise.

Why should wealthy countries invest in capacity building and technical assistance for developing countries? The answer is simple: it is in their own best interest to do so. If developing countries are less successful in WTO dispute settlement, this only incites cheating in the system more generally, which in turn hurts wealthier countries, not just poorer ones. Lesser success in dispute settlement would also have a chilling effect on the willingness of developing countries to negotiate future trade rounds. Investing in capacity building and technical assistance should thus be a priority for the WTO membership as a whole, particularly as a means to closing the early settlement gap.

8 Shaffer and Mosoti (2002), p. 16.

Figure 1

A Schematic of the WTO Dispute Settlement Process



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