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# Introduction

International trade negotiations once focused primarily on reducing border barriers such as tariffs and quotas that protected markets for manufactured goods. Such discussions took place in a rules-based, multilateral global system centered on the General Agreement on Tariffs and Trade—the GATT. The GATT was spectacularly successful in reducing border barriers. On average, tariffs on industrial goods fell from around 40 percent in 1947 to below 5 percent in the late 1980s. But as tariffs fell and markets opened, the challenges presented by the different laws and practices of trading nations became apparent. In response, the focus of trade policy-making shifted. Trade negotiations now often center on policies and rules once thought of as purely domestic in nature. Trading nations commonly seek not only to negotiate over tariffs but also to change practices by constraining, reconciling, or even harmonizing rules.

Our first volume, *Making the Rules*, presented case studies on negotiations to establish trade rules in this new context. However, the expanding depth and scope of trade rules has been accompanied by another important development. With the birth of the World Trade Organization (WTO) in 1995 came a new system for resolving trade disputes. By comparison, the early GATT system had limited provisions for dispute settlement: Adjudication was provided, but the emphasis was on diplomatic consultation and developing consensus. While the GATT evolved in the direction of a more juridical system, the WTO approach entails an even stronger, more routinized and juridical way of managing conflicts over trade. The result is a more powerful system with a greater ability to enforce trade rules—but also one that is more controversial.

The cases presented in this volume describe efforts to resolve trade disputes in the context of this new system. Our aim is to raise questions and

stimulate discussion. To that end, the cases explore the substance of the conflicts and their political context, and also delve into the dispute resolution process. By examining important recent trade conflicts, the reader can come to understand not only the larger issues surrounding trade policy today but also how participants seek to exert influence in the dispute resolution system and how the system evolves as a result of these pressures.

We have sought, both in our introduction and in the cases themselves, to avoid policy advocacy. The idea is neither to undertake an analysis of trade disputes from the perspective of a particular discipline nor to provide prescriptions as to how the situation should be resolved or the dispute settlement mechanism changed. As in our first volume, we pay particular attention to the United States and how the disputes play out in the American political context. The cases involve conflicts with Europe, Japan, and Brazil over a wide array of products—notably, cotton, steel, beef, bananas, and camera film. They also span a broad range of trade rules on food safety, technical barriers, competition policies, subsidies, safeguards, and quotas. Some of the trade conflicts are long-term, initiated during the GATT and continuing to the present day. Others arose after the creation of the WTO. Some focus on how domestic government officials deal with the dispute at hand, while others highlight the roles of business and consumer groups. But all of the cases explore the interaction between the rules, the politics, and the process of resolving trade disputes.

## **The Cases**

The six major disputes treated here are the US-EU fight over trade in hormone-treated beef, the US-EU dispute over trade in bananas, the efforts by the US photography giant Eastman Kodak Co. to penetrate the home market of its Japan-based rival Fuji Photo Film, the decision by the George W. Bush administration to impose tariffs on some imported steel and the European Union's response to these tariffs, the WTO challenge brought by Brazil against US cotton subsidies, and the US-EU dispute over trade in genetically modified (GM) foods. The cases are summarized below.

### **Food Fight: The United States, Europe, and Trade in Hormone-Treated Beef**

The long-standing US-EU dispute over trade in beef began with the widespread adoption of growth-promoting hormones for raising beef cattle in the United States. In 1989, Europe banned the use of these hormones. The ban covered all beef, including meat imported from the United States. At the core of the dispute lay fundamental disagreements about trade in food.

The United States argued that the European regulatory process had been captured by politics. US officials were frustrated by what they saw as a political move to protect the EU beef market by invoking scientifically unsupported claims about the detrimental health effects of hormones. Europe defended its ban, asserting that health issues should be decided democratically—by politicians who answer to voters. The real issue, Europe argued, was that the US trade system was overly influenced by industry—the United States had soured the entire transatlantic trade relationship by responding to the demands of the beef lobby. Ultimately, the United States brought a case against Europe at the WTO.

## **Banana Wars: Challenges to the European Union’s Banana Regime**

Despite the growth and liberalization of world trade in the post–World War II era, international trade in bananas remained highly regulated, especially in Europe. The import of inexpensive bananas distributed by large US-based brands was limited by trade quotas in EU nations—a policy justified by the European Union as a way to assist former European colonies, long reliant on banana trade. This case describes efforts by the Office of the US Trade Representative (USTR), urged on by such major distributors of Central and Latin American bananas as the Chiquita and Dole corporations, to end European banana import restrictions. The United States brought a successful case against Europe at the WTO, and later imposed retaliatory tariffs following EU resistance to the WTO panel’s findings.

## **Snapshot: Kodak v. Fuji**

This case describes the issues that arose when the US photography giant Eastman Kodak Co. sought to penetrate the home market of its worldwide rival based in Japan, Fuji Photo Film. It examines the relationship between the USTR and its Japanese counterpart, the Japanese Fair Trade Commission. The case focuses on the question of whether domestic regulations may, because of their practical application, amount to trade barriers—as Kodak alleged in the instance of Japan.

## **Standing Up for Steel: The US Government Response to Steel Industry and Union Efforts to Win Protection from Imports, 1998–2003**

The March 2002 decision by President George W. Bush to impose tariffs on some imported steel capped a long-running campaign by the US steel

industry and its unions for assistance in dealing with surges of low-priced imported steel in the aftermath of the 1998 Asian financial crisis. The Bush decision came as a surprise to many who assumed that a free trade-oriented administration would not adopt measures likely to be viewed as protectionist. The case traces the history of the steel dispute through the Clinton and Bush administrations. It examines the behavior of lobby groups and Congress, particularly the role of subgroups (such as the so-called Congressional Steel Caucus, a group of members from steel-producing states) and committees within Congress. It describes the sorts of pressures that converge on the executive branch as it confronts the prospect of bringing action under section 201 of the US rules—a policy response that is allowed when imports injure a domestic industry. The case also describes the successful European challenge to these tariffs at the WTO and the US decision to remove them in the face of threatened retaliation.

### **Brazil's WTO Cotton Case: Negotiation Through Litigation**

The United States is by far the world's largest exporter of cotton, accounting for between one-quarter and one-third of world exports. Like many other countries, the United States also provides subsidies to its cotton producers—\$2.3 billion in 2001–02 alone. Between December 2000 and May 2002, the world price of cotton declined by 40 percent, shrinking the value of the global cotton market from \$35 billion to \$20 billion in just 18 months. It bottomed out at 39 cents a pound, a record-low level in real terms. The reasons for this dramatic price decline are complex, but nearly everyone pointed a finger at US subsidies. In September 2002, Brazil initiated a WTO case against the United States—the first-ever challenge of a developed country's agricultural subsidies by a developing country. West African countries also lobbied the WTO to include a separate initiative on cotton in the Cancún text. Many in the media have framed the cotton case as a litmus test of whether the WTO can work for the poor.

### **The US-EU Dispute over Trade in Genetically Modified Crops**

In 1996, American farmers began planting GM corn and soybean crops. Use of these herbicide- and insect-resistant varieties skyrocketed in the United States. After some public debate, GM crops were generally treated the same as non-GM crops by the US regulatory system using existing laws. But not all countries were as quick to embrace agricultural biotechnology. The European Union developed a separate regulatory approach for GM products, including a different approach toward risk. Resistance to the technology grew in Europe, and many consumer groups, environmentalists, NGOs, and politicians rejected genetically modified organ-

isms (GMOs). Ultimately, the European Union placed a de facto moratorium on the approval of new GM products in 1998, frustrating US exporters. The US position on GM crops has been that there is no scientific evidence that can justify Europe's de facto ban of such plant varieties. But some noted that though European GM policies restricted trade, the moratorium was not a simple case of protectionism. The Bush administration decided to challenge the European Union at the WTO, arguing that the moratorium against GMOs violated the SPS agreement.

## **The Evolution of the WTO Dispute Settlement System**

The multilateral trading system's dispute resolution mechanism has evolved over the past 50 years in response to economic, institutional, and political forces. The success of the trading system, beginning with the GATT and continuing in the WTO, has dramatically increased the scope and depth of trade rules and the range of parties involved. This success has paradoxically resulted in more, and more difficult, disputes between trading nations. At the same time, structural, institutional, and psychological barriers make it difficult for the contending parties to resolve their own disputes through negotiation. Although the current WTO dispute resolution system represents a good mechanism, it nonetheless has strengths and weaknesses. Also, it has not prevented (and cannot prevent) countries from seeking to game the system by making strategic choices to advance their national interests.

## **The Increasing Scope and Depth of Trade Rules**

From its inception with the GATT to the current WTO, the history of the international trading system is characterized by increasing complexity. On one hand, the system has achieved enormous increases in global welfare.<sup>1</sup> On the other hand, it has increased both the number and the difficulty of disputes that need to be resolved.

### ***The GATT System***

For the four decades before the establishment of the WTO, a surprisingly weak institutional framework governed global trade. In the original design for the postwar economy, participants in the 1944 Bretton Woods Conference sought to create not only the International Monetary Fund (IMF) and the World Bank but also a third institution—the International Trade Organization (ITO). Before the charter of the ITO was negotiated,

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1. For a quantitative estimate, see, for example, Bradford, Grieco, and Hufbauer (2005).

however, an interim agreement known as the GATT came into effect and was used as the basis for negotiating tariff reductions. In March 1948, the ITO Charter was signed in Havana, Cuba. The commercial policy provisions of the charter were those of the GATT, but the agreement covered a wide range of additional issues, including fair labor standards, restrictive business practices, economic development and reconstruction, and special treatment of primary commodities. But because of opposition in the US Congress, the charter was never ratified.

Instead, until 1994, the trading system operated on the basis of the GATT. Given its original role as a provisional agreement, it is quite understandable that the GATT had a narrow mission focused on border barriers and a weak system for settling disputes and ensuring compliance.

According to its preamble, the purpose of the GATT was “to enter into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce.” The GATT sought to eliminate discriminatory treatment by requiring most favored nation (MFN) treatment of all members (Article I) and national treatment for imported goods (Article III). The agreement did not compel harmonized standards or policies; it simply required that domestic and imported goods be treated in the same way. Provided they respected this principle, GATT signatories (known as “contracting parties”) remained free to implement any domestic policies or rules they desired. Policies relating to measures such as standards and intellectual property were not covered by the GATT’s disciplines.

The GATT was remarkably successful. Its membership grew from the 23 countries that drew up the original agreement to the 123 countries that became charter members of the WTO. During the GATT years, the volume of world trade increased more than thirteenfold.<sup>2</sup> In addition, tariffs came down steadily. The first seven rounds of GATT negotiations lowered average tariffs on industrial products from about 40 percent in 1947 to 4.7 percent in 1994.<sup>3</sup>

But increased trade and decreasing tariffs led to new pressures on the system. As the world economy became more integrated, there were growing calls for more governance. Complex cross-border economic activities required more secure frameworks in which to operate. When trade occurred mainly in simple, standardized commodities, the most important issues for trade policies were the border barriers that segregated markets

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2. From 1950 to 1993, the volume of world trade increased 13.2 times (WTO, table II.1, “World Merchandise Exports, Production and Gross Domestic Product, 1950–2003,” *International Trade Statistics 2004*, [www.wto.org](http://www.wto.org)).

3. For more information, see WTO, “Statement of Ambassador Dr. Mounir Zahran, Chairman of the GATT 1947 contracting parties to the closing session, Geneva, December 12, 1995,” press release 36, December 12, 1995; and WTO (2005).

internationally. Export success for those able to produce simple products—say, lumber—at relatively lower cost depends mainly on market access. If foreign lumber can be brought into a market at prices below those charged for domestic substitutes, it will not be difficult to find willing marketers and buyers.

Many other factors beyond market access duties affected the sale of more sophisticated products, however. For example, in order to sell automobiles in a foreign market, firms could be required to comply with complex domestic regulatory standards; they might also need to establish or find extensive networks for marketing, sales, and service. Firms therefore wanted hospitable rules governing standards and regulations—so-called technical barriers to trade. Moreover, they had to be concerned about rules relating to operating distribution networks in foreign countries. As sales grew and reached a sufficiently high level, many firms also considered establishing production facilities in foreign markets. Aided particularly by improvements in communications and transportation, firms were increasingly able to manufacture products by sourcing from multiple locations. Raw materials might best be sourced in one country, labor-intensive processes performed in another, and technologically sophisticated processes carried out in a third. Production abroad focused attention on many other aspects of domestic regulation and taxation. Firms planning to source in one country and sell in another preferred secure intellectual property rights and compatible technical standards and regulations. They sought to avoid government measures that constrained their operations through local content and domestic performance requirements. All these forces created firms' growing demand to include rules for these policies in trade agreements.

In addition, with deepening trading, financial, and investment relationships came increasing demands from developing countries. As they shifted away from import substitution to export promotion strategies, developing countries became more interested in and affected by trade rules. Many of these nations sought special preferences and differential treatment in the trading system, as well as more comprehensive rules and more effective enforcement.

These pressures became particularly evident during the Tokyo Round of GATT negotiations, which concluded in 1977. Though the GATT's focus remained on rules and barriers that were clearly related to trade in goods, the Tokyo Round agreement included an "enabling clause" that created more scope for special and differential treatment of developing countries. The agreement also contained seven plurilateral codes dealing with import licensing, technical barriers to trade, customs valuation, subsidies and countervailing duties, antidumping measures, civil aircraft, and government procurement.

The codes represented an expansion of the GATT's mission to cover nontariff barriers and rules governing fair trade, but contracting parties

that did not sign the codes were not bound by them. The codes also had disparate and separate dispute settlement systems.

The Tokyo Round left many problems unresolved. As the many subsequent disputes between the United States and the European Union made clear, the combination of a weak dispute settlement system and opaque rules made it particularly difficult to impose disciplines on agricultural subsidies. In addition, many parties resorted to extralegal measures such as voluntary export restraints and, in the United States, unilateral retaliation that violated basic GATT principles (see Bhagwati and Patrick 1991).

### ***The Uruguay Round: Expanding the Rules, Increasing Complexity***

The next round of trade talks changed the game considerably. Concluded in 1994, the Uruguay Round Agreement dramatically increased the scope of trade rules beyond border barriers. It included agreements on services (the General Agreement on Trade in Services, GATS), Sanitary and Phytosanitary (SPS) Measures, Technical Barriers to Trade (TBT), Trade-Related Investment Measures (TRIMs), Trade-Related Aspects of Intellectual Property Rights (TRIPS), and a new agreement on Subsidies and Countervailing Measures (SCM). The TRIPS was particularly noteworthy, since it required countries to implement policy regimes that achieve a minimum level of intellectual property protection. Unlike the codes of the Tokyo Round, the Uruguay Round was a single undertaking to which all members agreed. It also included strengthened versions of the previous codes and created a much stronger and unified dispute settlement system. In short, the Uruguay Round dramatically increased the binding obligations of the members.

One result of expanding the scope of trade rules was a powerful change in the politics surrounding trade policymaking. When trade policies covered only border barriers, they brought a fairly narrow group of domestic producers and consumers into the political fray. But as the trading system expanded to constrain national regulatory policies, many more players entered the game. Some of these players saw trade agreements as an opportunity to further their agendas; others saw trade agreements as a threat.

Increasingly, the most important political agents—business interests, labor unions, and environmentalists—not only compete with their counterparts in other countries but also compete to have their concerns subject to international rules. Business complains that foreign firms are dumping underpriced products in the domestic market. Labor complains of “social dumping,” or competition from producers in countries with particularly lenient labor and social standards. Environmentalists complain of “eco-dumping” when competition comes from companies operating in countries with lax environmental standards. Fearing that such foreign competition will force the erosion of domestic protections, these groups seek to

prevent a race to the bottom by including labor and environmental standards in trade agreements.

Trade agreements have fundamentally altered the distribution of power over domestic (and international) decision making. Executives, legislators, bureaucrats, interest groups, and constituents that once were focused purely on domestic considerations are thus drawn into the trade arena. As new actors and interests are engaged, debates over trade become the battleground for political conflicts that reflect a wide range of concerns—much broader than the economic impact of trade. Attention is focused not only on how policies affect relative prices but also on shifts in the distribution of power.

For example, as the scope of trade agreements widened, the number of legislators and committees drawn into the policymaking process expanded accordingly. Until the Tokyo Round, responsibility for US trade policy was heavily concentrated in the Senate Finance Committee and the House Ways and Means Committee, because the major trade issue was tariffs—that is, essentially taxes. But the broadening of the purview of trade implied the need for others to be involved. In the Uruguay Round, a large number of committees felt obliged to participate in decision making and oversight.<sup>4</sup> On the one hand, the salience of trade as an issue made the trade committees more powerful; on the other hand, it also forced them to share their power to a greater degree.

Trade agreements have also changed the way that legislators put forward their policy agendas. Bundling particular issues into a trade agreement may help to overcome domestic opposition. Conservative legislators, for example, may not want to include labor standards in trade agreements, but some might go along if the agreement benefits their constituents who are exporters. Liberal legislators may resist freer trade, but might find agreements more appealing if they help strengthen labor standards abroad. Thus both the Right and the Left have tried to use trade agreements as a mechanism to advance their domestic policy agendas and constrain their opponents. On the right, trade agreements have been used to promote domestic reform and deregulation, as seen in the conditions associated with China's accession to the WTO. On the left, the promotion of a social clause in the European Union serves a parallel function. But those who are weakened by these maneuvers will inevitably question the process.

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4. No longer could the chairs of the two tax-writing committees control the contents of trade bills: Participation spread to include the House Energy and Commerce Committee (domestic content, certification standards), the House Foreign Affairs and Senate Foreign Relations Committees (foreign loans, export controls), the Judiciary Committee (antitrust reciprocity), the House Financial Services and Senate Finance Committees (banking, foreign investment, the export-import bank), the Agriculture Committee (farm trade), the Armed Services Committee (procurement), and so forth.

Once the rules are set, new constraints are imposed on legislators, and their ability to grease the political wheels using regulations that have a protective effect is reduced (see O'Halloran 1997). One appeal (domestically) of the Clean Air Act's standards was that they discriminated against foreign petroleum refiners, but Venezuela forced these provisions to be changed by bringing a case to the GATT. Regulators face similar constraints. As long as trade policy was focused on border barriers, regulators could operate independently. Thus, an agency such as the Food and Drug Administration (FDA) was unconcerned about international policy. It faced little interference either in setting standards and/or in assessing conformity to them. But deeper integration and the efforts at achieving mutual recognition of conformity assessment between the United States and the European Union dramatically changed the demands on the FDA—and transformed the future environment in which it will operate.

### ***The Result: More, and More Difficult, Disputes***

As the rules have become more extensive, more players have entered the political game, and as the WTO membership has become more diverse, the number of trade disputes has increased dramatically. As figure 0.1 shows, in its first decade (1995–2004), the WTO caseload averaged 35 disputes a year, more than three times the average under the GATT in the 1980s, and seven times as many as the annual average number brought under the GATT between 1948 and 1989.

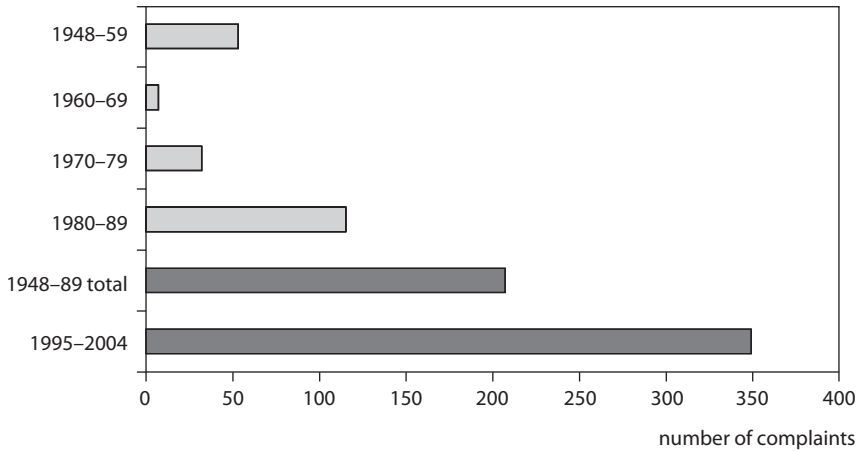
There has also been a marked increase in the diversity of countries involved in dispute settlement cases. Under the GATT, developing countries constituted only 21 percent of complainants and just 13 percent of respondents. But under the WTO, 38 percent of both complainants and respondents have been developing countries. Thus, developing countries are now both more likely to bring cases and to have cases brought against them.

The issues covered by the cases have undergone a considerable evolution as well. In the 1950s, for example, 38 percent of the disputes (20 cases) dealt with tariffs, 43 percent (23 cases) with nontariff barriers (such as quotas and discriminatory treatment) and 19 percent with unfair trade (dumping and subsidies). In those three categories, 23 percent of the cases dealt with agriculture.<sup>5</sup> In the 1980s, however, tariffs were just 14 percent of the cases, nontariff barriers 57 percent, and unfair trade 29 percent; 47 percent of these cases involved agriculture. Clearly, the focus has evolved away from tariffs and toward nontariff barriers and unfair trade, particularly in agriculture. In the 1990s, the mix of cases was even more diverse. Almost 30 percent of the 340 cases pertained to issues that were not even covered

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5. These numbers rely on Hudec (1993) prior to 1990 and the WorldTradeLaw.net database thereafter.

**Figure 0.1 Complaints under the GATT and WTO**



by the GATT agreement. As of 2004, there had been 60 cases devoted to dumping practices, 60 to subsidies and countervailing measures, 31 to safeguards (i.e., temporary restrictions of a product), 25 to TRIPS, 19 to TRIMS, 33 to technical barriers to trade, 14 to services, and 55 to agriculture.

Finally, while retaliation is still unusual, it has become more common. Under the GATT, no complaining party actually suspended its concessions to retaliate against a member that failed to come into compliance with a ruling. Indeed, only one party, the Netherlands, was even authorized to retaliate (against the United States, several times in the 1950s); it chose not to. By contrast, under the WTO, the United States has retaliated against the European Union (twice, over beef and bananas), as has the European Union against the United States (over foreign sales corporation, or FSC, export subsidies), and several other countries have been authorized to retaliate.

## Barriers to Negotiated Agreement

Once we have established that the trading system is generating greater numbers of more difficult disputes, the next question is why the parties can't negotiate their own settlement. Why does the system need a separate institution—in the form of the WTO Dispute Settlement Body—to act as referee? Given that the parties have successfully negotiated the rules of the game, what is it that prevents them from resolving their own conflicts?

The answer is that while trade agreements are negotiated by many parties on a broad set of issues, disputes tend to arise between a few parties on a narrow set of issues. Negotiations to resolve such disputes are bound

to be difficult, because (1) they tend to be zero-sum propositions, with clear winners and clear losers; (2) special interests that might have been overridden or placated when the full agreement was negotiated become fully mobilized to win—or avoid losing—a dispute (indeed, they may have initiated the dispute); and (3) once a conflict has begun to escalate, predictable transformations in the parties' attitudes create additional impediments to negotiated resolution. These barriers to negotiated agreement—structural, institutional, and psychological, respectively—are discussed in greater detail below (and see Arrow et al. 1995; Watkins 2000).

## Structural Barriers

Structural barriers arise when a negotiation structure results in a narrow or nonexistent zone of possible agreement. Negotiation structure consists of the following five elements (developed in Watkins 2002):

- the parties, their interests, and alternatives to agreement;
- the agenda of issues to be negotiated;
- communication channels through which negotiations are conducted;
- linkages among sets of negotiations; and
- time constraints and action-forcing events.

Each of these elements can give rise to structural barriers. Perhaps the wrong parties are negotiating, or the negotiations involve too many or too few parties to proceed productively. The issue agenda may be too narrow, generating a zero-sum, win-lose situation—or it may be too complex to tackle successfully. The parties' communication channels may be inadequate for conveying their interests and positions. The negotiations may be linked to past or future negotiations in ways that raise issues of precedent. Finally, the negotiations may lack sufficient time in which to be conducted or, equally problematic, an action-forcing event to push the parties to reach closure.

In trade disputes, the most common structural barrier is the narrowness of the agenda to be negotiated. Trade agreements are crafted as package deals, as multiple parties bundle together many issues in order to fashion mutually beneficial trades. In this way, each party to the agreement is made better off than it would be under any no-agreement alternative.

But disputes tend to arise between two (or a few) parties over a much narrower set of concerns, often a single issue. As a result, the negotiations are very likely to be a zero-sum game. It should therefore be no surprise when the parties come to loggerheads in their efforts to negotiate settlements. For example, Europe and the United States were unable to negoti-

ate a settlement after Europe banned hormone-treated beef. Because the dispute was over a single issue—trade in beef—its resolution would create a winner and a loser.

## Political Barriers

Negotiations to resolve trade disputes are further complicated by two-level game dynamics. Negotiations *between* nations interact with negotiations *within* them, constraining the ability of leaders to settle disputes.<sup>6</sup> As discussed in the previous section, these interactions have become more complex and problematic as the concerns of trade negotiations have shifted to issues of deeper integration.

Negotiated agreements to resolve trade disputes are fiercely resisted by the interests within each country that stand to lose. In the steel case, for example, domestic interests initiated the dispute by persuading the Bush administration to impose tariffs and then fought to sustain them. Opponents of a settlement typically allege that those in favor of negotiating are selling out. They may foment internal political turmoil that impedes compromise, as leaders who appear too accommodating become the target of attacks from their internal opposition.

Leaders thus have to work hard internally to build support for agreement while they are negotiating externally. Efforts to synchronize external negotiations and internal coalition building involve a delicate balancing act, because the interactions of the two levels reduce tactical flexibility. By engaging in hard bargaining externally, for example, leaders may bolster their internal political support. But they also may commit themselves to untenable positions in the external negotiations. Later, they may be unable to retreat from these positions because doing so would result in an unacceptable loss of face.

## Psychological Barriers

Finally, psychological transformations can further impede negotiations to resolve disputes. Psychological barriers are biases of perception and interpretation that reduce the potential for negotiated agreement.<sup>7</sup> The

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6. For an extensive discussion on bureaucratic politics and its impact on decision making, see Allison (1971); see also Iklé (1964).

7. Such barriers include equity and justice seeking, biases in assimilation and construal, reactive devaluation of compromises and concessions, loss aversion, judgmental overconfidence, and dissonance reduction and avoidance (Arrow et al. 1965, 10–19; more generally, see chapter 1). More in-depth explorations of psychological barriers are presented in Robinson (1996a, 1996b) and Ross and Ward (1995). See also Cialdini (1993), and Zimbardo and Leippe (1991).

experience of conflict changes the parties' perceptions in ways that can make conflicts self-sustaining (Robinson 1996b). Specifically, the adversaries develop *partisan perceptions*—emotional associations and expectations that are irreversible.<sup>8</sup> Their views of the situation, and of the actions of the other side, become distorted in predictable patterns.

For example, contending parties often experience *goal transformation*—they go from simply wanting to protect themselves to wanting to hurt the other.<sup>9</sup> Feelings of victimization and a desire for retribution and revenge sustain conflicts long after the initial causes have ceased to be important. Siblings continue to fight for parents' attention long after they are adults, and nations argue over scraps of land that no longer have strategic importance. Some suggest that Europe brought the foreign sales corporation case against the United States in part out of frustration with the US-initiated WTO cases on beef and bananas and a desire to strike back.

When conflicts become bitter, the contending parties also begin to gather and interpret information about each other in ways that are profoundly biased—a phenomenon known as *naïve realism*.<sup>10</sup> Research has shown that perceptions become distorted in three main ways. First, partisans assume that they themselves see things objectively while their opponents' views are extreme and distorted. Second, they tend to misjudge the other side's motivations, overestimating the importance of ideology and underestimating the situational pressures their counterparts face. Third, parties consistently overestimate the extent of the differences between themselves and the other side.

The result is the exaggeration of the actual differences between the sides, which are further exacerbated by the breakdown in communications that inevitably occurs when conflicts become more polarized. As a consequence, the parties experience *selective perception*—they interpret each other's actions in ways that confirm their preexisting beliefs and attitudes. They unconsciously overlook evidence that challenges their stereotypes, and they may also come to view the negotiation in purely win-lose terms. This behavior often contributes to making a failure to reach agreement a self-fulfilling prophecy.

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8. See Rubin, Pruitt, and Kim (1994); they define residues as “persistent structural change—in an individual, group, or community—which is due to past escalation and encourages further escalation” (1994, 99).

9. Rubin, Pruitt, and Kim (1994, chapters 6, 7) provide an overview of these concepts and others related to conflict escalation.

10. See Robinson et al. (1995); by “naïve realism,” the authors mean lack of awareness of one's own subjectivity in making predictions about oneself and others. As Arrow et al. (1995, 13) note, “Disputants are bound to have differing recollections and interpretations of the past—of causes and effects, promises and betrayals, conciliatory initiatives and rebuffs. They are also bound to have differing interpretations or construals . . . of the content of any proposals designed to end that dispute.”

An especially unfortunate consequence of partisan perceptions is that gestures meant to be conciliatory are often dismissed or ignored—a phenomenon known as *reactive devaluation*.<sup>11</sup> If one side believes that the other is intent on achieving total victory, any conciliatory gesture tends to be treated as either a trap or a sign of weakness. To conclude otherwise would require a fundamental reassessment of the other side. If the conciliatory overture is interpreted as a deception, the response is often counterdeception or rejection. If it is interpreted as a sign of weakness, the response may be to press forward aggressively.

## The Need for Alternative Dispute Resolution Mechanisms

Together, structural, political, and psychological barriers narrow or eliminate the zone of possible agreement in direct party-to-party negotiations to resolve disputes. Fortunately, however, there are alternative dispute resolution (ADR) mechanisms—involving third-party intervention—that can help overcome these barriers. These mechanisms fall on a spectrum ranging from voluntary mediation to binding arbitration.

Given the potent barriers to negotiating settlements to trade disputes, it is not surprising that the members of the WTO decided that they needed an ADR mechanism. Seen in this light, the WTO Dispute Settlement Understanding (DSU) is a way for the parties to precommit, during broader rule-making negotiations, to use an alternative mechanism in the (likely) event that they are unable to resolve their disputes. This was, effectively, a way to tie the hands of the parties and to guide difficult-to-resolve disputes into a more productive channel.

In addition, the DSU process, once activated and under way, helps the parties to deal with internal political issues and, to some degree, surmount psychological barriers to agreement. Developments in the formal dispute resolution process may even serve to spur the parties to try to negotiate a deal—a phenomenon known as “bargaining in the shadow of the law” (Cooter, Marks, and Mnookin 1982). For example, the loss by the United States in the cotton case might have induced it to be more forthcoming in the Doha Round and Free Trade Area of the Americas (FTAA) negotiations with Brazil.

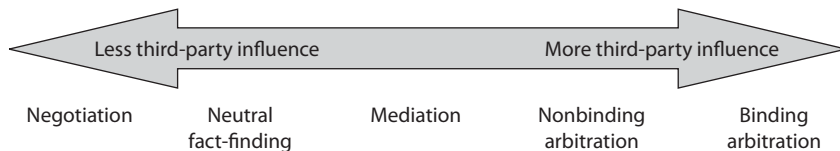
## Designing Dispute Resolution Systems

Given that the trading system needs a distinct mechanism to resolve disputes, the next question is what type of mechanism is needed. What

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11. Ross and Ward (1995, 270) define reactive devaluation as “the fact that the very act of offering a particular proposal or concession may diminish its apparent value or attractiveness in the eyes of the recipient.”

**Figure 0.2** Dispute resolution spectrum



are the strengths and weaknesses of different approaches to dispute resolution systems design?

As figure 0.2 illustrates, ADR mechanisms can be arrayed on a spectrum that runs from pure negotiation to pure mediation to pure arbitration, and that includes a wide range of hybrids in between.<sup>12</sup> In pure negotiation the parties seek, unassisted, to negotiate resolutions to their disputes. As discussed in the previous section, the existence of powerful structural, institutional, and psychological barriers to negotiated agreement provides the impetus for seeking alternative approaches involving third parties. At the same time, negotiations among the contending parties may proceed in—indeed, may be stimulated by—parallel third-party processes ranging from mediation to arbitration.

In pure mediation, the contending parties invite an impartial, mutually acceptable third party to assist them in resolving their dispute. Participation in the process is voluntary, and the parties are free to exit the process and pursue other alternatives. Mediators help contending parties to overcome barriers to agreement by

- enhancing and shaping communications among the disputants;
- evaluating and critiquing the parties' positions;
- developing creative options;
- persuading the parties to make concessions;
- enabling the parties to save face by coordinating mutual concessions;
- absorbing anger or blame; and
- serving as a witness to agreement.

Mediation can in principle be quite helpful in overcoming psychological barriers to agreement. But because it is voluntary, it is seldom effective when there are significant structural or political impediments to resolving a dispute. In practice, mediative solutions to trade disputes are therefore quite rare.

12. For a good overview of the mediation process, see Moore (1996). For distinct types of intervention roles, see Watkins and Winters (1997).

At the other end of the ADR spectrum is binding arbitration. In a pure arbitration process, the parties are required to submit their dispute to a third party for investigation and adjudication. The arbitrator takes evidence and renders judgment according to some set of rules (in a code-based system), precedents (in a common law system), or a combination of both. In a pure arbitration system, the decision of the arbitrator is binding on the parties and fully enforceable. Put another way, the arbitrator has the coercive power necessary to (a) impel the parties to participate in the process and (b) impose and enforce terms of settlement on them, while the mediator must be acceptable to the disputants and seek only to influence them.

In contrast to mediation, arbitration can be quite effective in overcoming structural and political barriers to agreement. Arbitration rulings define a winner and a loser, and therefore address the zero-sum nature of most disputes. In addition, rulings give leaders a potent tool in overcoming internal resistance in the two-level game. Leaders can assert that they are committed to abide by the arbitrator's findings, and that a failure to do so would have much broader negative consequences for their constituencies.

Between the poles of pure mediation and pure arbitration are ADR processes in which the third party has some ability to press the parties to accept a specific settlement. At the mediation end of the spectrum, we find mediators whose reputations or positions give them clout. At the arbitration end of the spectrum, we find adjudication processes in which the findings of the arbitrator are not fully binding or enforceable.

## **Dispute Resolution in the Trading System**

Having established a vocabulary for analyzing dispute settlement systems, we are ready to explore the evolution of dispute resolution in the multilateral trading system. In terms of the framework developed in the previous section, dispute resolution in the GATT began *de facto* as a mediation system and progressively evolved in the direction of becoming more like arbitration. The establishment of the WTO represents the logical conclusion of this process, enshrining a weak arbitration system in international law.

### **Dispute Resolution in the GATT**

The ill-fated ITO Charter, which would have integrated the ITO into the United Nations system, contained elaborate provisions for adjudicating disputes among its members and even for appeals to the International

Court of Justice at The Hague.<sup>13</sup> The GATT, by contrast, had an uncertain link to the UN system and fairly limited provisions for dealing with member complaints, with no means of formal juridical dispute settlement. The major focus was on providing contracting parties with a mechanism for dealing with nullification or impairment of benefits under the agreement. Diplomatic methods of consultation were emphasized. Thus Article XXII required contracting parties to “accord sympathetic consideration to and adequate opportunity for consultation to” other GATT parties. Article XXIII allowed parties first to attempt bilateral negotiations and subsequently to refer the problem to the entire body.

Signatories to the GATT could file a complaint if another party violated an agreement or discipline under Article XXIII. Even if no specific agreement had been violated, a complaint could be launched if another party adopted measures that had the effect of undermining previously granted concessions (Article XXIII:1([b])). Article XXIII then called for the contracting parties as a whole to “promptly investigate any matter so referred to them” and “make appropriate recommendations” or “give a ruling on the matter as appropriate.” It allowed them to “authorize the suspension of the application to any other contracting party of such concessions or other obligations as they determine to be appropriate in the circumstances.”<sup>14</sup>

It is important to note that the GATT Secretariat did not police compliance. Instead, it offered assistance to contracting parties in settling disputes when parties felt that an agreement had been violated. In addition, the settlement system was weak, since the consensus rule by which GATT took decisions had the effect of making participation by defendants voluntary. Defendants could prevent the GATT from dealing with disputes and they could also block any rulings from being adopted.

Moreover, the GATT Agreement did not detail the precise manner in which the body as whole was to carry out its investigations and apply its rulings. Indeed, these practices changed over time, evolving in the direction of a more juridical approach. In its early years, complaints were dealt

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13. See Article 96 of the Havana Charter on the International Court of Justice:

1. The Organization may, in accordance with arrangements made pursuant to paragraph 2 of Article 96 of the Charter of the United Nations, request from the International Court of Justice advisory opinions on legal questions arising within the scope of the activities of the Organization. . . .

5. The Organization shall consider itself bound by the opinion of the Court on any question referred by it to the Court. In so far as it does not accord with the opinion of the Court, the decision in question shall be modified.

14. There has been considerable debate over the reason for permitting these suspensions of concessions. Was the purpose to enforce compliance, provide compensation, or offer a safety valve? For an extensive discussion, see Lawrence (2004). The literature suggests some role for each of these explanations, but the maintenance of reciprocity appears paramount. In most instances, the suspension of concessions was supposed to be equal to the level of nullification or impairment.

with at semiannual plenary meetings; later they were delegated to working group, and finally to panels of neutral adjudicators. These panel proceedings, developed in 1955, were informal; both the judges and the advocates were diplomats rather than lawyers.<sup>15</sup> In contrast to working parties in which participants represented their countries, panel members were supposed to be neutral and not receive instructions from their governments. Nonetheless, as Robert Hudec observes in his history of GATT dispute settlement (1993, 12), “Legal rulings were drafted with an elusive diplomatic vagueness.”

To use the terms defined above, this was a mediation system. Reliance on this approach accounts for some of the difficulties encountered by the “diplomatic” dispute resolution process practiced in the GATT during the late 1940s and 1950s. The parties voluntarily took their dispute to a group of “wise men” (i.e., mediators), who would help them work out an acceptable solution. The parties were free to accept or reject the recommendations. Solutions often had a compromise or split-the-difference character to them, consistent with the outcomes of most mediative processes. While this approach helped to resolve many trade disputes early in the history of the GATT, it may have actually encouraged parties to breach the rules, because they knew they were likely to retain some of their gains. Ultimately it was rejected by parties that wanted clear rulings in their favor when they felt the rules had been violated.

GATT participants therefore came to differ over how the dispute settlement system should operate. On the one hand, the European Community (EC) found itself in a defensive posture as a result of its Common Agricultural Policy (CAP)—which many other countries viewed as a highly protectionist instrument—and its preferential arrangements with former colonies. As a result the European Commission had a strong preference for approaches to dispute settlement that were diplomatic (mediation) rather than legal (arbitration). On the other hand, particularly in the 1960s, the developing-country members called not only for special and differential treatment for themselves but also for stricter enforcement of developed-country obligations, backed up by a system with multilateral retaliation against violators.<sup>16</sup>

The United States never wholly agreed with the EC’s “diplomatic” approach, but for a period it took a rather strong stand with the EC on the side of “anti-legalism.” The two trade superpowers preached that trade restrictions must be approached gradually, and with careful attention to social realities. They branded formal legal claims by other GATT members “legalistic,” creating a climate in which such legal actions were

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15. At the Ninth Session of the GATT Contracting Parties, the first Panel on Complaints was established in response to a dispute between Italy and Sweden (see Jackson 1969, 173).

16. In 1961 Uruguay launched a case challenging many practices in developed countries, particularly in agriculture.

viewed as unfriendly actions; indeed, there were no cases brought between 1963 and 1969 (see Hudec 1993). In the 1970s, however, the GATT began to move more toward a legalistic system of dispute settlement. Hudec (1993, 13) notes, "The primary pressure for rebuilding came from the United States, which abandoned its anti-legalist position when political developments at home created a need for stronger enforcement of US trade agreement rights." The United States sought to expand the ambit of the GATT by supporting the codes in the Tokyo Round and seeking tougher rules and time lines for dispute settlement. While the United States was able to have the GATT's dispute settlement system described in detail in a memorandum of understanding,<sup>17</sup> opposition forestalled any significant change in procedures (Jackson 1997a, 116).<sup>18</sup>

Dissatisfaction with the GATT dispute settlement system grew during the 1980s. One particular obstacle to success was the ability of disputing nations to block the adoption of panel reports. A second was related to enforcement. Although retaliation was authorized under the GATT, it was never actually implemented in any case. The weakness of the international dispute settlement system and the limited coverage of the rules became increasingly frustrating for the United States. Delay and uncertainty in the process, absence of legal rigor in rulings, uncertainty about adoption, and delay in compliance were all seen as problems (Howse and Trebilcock 1999, 55–56).

The United States responded by seeking to leverage its market power to reduce barriers to its exports, using unilateral measures without GATT authorization. Section 301 in the 1974 Trade Act provided a procedure for dealing with foreign measures that constrained US exports. In the mid-1980s, the United States dramatically stepped up its use of section 301 legislation to target foreign practices not covered under the GATT that it nonetheless deemed unreasonable. These included the failure to respect intellectual property, refusal to provide access to telecommunications, and other foreign regulatory practices deemed to discriminate against US products and firms. In the Omnibus Trade Act of 1988, the United States adopted Super 301, which contemplated bilateral negotiations and the unilateral adoption of sanctions by the United States in the event that they failed.

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17. "Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance," GATT BISD [Basic Instruments and Selected Documents], 26th Supplement (1979): 210.

18. Since the 1950s, the GATT system had clearly evolved in the direction of a greater emphasis on rule-making and not simply the adjudication of disputes. In addition to replacing national representatives with neutral panelists in dispute settlement, the GATT case brought by Uruguay in 1962 produced a ruling that if a complaining party established "violation," this would be deemed a "prima facie nullification or impairment." As a result, the burden of proving that there was no nullification or impairment shifted to the responding parties. This concept was embraced in the 1979 understanding at the end of the Tokyo Round.

## The WTO Dispute Settlement System

Out of a desire in part to restrain this US unilateralism, as well as to create a more effective system, the WTO DSU was negotiated in the Uruguay Round. The Uruguay Round Agreement also enhanced the power of the Dispute Settlement Body (DSB) to enforce trade rules. Because it required unanimity to prevent proceedings, no one country could block the panel from hearing a dispute. The single undertaking meant that all WTO rules and most agreements were subject to the DSU. WTO members therefore had the ability to implement cross-sectoral retaliation. For example, if a country violates the TRIPS agreement's intellectual property rules, it can be subject to the loss of other trade benefits, such as low tariffs on manufactured goods.<sup>19</sup> While members could no longer veto the adoption of panel rulings, they were given the right to appeal such rulings to the Appellate Body (AB) established in the DSU.

According to the DSU, parties may seek to resolve conflicts by using the good offices of the director-general or by agreeing to arbitration.<sup>20</sup> But they may also invoke the formal dispute settlement mechanism. The parties to the dispute are first required to engage in consultation. If these consultations are unsatisfactory, a complainant can request the establishment of a panel to hear the case within 60 days. To establish such a panel, the WTO DSB (the WTO members) draws on a roster of potential panelists nominated by WTO members. The panel then examines the case; after issuing an interim report, it delivers a final report with conclusions and, at its discretion, it provides suggestions as to how the parties might come into compliance. If the panel finds that a member has failed to comply, absent an appeal by that member, it can make a recommendation as to how the member could come into compliance.<sup>21</sup> If complying immediately is impractical, the member is given "a reasonable period of time to do so" (DSU, Article 21.3).

The finding can then be appealed. If the member loses the appeal and fails to act within this period, the rules call for the parties to negotiate compensation, "pending full implementation." Compensation is "volun-

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19. Article 22.3 of the WTO DSU tries to match the sector in which the violation occurs and the sector in which concessions are suspended. However, if such matching is deemed not "practicable or effective" by the complaining party, it may seek to suspend concessions in other sectors or in another covered agreement.

20. See Article 25 of the DSU: "Expeditious arbitration with the WTO as an alternative means of dispute settlement can facilitate the solution of certain disputes that concern issues that are clearly defined by both parties."

21. Panel reports must be adopted within 60 days, unless a consensus exists not to adopt or a party appeals the findings. Appeals, which are limited to issues of law and legal interpretation, are heard by an appellate body composed of seven members. Appeals proceedings must be completed within 90 days.

tary,” however (Article 22.2, 22.1). Moreover, it is generally understood that any compensation provided should be on an MFN basis.<sup>22</sup> If, after 20 days, compensation cannot be agreed on, the complainant may request authorization from the DSB to suspend equivalent concessions.<sup>23</sup> In particular, “the level of the suspension of concessions . . . shall be equivalent to the level of nullification and impairment” (Article 22.4). The magnitude of the retaliation is determined by the DSB, generally on the recommendation of the original panel. Arbitration, to be completed within 60 days, may be sought to address the suspension, the procedures, and the principles of retaliation (Article 22.6).

### ***Strengths and Weaknesses***

To use the terms defined previously, the WTO dispute settlement mechanism is an example of a weak arbitration process. The parties are required to submit to the process if one party launches a complaint. The arbitrator (in this case, a panel) investigates and reaches conclusions based on specified rules (in this case, negotiated by the parties). The resulting rulings are binding on the parties. However, *de jure* the WTO system remains weaker than the pure arbitration processes common in domestic legal systems for four major reasons: precedents are not binding, enforcement is not automatic, standing is not assured, and remedies are limited. But in some instances the WTO practice actually comes closer to a domestic legal system than these principles might imply.

First, the WTO DSU is not a common-law system with binding precedents. Technically, there is no *stare decisis*. Each panel ruling is thus unique—only the members themselves can adopt rules that add to or subtract from the agreement. In principle, the adjudication is a process of dispute settlement, not a court case. In practice, however, panelists usually find the arguments made by other panelists to be persuasive and give considerable weight to precedent. Indeed, the Appellate Body, and hence the panels, actually follow precedent very closely. So in practice, if not by rule, the system in some ways mirrors domestic legal procedures. In addition, as Article 3.2 of the DSU notes, members recognize that the dispute settlement system clarifies the “existing provisions of these agreements in accordance with customary rules of interpretation of public international law.”

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22. The statement that “compensation is voluntary and, if granted, shall be consistent with the covered agreements” (DSU, Article 22.1) is generally understood to require that it be based on MFN principles.

23. According to Article 22.3 of the DSU, the complaining party should first seek to suspend concessions in the same sector as that in which the panel body has found a violation. If that party considers such action not practicable or effective it may seek to suspend concessions in other sectors under the same agreement; if this, in turn, is not practicable or effective, then obligations under another covered agreement may be suspended.

Second, WTO members do not automatically implement WTO rulings. Members have discretion as to whether or not they will comply. Although the WTO does review its members' trade policies, there is no central policing mechanism. The WTO itself does not investigate and prosecute its members for violations. Instead, only members believing their rights have been nullified or impaired can bring cases.<sup>24</sup> Nonetheless, in practice, compliance with both GATT and WTO rulings has been widespread.

Third, until 2005—when the two disputants, the United States and the European Union, agreed to open to the public the proceedings of the case in which the European Union challenged continued US retaliation over the banning of hormone-treated beef<sup>25</sup>—all panel proceedings occurred in closed sessions attended only by the participants in the dispute. Panelists may at their discretion choose to consult outside experts or read outside briefs, but they are not required to do so. Although private counsel can be employed to make their arguments, only governments have standing to bring cases. There is no private right of action.<sup>26</sup>

Fourth and finally, there are significant limits to the remedies available to the “winners.” The panel's findings demand that the rule breakers bring their systems into compliance. But unlike rulings on contract cases in common-law legal systems, no attempt is made to compensate the winner for damages incurred during the period of noncompliance. This failure to require compensation has the advantage of avoiding further disputes over the size and payment of such damages. But it also has a downside: Parties expecting to lose have an incentive to draw out the process as long as possible. Parties also may engage in rule-breaking behavior with the knowledge that at most, they will be tasked with coming into compliance at a later date. Thus, the Bush administration imposed tariffs on steel in the full knowledge that they would be challenged and possibly overruled but correctly judged that the action would placate domestic interests for a significant period of time.

Moreover, if the losers do not bring their systems into compliance, at most they will be subject to retaliation. De jure, such retaliation is meant

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24. One exception is disputes over prohibited subsidies. Violations of export subsidies for example may be challenged by any member regardless of whether that country believes it has been adversely affected.

25. As noted on the WTO Web site, “At the request of the parties in the disputes ‘Continued suspension of obligations in the EC-hormones dispute’ (US—Continued suspension of obligations in the EC-hormones dispute, DS320; Canada—Continued suspension of obligations in the EC-hormones dispute, DS321) the panels have agreed to open their proceedings with the parties on 12, 13 and 15 September 2005 for observation by WTO Members and the general public via closed-circuit broadcast to a separate viewing room at WTO Headquarters in Geneva” ([www.wto.org](http://www.wto.org)).

26. The long-running dispute over bananas eventually allowed member states to employ private lawyers in their litigation; actions over turtles and shrimp as well as asbestos opened up the process to amicus curiae briefs.

to be temporary: countries still have an international legal obligation to comply. But in practice, because there are no additional trade consequences aside from retaliation, it can become the “permanent” solution to a dispute. In the beef hormone case, for example, retaliation has served as a de facto substitute for compliance. While in practice the dispute resolution procedure therefore can operate like a safety valve, overreliance on retaliation may undermine the system as a whole.

More generally, there remains a strong tension between the two roles of the dispute settlement system: It is both an institution that enforces rules and a framework for negotiation and compromise. In the first function, the emphasis is on adjudication—the consistent application of relevant rules and ensuring that the rules are followed. In the latter, the purpose is to find a solution the participants can live with.

Nonetheless, the formalization of the system and the inability of members to veto the proceedings have strengthened the WTO’s ability to enforce rules and have broadened its jurisdiction. In emphasizing the significance of the change, Joseph Weiler (2001) describes the former dispute settlement under the GATT as “diplomacy by other means.”<sup>27</sup> By contrast, he argues, the WTO system has now imported the norms, practices, and habits of legal culture: “Disputes are not settled, they are won or lost, parties go for the jugular, ‘we can win in court’ becomes for most lawyers an automatic trigger to ‘we should bring the case.’” He adds, “The new ethos is no longer a 5–4 mentality, it is ‘getting it [legally] right’ or ‘making it appeal proof’” (Weiler 2001, 340). Weiler probably overstates somewhat the contrast between the GATT and WTO since the GATT system had clearly evolved in a more juridical direction. Nonetheless, the questions he raises are important. Is the shift toward this more legalistic approach desirable? Opinions are mixed. On one side are those who point to the merits of a trading system based on enforceable rules and contrast it with a system based on power politics. The legal scholar John Jackson (1997b), for example, is firmly in this camp (see also Jackson 2004). He stresses the importance of such rules not just in making the system more fair but also in establishing a predictable framework for private decisions. He also points to the role of dispute settlement findings in filling in gaps and clarifying ambiguities that are inevitable in all rule-making systems.

On the other side are those who voice strong reservations, such as political scientist Claude Barfield (2001). In particular, Barfield believes that there is a serious imbalance between the legislative and judicial capacities of the WTO, made worse by the WTO DSU with its firm deadlines and certain rulings. To negotiate rules in the WTO is cumbersome and time-consuming. Inevitably, therefore, as the rules become more complex,

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27. Under the GATT, “Crafting outcomes that would command the consent of both parties and thus be adopted was the principal task of the panelists” (Weiler 2001, 338).

Barfield is concerned that the DSB will be drawn into providing opinions and filling in gaps where the agreements themselves provide no guidance. Such a development is natural: If the US Congress met only once each decade, the US courts would become more active in making laws. Barfield worries that the DSB's growing role will shift power away from national governments toward panelists and thereby undermine national sovereignty. He therefore would like the Appellate Body to refuse to decide cases in which the rules are not clear.

When the WTO system for dispute settlement became more effective, it drew attention to the question of how the WTO deals with issues that may relate to trade—such as international environmental treaties, international labor standards, and human rights—when signatories do not have access to mandatory dispute settlement. Indeed, many have sought to have these issues included in trade agreements precisely to gain access to the dispute system. On the one hand, some observers fear that if more issues are included, the WTO risks losing its trade focus and experiencing excessive mission creep (Bhagwati 2002). Developing countries are also concerned that covering these issues in the WTO could make them subject to protectionism. In the 1980s it was already apparent that advocates of including services and intellectual property in the trading system were driven largely by their desire to use the dispute settlement system (see Devereaux 2005). On the other hand, those concerned about these other areas have become increasingly fearful that a narrow trade perspective will trump their interests.

Another controversy relates to the use of retaliation in the enforcement mechanism. Some object that the use of retaliation is ineffective in inducing compliance, others are concerned that it is protectionist, a third group complains about overriding national sovereignty, and a fourth believes that the system is inequitable (for discussion, see Lawrence 2004). Nevertheless, compliance with the WTO seems to be strong and, again, the system can operate as a safety valve—though this function, as noted above, is controversial.<sup>28</sup>

## Gaming the System

At the same time, the WTO dispute resolution mechanism does not, and probably cannot, prevent nations from seeking to game the system. They may do so by intentionally breaching their commitments, in the full knowledge that they are likely to trigger WTO actions. In addition, once cases are under way, nations may employ a broad range of strategies in their efforts to either win or avoid losing.

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28. For a discussion of possible reforms of the dispute settlement system, see Sutherland et al. (2004, chapter 6).

## Rational Breach

The cases in this volume illustrate several reasons why nations may engage in a strategy of “rational breach.” One overarching justification is the short-term political interests of leaders, which sometimes override the long-term economic interests of their nations. In the steel case, for example, the Bush administration certainly knew that its actions could be challenged in the WTO, but proceeded nonetheless so that it might satisfy powerful domestic constituencies—the steel companies and their unions.

In some cases, the breach of WTO commitments by one party paradoxically enables both the offender and the offended to achieve domestic political gains, albeit once again at the cost of overall economic welfare. Thus the European refusal to accept hormone-treated beef enabled the leaders in the European Union to assist their domestic farming constituencies and gain support from consumer groups. At the same time, the willingness of successive US administrations to pursue cases against the European Union in the WTO placated their farming constituencies. The result was a political win-win and an economic loss-loss.

Another important factor is the value of delay associated with breaching commitments and triggering WTO cases. Such a breach can be perfectly rational if the resulting (significant) time it takes for the case to be heard, appeals to be completed, and retaliation to be approved permits domestic industries to adjust and critical political events—for example, elections—to pass. In such situations (as the steel case makes clear), breach functions as a sort of political safety valve whose effectiveness rests in large part on the lack of provisions for recovering damages through WTO cases. The benefits achieved during the period between breach and retaliation are essentially costless for the offending party, unless, of course, the original violation triggers a tit-for-tat spiral of counterbreach.

Finally, breach can be used to intentionally push the envelope when rules are ambiguous. While WTO rulings do not officially create precedents, that outcome is almost unavoidable in practice. In addition, success in launching cases in areas where there is ambiguity is an effective mechanism for increasing the pressure on other parties to seek to extend or clarify the rules in subsequent rounds of trade negotiations. In the bananas case, for example, the European Union basically pretended to comply in the hope the United States might drop its challenge or at least delay its retaliation.

## Strategies for Influencing Outcomes

Once launched, WTO cases go forward according to established principles and time frames. But such procedural norms by no means prevent the parties from crafting strategies designed to influence the ultimate outcome. It

is possible for them to do so because negotiations among the players can be carried on in parallel with the more formal arbitration processes. These negotiations can powerfully influence how far the formal process proceeds or can lead to understandings between the contending parties once rulings have been made. In domestic legal systems, as already mentioned, this is known as “bargaining in the shadow of the law.”

The goal in fashioning these strategies is to favorably influence counterparties’ perceptions of their interests and alternatives—for example, in order to make a negotiated settlement appear preferable to risking a full-blown defeat. The tools most commonly relied on are coalition building and issue linkage.

The parties that file WTO cases often seek to build international alliances in order to bolster the importance of their case or to generate favorable public opinion in support of their positions. Complainants will lobby third members to join them in bringing cases as either complaining or third parties. In addition, though public opinion has no direct impact on WTO proceedings, parties may also seek to use it to impose a real, albeit non-trade-related, cost on the party that has breached its obligations. The public relations efforts by the West African countries in the cotton case served this purpose. At the same time, defendants will attempt to prevent these coalitions from forming. In the cotton case, for example, fear that the United States might retaliate through measures such as reducing foreign aid dissuaded the West African cotton producers from formally joining Brazil in launching WTO proceedings. But Brazil was able to counter this US threat by getting the vulnerable parties to play a critical role in influencing public opinion.

Issue linkage is the second major strategy employed by those seeking to influence perceptions of interests and alternatives during dispute settlement proceedings. The breaching parties typically seek to keep the terms of the dispute narrow, both to make the costs of accepting the breach palatable to the other side and to avoid sparking domestic political battles. The parties that file cases attempt to broaden the dispute for the converse reasons: Doing so enlarges the pie that is at risk, perhaps undermining domestic political support for leaders in the breaching party, and makes it easier to mobilize and sustain supportive domestic political coalitions. For example, the European Union challenged US exports in its case against foreign sales corporations in response to US victories on beef and bananas.

## Questions to Consider

Many of the issues discussed in our introduction arise in the cases we have selected for this volume. First, all of the disputes deal with the behind-the-border or deeper integration concerns in trade policy. Second, none of the disputes could be amicably settled by the parties. Some were resolved, in

the sense that the losing defendant withdrew its measure (steel) or the losing complainant dropped the matter (film), but in others compliance was difficult (bananas) or as yet impossible (beef, GMOs) to obtain. In several, while the cases themselves had varying degree of success, they were actually brought in order to make larger points and hence had significance beyond the measures concerned: for example, the Kodak-Fuji case to show that the informal barriers in Japan violated WTO rules, the cotton case to pressure on the United States to reduce farm subsidies in the Doha Round, and the beef hormone and GMO cases to challenge EU regulatory practices. As you read through each of the cases, consider five major questions.

### **What WTO Rules Were Challenged?**

The case studies in this volume cover a wide range of policy issues that extend far beyond border barriers. They therefore allow for reflection on the precise nature of the agreements that constrain domestic policies and for consideration of whether these rules are appropriate. These WTO rules include the agreements on sanitary and phytosanitary standards (hormones and GMOs); technical barriers to trade (GMOs); agriculture, export, and domestic content subsidies (cotton); safeguards (steel); domestic measures that are not covered by GATT rules but that may nullify or impair a member's legitimate expectations of benefits (film); quotas (bananas); services (bananas); and dispute settlement rules (bananas). They involve the United States as a complainant (hormones, GMOs, film, and bananas) and respondent (cotton), in cases against both developed countries (Japan and the European Union) and developing countries (Brazil). As you read the cases, think about the nature of the rules in question, asking,

- Are the rules really necessary to ensure free trade?
- Are the rules too vague or unclear?
- Do the rules threaten national sovereignty?
- Are they fair?

### **Why Were the Rules (Allegedly) Breached?**

The cases illustrate that countries may sometimes violate rules quite deliberately, knowing they might eventually pay a price at the WTO; at other times they may do so inadvertently because the rules themselves are complex or ambiguous, or because domestic policies were adopted with inadequate attention to their WTO implications. Once they were found in violation and lost their appeals, some respondents came into compliance

when threatened with retaliation, while in other cases they did not and retaliation was authorized and applied (hormones, bananas). As you read the cases, consider why the rules were breached, asking,

- What implementation problems did the rules pose for members?
- Were these anticipated during the rule-making negotiations or did they emerge later on, during implementation?
- Did changing domestic economic and political conditions trigger the breach?
- Did the parties try to take advantage of loopholes? Were they successful?

### **Why Was the Breach Challenged?**

Various courses of action are open to countries that believe their trading partners have violated an agreement. They can choose to ignore the violations, seek to negotiate with the trading partner, or choose to bring a case. If compliance is still not forthcoming after a WTO ruling, complainants can again choose to do nothing, seek authorization for retaliation, or retaliate in order to induce compliance. In making these choices, countries may be driven by a number of considerations and needs. These include promoting national economic interests, responding to domestic interest groups, preserving international relations, and setting a precedent for other rules and relationships with other trading partners. The cases provide examples of countries that choose not to file cases and those that do. In some cases, particular interests and concerns dominate; in others, the dispute has been brought to the WTO in order to make a point. In reading the cases, therefore, you should think about why the breach was challenged, asking whether this dispute was brought to the WTO

- simply to resolve the problems of particular producers;
- to clarify certain rules;
- to obtain through litigation what could not be obtained through agreement; or
- to create conditions for negotiation.

### **What “Influence Games” Are the Parties Playing?**

The WTO DSU is a system through which players seek to advance their interests by litigation. They breach rules and file cases in order to achieve strategic objectives. To achieve advantage, they also craft and enact strategies—such as negotiation and coalition building—in parallel with the lit-

igation process. As you read the cases, think about the game that is being played and the strategies the players are employing by asking,

- Who are the key players? What are their interests?
- What are their alternatives to complying with the rules? To permitting others to do so?
- What is the larger context in which the cases are filed? How is the subject of the dispute linked to other issues?
- Beyond filing and defending the cases, what do the parties do to try to influence their outcomes? To what extent do they engage in negotiation with the other side?
- What coalitions do they seek to build and why?
- To what other issues do they try to link their dispute and why?

### **How Well Did the Dispute Settlement System Work?**

Finally, think about what the case tells us about the WTO dispute settlement system and its strengths and weaknesses. Some view the WTO system as a great achievement, while others have concerns. As you read the cases, consider the implications for the system by asking,

- Did the WTO operate in an equitable manner?
- Did the dispute settlement system provide effective relief for the complainant?
- Was it effective in achieving compliance?
- Did the result undermine national sovereignty? What are the merits in and the problems of relying on litigation to deal with conflicts over deeper integration?
- Was an important precedent set with implications for other policies?
- Did the case contribute to or detract from the long-run legitimacy of the WTO?
- How does the dispute system affect the balance of power of individual countries?
- How does the system affect the domestic balance of power within countries?