Shadow Unilateralism: Enforcing International Trade Law at the WTO

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For lawyers, the study of international law is often frustrating for its distinct lack of a court system. The institution of law exists, but there are rarely neutral arbitrators to announce the content of the rules or declare government has violated the law. Rather, it is up to the disputing parties to decide whether a breach has occurred and what remedy, if any, is available. As if this was not difficult enough, where international courts do exist, governments have the habit of resisting the courts' jurisdiction or ignoring their rulings. International law skeptics ask whether, given such a system of unilateral rather than centralized enforcement, international law can properly be called law at all.

Advocates of international law generally point skeptics to one notable exception – the quasi-judicial system of the World Trade Organization (WTO). Within this trade agreement, the member governments have established a set of procedures, embodied in the Dispute Settlement Understanding (DSU) agreement, whereby a neutral judicial panel has compulsory jurisdiction over claims brought by member governments, has the exclusive power to decide when violations of the agreement have occurred, and sets out the remedy for violations. Moreover, thus far, governments have generally abided by the terms of the DSU agreement. The success of the WTO in establishing a multilateral dispute settlement system has led to significant political and scholarly attention. Diplomats and trade negotiators have referred to the DSU as the "crown jewels" of the WTO system. International law scholars have developed varying hypotheses to explain the success of the trade institution. In this brief essay, I want to discuss what the DSU has accomplished in terms of enforcing trade rules through a multilateral process. In doing so, I want to point out the successes of the institution in curtailing unilateralism but also its limits. Both are significant.

Given the special format of this issue, I take for granted that the reader has some knowledge of the WTO system. This brief essay begins in Section I with a short background to the General Agreement on Tariff and Trade (GATT) and WTO dispute settlement systems (other more detailed analyses of the evolution of the trade system are easily available elsewhere). In Section II, I discuss how a multilateral system and unilateral system of trade enforcement coexisted under the GATT regime. Governments could seek multilateral resolution of trade disputes through the GATT system, but governments (particularly the United States) often chose to make and enforce their own determinations of whether another government had breached a trade agreement. By contrast, the major innovation of the WTO system is that governments have agreed that the DSU will be the exclusive means to enforce trade law. Governments are to cease the unilateral enforcement of WTO rules.

In Section III, I analyze how the institutional design of the DSU impacts its goal of supplanting unilateral means of trade enforcement. Specifically, I examine how the DSU system only provides a prospective remedy – that is, the DSU permits retaliation only for injuries that take place after the WTO litigation of whether a breach occurred is concluded. The DSU thus immunizes violations of WTO trade law from retaliatory sanctioning so long as the offending measures are withdrawn at the end of the litigation process, which is often several years later. This immunity, which I refer to as the "stall-and-withdraw" loophole, leaves injured governments with no immediate remedy for WTO violations under the DSU system, regardless of how great the trade effects of the violation are. In this section, I suggest that the institutional design of the DSU effectively creates a need for the unilateral enforcement of trade rules and, oddly, provides legal protection for unilateral sanctions. I conclude by attempting to provide a view of the DSU that acknowledges its advances from its origins in the GATT regime but acknowledge its inability to completely control unilateral retaliation.

I. A Brief History of GATT and WTO Dispute Settlement

A full account of the evolution of international trade law from the GATT to the current WTO regime cannot be captured in an essay. It is a rich history involving changing views of economic growth theory, international security concerns, contentious domestic politics, experimentation in legal institutional design, changing environmental and public health demands, among many other influences. Below I provide a brief account of the events and political demands that led to the creation of the DSU.

Following the end of World War II, the victorious wartime allies began to negotiate a multilateral agreement to govern international trade rules. The trade negotiations lasted from 1946 to 1948 and culminated in the drafting of the International Trade Organization (ITO) Charter – a multilateral agreement on the trade in goods. The ITO was to have a sophisticated organizational structure that included submitting all trade disputes to the United Nation's International Court of Justice. The ITO, however, failed to come into existence, because it failed to gain sufficient political support in the United States Senate. Once it became clear that the Senate would not ratify the agreement, other governments had little interest in bringing the treaty into force. The failure of the ITO effectively eliminated the prospect of a formal dispute settlement system in international trade law. Without the ITO, the operative treaty governing trade relations became the 1947 General Agreement on Tariffs and Trade (GATT) agreement, a skeletal agreement that was negotiated by the Bretton Woods governments as an interim measure to lower tariff levels. Unlike the ITO, the GATT agreement did not have an organizational structure: there was not a formal organizational body, there were no provisions for future trade negotiations, and there were no procedures for the resolution of disputes. A trade system was born without a formal set of procedures for enforcing trade law.

As is well documented by Robert Hudec and others, a dispute settlement system eventually developed in the GATT regime that was a mix of legal analysis and diplomacy. The dispute settlement system evolved over the life of the GATT regime

(and some of its practices changed significantly), but it can nevertheless be described in broad strokes. Trade disputes were supposed to be submitted to arbitration, which consisted of a panel of three arbitrators selected by the parties. The arbitrators would decide if there was a trade violation and submit a report to the GATT governments. The governments could then adopt the report and, if the panel found a violation, authorize the complaining party to retaliate against the respondent government.

While this system seems quite legal in principle, we must examine its political aspects to understand how the GATT system operated in practice. Dispute settlement worked on a consensus system – that is, every party to the GATT agreement had to agree, or at least not object, to any action by the GATT body. Thus each step of the dispute resolution process had to meet the consensus requirement. Both the complaining government and the respondent government had to agree to the formation of a panel to hear the dispute, the selection of the arbitrators, and the adoption of the report by the GATT parties. In short, the respondent government could veto the process at several different points – at which time the legal case would, for most intents and purposes, simply cease. Yet parties often did not veto the panel process. In the later days of the GATT regime, the parties mutually agreed not to block the formation of a panel but respondent governments could still slow the process significantly and retained the ability to block the adoption of the report.

For all its institutional weakness, the GATT system worked fairly well as a diplomatic dispute settlement system. When governments were politically open to settling the dispute, the GATT system provided a neutral arbitration process. Complaining governments could also raise awareness of other states' poor trade practices even if the legal case never advanced significantly. In the end, the GATT system did a surprisingly good job of dispute resolution given its procedural limitations.

The GATT system of dispute resolution was intended to be the exclusive means of determining whether a violation of the agreement had occurred, but it was not. In practice, the GATT system coexisted with a unilateral system of trade law enforcement. Given the ineffectiveness of GATT in dealing with politically sensitive breaches of trade law, governments starting enforcing international trade rules on their own. For example, the United States government famously began using an exclusively domestic decision-making process to determine whether other governments were violating GATT trade rules or otherwise trading in ways the United States government deemed "unfair." The United States government would unilaterally impose trade sanctions when it found violations. These measures were called "Section 301" actions, after the section of the 1974 Trade Act that authorized the executive to apply these sanctions. As the sole judge, the United States, unsurprisingly, was quick to find that other states were breaching the GATT while never finding its own questionable trade measures were violations.

The United States government was able to maintain this system of unilateral enforcement of trade law without significant fear of retaliation (with the exception of the European Communities (EC) and sometimes Japan) primarily because access to the American market was more important to U.S. trading partners than any one export market was to

the United States. Restated, the size of the United States market made exclusion from this market very costly to an economically smaller nation's exporters, but the smaller size of the other nation's market made exclusion from its markets only moderately costly to American exporters. While the United States was not the only country to take such measures – the EC similarly had the authority under its law to sanction violations of international trade law – American Section 301 actions caused significant consternation abroad. Other governments charged that the United States was acting "unilaterally" – using access to the American market to attack other governments' policies while refusing to alter its own breaches of trade law.

In advance of the GATT's Uruguay Round – the 1982-1994 round of trade negotiations that established the WTO agreements – the participating governments agreed that the current system of dispute resolution needed to be reformed. Even the U.S. Congress was pressing the executive branch to negotiate a stricter system of international trade enforcement. Although all of the governments were repeating the mantra of reform, their political goals were vastly different. Most governments wanted the United States to abandon its practice of unilaterally enforcing its own interpretation of trade law, while the U.S. Congress wanted the rest of the world to approve (and thus stop objecting to) its Section 301 process. During the negotiations, the United States executive branch pushed for a quasi-court system: an arbitration body that (1) could adjudicate complaints on a strict time schedule and (2) whose decisions would be automatically enforced through trade sanctions. Other governments were more skeptical of such a legalized process, preferring instead the existing GATT approach with its emphasis on diplomacy; these governments were primarily concerned with curtailing the United States government's use of Section 301.

To address these concerns, the governments participating in the Uruguay Round created the World Trade Organization as a framework agreement and embodied the specific procedures for multilateral enforcement of trade rules in the Dispute Settlement Understanding. The ultimate compromise on trade law enforcement includes strict time limits, which can not be blocked by the respondent governments. The decisions of the arbitration panel are subject to review by a standing and independent Appellate Body and are then adopted by the WTO members (sitting as the Dispute Settlement Body). The Dispute Settlement Body adopts the reports by reverse consensus – that is, the report is adopted unless every member government, including the winning government, objects to the decision. In return, the United States agreed to apply trade sanctions only if the new multilateral dispute settlement process determines that there is a violation. At its core, the DSU requires that the United States forego its practice of unilateral trade enforcement in return for an effective multilateral process.

Like most compromises, none of the parties were entirely pleased by the Dispute Settlement Understanding (DSU). Various governments objected that the new system was too litigious and gave insufficient deference to national trade policy goals. The U.S. Congress objected on different grounds. Members of Congress argued that the new system undermined state sovereignty and gutted the U.S.'s ability to apply trade sanctions when it believed there was a violation of the trade agreement. Instead of negotiating the

international system's approval of Section 301, the executive had all but ended the program. Members of Congress threatened to reject the DSU agreement, but eventually accepted the DSU system as part of the package of WTO trade concessions.

In Section III, I discuss how the DSU is not the exclusive means by which governments seek to enforce WTO trade rules. A system of unilateral enforcement continues to exist along side the multilateral system. But before we understand the limitations of the DSU, in particular the way in which the DSU as an institution effectively permits (and perhaps encourages) retaliation outside of its framework, we need to discuss the structure of the DSU system.

II. The Impact of the DSU on the Enforcement of Trade Rules

The core of the DSU agreement can be summed up as follows: Member states have promised to subordinate their right to retaliate legally for the illegal act of another government to WTO arbitration. The arbitration covers both whether a breach has occurred, and, if so, the extent to which the complaining government can retaliate. In addition, respondent governments have agreed to accept the decision of the arbitrator (be it a panel or the Appellate Body) as to whether its actions are in breach of the agreement and thus will not counter-retaliate. To understand the significance of this agreement, we first have to know how international law dispute resolution works without such a procedural agreement.

A. A Brief Analysis of Public International Law

International law is popularly viewed as significantly different than "real" domestic law because international law lacks an entrenched system of enforcement. International law has rules but not necessarily a judicial system to enforce these rules. Given the special format of this issue, I offer a simplified description of the enforcement of international law in the absence of agreed upon dispute settlement rules. Governments can commit in a treaty to a system of rules, and the treaty forms the basis for international law – that is, legally binding rules between the parties to the treaty. There are various other ways to form international law (some of which are more controversial), but I focus here on treaties because treaty law is the basis of most international trade rules. Treaty law is formed when a group of governments agree to a treaty text and ratify that text. The treaty is then international law, at least with regard to the parties to the treaty.

The existence of the treaty, however, does not necessarily mean that there is a neutral, authoritative body to declare what the treaty requires and whether one party has breached it. Rather, both governments are equally valid interpreters of the treaty (and, thus, why governments almost never admit that they have violated international law even if they privately think a violation has occurred). The interested parties themselves are equally authoritative judges. The parties could mutually agree to resolve the dispute by appointing a neutral arbitrator, but both parties have to consent. While sometimes governments agree to do this, one party often refuses to consent for various reasons, not the least of which is a distrust that the arbitrator will "correctly" interpret the treaty.

Now that the treaty exists, let's say that one party takes an action that the other party considers to be a violation of the agreement. So Government A believes that Government B has passed some domestic measure that breaches the treaty. Government B disagrees and claims that its actions are perfectly consistent with the treaty.

What will the governments do to resolve their dispute? We have a situation where two interpretations of the treaty exist. Government A can claim that the treaty was violated, and, under its interpretation, legally retaliate against Government B by breaching the agreement in a proportionate manner. Government B can then disagree that any violation occurred and, under its interpretation, declare that Government A's countermeasures are themselves a violation of treaty – one that Government B views as illegal because Government B does not acknowledge that a preceding violation of the treaty ever occurred. This can continue in a spiral: Government B adopting countermeasures for Government A's violation, Government A then adopting additional countermeasures for Government B's new "illegal" response to its "legal" retaliation, and so on. In the context of trade law, the spiral is referred to as a "trade war." Obviously, disputes do not always spiral like this. The threat of a spiral can keep Government B from breaching initially, keep Government A from retaliating in the first instance, keep Government B from responding to Government A's retaliation, or otherwise stop the fight at some later point.

The frustration for lawyers is that result of the dispute tends to be based on politics (who can hurt whom worse or who was the political will to stay in the fight longest) rather than the legal merits. The enforcement of international law is often an exercise in political or economic power rather an analysis of each government's legal arguments.

B. Returning to International Trade Law

It is against this backdrop that the GATT system operated – a system of international law enforcement where each government is able to maintain the correctness of its legal analysis and unilaterally retaliate against perceived violations. The DSU is significant because it moved beyond the default international law baseline. Governments have foregone their right to determine on their own whether another government has violated the WTO agreement. Consequently, the DSU can claim to have eliminated the two-interpretation problem. As I will discuss in Section III, however, the institutional design of the DSU still permits unilateral retaliation and, thus, has not solved this issue completely.

The GATT effectively let unilateral enforcement coexist with its multilateral system. The GATT achieved notable successes in establishing a system of neutral dispute resolution, but it was slow and could be effectively blocked by either party to a dispute. Consequently, the participating governments often resorted to unilateral determinations of what was a violation of international trade rules and unilateral enforcement of the agreement. Unilateral retaliation could (and sometimes did) descend into trade wars, although far more often led to more economically powerful governments imposing their

views on less economically powerful governments. The differences in economic power allowed the U.S. government and the EC (as its internal market integrated in the later years of the GATT) to impose sanctions against its trading partners with smaller economies without much fear of counter-retaliation. Although unilateral trade enforcement was never explicitly permitted under the GATT regime, the weakness of the institution created a situation where this was the open practice of some governments, even though many commentators would say that unilateral retaliation under the GATT was illegal.

The DSU has changed the GATT system in significant ways. If one member has allegedly breached a WTO agreement, the members of the WTO have agreed to constraints on their ability to breach (legally) the treaty in reply, claiming the other member's violation as the legal justification. The notable point for the "rule of law" element is that the finding of breach is based upon the legal merits of the case rather than the relative economic power of the parties. Of course, the influence of economic power remains: The decision to bring a case, the extent to which sanctions are effective, the cost of good legal representation at the WTO and other advantages of economic power continue to influence the WTO dispute settlement system. Nonetheless, the DSU system is a more rule-based system than the previous GATT system.

By ceding the authority to adjudicate trade disputes to an arbitration body, member governments have created a system of dispute resolution that is ostensibly based on legal rules rather than power, at least with regard to whether a government has or has not breached the agreement. In practice, the DSU system works something like this: If Government A raises its tariff rates on cars coming from the territory of Government B and Government B believes that this is a violation of the GATT agreement (or another agreement in the WTO), then under international law rules, Government B may want to retaliate by breaching the agreement in a proportionate way – say, by raising the tariff rates on motorcycles coming from the territory of Government A. While under the GATT regime Government B could, as a matter of state practice, act unilaterally or multilaterally, the DSU agreement explicitly requires that Government B receive authorization from the WTO before retaliating against Government A for the retaliation to be legally justified. Restated, Government B's retaliation is not itself a violation of the WTO agreement if it receives authorization for the retaliation through the DSU process. If the WTO finds that there was not breach, then Government B cannot legally retaliate at all. Thus for WTO members to claim *the legal right to retaliate* against others members' alleged breaches of the agreement, they must first receive the approval of the WTO by going through DSU procedures.

III. The Important Gaps: Retaliation Outside of the DSU Process

While the DSU is a significant development in international dispute settlement, the agreement has not successfully curtailed the unilateral enforcement international trade law as many scholars suggest. Governments can still adopt retaliatory trade policies – that is, punitive sanctions or a measure that mirrors the one about which they are complaining, although they can no longer claim that such actions are legal. The DSU

agreement links the legality of retaliation to use of the WTO dispute resolution procedures. Retaliation is illegal – even if proportionate – if it is based on a unilateral determination of a violation.

The interesting element here is that the DSU institution *effectively* permits such illegal retaliation because it immunizes both violations and illegal retaliation to those violations for at least 18 months (although the time period is likely to be much longer) – what I refer to as the "stall-and-withdraw" loophole. I say "effectively" because this is not the explicit goal of the DSU, and it certainly does not match the text of the DSU. By its own terms, the DSU claims to have jurisdiction over all disputes regarding almost all of the WTO agreements (the "covered agreements," in DSU terms), and states have agreed to give up unilateral retaliation. Nevertheless, the institutional design of the DSU permits governments more options in practice. In fact, the failure of the DSU design to provide a remedy during the litigation process arguably *creates* an incentive for governments to use enforcement strategies that are formally prohibited the WTO framework. This is where the institutional design analysis and the legal analysis of the DSU text differ. My analysis is concerned with the institutional design elements.

The DSU system *effectively* permits retaliation by providing governments with legal immunity for their actions until such time as the DSU adjudicatory system declares the action to be a violation. Under the terms of the DSU, governments cannot legally impose sanctions for violations of the agreement until they have received a WTO finding of a breach. Then the WTO will only authorize *prospective* sanctions, meaning sanctions from the time of the finding going forward into the future. Any economic damage caused by the breach up until the WTO finding is not compensated.

A government can breach the WTO agreement until the DSU litigation is complete and other governments are not legally permitted to retaliate. The minimum time to complete the litigation process is 18 months. This includes consultations, a panel hearing, an appeal and a reasonable period of time to comply. WTO litigation may continue after this point, but then the complaining government can apply sanctions for the *current* negative trade effects if the offending measure is not removed (subject to an arbitration hearing on the level of sanctioning). Although the minimum time is 18 months, most litigation at the WTO takes years. For instance, the Brazil is currently in litigation with the United States regarding American subsidies to cotton farmers. That litigation began in August 2006 and the case is still ongoing. Retaliatory sanctions, if the WTO authorizes any, will not come before April 2009 – over two and half years after the case was filed. Others cases have gone on for much longer.

If a government removes the offending measure after the DSU process is completed, then other governments are not compensated no matter how much damage the measure has caused. Of course, the DSU text does not state that governments have immunity from sanctions until the case is adjudicated. Quite the opposite: The DSU states that governments should comply at all times with their legal obligations. It is here that an analysis of the text of the DSU and an analysis of the DSU's institutional design lead in different directions. The legal text does not explicitly authorize government immunity

for breaches of trade law during the DSU adjudication process, but the design of the institution creates a de facto free pass so long as the measure is withdrawn at the end of the litigation.

For instance, in March 2002, President Bush raised tariff rates on steel imports. Although President Bush claimed that this was legal under the WTO agreement, it was widely viewed as a violation of international trade rules by both domestic and foreign observers. Yet other nations were not allowed to retaliate under the DSU rules until the WTO's Dispute Settlement Body declared this measure a violation. When the WTO did formally declare the higher tariff rates a violation in December 2003, President Bush simply withdrew the measure. Blatantly using this "stall and withdraw" loophole, President Bush was able violate the WTO agreements and yet other governments were not permitted to retaliate against the United States for the damage caused. Other states may have altered their diplomatic posture towards the Bush administration during this time or there may have been some reputational loss (although the impact and degree of reputational losses are controversial), but other governments were unable, if they abide by the legal strictures of the WTO, to reply in kind.

Of course, other states can reply in kind. The complaining governments do not claim that such retaliation is legal – these governments will probably privately view such retaliation as illegal under the WTO although the governments have absolutely no incentive to ever publicly admit to that – but unilateral retaliation remains within the range of policy choices for governments. The issue here is not just that states can violate in international law, even procedural rules about addressing violations. Rather, it is that the institutional design of the DSU influences governments' decisions on when and how to act outside of the DSU framework. That is, the institutional design of the DSU influences governments' decisions as to when they should violate the DSU.

Specifically, the DSU's stall-and-withdraw loophole creates a demand for trade retaliation outside of the DSU framework. Governments that find that the DSU's forward-looking remedies, which do not provide for compensation for economic damages that occur during the litigation process, are unsatisfying will seek an alternative. In addition, where the immediate effects of a violation have a significant economic impact on the injured state, domestic political conditions may require domestic leaders to take action before the DSU process can be concluded.

The DSU's institutional design *effectively* permits such actions because, ironically, it provides some cover for WTO illegal retaliation. Just as other states cannot legally retaliate against the initial breach, retaliation in response to that breach is entitled to the same protection. Thus both governments may be in breach of the WTO agreement but neither is legally allowed to respond to the other's violation before the DSU process has been completed. In practice, this means that injured states can pursue a two-step enforcement policy. They can retaliate immediately (and illegally) for the perceived violations of one of their trading partners as well as pursue WTO litigation. This is one way to interpret the ongoing dispute between the United States and the EU over subsidies to Airbus and Boeing. Each has alleged the other unfairly subsidizes its aircraft

manufacturing industry. Both governments are arguably violating the WTO's rule on subsidies, but nonetheless each is retaliating outside of the WTO permitted framework while simultaneously pursuing a DSU ruling. This set of cases – the EU and United States have each filed a complaint against the other's practices – began in October 2004 and is still ongoing.

Along the same lines, in 2007, the European Union actively considered a proposal, advocated by French President Jacques Chirac, to impose a carbon tax on imports from the United States until such time as the United States joins the Kyoto Protocol. This imposition of carbon tax on U.S. goods is arguably a violation on the WTO Agreement. The mostly likely response by the United States government, which is considering its own carbon duty on imports, to the EC actions would have been imposing a similar carbon tax on the goods from the EC (and perhaps other states as well). One or both could also bring a WTO case, but more immediate measures are also in either government's range of policy options. Indeed, the stall-and-withdraw loophole creates a need for more immediate, if illegal, action.

Finally, governments can retaliate using measures that seem tangential to the issue at hand, and yet be attempting to enforce trade rules outside of the WTO framework. For instance, the United States government could respond to EU health and safety measures that the U.S. views as a violation the WTO's Sanitary and Phytosanitary (SPS) Agreement by increasing its inspections of EU agriculture exports or quarantining certain products. The public may not recognize this as unilateral enforcement action and yet it could influence the EU's implementation of health and safety measures**.**

Conclusion

The DSU has made major strides in establishing a rule of law system for the adjudication of international trade disputes. In many ways, it is a model for how dispute settlement institutions in other areas might be designed. And yet the DSU has its own institutional limitations. The core legal principle of the DSU is that governments forego unilateral trade enforcement in favor of a multilateral process, but the institutional design of the DSU has a different effect. The structure of the DSU creates a demand for unilateral retaliation by immunizing breaches of the WTO agreement during litigation. So long as the respondent government withdraws the measure after the DSU litigation is complete, WTO member governments cannot *legally* respond to the breach. In addition, the DSU system permits the unilateral retaliation the same legal immunity as the alleged breach. Consequently, an analysis of the DSU system has to balance the successes of the system in constraining unilateral action with the institutional design elements of the DSU that permit, if not encourage, unilateral action.