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No. 11/2018

Impasse in the WTO Dispute Settlement Body: Consequences and Responses

By Robert McDougall, *an independent trade law consultant in Geneva*

EXECUTIVE SUMMARY

As the United States maintains its block on appointments of new members to the Appellate Body, there is growing concern about the pending incapacitation of the dispute settlement function of the World Trade Organisation. If the WTO can no longer offer effective dispute resolution, some argue, there is a risk that the whole WTO system of rules will collapse. How-

ever, while it is important to defend the integrity and effectiveness of dispute resolution, the rules-based system is about more than just the resolution of disputes. What is needed now is measured analyses of the interim options for the WTO if the impasse continues. This Policy Brief reviews some of these options, including the use of “no appeal agreements” and the estab-

lishment of alternative plurilateral mechanisms for dispute resolution. It concludes that the alternatives have their own weaknesses and risks, and that the best way forward is for WTO members to pursue constructive and inclusive cooperation in order restore trust in the trade rules and in the good faith of other members.

INTRODUCTION

As the impasse in the WTO Dispute Settlement Body (DSB) over the appointment of new members of the Appellate Body drags on,¹ it is only a matter of time before the tribunal will cease to function. The United States has now at least explicitly linked its block on new appointments to its longstanding systemic concerns about certain aspects of the dispute settlement mechanism.² There also now seems to be a willingness among some other members to acknowledge and address at least some of those concerns.³ However, with the United States continuing to impose and threaten tariffs on its major trading partners and escalate trade tensions with China,⁴ and with the associated legal disputes moving ahead in the WTO,⁵ the impasse in the DSB is unlikely to end any time soon.

With the increasing likelihood of an incapacitated Appellate Body, attention is turning to the consequences of this outcome and the steps that might be taken to preserve an appeal function. Some proposals envisage an alternative dispute settlement mechanism negotiated without the United States⁶ or even, in some scenarios, a “new international trade organization minus the United States”.⁷ Most of these proposals, however, overestimate the capacity of the dispute settlement mechanism to resolve the current trade tensions, and underestimate the effort required, limitations and systemic risks of exclusionary reactions to US trade policy action. Instead, the best responses to the impasse in the DSB will be those that contribute to restoring trust and confidence in the trading system and involve new forms of inclusive leadership.

KEEPING THE CONSEQUENCES IN PERSPECTIVE

Without a breakthrough that allows new appointments, the Appellate Body will cease to be able to hear new appeals by the end of 2019, even earlier in the case of a recusal, illness or early departure of even one of the three current members. With disputes stalled at the appeal stage, the fate of circulated panel reports will be decided by agreement of the parties. At that point, dispute settlement in the WTO will effectively revert to what it was under the GATT: the formal adoption of reports, which is required to give them legal effect and start the clock on compliance obligations and enforcement rights, will be subject to a veto by the responding party.

While WTO members are justifiably worried about the consequences of a diminished dispute settlement mechanism, contrary to the scenarios posited by some, it will not bring about the collapse of the rules-based trading system. Of course, hard cases will again be more difficult to resolve, some members may take opportunistic trade measures, and the trading system may be less secure and predictable (if that is possible). But a diminished dispute settlement mechanism is unlikely, on its own, to open the floodgates for trade distorting measures. WTO members will continue to respect their trade obligations, which will remain binding, just as they do their international commitments in other areas. The evaluation of the consistency of national measures

¹ Summary of the DSB meeting of 29 October 2018, at: <www.wto.org/english/news_e/news18_e/dsb_29oct18_e.htm>.

² US Statement at the DSB meeting of 27 August 2018, at: <geneva.usmission.gov/wp-content/uploads/sites/290/Aug27.DSB_Stmt_as-delivered.fin_public.pdf>.

³ Communication from the EU, China, Canada, India, Norway, New Zealand, Switzerland, Australia, Korea, Iceland, Singapore and Mexico to the WTO General Council, at: <trade.ec.europa.eu/doclib/docs/2018/november/tradoc_157514.pdf> and Strengthening and Modernizing the WTO: Discussion Paper from Canada, at: <international.gc.ca/gac-amc/campaign-campagne/wto-omc/discussion_paper-document_travail.aspx>.

⁴ Martin Wolf, “The US must avoid a new cold war with China”, *Financial Times*, 30 October 2018, at: <www.ft.com/content/c9e5ab54-dc2a-11e8-8f50-cbae5495d92b>.

⁵ Summary of the DSB meeting of 21 November 2018, at: <www.wto.org/english/news_e/news18_e/dsb_19nov18_e.htm>.

⁶ James Bacchus, “Saving the WTO’s Appeals Process”, *CATO Institute*, 12 October 2018, at: <www.cato.org/blog/saving-wtos-appeals-process>.

⁷ Pascal Lamy, “Trump’s protectionism might just save the WTO”, *Washington Post*, 12 November 2018, at: <www.washingtonpost.com/news/theworldpost/wp/2018/11/12/wto-2/>.

with the trade rules will not change, even as the evaluation of the risk, and consequence, of legal challenge obviously will. The prospect of formal legal challenge is however only one, and not even the most significant, factor in the adoption of measures that might affect trade.

The sense of panic setting in about the prospect of a diminished WTO dispute settlement mechanism is driven, at least in part, by a presumption that its enforcement features are the only source of its success. Since traditional evaluations tend to focus on the rate of compliance with adopted reports, this is understandable. However, a number of features influence the success of a dispute settlement mechanism, not all of which are affected by the final fate of an adjudicator's report. Information exchange and mutual learning, as well as the reputational costs associated with a measure being challenged can all still positively affect the outcome of a dispute, even if formal enforcement options are denied. Indeed, the additional reputational costs of blocking the adoption of a panel report by appealing to an incapacitated Appellate Body, and the resulting risk of unauthorized countermeasures, will do much to restrain the behaviour of WTO members.

We know this to be true because that was the experience in the GATT. Dispute settlement under GATT obviously had many weaknesses, which motivated the innovations introduced in the WTO. But it was not without its strengths, some of which may even have been lost in the WTO. For example, the need for consensus to adopt panel reports gave disputing parties the incentive to pursue mutually agreed solutions. This incentive has arguably been diminished by the move to compulsory dispute settlement in the WTO. In the current circumstances, perhaps necessity will once again become the mother of (re)invention, by providing members the incentive and opportunity to rediscover the benefits of alternative dispute settlement mechanisms.⁸

This is not meant to downplay the effectiveness of the WTO dispute settlement mechanism or to suggest that it should not be vigorously defended. Nor is it to endorse USTR Robert Lighthizer's apparent nostalgia for dispute settlement under GATT⁹. It is only to caution against the conclusion that a period of diminished capacity of the dispute settlement function will bring about the collapse of the rules-based trading system or render the WTO completely ineffective in settling trade disputes. As the current trade tensions clearly illustrate, effective trade cooperation, and trade peace, depends on more than just the availability of enforceable dispute settlement. A realistic appreciation of the consequences of a diminished dispute settlement capacity therefore matters for the prescription about how to respond. An exaggerated sense of concern risks provoking an overreaction that may be ineffective at best and even counterproductive. It may also just increase the leverage of the United States in the impasse.

EVALUATING THE INTERIM OPTIONS

If the Appellate Body becomes completely incapacitated, the WTO dispute settlement mechanism loses its three most important innovations: quasi-automatic adoption of reports, a chance to correct "bad" panel reports and a mechanism to provide consistency between disputes. Pending resolution of the impasse, WTO members may wish to preserve these features in some form. For example, they could simply agree not to appeal reports circulated by panels, allowing them instead to be adopted on negative consensus as prescribed. While "no appeal agreements" could be set up separately for each dispute, they would be more effective if agreed in advance among multiple WTO members. This approach would be simple to implement and scale using an existing informal mechanism in the DSB to encourage and monitor exactly this kind of

⁸ Robert McDougall, "Making Trade Dispute Settlement More Accessible and Inclusive", Centre for International Governance Innovation, 2 November 2017, at: <www.cigionline.org/articles/making-trade-dispute-settlement-more-accessible-and-inclusive>.

⁹ Interview of USTR Robert Lighthizer by John Hamre, "U.S. Trade Policy Priorities", Center for Strategic and International Studies, 18 September 2017, at: <www.csis.org/analysis/us-trade-policy-priorities-robert-lighthizer-united-states-trade-representative>.

plurilateral procedural agreement. While “no appeal agreements” would preserve access to the WTO’s enforcement procedures, they would not address concerns about “bad” panel reports and inconsistency between panels.¹⁰

One option advocated by some¹¹ to address these additional concerns is for members to establish a temporary alternative appeal mechanism, for example through the seldom-used arbitration provisions of Article 25 of the Dispute Settlement Understanding (DSU). According to this proposal,¹² members would agree that instead of appealing a panel report under Article 16.4 of the DSU, a party could refer it to an “appeal-arbitration” under Article 25. As with “no appeal agreements”, members could agree to “appeal-arbitration” agreements on a dispute-specific basis or in advance among a wider group of members. Indeed, a wider plurilateral agreement would likely be required to implement certain systemic features that might be more difficult to address in dispute-specific agreements (such as a roster of arbitrators, appointing authority, etc.).

An Article 25 “appeal-arbitration” mechanism would still face a number of challenges and risks.¹³ First, implementing it in a way that replicates the most essential features of the existing system would still be difficult and time consuming. For starters, converting the current unity of opposition to the US’ disruptive trade policy into a positive consensus around an alternative mechanism will be harder than advocates anticipate. And assuming agreement can be reached, many members will require that it be subject to domestic ratification procedures in order to provide an acceptable level of certainty and reciprocity.

Second, even its most ambitious variant would remain institutionally incomplete. For instance, while participants in a plurilateral mechanism could establish a roster of adjudicators, unless they also agree to fund a separate standing tribunal, appeal-arbitrators would still only be appointed on an ad-hoc basis for specific disputes. As a result, appeal-arbitration reports would not have the same authority as Appellate Body reports, meaning that while they may correct the legal errors of individual panels, they would be less effective at addressing concerns about consistency between disputes.

Third, the main disadvantages and risks arise from the exclusion of the United States from the mechanism. Not only would this vastly diminish its appeal for most members, unless WTO members are prepared to breach their own commitments by discriminating against the United States, the latter would effectively become a free-rider in a rules-based trading system that makes others subject to enforceable dispute settlement but not itself. Moreover, by normalizing an ad-hoc appeals mechanism that would, by necessity, be inferior to the Appellate Body, an appeal-arbitration mechanism might actually contribute to the apparent US objectives of making WTO adjudication more like arbitration. Nothing would prevent it from joining such a mechanism, and then eventually pushing for it to replace the existing system permanently. In other words, far from reducing the leverage of the United States, a plurilateral appeal-arbitration mechanism gives it a free pass, and perhaps even gives it what it seeks.

A temporary plurilateral appeal mechanism will therefore require significant diplomatic effort to establish, have unavoidable limitations and deficiencies, and present systemic risks to a more stable dispute settlement mechanism in the long run. These disadvantages may not be worth the benefits that are only slightly better than signing “no appeal agreements”. Instead, it would be

¹⁰ Statement on a Practice Mechanism, Minutes of the DSB Meeting of 26 July 2016, at: <<http://bit.ly/dsb-minutes-mechanism>>.

¹¹ Bacchus, *supra* note 6.

¹² Scott Andersen et al., “Using Arbitration Under Article 25 of the DSU to Ensure the Availability of Appeals”, CTEI Working Paper 2017-17, at: <graduateinstitute.ch/files/live/sites/iheid/files/sites/ctei/shared/CTEI/working_papers/CTEI-2017-17-.pdf>.

¹³ Robert McDougall, “The Search for Solutions to Save the WTO Appellate Body”, ECIPE, December 2017, at: <ecipe.org/publications/the-search-for-solutions-to-save-the-wto-appellate-body>.

far better to expend the same effort trying to improve the current dispute settlement mechanism to accommodate US concerns, not all of which are unreasonable.¹⁴

RESTORING TRUST AND LEADERSHIP IN PURSUIT OF TRADE PEACE

The instinct to preserve the appeal and enforcement features of the dispute settlement system at all costs, if necessary without the involvement of the world's largest economy, is understandable but may ultimately prove to be a distraction. While these features make an important contribution to the security and predictability of the trading system, they are not the only sources. The effort to preserve them should therefore not be allowed to overshadow or undermine the equally, and possibly more, important efforts to strengthen the other functions of the WTO that support cooperation on trade. Indeed, making the modernization efforts conditional upon first restoring the dispute settlement function only contributes to the growing lack of trust and divisiveness among trading partners and in the trading system.

The current trade tensions that have been precipitated by profound changes in the global economy will not be resolved by improving the capacity of WTO members to obtain enforceable rulings through win-lose litigation. It must instead be based on cooperation and constructive dialogue designed first to restore confidence in the trade rules themselves and in the good faith of other WTO members. This will require a recommitment to self-restraint, and the emergence of new form of inclusive leadership that can chart a pathway back to respect for rules-based trade and the institutions that sustain it.

¹⁴ Robert McDougall, "Crisis in the WTO: Restoring the Dispute Settlement Function", CIGI Paper No. 194, 16 October 2018, at: <<https://www.cigionline.org/publications/crisis-wto-restoring-dispute-settlement-function>>.