SIGNIFICANT CONTRIBUTIONS OF THE GATT AND THE WORLD TRADE ORGANIZATION TO THE SETTLEMENT OF INTERNATIONAL ECONOMIC DISPUTES

Andrei GRIMBERG[*]

Abstract

This study examines the role of the degree of legal controversy with respect to a panel ruling in determining the countries' tendency to block/appeal a panel report. It shows that, under both the GATT and WTO regimes, there is an asymmetric advantage between the plaintiff and the defendant. The plaintiff's potential benefit of blocking/appealing an adverse panel ruling is smaller than the that of the defendant, but it bears the same cost structure as the latter. This disadvantage to the plaintiff is diminished under the WTO procedure compared to the GATT, though it is not completely eliminated. The study also shows that the level of legal controversy over panel rulings increases, in general, proportionate to the increase in the frequency at which panel reports are blocked under the GATT regime. However, the tendency to appeal a panel report under the new WTO procedure is, basically, higher than the tendency to block a panel report under the GATT, when such reviews in appeal were not available.

Keywords: *GATT, WTO, dispute settlement, mechanism, developing county, trade*

1. Introduction

Since its inception in 1947, the General Agreement on Tariffs and Trade (GATT) has evolved into a global framework of international trade laws, which is still in effect today under the World Trade Organization (WTO). The relative effectiveness of the GATT legal system has to a large extent depended on its dispute settlement mechanism.[1] This procedure allows member states to challenge other member countries' "questionable trade measures with reference to the GATT/WTO agreements." Hence, it has served as a mechanism of mutual surveillance and enforcement of the GATT/WTO.

A general problem that overshadowed the dispute procedure under the GATT regime was the common practice to require that all decisions be made by consensus.[2] The defending party objecting to the consensus could delay or block the procedure. Therefore, the most serious problem posed by this procedure is the potential of the defending country to block an adverse panel report. The practice established under the GATT is that "a panel of experts would be established to hear and rule on a dispute, if a bilateral agreement could not be reached between the disputing parties". However, because only the

[*] Assistant Lecturer, PhD, Faculty of Law, "Nicolae Titulescu" University of Bucharest (e-mail: avocatgrimberg@yahoo.com).

[1] Layla Hughes, *Limiting the Jurisdiction of Dispute Settlement Panels – The Appellate Body Beef Hormone Decision* in "The Georgetown International Environmental Law Review", vol. 10, 1998, pp. 915-942.

[2] Jacques H. J. Bourgeois, *Comment on a WTO Permanent Panel Body*, in "Journal of International Economic Law", vol. 6, nr. 1, 2003, pp. 211-214.

"contracting parties" have the power to decide on a given matter, the panel report has to be adopted or approved by the contracting parties before its become binding. In the face of an adverse panel report, the defending party can therefore block the report and thus avoid implementing the recommendations made by the panel.

Although during 1950s-1970s, only one out of 41 panel rulings was blocked, the blocking problem became more obvious during the 1980s, when ten out of 47 panel reports were blocked.[3] Due, perhaps, the international diplomatic pressure or considerations regarding possible future disputes, some countries chose not to veto to a panel report, unless it was necessary indeed.

In 1995, the World Trade Organization (WTO) was established, replacing the GATT, and a new dispute settlement procedure was put in place under the WTO, which altered some of the features of the previous GATT mechanism.[4]

The most significant alteration was the removal of the consensus rule for panel adoption and hence the elimination of the blocking problem. The panel report on any dispute will be deemed automatically adopted. To protect the parties against errors that may occur at panel level, a new appellate procedure was created instead. In the case of appeal, the dispute will be referred to an appellate panel, whose judgment will be final and, certainly, adopted automatically, unless there is a consensus against adoption. In the first six years of operation of the new WTO, this new appellate procedure has been invoked at an enormous frequency: 78% of panel rulings were appealed.

Another issue, less explicit, about the dispute settlement mechanism under the GATT/WTO is the potential of a developed country to influence the dispute settlement procedure, if a dispute arises with respect to its relations with a developing county. During the dispute settlement process[5], this political consideration might also affect the ability of the parties to close a bilateral settlement and might also influence the developing country's decisions to move the procedure forward or to give up.

Depending on the degree of confidence in the effectiveness of the dispute settlement procedure under the GATT/WTO and the international acceptance of using the WTO procedure as a valid mechanism to solve trade conflicts, the developed countries might influence this system to a grater of lesser extent.

The data on settlement of dispute cases under the GATT regime during the 1950s-1980s vary in terms of the number of complaints filed and the procedural outcomes. One possible indication of the degree of political power's influencing the course of the peaceful settlement process is the proportion of cases withdrawn. In the 1950s, 53 trade disputes were brought under the GATT legal system, of which ten were withdrawn. In the 1960s, the system basically became void. The settlement procedure was invoked only seven times and no complaint was withdrawn. In the 1970s, the legal activities seemed to thrive again, with 32 new cases filed, of which 5 were

[3] Ernst-Ulrich Petersmann, Dispute Settlement in International Economic Law – Lessons for Strengthening International Dispute Settlement in Non-Economic Areas, in "Journal of International Economic Law", vol. 2, nr. 2, 1999, pp 189-248.

[4] Kara Leitner, Simon Lester, WTO Dispute Settlement 1995- 2002 – A Statistical Analysis, in Journal of International Economic Law, vol. 6, nr. 1, 2003, pp. 251-261.

[5] Gabrielle Marceau, Peter N. Pedersen, Is the WTO Open and Transparent? A Discussion of the Relationship of the WTO with Non- Governmental Organisations and Civil Society's Claims for More Transparency and Public Participation, in "Journal of World Trade", vol. 33, nr. 1, 1999, pp. 5-49.

withdrawn. This impetus continued to the 1980s, when we witnessed both an upsurge in the litigation settlement activities (115 complaints) and an increase in the number of withdrawn cases (40 cases).

The data above illustrate some interesting evolutions in the peaceful settlement mechanisms under the GATT/WTO regime, which might affect countries' interests and the political costs of using the system.

The goal of this paper is to develop a unified theoretical model to explain the facts observed in a stylized way across different decades of the GATT/WTO regimes.

The paper tries to answer some questions raised by the specialized literature, such as:

1. How can we explain the upsurge in the blocking incidence during the 1980s and what were the costs and benefits of the parties in dispute when they decided to block the adverse panel ruling?

2. Why has the new appellate procedure been invoked under the WTO at such a high rate and to what extent has the new appellate procedure altered the disputing parties' incentive structure to challenge a panel ruling?

3. Is there a systematic way in which we can explain the pattern of filing dispute settlement activity and of the withdrawal incidence over different decades of the GATT regime?

4. Can we, in theory, draw up a map of the characteristics the system has acquired during these decades in the form of an underlying variable that in turn will determine the pattern of the filing activity and the frequency of the various procedural outcomes?

Many studies on the GATT and WTO dispute settlement mechanisms have been conducted in the field of law and political science. However, there is only a short list of economics literature available at the moment, attempting to explain the way this international litigation procedure operates. Butler and Hauser (2000)[6] was the first theoretical paper to systematically investigate this mechanism from an economic outlook. However, they focused mainly on the new WTO dispute settlement procedure. As such, the incentives and interactions amongst countries in using the dispute procedure under the GATT regime were disregarded in this paper. Secondly, Butler and Hauser (2000) theoretical model maintained a complete information framework and, consequently, only cases with positive expected outcomes from panel proceedings were examined. With this structure, one cannot explain the withdrawn or abandoned cases that exist in the database.

Literature on this topic has seen an enormous progress in the economic analysis of "civil" legal disputes. A comprehensive analysis of this literature was made by Cooter and Rubinfeld (1989).[7] However, most of this literature assumes that the expected outcome from a trial is positive. This assumption effectively excludes the possibility that a plaintiff might drop the case after bringing a lawsuit, while also reducing quite drastically the strategic possibilities of the plaintiff.

The specialized literature includes a series of papers on the settlement decisions

[6] Monika Butler, Heinz Hauser, *The WTO Dispute Settlement System: A First Assessment from an Economic Perspective,* in "Journal of Law, Economics, & Organization", Oxford University Press, vol. 16, nr. 2, October 2000, pp. 503-533.

[7] Robert D. Cooter, Daniel L. Rubinfeld, *Economic Analysis of Legal Disputes and Their Resolution*, in "Journal of Economic Literature", vol. XXVII, September 1989, pp. 1067-1097.

developed by Bebchuk[8] (1984) and Reinganum and Wilde[9] (1986), with one-sided asymmetric information, and Schweizer (1989) and Daughety and Reinganum (1994), with two-sided asymmetric information.

P'ng (1983), Nalebuff[10] (1987) and Bebchuk (1988) are a few exceptions. Using Bebchuk (1988)'s terminology, they "allow the possibilities of a negative-expected-value (NEV) suit and the outcome that a suit might be withdrawn or dropped if a settlement fails. These three papers have in common the fact that there exists one-sided asymmetric information, but are different in the side which owns private information and/or which proposes the settlement offer. These three models are not so satisfactory in terms of explaining withdrawn suits, however, because upon closer inspection, the "withdrawal" outcome in these models either does not exist in the equilibrium (Nalebuff 1987), or exists in the equilibrium only because no cost is incurred by the plaintiff by filing and then withdrawing a suit"(P'ng 1983 and Bebchuk 1988). In reality, it is more than likely that the plaintiff will not have to incur some costs by bringing a lawsuit.

According to Nalebuff (1987), the defendant holds private information about the expected outcome of a trial. Initially, the plaintiff sees his lawsuit as having a positive value for him, but he might be requested to revise its estimate of the expected value of filing the lawsuit, if his request for settlement is rejected. Nalebuff (1987) shows that, in equilibrium, the plaintiff always asks for a sufficiently large settlement so that, if his offer is rejected, he may proceed to court with probability one.[11] This implies that, in equilibrium, we cannot have a withdrawal outcome. In P'ng (1983), a plaintiff with a NEV complaint might be able to secure a settlement from the defendant in a Nash equilibrium. However, as Bebchuk (1988) indicates, this is not a sub-game perfect equilibrium.[12] The defendant has perfect information and he knows when the plaintiff has a NEV complaint. This is not a credible threat for the plaintiff to go to trial, if the defendant refuses to settle. Therefore, the defendant will not settle with the plaintiff with a NEV complaint and such a plaintiff will simply have to drop the lawsuit after starting it. However, the outcome of this "withdrawal" equilibrium will disappear, if we attach some litigation costs, in the event of such a strategy employed by the plaintiff. Since a plaintiff with a NEV complaint knows he will not be able to secure any settlement by bringing a complaint against the defendant, he will simply opt not to file the action at all, so as to avoid incurring litigation costs.

In Bebchuk (1988)[13], the plaintiff has private information regarding the expected judgment, so that, in some scenarios, a plaintiff with a NEV complaint will be able to get an offer to settle by exploiting the fact that the defendant is unsure about the actual merit of the plaintiff's case. In the case that the settlement fails, the plaintiff with a NEV complaint may always choose to drop the lawsuit. Again, however, this "withdrawal" equilibrium outcome will not exist, in the

[8] Lucian Arye Bebchuk, *Litigation and Settlement Under Imperfect Information,* "Journal of Economics", vol. 15, nr. 3, 1984, pp. 405–415.

[9] Jennifer F. Reinganum, Louis L. Wilde, *Settlement, Litigation, and the Allocation of Litigation Costs*, "Journal of Economics", vol. 17, nr. 4, 1986, pp. 557-566.

[10] Barry Nalebuff, *Credible Pretrial Negotiation*, "Journal of Economics", vol. 18, nr. 2, 1987, pp. 198-210.

[11] *Ibidem.*

[12] Lucian Arye Bebchuk, *Suing Solely to Extract A Settlement Offer*, "Journal of Legal Studies", vol. 17, 1988, pp. 437-449.

[13] *Ibidem.*

event that the plaintiff has to incur some costs with the filing and the withdrawal of the lawsuit. Given that the plaintiff possesses complete information, he knows, based on such information, whether the defendant is willing to settle or not. Faced with litigation costs to start a lawsuit, a plaintiff with a NEV complaint will choose not to file the case in the first place, unless a settlement is foreseeable.

To explore the effects of the political power, this study allows for some potential litigation costs the plaintiff would be expected to incur by bringing a dispute under the GATT/WTO settlement procedure. Such potential litigation costs include possible international political costs that might derive from an aggravated international relationship with the defending country. For example, such cost might take the form of a loss of an existing financial aid or preferential treatment provided by the defending country, or damage to a possible mutual cooperation between the countries from commerce or politics viewpoint.

On the other hand, a government usually brings a case under the GATT/WTO in response to a request made by a domestic industry or a lobby group. By agreeing with their request, the government gains political support from the part of these industries or lobbyists, which may consist of more political contributions or a larger electorate in the future.

These potential international political costs[14], less the internal political support, stand for the various political powers that might influence a country's decision to use the dispute system.

The P'ng (1983) and Bebchuk (1988)[15]'s one-sided asymmetric information models, as we said before, cannot explain the withdrawn cases, if there are positive litigation costs associated with this outcome. Nevertheless, the "withdrawn or abandoned" cases account for quite a significant share of the complaints filed under the GATT system. All in all, they amount to 27% of 207 complaints filed under the GATT during 1948–1989.

To explain these withdrawn cases, this paper uses a two-sided asymmetric information framework with potential litigation cost.

The intuition regarding the withdrawal outcome is that, because the litigation (political) costs will accrue with time for a complaining country once it files a dispute against another member country under the GATT, a complaining country that is not optimistic enough about the panel judgment will not sue through the panel procedure. In other words, it will withdraw the complaint, if the defendant refuses to settle.[16] However, the complaining country foresees some chances that the defending country might settle on account of the asymmetric information. If the prospect and the extent of a settlement are large enough, this might justify its decision to file the complaint in the first place.

The results of the model indicate that, as the political cost increases in relation to the potential benefit of using this mechanism to settle trade conflicts, the dispute procedure is initiated less frequently, whereas the incidence of withdrawn/abandoned cases increases at first, but then it decreases down to zero.

Conclusions

This study also examines the role of the degree of legal controversy with respect to a panel ruling in determining the

[14] D. Carreau, P. Juillard, *op. cit.,* p. 133 et seq.
[15] Lucian Arye Bebchuk, *op. cit.,* 1984, pp. 405–415.
[16] Chad P. Bown, *op. cit.,* pp. 811-823.

countries' tendency to block/appeal a panel report.

It shows that, under both the GATT and WTO regimes, there is an asymmetric advantage between the plaintiff and the defendant. The plaintiff's potential benefit of blocking/appealing an adverse panel ruling is smaller than the that of the defendant, but it bears the same cost structure as the latter. This disadvantage to the plaintiff is diminished under the WTO procedure compared to the GATT, though it is not completely eliminated.

The study also shows that the level of legal controversy over panel rulings increases, in general, proportionate to the increase in the frequency at which panel reports are blocked under the GATT regime. However, the tendency to appeal a panel report under the new WTO procedure is, basically, higher than the tendency to block a panel report under the GATT, when such reviews in appeal were not available.

References

- Barry Nalebuff, Credible Pretrial Negotiation, "Journal of Economics", vol. 18, nr. 2, 1987, pp. 198-210.
- Ernst-Ulrich Petersmann, Dispute Settlement in International Economic Law – Lessons for Strengthening International Dispute Settlement in Non-Economic Areas, in "Journal of International Economic Law", vol. 2, nr. 2, 1999, pp 189-248.
- Gabrielle Marceau, Peter N. Pedersen, Is the WTO Open and Transparent? A Discussion of the Relationship of the WTO with Non- Governmental Organisations and Civil Society's Claims for More Transparency and Public Participation, in "Journal of World Trade", vol. 33, nr. 1, 1999, pp. 5-49.
- Jacques H. J. Bourgeois, Comment on a WTO Permanent Panel Body, in "Journal of International Economic Law", vol. 6, nr. 1, 2003, pp. 211-214.
- Jennifer F. Reinganum, Louis L. Wilde, Settlement, Litigation, and the Allocation of Litigation Costs, "Journal of Economics", vol. 17, nr. 4, 1986, pp. 557-566.
- Kara Leitner, Simon Lester, WTO Dispute Settlement 1995- 2002 – A Statistical Analysis, in Journal of International Economic Law, vol. 6, nr. 1, 2003, pp. 251-261.
- Layla Hughes, Limiting the Jurisdiction of Dispute Settlement Panels – The Appellate Body Beef Hormone Decision in "The Georgetown International Environmental Law Review", vol. 10, 1998, pp. 915-942.
- Lucian Arye Bebchuk, Litigation and Settlement Under Imperfect Information, "Journal of Economics", vol. 15, nr. 3, 1984, pp. 405–415.
- Lucian Arye Bebchuk, Suing Solely to Extract A Settlement Offer, "Journal of Legal Studies", vol. 17, 1988, pp. 437-449.
- Monika Butler, Heinz Hauser, The WTO Dispute Settlement System: A First Assessment from an Economic Perspective, in "Journal of Law, Economics, & Organization", Oxford University Press, vol. 16, nr. 2, October 2000, pp. 503-533.
- Robert D. Cooter, Daniel L. Rubinfeld, Economic Analysis of Legal Disputes and Their Resolution, in "Journal of Economic Literature", vol. XXVII, September 1989, pp. 1067-1097.