1

Introduction

HENRIK HORN AND PETROS C. MAVROIDIS

1 The project

This is the first annual report of the American Law Institute (ALI) project *Principles of Trade Law: The World Trade Organization.* The project's object of study hardly needs any motivation. The World Trade Organization (WTO) Agreement is one of the most extensive international agreements ever. With 145 Members, ranging from the poorest to the richest countries on the globe, the Agreement covers the vast majority of international commerce in goods and services, and also contains an agreement on the protection of intellectual property.

The WTO contract contains a rarity in international relations – a compulsory third-party adjudication clause – embodying the idea that trade conflicts should be resolved through multilateral adjudication rather than through unilateral actions. As is the case with many contracts, many of the terms in the WTO Agreement[1] are opaque, leaving much discretion to adjudicating bodies to determine the actual content of the obligations. The case law thus provides more than a mechanical execution of clear-cut rules.

The WTO contract and its interpretation by the WTO adjudicating bodies are subject to intensive policy debate, conducted largely by politicians and non-governmental organizations. There is also an ongoing debate among trade law practitioners and legal scholars concerning the appropriate interpretation of the law. Academic economists, on the other hand, with some notable exceptions, very rarely intervene in these discussions.

The aim of this project is to bridge this divide by providing systematic analysis of WTO law based in both Economics and Law. Such an

[1] We use "the WTO contract" synonymously with "the WTO Agreement."

interdisciplinary approach is in our view necessitated by the fact that the WTO Agreement has inherently economic objectives. For instance, the Preamble states the Agreement's objectives as:

> . . . raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, and expanding the production of and trade in goods and services, while allowing for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both to protect and preserve the environment and to enhance the means for doing so in a manner consistent with their respective needs and concerns at different levels of economic development . . .

Since a thorough analysis of the appropriate design of Trade Law inevitably has to take into account the purpose of the trade agreement, its focus must be on the interaction between the law and the world economy it seeks to regulate. Of course, this is not to deny the possibility that members might also have other objectives in mind when signing the contract.

A fundamental methodological problem facing the project is the lack of a "manual" for how to perform a joint economic and legal analysis of the WTO contract; there is no field, "The Economics of Trade Law," that can be relied upon for the purpose of the project. The relevant specialized fields, such as International Trade Law and International Economics, instead differ widely, both in terms of aims and in terms of method, and lawyers and economists are typically too specialized in their respective fields to be able to undertake a legal-*cum*-economic analysis of the law by themselves. Instead, such an analysis requires the joint efforts of economists and lawyers. The main idea behind this project is to develop such collaboration.

The project will undertake yearly analysis of the case law from the adjudicating bodies of the WTO. The intention is each year to analyze all disputes that in the previous year came to an administrative end, either because they were not appealed, or because they have gone through both the panel and the Appellate Body (AB) stages (even though time constraints may prevent us from covering each and every dispute that falls into this category). Each dispute is to be evaluated jointly by an economist and a lawyer. Their general task is to evaluate whether the ruling "makes sense" from an economic as well as a legal point of view, and if not, whether the problem lies in the legal text, or in the interpretation thereof. The teams of lawyers and economists will not always cover all issues discussed in a case;

they will however seek to discuss both the procedural and the substantive issues that form the "core" of the dispute.

The Reporters' Studies are initially scrutinized in a meeting of all of the Reporters. After revisions resulting from that meeting, the Reporters' Studies are next presented and discussed in a meeting with an external advisory group, comprising both lawyers and economists. The final versions, such as those published in this volume, have been subject to another round of revisions derived from the advisory meeting. Despite these collective efforts, each pair of authors remains solely responsible for the studies it has authored.

The analysis of the WTO case law is meant to serve two purposes. First, given the central role of the Dispute Settlement system in the WTO (and the lack of accountability of its adjudicating bodies seen by some observers), it is of vital importance that the system is constantly and carefully scrutinized. Our yearly independent analysis of the emerging case law will hopefully contribute toward this end.

Second, the yearly scrutiny of the case law is meant to serve as a steppingstone toward an analysis of the core provisions of the contract itself. Depending on the progress that we will make over the years, and our views on the quality of the primary and secondary WTO law, this might eventually take the form of a developed set of Principles, or perhaps even a Restatement, of WTO Law.

Before turning to the content of this volume, we would like to express our gratitude to the American Law Institute (ALI), which welcomed the project under its aegis, and provided it with administrative and financial support. Its Director, Lance Liebman, has been instrumental in taking the project to where it is today. We have also benefited greatly from the support of Michael Traynor, the President of the ALI, as well as from the efficient administrative aid provided by Elena Cappella and Michael Greenwald, Deputy Directors at the ALI, as well as by other ALI staff members. Frank Ravue Ito read the manuscript and provided excellent editorial assistance. We are also extremely grateful for financial support from the Jan Wallander's and Tom Hedelius' Research Foundation, Svenska Handelsbanken, Stockholm as well as from the Asia-Pacific Economic Cooperation Study Center at Columbia University and the Milton and Miriam Handler Foundation.

2 The Reporters' Studies on the WTO Case Law of 2001

The Reporters' Studies have been drafted by the following persons, who have been appointed Reporters for the project by the ALI:

Gene Grossman, Jacob Viner Professor of International Economics, Princeton University, USA.
Henrik Horn, Professor of International Economics, Institute for International Economic Studies, Stockholm University, Sweden.
Robert Howse, Professor of Law, University of Michigan Law School, USA.
Merit Janow, Professor in the Practice of International Trade, Columbia University, USA.
Petros C. Mavroidis, Professor of Law, Columbia Law School, USA, and University of Neuchâtel, Switzerland.
Damien J. Neven, Professor of Economics, Graduate Institute for International Studies, University of Geneva, Switzerland.
Robert W. Staiger, Professor of Economics, University of Wisconsin, Madison, USA.
Joseph H. H. Weiler, Professor of Law and Jean Monnet Chair, New York University School of Law, USA.

This first year of the project focused on the case law of the year 2001. The Reporters' Studies in the volume benefited from extremely helpful discussions with participants in an invitational conference, consisting of practising lawyers and economists, on February 6 and 7, 2003, in Philadelphia:

Professor José E. Alvarez, Columbia University Law School, New York, NY.
Professor George A. Bermann, Columbia University Law School, New York, NY.
The Rt. Hon. The Lord Brittan, Vice Chairman, UBS Warburg, London, England.
Steve Charnovitz, Esquire, Wilmer, Cutler, & Pickering, Washington, DC.
Professor William Davey, University of Illinois College of Law, Champaign, IL.
Claus-Dieter Ehlermann, Esquire, Wilmer, Cutler, & Pickering, Brussels, Belgium.
Susan G. Esserman, Esquire, Steptoe & Johnson, Washington, DC.
Professor Wilfred Ethier, University of Pennsylvania, Department of Economics, Philadelphia, PA.
Dean David W. Leebron, Columbia University Law School, New York, NY.
Professor Mitsuo Matsushita, Seikei University, Department of Law, Tokyo, Japan.
Professor Patrick Messerlin, Institut d'Etudes Politiques, Paris, France.

David Palmeter, Esquire, Sidley Austin Brown & Wood, Washington, DC.
Professor Thomas J. Prusa, Rutgers University, Department of Economics, New Brunswick, NJ.
Professor Donald Regan, University of Michigan Law School, Ann Arbor, MI.
Professor David A. Wirth, Director of International Programs, Boston College Law School, Newton, MA.
The Hon. Diane P. Wood, US Court of Appeals, 7th Circuit, Chicago, IL.
Professor Claire Wright, Thomas Jefferson School of Law, San Diego, CA.

One invitee to the conference, Robert E. Hudec, was unable to attend because of illness. He, nevertheless, provided us with cogent and helpful comments on the materials before his untimely death later in the year. He was a great pioneer in the field of trade law and his death is a major loss to this enterprise.

We briefly summarize the studies in the order of their appearance in the volume:

The *EC – Asbestos* report is presented by Horn and Weiler. The dispute concerned a French health-motivated ban of asbestos-containing construction materials. Canada argued that the French decree was an impermissible discrimination between two otherwise like products (asbestos- and non-asbestos-containing construction material), which operated to the disadvantage of imported products and thus constituted a violation of Article III.4 GATT. The AB dismissed Canada's claim, essentially arguing that the two products were not like due to their different impacts on human health.

The authors do not put into question the outcome, that France had not violated their obligations under the GATT. They disagree, however, with the reasoning underlying the AB's findings, arguing that it lacks logical coherence, and that it adds to the existing uncertainty surrounding what is and what is not a legitimate motive for government intervention. They also find the AB report overly focused on the burden of proof issue, and they provide several examples of situations where the reasoning of the AB in the *EC – Asbestos* case, if replicated elsewhere, might yield unwarranted outcomes. In their study they identify three separate methods of interpreting the non-discrimination provisions in the GATT, and discuss the pros and cons of each.

The *US – Shrimp* (Article 21.5 DSU) report by the AB is discussed by Howse and Neven. This AB report is the final step in the long *US – Shrimp* saga. Very briefly, the United States enacted legislation banning imports of shrimp that were caught in a manner leading to a high incidental taking of

sea turtles. At the same time, the United States had negotiated with some, but not all, WTO Members treaties aiming to ensure that the incidental taking of sea turtles would be at acceptable levels. Such treaties, in return, allowed WTO Members that had adhered to them to continue to export shrimp to the United States. A number of countries (Malaysia playing a key role) complained about the US practice.

The AB, reversing the original Panel's findings, upheld the US practice as WTO-consistent but found that the United States had applied it in a discriminatory manner by not offering negotiations to other Members. It also requested the United States to show flexibility in the application of their legislation and to accept methods of fishing shrimp, other than those used by US fishermen, as equivalent to the US method, to the extent that they led to a comparable amount of incidental taking of sea turtles. The AB requested that the United States bring their measures into compliance within the implementation period. To this effect, the United States offered negotiations with a view to signing an agreement with the exporters of shrimps that had not initially been offered such negotiations (that is, when the legislation was first introduced).

Negotiations were unsuccessful and Malaysia complained to the WTO, arguing that the United States had not implemented its obligations in good faith, since no international agreement between them and interested exporters was concluded at the end of the day. The AB dismissed the claim, stating that the United States did not have to guarantee a successful outcome of the negotiations offered. It simply had to ensure (to respect non-discrimination) that it entered into good faith negotiations with those countries that had not been initially offered this possibility.

The AB report also found that the United States, by adopting a flexible approach towards certification of exporters (that is, that exporters do not have to use the same abatement technology used by US fishermen in order to be permitted to export to the US market), complied with the requirement of the chapeau of Article XX GATT to provide flexibility.

Howse and Neven find that, from a strictly legal perspective, the AB's ruling is correct: the United States indeed cannot unilaterally guarantee the success of international negotiations. By offering in good faith this possibility to Malaysia (as they had done vis-à-vis other WTO members before), they complied with their obligations under the WTO. On the other hand, in order to conform to the flexibility requirement, the United States would have to accept imports of shrimp from countries with different but equally efficient (when it comes to incidental taking of sea turtles) abatement technology, which the United States did.

From an economic perspective however, the issue is more complicated. The authors observe that to make imports contingent on the adoption of an abatement standard can be a very effective means of addressing external effects across jurisdictions, at least when efficient abatement technologies are available. In the view of the authors, however, it would have been appropriate for the AB to clarify what is meant by "comparable in effectiveness" when discussing flexibility. Furthermore, the AB should have indicated that comparable effectiveness does not imply that different jurisdictions should reach similar standards, but rather that the marginal effectiveness of resources invested in abatement should be comparable across countries.

Horn and Mavroidis discuss the AB *US – Lamb* report. In this case, New Zealand and Australia complained that imposition of safeguards by the United States on imports of lamb violated various provisions governing safeguards in the WTO. The AB found that the United States indeed had failed to show that the increase of imports was the result of unforeseen developments and that the United States did not properly attribute injury to its various sources. Due to these findings, the AB found the safeguard to be illegal.

The authors do not disagree with the final verdict when it comes to attribution. Indeed, in their view, the US safeguard investigation did not comply with the requirements for attribution as specified in the WTO contract. However, they point out that the AB could have been clearer as to the use of quantitative evidence in this respect. In their view, some form of quantification is typically necessary in order to attribute injury, and to demonstrate the necessity of the measure, in a reasonable manner.

Horn and Mavroidis also see a weakness in the text of the Agreement: imports should be seen as the result of the interaction between more fundamental economic forces, such as foreign supply and demand and domestic supply and demand. An import surge may stem from changes in any of these. To blame imports for injury thus begs the question of who or what is actually responsible for an import surge. The authors also argue that an "unforeseen developments" requirement should be interpreted as an obligation for national authorities entrusted with the administration of safeguards to respect a due diligence standard. This standard should not exonerate them from responsibility for actions that their own government has provoked.

Janow and Staiger comment on the *EC – Bed Linen* jurisprudence. In this case, India complained about the methodology employed by the European Community with respect to anti-dumping duties on imports

of cotton bed linen. The latter had based its calculation of the "normal value" for all Indian exporters on sales data for a single company, although the sales at hand were outside the ordinary course of trade (as defined in the WTO anti-dumping agreement). India complained about this EC practice and also about the defendant's practice of "zeroing," whereby dumping margins are calculated on the basis of dumped transactions and all non-dumped transactions are zeroed. The AB found fault with these practices.

Janow and Staiger agree with the finding that "zeroing" can exaggerate the margin of dumping contrary to the letter and the spirit of the WTO Anti-dumping Agreement (Article 2). They further agree with the finding that a weighted average of dumping margins for all Indian exporters based on data from one exporter only can be problematic as well. In their view, however (and in this respect they distance themselves from the formalistic findings of the AB), this is the case because such a procedure is likely to introduce a large element of "noise" into the cost calculation. Finally, the authors point out that from an economic perspective, the foundations of the Anti-dumping Agreement as such are highly problematic.

The *Mexico – Corn Syrup* Article 21.5 DSU compliance Panel decision is examined by Howse and Neven. In this case, Mexico was initially condemned for issuing an anti-dumping order in contravention of various provisions of the Anti-dumping Agreement. Mexico agreed to implement the findings, but, in the view of the United States, this did not occur. The United States requested a compliance panel to evaluate whether Mexico failed to comply with its obligations under the WTO Agreement by improperly analyzing factors of injury laid down in Articles 3.4 and 3.7 of the anti-dumping Agreement. At issue in this dispute was also the appropriate standard of review to be applied by panels when adjudicating disputes under this Agreement (Article 17.6).

The authors conclude that the correct understanding of the standard of review laid down in the Anti-dumping Agreement requires WTO panels to accept the determination of national investigating authorities as such and thus avoid entering into a *de novo* review. In this respect they are in agreement with the final decision by the AB. But they also point to an error by the Panel that was not corrected by the AB, the failure to take into account market segmentation. In the authors' view, isolating the appropriate segment of the market may well enhance the accuracy of an analysis of injury.

Howse and Neven also discuss the *Argentina – Ceramic Tiles* Panel decision. In this case, the European Community complained that Argentina,

when imposing anti-dumping duties on imports of ceramic tiles, did not respect its obligations under Articles 6.8 and 6.9 of the Anti-dumping Agreement, which regulate the legitimate recourse to "facts available." The complainant also maintained that Argentina violated its obligations under Article 6.10 of the same Agreement by failing to calculate individual dumping margins for each exporter. Finally, it was argued that Argentina violated Article 2.4 of the Anti-dumping Agreement as well by not taking into account differences in physical characteristics when making price comparisons. The Panel agreed with all claims advanced by the European Community.

The authors do not put into question the Panel's findings on Article 6.8 as such. They would have preferred, however, that the Panel had seen Argentina's recourse to facts available in the wider context of the investigation (this is in their view the appropriate understanding of the standard of review imposed on panels when discussing anti-dumping litigations as laid down in Article 17.6 of the Anti-dumping Agreement). Viewed in this perspective, they find nothing wrong with Argentina's due diligence standard.

The authors disagree with the Panel's understanding of Article 6.9: in their opinion, this Article does not oblige authorities to explain why a final decision will not be based on information supplied by the exporters. The authors further disagree with the Panel's interpretation of Article 6.10. In their view, this provision clearly allows investigating authorities the possibility of not calculating individual margins when the number of exporters appears to be too large, and the provision at the same time offers no specific guidance as to what constitutes a "large number." This element was overlooked because the Panel failed to apply the appropriate standard of review. Finally, the authors find the Panel's conclusions with respect to Article 2.4 sound.

Grossman and Mavroidis comment on the *US – Lead and Bismuth II* dispute. In this case, the European Community complained about the US practice of imposing countervailing duties (CVDs) on exports of steel products of EC companies that had received state aid before they were privatized. The heart of the dispute concerns the extent to which an arm's length privatization of a previously subsidized company suffices to eliminate all subsidies previously paid. The AB concluded that the United States, in their determination to impose CVDs, did not demonstrate why a benefit (in the sense of Article 1 Subsidies and Countervailing Measures [SCM] Agreement) survived the arm's length privatization. By not offering the proof, the United States illegally imposed CVDs on EC exports.

The authors agree with the outcome in this respect: the United States indeed did not demonstrate why subsidies survived privatization. They do disagree, however, with the opinion expressed by the AB that non-recurring subsidies are always extinguished whenever the company that benefited from them is privatized at arm's length. In their view, this is not necessarily always the case. The question that the AB should have asked is whether the original investment would have taken place under market conditions (the private investor test). If the answer is no, then there is at least a possibility that the original subsidy has survived the privatization. To rule otherwise would be tantamount to stating that any time shares of subsidized companies change hands in stock market operations all benefits are ipso facto extinguished.

The *US – Export Restraints* decision is commented upon by Janow and Staiger. The case concerns a long-standing disagreement between the United States and Canada as to the treatment under the GATT/WTO of export restraints by the former. Canada was here attacking the propriety of the legislation itself and not a particular measure. The Panel, by considering both the language of the disputed US statute (the US Statement of Administrative Action) and its practice, concluded that the US measures at hand could not be characterized as mandatory legislation. Following previous case law, the Panel thus concluded that the legislation could not be the subject of a complaint independently of its application. The Panel further ruled that the aforementioned export restraints could not be characterized as subsidies either, since they did not constitute a financial contribution (as required by Article 1.1 SCM).

The authors do not question the soundness of the Panel's approach. In fact, they offer additional reasons why export restraints should not be accepted as tantamount to subsidies: in their view, the specificity requirement is missing. Moreover, if such an expansive interpretation of the term "subsidy" were adopted, then even legal import tariffs could be put into question, since import tariffs implicitly subsidize the consumption of the comparable domestic product. The authors also point to the fact that the SCM Agreement is sometimes hard to reconcile with economic principles, essentially since it does not address in a comprehensive manner the overall welfare implications of subsidies.

Janow and Staiger also discuss the *Canada – Dairy* report. The United States and New Zealand complained that Canada, by using a target prices system in its domestic market and allowing for exports of over-quota milk (which did not benefit from domestic support schemes), was in fact