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"The Future of Trade Dispute Resolution"

Introduction

Although commentators argue about the status of the World Trade Organization (WTO) compared to free trade agreements (FTAs), there is consensus that WTO dispute resolution through its Dispute Settlement Understanding (DSU) has been its "crown jewel".[1]

Despite the perceived success of WTO dispute resolution, the system has been paralyzed by the United States refusing to accept new appointments to its Appellate Body (AB), the number of members falling below the required quorum in December 2019. The United States has oft expressed concern about AB "judicial overreach", and by vetoing new appointments, WTO panel decisions can now be appealed "into the void".

With the WTO being dysfunctional, the United States has chosen to follow a bilateral/regional approach to trade dispute resolution. On the one hand, its bilateral agreement with China is fundamentally a rejection of independent dispute resolution and a distinct break from other free trade agreements (FTAs) to which it is a signatory, but at the same time it has sought resolution of several disputes with Mexico and Canada, its US-Mexico-Canada Agreement (USMCA) partners.

In contrast the European Union (EU) has led implementation of the Multiparty Interim Arbitration Arrangement (MPIA) based on Article 25 of the WTO's dispute settlement protocol, whereby 26 WTO members, including Japan and China, have agreed not to appeal panel reports, but instead follow an arbitration process. At the same time, the EU has initiated disputes through FTAs of which it is a member.

So where does this leave trade dispute resolution? Despite US-EU divergence, the fact that both are using regional dispute resolution suggests there may be a way forward.

Dispute Resolution and the WTO

From GATT to the WTO

Settlement of trade disputes has always been part of the GATT/WTO multilateral system, but with inception of the WTO in 1995, there was a clear switch from the "diplomacy-based" system that characterized GATT, to a much more "legalistic" system. The central dispute resolution mechanism of GATT was contained in Articles XXII and XXIII, the former calling for consultation between disputing parties, the latter calling for a procedure possibly culminating in a voting action by the ruling GATT body.

Formation of the WTO added the DSU, a comprehensive, 37-page dispute resolution

[1] See Richard E. Baldwin. 2016. "The World Trade Organization and the Future of Multilateralism." *Journal of Economic Perspectives* 30(1): 95-116.

mechanism covering of 27 Articles.[2] Design of the DSU consisted of two major components: first, formalization of a "negative-consensus" or "automaticity" rule for WTO decision-making that would make it impossible for any parties to a trade dispute either to block establishment of a panel or adoption of panel and AB reports, i.e., requests to the Dispute Settlement Body (DSB) must be granted unless all WTO members at a DSB meeting choose to reject it; and second, adoption of a two-instance adjudication system consisting of a panel whose legal reasoning could be appealed.[3]

The two-instance system is designed to function as follows: the DSB, consisting of all WTO members, must adopt a decision of a panel or AB before it has any legal effect. Panel decisions that are not appealed can be directly adopted by the DSB, and panel decisions that are appealed, are then open for adoption by the DSB, following a ruling by the AB. As noted above, panel and AB decisions are adopted by the DSB under the negative-consensus rule, i.e., decisions are adopted unless all members of the DSB decide against.[4]

Negative-consensus was the key innovation of the DSU in that removal of blocking behavior by individual countries would reduce uncertainty concerning the WTO's ability to enforce implementation of negotiated commitments. Two-instance adjudication was designed to be a means for WTO members to protect themselves against loss of sovereignty resulting from the formalization of negative consensus, which the GATT had effectively been moving towards incrementally. Given the number of disputes resulting in either a panel or an AB ruling since 1995, it would appear that WTO dispute settlement has been working, earning it the descriptor of "crown jewel" of the multilateral trading system.

Non-Functioning of the Appellate Body (AB)

The AB ceased to function in December 2019, largely driven by US dissatisfaction with its decisions. The US critique of the AB has essentially focused on the way in which it has executed its mandate, and its dissatisfaction with some of its decisions. The latter fall into three groups: those decisions that (i) held certain US statutes to be in violation of WTO law, thereby requiring their repeal; (ii) rejected US enforcement of trade remedies such as anti-dumping laws; and (iii) ruled in favor of China in several cases, despite China not meeting its WTO commitments to dismantle its state-led economy, notably its continued use of industrial subsidies.[5]

Essentially, the United States believes the AB has exceeded its authority by engaging in "judicial activism", claiming that it has rejected existing US rights, as well as inventing new rights and obligations in its rulings against the United States.[6] First, the US charge of judicial activism is driven by the fact that while the AB was created to correct legal errors by panels, there has been no effective check on AB decisions, exacerbated by its *de facto* application of the principle *stare decisis*, the United States arguing the AB has been "creating its own rules". Second, the AB has addressed issues not raised by parties as well as providing unnecessary opinions, i.e., commentary that in legal terms would be considered *obiter dicta*, and in the US view this has the potential to wrongly influence future disputes if treated as precedent.

Therefore, given the United States believes such decisions have been made outside of the defined authority of the WTO, they are considered unlawful, the United States having no obligation to abide by them – fundamentally, in the view of the United States, the AB has undermined its legitimate sovereignty.[7]

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[2] See World Trade Organization. 1994. *Understanding on Rules and Procedures Governing the Settlement of Disputes*. Geneva: WTO.

[3] See Bernard M. Hoekman and Petros C. Mavroidis. 2020. "To AB or Not to AB? Dispute Settlement in WTO Reform." *Journal of International Economic Law* 23(3): 703-722.

[4] See Daniel C.K. Chow. 2023. "A Critique of the 2020 United States-China Trade Agreement and Suggested Corrective Measures." In *The Future of Trade: A North American Perspective*, edited by David A. Gantz and Tony Payan, 175-199, Cheltenham, UK: Edward Elgar.

[5] See Chow *op. cit*.

[6] See Chow *op. cit.*

[7] See Hoekman and Mavroidis *op. cit.*

Which Way(s) Forward?

For panel reports released after December 10, 2019, there are four possible interim scenarios:[8] (a) they will be appealed "into the void", thereby blocking the panel report, the United States having already followed such a strategy in 2020 after a panel ruled it had violated GATT Articles I and II in imposing tariffs on Chinese products; (b) no appeal of panel reports followed by their automatic adoption; (c) DSU Article 25 appeal arbitration with automatically binding results, the only option preserving both panel and appellate stages, as well as automaticity; and (d) "floating" panel reports that are neither adopted nor appealed/blocked, but are instead used in continued negotiations between parties to a dispute.

The following observations can be drawn about these scenarios.[9] First, appealing panel decisions "into the void' is highly likely, especially in cases where either a powerful respondent loses a case against a weaker complainant or in disputes between equally powerful parties. Currently, 31 disputes are in limbo, of which eight were not completed in time before the AB quorum lapsed.[10]

Second, some panel reports will not be appealed, automatically being adopted by the DSB, e.g., parties choose not to appeal because of the associated costs (reputational and risk of retaliation). At the time of writing, panel reports in four cases have been adopted by the DSB post- December 2019.[11]

Third, in 2019, the EU circulated a draft text providing for interim appeal arbitration pursuant to Article 25 of the DSU, but at the time, the EU proposal had not been tested, and it was not clear how many other WTO members would sign up to it. However, in April 2020 an interim replacement of the AB was created by an EU-led coalition of 19 WTO members, denoted as the MPIA, and which now has 26 members, including Australia, Canada, China, and Japan.

The MPIA commits signatories that act as either complainants or respondents in panels to either accept their reports or use the MPIA to appeal their findings through an AB-like process. When MPIA was introduced, some skepticism was expressed about its potential as a plurilateral agreement, including that it represents a small percentage of total WTO membership, and perhaps most importantly it does not include the United States.

Fourth, the potential for "floating" panel reports depends very much on the balance of power between complainants and respondents, as well as the credibility of either party threatening to appeal a panel decision. For example, a complainant could win, but the respondent may want to avoid the costs of appealing "into the void", such an outcome also being sub-optimal for the complainant. In which case, the winning complainant could choose not to get the panel report adopted by the DSB, as long as the losing respondent commits to not appealing the panel report, i.e., the panel report would not be adopted, appealed or blocked.

The overall conclusion is that WTO dispute settlement will "…likely get worse before it gets better…".[12] However, dispute resolution under FTAs might in some circumstances fill the gap. Many WTO consultation requests, if filed now would be between members of FTAs that provide for judicial resolution of trade issues, although major trading partners such as the United States and the EU currently lack a FTA.

FTAs and Dispute Resolution

Key Features

A way of classifying dispute resolution mechanisms in FTAs draws on their increasing degree of legalism: political/diplomatic dispute resolution, referral to an *ad hoc* arbitral panel (quasi-judicial), and systems administered by a standing tribunal (judicial).[13]

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[8] See Joost Pauwelyn. 2019. "WTO Dispute Settlement Post 2019: What to Expect?" *Journal of International Economic Law* 22(3): 297-321.
[9] See Pauwelyn *op. cit*.
[10] See World Trade Organization. 2024. *Appellate Body*. Geneva: WTO.
[11] See World Trade Organization. 2024. *Chronological List of Dispute Cases*. Geneva: WTO.

[12] See Pauwelyn *op. cit.*
[13] See Claude Chase, Alan Yanovich, Jo-Ann Crawford, and Pamela Ugaz. 2016. "Mapping of

Application of this classification to 226 FTAs notified to the WTO through the end of 2012, shows that until 2004, the political/diplomatic option was dominant, but was replaced after by the quasi-judicial option, whose growth in use appears to be correlated with the rapid increase in the number of FTAs post-1995. By the end of 2012, 147 FTAs employed the quasi-judicial option, typically modeled on the WTO DSU, often having authority to resolve WTO issues involving the FTA, as well as including clauses providing that any violation of the WTO is a violation of the FTA.[14]

Given its dominance in FTAs, the key features of the quasi-judicial option are typically: allowance for claims against measures deemed inconsistent with the FTA(s); complainants can choose between either the FTA or WTO forum, but once a choice is made, the non-selected forum is foreclosed; consultations between disputing parties is allowed at a pre-adjudication stage; *ad hoc* panels are typically composed of three members, with automaticity of composition; and appellate review is not typical.

While the number of FTAs containing some type of dispute resolution mechanism has grown, the number actively using that mechanism has been small. FTA members who were parties to a dispute have typically filed a complaint at the WTO as opposed to through their FTA, even though some of the disputes could have been brought to a quasi-judicial dispute resolution mechanism.

Current US Approach(es) to Dispute Resolution

Successive implementation of tariffs against China over the period 2018-20, indicate there has been a substantive change in the US approach to its international trading relationships. The United States also continues to veto any attempts to appoint new members to the AB, the most recent proposal being blocked in February 2024, and a recently floated US proposal on reconstituting the AB seems to suggest use of the WTO's dispute settlement system should be optional, i.e., any party that loses at a proposed non-binding panel stage can then refuse to move to the second stage, allowing for panel decisions to be ignored.[15]

There is also a distinct probability that the trade war with China could be ratcheted up, a US House Select Committee recommending that the United States discontinue Permanent Normal Trade Relations (PNTR) with China, i.e., China's most favored nation (MFN) status would be revoked.[16]

US-Unilateral/Bilateral Dispute Resolution

The observation to be drawn here is that there is bipartisan support for the United States to continue shifting to unilateral/bilateral means of setting its trade relations with China. This is an extension of an interpretation of the US-China trade war as the former switching from a "rules-based" to a "power-based" approach to trade negotiations,[17] a key component of the strategy being the disabling of the WTO's DSU through paralyzing the AB.[18]

On some level the US switch to "power-based" bargaining did work with signing of the Economic and Trade Agreement between United States and China (USCTA) in early-2020.[19] As a bilateral trade agreement, USCTA contains a dispute resolution mechanism in its Chapter 7, providing one signal of how the United States is currently

Dispute Settlement Mechanisms in Regional Trade Agreements – Innovative or Variations on a Theme? In *Regional Trade Agreements and the Multilateral Trading System*, edited by Rohini Acharya, 608-702, Cambridge, UK: Cambridge University Press.

[14] See Chase et al. *op. cit*.

[15] See Sarah Anne Aarup. 2023. "Reform or die? If the US gets its way, the WTO might do both." Politico. Brussels, Belgium: Politico.

[16] See United States (US) Congress – The Select Committee on the Strategic Competition Between the United States and the Chinese Communist Party. 2024. *Reset, Prevent, Build: A Strategy to Win America's Economic Competition with the Chinese Communist Party.* Washinton, DC: US Congress.

[17] Aaditya Mattoo and Robert W. Staiger. 2020. "Trade Wars: What Do They Mean? Why Are They Happening Now? What Are the Costs?" *Economic Policy* 35(103): 561-584.

[18] See Chow *op. cit.*

[19] See Economic and Trade Agreement Between the United States and China (USCTA). 2020. *Economic and Trade Agreement between the Government of The United States of America and the Government of the People's Republic of China.* Washington, DC: USTR.

approaching trade relations, and one that creates a procedure completely within its control and outside of the WTO.[20]

Effectively, the United States can unilaterally impose a trade sanction against China, the latter not being able to respond if it believes a complaint made by the United States has been made in good faith, and little alternative but to pull out of USCTA if it feels a complaint made by the United States has been made in bad faith. The United States is the most likely party to make use of trade retaliation to solve any trade grievance with China.[21]

Significantly, not only does USCTA require disputes to be solved internally, but it is also in violation of DSU Article 23. WTO members are expressly prohibited from taking unilateral action if it believes its rights have been violated by another WTO member, such that determination can only be made through its dispute resolution mechanism. Integrity of the system is preserved through the requirement that all members wait for a decision by the WTO, and to base any national findings on that decision.

US-FTAs and Dispute Resolution

Fundamentally, USCTA is a rejection of independent dispute resolution as embodied in the WTO's DSU, as well as being a distinct break with all FTAs the United States has previously signed, covering 20 countries, all of which require the use of independent and neutral arbitration panels which can render decisions either for or against the United States, and where disputes can be resolved through the relevant FTA or the WTO. Excluding USMCA, these FTAs, along with the relevant article covering choice of dispute settlement, are: the United States-Australia FTA (Article 21.4); United States-Bahrain FTA (Article 19.4); United States-Chile FTA (Article 22.3); United States-Morrocco FTA (Article 20.4); United States-Columbia Trade Promotion Agreement (Article 21.3); CAFTA (Article 20.3); United States-Korea FTA (KORUS) (Article 22.6); United States-Oman FTA (Article 20.4); and the United States-Panama Trade Promotion Agreement (Article 20.3).

In the case of USMCA, state-to-state dispute resolution under the provisions of USMCA Chapter 31, is a modification of the procedure that operated under the provisions of the North American Free Trade Agreement (NAFTA). The rate at which USMCA dispute resolution is being utilized by its three member countries is clearly more extensive than under NAFTA, where only three panel reports were ever circulated. Since 2022, there have already been four Chapter 31 panel reports, including two involving dairy tariff rate quotas (TRQs). In addition, a panel is currently investigating a proposed ban by Mexico on imports of genetically modified (GM) corn used in food products. The United States has challenged the ban on the grounds that it violates Chapter 9 of the USMCA which is based on the WTO's Sanitary and Phytosanitary Agreement (SPS).

The conclusion one can draw here is that the United States' use of the USMCA dispute resolution mechanism suggests that the ongoing efforts of those who seek to rescue the WTO from its crisis may be in vain, the United States already having shown its hand that it does not intend to agree to any reforms that would revive the WTO's AB. Rather, the United States will abandon the WTO and substitute its own dispute resolution mechanism in FTAs that can be used to resolve both WTO and particular FTA disputes.

Current EU Approach(es) to Dispute Resolution

In contrast to the United States, the EU appears to be following both multilateral and FTA-based approaches to the resolution of trade disputes. An EU coalition of 19 countries (now 26), created the MPIA as a response to the non-functioning AB with the objective of preserving WTO dispute settlement, thereby preventing appeals "into the void". Participants in MPIA have committed not to appeal panel reports, but instead use the alternative of arbitration as laid out in DSU Article 25. Effectively, this is a two-instance adjudication system already allowed for within the WTO's rules, and one that can be described as an open plurilateral solution concluded *ex ante* between a sub-set of WTO

[20] See Chow *op. cit.*
[21] See Chow *op. cit.*

members, but open to other members to join.[22]

The MPIA produced its first appellate award at the end of 2023. Specifically, the EU filed a dispute against anti-dumping duties imposed by Colombia on frozen fries from Belgium, Germany, and the Netherlands. At the first stage, the panel found that Colombia had violated a number of provisions of the WTO Anti-Dumping Agreement, and at the second stage the MPIA appeal arbitrators reversed one and confirmed three of the panel's findings. The findings were then discussed at the DSB, but per DSU Article 25, they were not formally adopted. Notably, Colombia signaled its intention of complying with the findings, noting at the DSB that the MPIA had been shown to be a viable and well-functioning interim mechanism that preserved the right of appeal of WTO members.[23]

It would seem that the EU, through its leadership in setting up MPIA, and also its involvement in the first case that went to MPIA arbitration, remains committed to a multilateral approach, backed up by its support for making WTO dispute resolution system operational again. At the same time though, the EU has continued to sign FTAs and is also beginning to test the viability of dispute resolution outside of the WTO.

Like the evolution of FTAs generally, the dispute resolution mechanisms incorporated into FTAs of which the EU is a member, have transitioned from the diplomatic to a quasi-judicial option.[24] The shift to the quasi-judicial option began with signing of the EU-Mexico FTA in 1997 which was designed to be compatible with the WTO's DSU. This was followed in 2002 by the EU-Chile FTA which embodied a separate set of detailed rules on dispute resolution.

These rules are very similar to those in other FTAs: preliminary consultation between parties, unilateral initiation of arbitral proceedings by a complainant if consultations fail, panel formation from an agreed list of arbitrators, release of a final panel report and ruling, and ensuring compliance with a ruling. These fundamental procedures have also been built into subsequent FTAs involving the EU, such as the EU-Canada Comprehensive Economic Trade Agreement (CETA) and the EU-Japan Economic Partnership which entered into force in 2017 and 2019 respectively. The key difference between dispute resolution in FTAs of which the EU is a member and the WTO's, is the lack of two-instance adjudication, i.e., there is no equivalent of the AB.

While issues relating to the WTO's DSU regime are ongoing, and likely influencing the EU's choice of forum to resolve trade disputes, the EU has taken leadership in seeking an alternative plurilateral mechanism under the WTO rules, which lies in very clear contrast to the unilateral/bilateral/FTA strategy currently adopted by the United States.

Conclusions

While the United States shows no desire to revive/reform WTO dispute resolution, and has not joined MPIA, the rate at which it has been engaged in dispute resolution under USMCA suggests it regards this and other FTAs as a robust alternative to the WTO's DSU. At the same time, the EU clearly supports multilateral solution to trade disputes, but since 2018 the EU has also made greater use of FTA dispute resolution.

Given this commonality, a proposal is made here for a possible way forward for trade dispute resolution: FTAs could have an "opt in" clause for non-members. The clause would allow non-members of a specific FTA to use its dispute resolution mechanism in any trade dispute with a member of the treaty. To take the USMCA as an example, the opt in clause would allow a third country, such as Germany or Japan, to use the USMCA dispute resolution mechanism for trade disputes with the United States, Mexico, or Canada, and then be a non-member country for disputes that arise out of WTO obligations. USMCA Article 31.3 covers disputes under the USMCA or the WTO and provides the choice of the USMCA or the WTO dispute resolution mechanism. Currently, for

[22] Joost Pauwelyn. 2023. "The WTO's Multi-Party Interim Appeal Arbitration Arrangement (MPIA): What's New?" *World Trade Review* 22(5): 693-701.
[23] See Pauwelyn *op. cit.*
[24] See Jonas Weinberger and Sven Van Kerckhoven. 2022. "The EU's Trade Dispute Settlement Mechanism: An Alternative to the WTO DSU?" SSRN Working Paper.

non-members of the USMCA, the only option would be to choose the WTO. The same opt in clauses can be adopted by all of the other trade agreements set forth above, which would create a larger network of agreements that can be used to resolve WTO disputes.

In addition, it is proposed that the WTO be the clearinghouse and center at which the opt in clauses are exercised. The WTO membership includes the vast bulk of nations all with offices at the WTO headquarters. The WTO can serve as a convenient and central location at which the opt in clauses are notified and implemented and at which the FTA dispute resolution bodies can hear cases. With the continuing proliferation of bilateral and regional FTAs, this approach could provide substantial opportunities for countries to resolve their WTO disputes in fully functioning dispute resolution systems without having to wait for the restoration of the WTO's AB.

Of course, such an approach has weaknesses and shortcomings. Decisions by PTAs on WTO issues do not form part of WTO jurisprudence as these are decisions that have not been adopted by the DSB. These decisions will have no legal status within the WTO and have no precedent value. Decisions will also be issued by different tribunals that could proceed under different procedures and legal assumptions lacking unity and harmonization. With the institutional support of the WTO, however, the use of FTAs to resolve WTO disputes will no doubt evolve and changes, improvements, and efficiencies could be forthcoming.

Further reading:

Daniel C.K. Chow and Ian Sheldon. 2024. "The Future of Trade Dispute Resolution in a Post-WTO World." Ohio State Legal Studies Research Paper No. 872.

Andersons Policy Bulletins are discussions of key trade and policy issues. The author of this bulletin, Ian M. Sheldon, is Andersons Chair of Agricultural Marketing, Trade and Policy in the Department of Agricultural, Environmental, and Development Economics within the College of Food, Agricultural, and Environmental Sciences at The Ohio State University.

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