BRIEFING

European Parliament

International trade dispute settlement

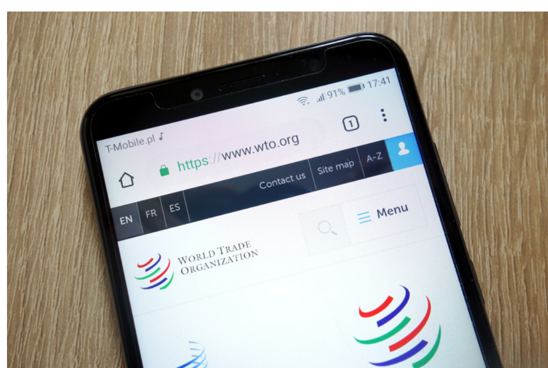
WTO Appellate Body crisis and the multiparty interim appeal arrangement

SUMMARY

When disputes arise in international trade, they can be settled with binding rulings under international trade or investment agreements. For World Trade Organization (WTO) agreements, members can launch such disputes through the two-step WTO dispute settlement mechanism. The European Union (EU) also includes similar dispute settlement provisions in its trade agreements.

The United States' blockage of appointments to the WTO Appellate Body, the highest instance of the WTO dispute settlement, plunged the multilateral rules-based trading system into crisis. The US grievances include questions of delay, judicial over-reach, precedence, and transition rules. As the Appellate Body is unable to hear new appeals, no disputes can now be resolved at the highest instance, causing widespread concern in the context of escalating global trade protectionism.

To find a temporary solution to the impasse, the EU and a number of trade partners set up a multiparty interim appeal arbitration arrangement (MPIA). The parties continue to seek resolution of the Appellate Body crisis, and agree to use the MPIA as a second instance as long as the situation continues. The MPIA is also open for more WTO members to join. The recently amended EU Enforcement Regulation also enables swift suspension of obligations under trade agreements while the dispute settlement mechanism is blocked. While the USA has criticised the MPIA, the US approach to multilateral cooperation may change under President Joe Biden. The European Commission Trade Policy Review of February 2021 restates the EU's commitment to WTO reform.



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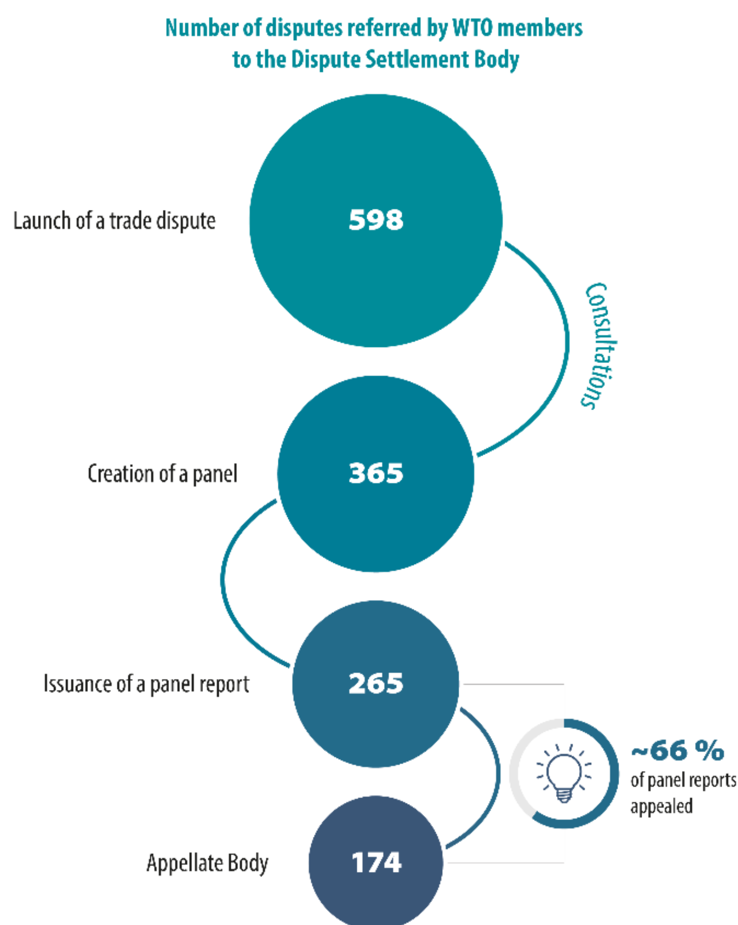
Crisis in the WTO Appellate Body

World Trade Organization (WTO) members have entered into a number of trade agreements with one another that uphold the multilateral trading system. Disputes can arise when one member government considers that another member government is in breach of its commitments made in one or more WTO agreements. To settle such disputes, WTO members have agreed the Dispute Settlement Understanding (DSU), which prescribes a set of procedures for adjudication of an international dispute and compliance with the rulings. In the EU, the European Commission decides on the launch and conduct of disputes on behalf of the Member States. The dispute settlement cases are prioritised based on legal soundness, economic importance, and systemic impact in terms of the wider context of the case. The recently established EU Chief Trade Enforcement Officer ensures that the dispute settlement actions contribute in a coherent and streamlined manner to EU policy objectives of implementation and enforcement policies.

From January 1995, when the WTO was established, until December 2019, the Appellate Body functioned as the highest instance of WTO dispute settlement, upholding, modifying or reversing legal findings and conclusions of panels, the quasi-judicial bodies in charge of adjudicating disputes between members at first instance. For over two decades, the Appellate Body consisted of seven members serving four-year terms. The WTO settlement mechanism is one of the most active and effective settlement mechanisms in the world. Between 1995 and 2020, WTO members launched consultations, initiating a dispute, 598 times; of these, 365 disputes led to the creation of a panel to adjudicate a dispute between members, and panel reports were issued in 265 cases, the conclusions of which were appealed in 174 disputes. That two-thirds of panel reports were appealed highlights the deference members attributed to the Appellate Body and the importance of a higher instance in a dispute settlement procedure. In addition, members largely complied with the rulings in disputes: only 19 % of disputes that involved a panel report resulted in the creation of a compliance proceeding (where parties disagree about whether compliance has occurred by the end of the implementation period). The EU has often had recourse to WTO dispute settlement, launching over 100 disputes since 1995. As of February 2021, the EU was party to 45 pending WTO disputes, with disputes concerning the USA representing the highest number of active disputes.



Source: WTO dispute settlement as of 31 December 2020.

Under the Obama administration in 2011, the USA refused for the first time to reappoint an Appellate Body member for a second term, in the case of Jennifer Hillman. At the time, the US Trade Representative did not provide clear reasons for the refusal, with commentators speculating that the decision was rooted in US displeasure with Appellate Body rulings on trade remedy laws. In 2016,

an election year in the USA, the reappointment of Appellate Body member Seung Wha Chang was also blocked, reportedly due to US concerns over judicial over-reach. The blockage of nominations continued under the Trump administration. The Appellate Body gradually stopped functioning as the terms of existing members expired. Whilst in the early 1990s, the USA was previously among the countries that most favoured the establishment of a binding and enforceable dispute settlement in the WTO, the country has since taken issue with several practices. In 2018, the US Trade Representative (USTR) – US counterpart to the EU Trade Commissioner – communicated US concerns with WTO dispute settlement in the US President's Trade Policy Agenda. In February 2020, this was followed by an in-depth Report on the Appellate Body of the WTO. Some of the main issues raised by the USA include:

- Frequent disregard for the 90-day **deadline** for deciding appeals provided for in Article 1 of the Dispute Settlement Understanding
- **Judicial over-reach**: Appellate Body findings that, the USA viewed as unnecessary to the resolution of the dispute (*obiter dicta*), issuing unnecessary advisory opinions, or issuing findings on issues of fact including on matters that relate to domestic law. In particular, the USA has called into question decisions such as Appellate Body findings against the practice of zeroing (a method for calculating the extent of dumping).
- After the General Agreement on Tariffs and Trade (GATT), the Anti-dumping Agreement constituted the most commonly raised agreement in WTO disputes in 1995-2020 (Anti-dumping Agreement – 137 of 598 disputes, GATT – 488 disputes). Zeroing became one of the most litigated issues and featured as a key issue in several Appellate Body reports.
- The Anti-dumping Agreement enables WTO members to react when goods are unfairly exported below home market value. The usual practice for calculating dumping involves a weighted average between export price and home market price.
- With zeroing, members set this value to zero, which increases the likelihood that dumping is found and that counter-measures can be justified. This upward bias can in turn increase the level of the eventual anti-dumping duties levied by member governments.
- **Establishment of precedents**: The USA claims that the Appellate Body has required panels to treat its prior interpretations as binding precedents, whereas the DSU prescribes that 'recommendations and rulings of the dispute settlement body cannot **add or diminish** the rights and obligations provided in the covered agreements' (DSU Article 3.2). However, the Appellate Body has not explicitly said that its rulings set precedents, but only held that it follows the principle of predictability and stability by ruling in the same way on the same issues.
- **Transition rules**: Appellate Body members continuing to issue reports beyond their term on unfinished cases, based on Rule 15 of the Working Procedures for Appellate Review, which seeks to ensure the completion of the treatment of an appeal by the same person. The USA is concerned that outgoing Appellate Body members have increasingly stayed on past the expiration of their term to resolve cases since 2017.
- Treatment of **domestic (or 'municipal') law** as a legal issue subject to Appellate Body review, which can blur the discernible division between issues of fact and of law.

US grievances are linked to the broader question of the need to reform the WTO. Commentators have implied that the USA is using the Appellate Body crisis as leverage to effect other changes to the WTO, which largely stem from the paralysis in the negotiating function and other disruptive issues, such as the perceived incompatibility of Western and Chinese forms of capitalism. According to this view, the WTO reforms that would most help level the playing field are linked to renegotiation of rules for industrial subsidies and rules for state-owned enterprises. In addition, tackling subsidies includes strengthening transparency in the WTO. As it stands, officials have difficulties in tracking and identifying WTO-incompatible subsidies in trade partners' jurisdictions. In part, this is due to non-compliance with notification obligations. However, prospects for renegotiation of the rules in

this area are mediocre. Substantive and procedural disagreements between major economies remain considerable.

The USA has also proposed reform of special and differential treatment (SDT) afforded to developing countries, which could help level the playing field in the multilateral trading system. While the WTO defines 'least developed countries' (LDCs) along United Nations criteria, there is room for interpretation around what constitutes a 'developing country'. The USA is concerned that special rights (exceptions, time allowances and safeguards), i.e. differential treatment, are too widely available to countries that self-declare their 'developing' economy status.

In the 2021 EU Trade Policy Review, the European Commission committed to the twin actions of restoring the WTO dispute settlement mechanism and reforming the WTO, including in terms of sustainable development and state intervention. The EU has stated that it will prioritise transatlantic cooperation to this end, and that dispute settlement is the most urgent of WTO reforms.

Proposed solutions to the Appellate Body crisis

The EU shares the United States' systemic concerns about the need to level the playing field with regard to the use of State aid, subsidies and developing country status in the WTO, but disagrees with the US decision to unilaterally block the Appellate Body. Many of the EU priorities and proposals were laid out in a 2018 concept paper on WTO reform. Later that year, proposals to reinvigorate the Appellate Body made in a joint communiqué on WTO reform of the Ottawa Group of like-minded countries,[1] considered that a healthy dispute settlement mechanism is a prerequisite for a rules-based multilateral trading system and sought to reinvigorate the system through discussions to find ways to safeguard and strengthen the dispute settlement mechanism.

At the level of the WTO General Council, a coalition of members[2] initially put forward specific solutions to the impasse in a 2018 communication on the Appellate Body crisis. They include a specific set of proposed amendments, largely in line with the EU proposals (see below). These include new transitional rules for outgoing Appellate Body members, the extension upon agreement of the 90-day deadline, sole focus on issues that 'are necessary for the resolution of the dispute', as well as better communication channels to discuss issues of precedent. Subsequently, WTO members engaged in nine months of intensive consultations, led by New Zealand Ambassador David Walker, to find a solution to the impasse, presenting the results of the informal process to the General Council on 15 October 2019. The key proposals are:

- An obligation to respect the 90-day **deadline** when issuing a report;
- **Judicial over-reach**: Clarification that Appellate Body findings and recommendations cannot add to the obligations under the WTO agreements;
- Clarification that **binding precedent** is not created in WTO dispute settlement. However, consistency and predictability in treaty interpretation are highly valued by WTO members. Therefore, previous Panel or Appellate Body reports should be taken into account when relevant;
- **Transitional rules** for outgoing Appellate Body members, allowing them to complete an appeal process in which an oral hearing has been held prior to the normal expiry of their term. Sufficient time should be planned for filling vacancies;
- In certain cases, treating the meaning of **municipal law** as a matter of fact in reviewing a case. However, the Appellate Body cannot engage in a new review of the facts of the dispute.

The USA has rejected these proposals, and as a result, a 'coalition of the willing' has transitioned to the multiparty interim appeal arbitration arrangement (MPIA). One of the most difficult issues to solve remains the concerns about over-reach, and the perceived consequences for the use of trade remedies. However, the election of President Joe Biden has raised hopes for restoration of the Appellate Body, meaning parties would not need to resort to the MPIA. However, any potential policy reversals regarding the Appellate Body are likely to take time, and in a WTO Dispute

Settlement Body meeting held in February 2021, the USA continued to block nominations. The reform of the multilateral dispute settlement mechanism is also considered to be a top priority for the new WTO Director-General Ngozi Okonjo-Iweala, alongside trade policy reaction to the Covid-19 pandemic, including trade in vaccines. In the annex to the EU Trade Policy Review, the European Commission has recognised a number of US concerns. In particular, the Commission agrees with the need for the Appellate Body to exercise judicial economy, avoid binding precedents, and comply with mandatory timelines. In addition to the solutions developed by the MPIA process, the EU is open to stronger legal formulations and additional improvement. The EU also published a new multilateralism strategy in February 2021, which highlights the EU's leadership position in reforming the WTO in an effort to ensure stability, certainty and fairness in the global trading system.

Multiparty interim appeal arbitration arrangement

In response to the Appellate Body paralysis, the EU (including its Member States) and 15 WTO member countries[3] decided to develop an independent appeals mechanism in January-April 2020. As a result, the multiparty interim appeal arbitration arrangement (MPIA) was established on 30 April 2020, based on Article 25 of the WTO DSU, which provides for 'expeditious arbitration as an alternative means of dispute settlement' under mutual agreement between parties. The signatories must also agree to the eventual arbitration award, thus rendering the appeal procedure binding upon themselves. In July 2020, the MPIA became operational as a pool of 10 standing arbitrators was confirmed, following candidate nominations by the participants.

Participating WTO members agree to use the MPIA as a second instance, as long as the Appellate Body is not operational, and not to pursue appeals 'into the void' during this time. Some of the proposed solutions to the underlying Appellate Body crisis have already been included in the MPIA. For example, the MPIA requires arbitrators to focus on issues 'necessary for the resolution of the dispute', in an effort to address judicial over-reach concerns. The MPIA is open for more WTO members to join and membership grew from 16 to 24 within a few months after countries including Benin, Ecuador and Nicaragua joined.[4]

The USA criticised the MPIA in a letter to WTO Director-General Roberto Azevêdo in June 2020. Wary of creating a 'permanent' structure, the USA objected to 'both the establishment of what appears to be a new WTO division for the benefit of participants in the China–EU arrangement and the allocation of the staff for the exclusive use of these participants', as well as financing of MPIA through the WTO budget. In response, the EU and other partners have repeatedly highlighted that this is a temporary 'stop-gap' solution, in force only until the Appellate Body resumes its activity. The EU has highlighted that the MPIA is temporary in nature and does not represent a new body that would require treaty change. Another way that WTO members have attempted to avoid 'appealing into the void', is by setting up ad hoc agreements to decline to appeal panel reports at the beginning of a dispute. For example, Indonesia and Taiwan have agreed not to appeal in the Indonesia – safeguards on certain iron and steel products case if the Appellate Body is still not operational on the date the panel eventually issues its report .

More broadly, commentators have raised practical questions that can influence the functioning of the MPIA, including its budget, effectiveness, degree of authority compared to the institution of the Appellate Body, whether the appeals process will be used very often, and how much deference the MPIA will pay to panel reports. For instance, a dedicated WTO Secretariat division assisted the Appellate Body, including with drafting reports, formulating questions in oral proceedings, and identifying key issues. The MPIA, which will not benefit from secretariat support, has sought to establish strong working procedures prior to the arrival of the first cases. In the case of the MPIA, there is a strong commitment to the 90-day deadline and for a collegial approach, whereby three arbitrators hear a case and seven have the opportunity to express opinions on legal issues. Some of the first cases, where both parties have signed up to the MPIA, and that could therefore reach the MPIA include:

- Mexico's complaint against Costa Rican measures on Mexican avocado imports;
- EU case against Colombia's anti-dumping duties on frozen fries from Belgium, Germany and the Netherlands;
- Australia's request for consultations on China's anti-dumping and countervailing duties on Australian barley.

At the same time, cases where a party is not signatory to the MPIA could in theory be appealed 'into the void' if the case reaches the panel report stage while the Appellate Body is still in deadlock. This includes for instance Malaysia and Indonesia's dispute against the EU's amended Renewable Fuels Directive, which has classified palm oil as a high-risk fuel contributing to deforestation.

Stakeholder views

There is broad agreement among the EU's export-dependent economies and their businesses to safeguard the rule of law in international trade. Some have seen the review of the Enforcement Regulation as an incentive for trade partners to join the MPIA or unblock the Appellate Body crisis. In addition, the EU has taken legislative action, in part triggered by the Appellate Body, by amending the Enforcement Regulation. The changes allow the EU to introduce economic countermeasures such as customs duties, quantitative restrictions and measures in the area of public procurement – when an EU trade partner adopts illegal trade measures and simultaneously blocks the dispute settlement mechanism at the level of the WTO, or in the context of a bilateral or regional trade agreement.

Increasing use of bilateral trade agreements?

In parallel with the WTO Appellate Body crisis, a debate about whether countries and trade blocs will increasingly resort to the dispute settlement mechanisms under trade and economic partnership agreements has taken place. The dispute settlement provisions of bilateral trade agreements are modelled on those of the WTO.

The EU has been particularly active in this area, launching disputes with Ukraine on wood export restrictions, with the Southern African Customs Union on poultry safeguards, with Algeria on trade restrictive measures and with South Korea on labour commitments. This latter became the EU's first case under a free trade agreement sustainable development chapter.

Source: European Commission, Disputes under bilateral trade agreements.

Whilst WTO disputes are chosen based on pre-determined criteria of legal argument and economic as well as systemic importance, they tend to concern specific sectors and industries. Active cases include cases launched following complaints from, for instance, European ceramic tile, alcoholic beverage, and the information and communications technology (ICT) industries. Businesses and chambers of commerce have welcomed the creation of the MPIA, while simultaneously condemning the Appellate Body crisis.

As regards judicial over-reach, commentators have noted the importance of safeguarding a 'safety valve' in the form of trade defence measures, through which members can take action when competitive pressures increase. Indeed, many European and American industrial producers have welcomed the effective use of trade defence instruments in recent years.

Traditional stakeholder criticism of the WTO dispute settlement system has in part been aligned with US concerns, e.g. whether the WTO is overstepping domestic regulatory power, and the lack of a civil society voice in the legalistic dispute settlement proceedings (e.g. no public hearings for NGOs). Critics have also posited that the structural design of the WTO dispute settlement mechanism favours state and business interests, over civil society concerns.

European Parliament position

The EU has repeatedly voiced its commitment to the multilateral rules-based trading system that rests on a functioning dispute settlement mechanism. In practice, this means that the EU would not

be prepared to accept any provisions that would compromise the independence of the Appellate Body, or create a dispute settlement mechanism that is not binding.

In its November 2019 resolution on the WTO Appellate Body crisis, the European Parliament voiced its deep concern about the situation and called on the European Commission to engage with WTO members, including the USA, to unblock the appointments. Parliament voiced its support for interim arrangements that enable the EU to continue to resolve trade disputes through two-level, independent adjudication, and recalled that restoring the standing Appellate Body remains a priority.

In a December 2019 European Parliament hearing, the Commission's Director-General for Trade, Sabine Weyand noted that the EU will seek to preserve the two-step dispute settlement, advocate for negative consensus for the adoption of Appellate Body reports to ease procedures, and implement the MPIA, while engaging in the broader reform efforts.

In January 2021, the Parliament adopted a legislative resolution on amendment of the Enforcement Regulation, which now enables the EU to suspend trade concessions or obligations if effective recourse to dispute settlement is blocked by an uncooperative country. The resolution also recalls the importance of reforming the WTO dispute settlement mechanism and seeks to ensure the functioning of the Appellate Body. In annex to the legislative resolution, the Commission provided a declaration on compliance with international law. If the EU launches a dispute against another WTO member, the Commission will try to seek agreement on resorting to arbitration under Article 25 of the DSU as an interim appeal procedure.

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ENDNOTES

[1] Australia, Brazil, Canada, Chile, European Union, Japan, Kenya, Korea, Mexico, New Zealand, Norway, Singapore and Switzerland.

[2] Australia, Canada, China, EU, Iceland, India, Norway, New Zealand, Mexico, Republic of Korea, Singapore, and Switzerland.

[3] Australia; Brazil; Canada; China; Chile; Colombia; Costa Rica; the European Union; Guatemala; Hong Kong; Mexico; New Zealand; Norway; Singapore; Switzerland; and Uruguay

[4] As of December 2020: Australia, Benin, Brazil, Canada, China, Chile, Colombia, Costa Rica, Ecuador, the EU including its Member States, Guatemala, Hong Kong, Iceland, Macao SAR, Mexico, Montenegro, New Zealand, Nicaragua, Norway, Pakistan, Singapore, Switzerland, Ukraine, Uruguay.

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