

Fall 2002

The Role of World Trade Organizations in Settling Trade Disputes Between the United States and the European Union

Erin Walker

University of Arkansas, Fayetteville

Follow this and additional works at: <http://scholarworks.uark.edu/inquiry>



Part of the [International Economics Commons](#)

Recommended Citation

Walker, Erin (2002) "The Role of World Trade Organizations in Settling Trade Disputes Between the United States and the European Union," *Inquiry: The University of Arkansas Undergraduate Research Journal*: Vol. 3 , Article 13.

Available at: <http://scholarworks.uark.edu/inquiry/vol3/iss1/13>

This Article is brought to you for free and open access by ScholarWorks@UARK. It has been accepted for inclusion in Inquiry: The University of Arkansas Undergraduate Research Journal by an authorized editor of ScholarWorks@UARK. For more information, please contact scholar@uark.edu.

THE ROLE OF WORLD TRADE ORGANIZATIONS IN SETTLING TRADE DISPUTES BETWEEN THE UNITED STATES AND THE EUROPEAN UNION

Erin Walker
 Department of Economics

Faculty Mentor: Gary D. Ferrier
 Department of Economics

Abstract:

Description of Topic: In settling trade disputes, members of the World Trade Organization use a dispute settlement mechanism set forth in the Uruguay Round of trade negotiations. This multilateral system of settling disputes is implemented if a member believes other members are violating trade rules. Disputes arise when countries adopt policies that break the WTO agreements or that cause them to fail to fulfill obligations. Dispute settlement procedures have existed under many different trade agreements. While current processes are more effective than those of past agreements, they still lack credibility and effectiveness.

Research and Results: The United States and the European Union have used the WTO dispute settlement processes in settling many trade disputes over the past decade. Currently, the United States and European Union are involved in several disputes, including the trade of meat treated with growth hormones, the use of the U.S. Foreign Sales Corporation tax exemption, and state subsidization of the steel industry. Recent resolution of the long-standing dispute over the European Union banana regime is a positive indicator of progress in trade relations between the United States and the European Union. These cases will be used to illustrate the point that current WTO recommendations are not the most authoritative means of settling international trade disputes and to suggest improvements, such as increased use of negotiation and arbitration, to the dispute settlement process. The mutually benefiting trade relationships among independent nations can be greatly enhanced by cooperation in and resolution of trade issues. Improvements to the dispute settlement system would facilitate the edification of the global economic environment.

Summary of Problem:

The World Trade Organization (WTO) offers to its members a settlement mechanism for use in trade disputes. However, this mechanism is not as effective or credible as it could be, as it allows countries to delay in implementing WTO rulings. This is

because the rulings do not specify what governments must do to comply with the decisions ("Monkey Business"). The mechanism loses efficiency because the process of settling trade disputes is too lengthy.

The Uruguay Round of trade negotiations, which ended in 1994, set forth a multilateral system of settling disputes for members of the WTO to use if they believe other members are violating trade rules. Disputes arise when countries adopt policies that break the WTO agreements or that cause them to fail to fulfill obligations. This dispute resolution system is based on a laissez-faire attitude under which quarreling countries are encouraged to settle disputes themselves through consultations and mediation.

The steps involved in settling disputes under the Uruguay Round agreement have target time periods to be carried out. The total amount of time spent on a case is set, but within that confine, the timeline for each stage is flexible. The Dispute Settlement Body oversees the case by establishing panels to consider the case, monitoring enforcement of the rulings, and allowing retaliation when rulings are not followed. The first stage of the process is consultation. Countries involved in the dispute must communicate in an effort to settle the problem themselves. If they are not successful, or if they simply do not want to communicate with one another, they may ask for mediation from the WTO director general. In the second stage, which occurs if consultation fails, the protesting nation may ask for a panel to be appointed to assist the Dispute Settlement Body in making a judgment on the case. This panel receives each side's case in writing, and then, a preliminary hearing is held. At this hearing, the disputing countries and any other country with a declared interest in the controversy present their cases to the panel. Next, the countries involved present written rebuttals and make oral arguments at the second meeting of the panel. Throughout this entire process, the panel may consult outside experts if necessary. In the first draft of its report, the panel gives the factual and argument sections to the parties, who have two weeks to comment. The panel then submits an interim report including findings and conclusions to the two sides, allowing one week for review. A

final report is given to the disputing countries; three weeks later, the report is sent to all WTO members. The panel may make suggestions as to how to correct a trade policy that does not comply with WTO rules. Within sixty Ms. Kapouliandays of the final report being distributed, it becomes the Dispute Settlement Body's ruling unless it is rejected by a consensus.

Either side can appeal the panel's ruling based on a point of law, but evidence cannot be reexamined or introduced. The Dispute Settlement Body sets up a permanent seven-member Appellate Body that represents a diverse range of WTO member countries. The Appellate Body may uphold, modify, or reverse the panel's ruling. Following the ruling of the Appellate Body, the Dispute Settlement Body has 30 days to accept or reject the appeals report, with a consensus required for rejection.

Stage of Settlement Process:	Time Allotted:
Consultations	60 days
Panel sets up and panelists' appointments	45 days
Final report to the parties	6 months
Final panel reports to WTO members	3 weeks
Dispute Settlement Body adopts report (if no appeal)	60 days
Total	1 year (without appeal)
Appellate Body report	60-90 days
Dispute Settlement Body adopts Appellate Body Report	30 days
Total	1 year 3 months (with appeal)

After the case has been decided, rapid action should be taken by the losing country to bring its trade policies into step with WTO rules. The "defendant" country must follow the recommendations of the panel or appellate body. It must state its intention to do so at the final meeting of the Dispute Settlement Body, where it can also make a case for acting within a reasonable amount of time instead of immediately. However, if corrective action is not taken within that time period, it has 20 days to negotiate with the other country and come up with a plan for compensation. If no agreement is reached within 20 days, the complaining country can ask the Dispute Settlement Body for permission to impose limited trade sanctions on the other country. This dispute settlement mechanism is widely used by member

nations of the WTO. It has often been used by the United States and the European Union to settle trade disputes between the two. Trade relations between the United States and the European Union see few disputes, with only a little over 1% of transatlantic trade volume under formal dispute (Burghardt). However, the few problems that do exist between the groups have received an overwhelming amount of media attention. This attention far exceeds their economic importance (Wielard). The fact that the economies of the United States and the European Union are so closely tied contributes to the problems that exist. With such an extended relationship and sometimes differing ideas about economic circumstances, there are bound to be some disagreements; two of these disagreements will be used to illustrate the inefficiencies that exist in the WTO dispute resolution procedures.

Recently, trade disputes between the United States and the European Union have begun to move from traditional trade barrier issues to problems stemming from regulation, licensing, and standards relating to health, consumer, and environmental protection. The European Union has a \$5 million banana market that was at the center of a major trade dispute for eight years. In 1993, the European Community adopted a Common Market Organization for bananas. The trade policies established under this system favored imports from former colonies of EU member nations. These policies restricted Latin American access to European banana markets. This regime was found to be illegal under WTO guidelines in 1997. In January 1999, a new import scheme was implemented. This was also declared illegal according to WTO standards because there was a quantity set aside specifically for ACP countries. The United States became involved in the case because two major American firms, Chiquita and Dole, market bananas produced in Latin America and were denied the opportunity to market their bananas to European nations. In April 1999, the United States was authorized by the WTO to place trade sanctions on the European Union for an annual value of \$191 million (Bahree and Muffay). The United States imposed 100% duties on an equivalent amount of trade on March 3, 1999 ("New Developments Complicate Banana Dispute").

The disputing parties eventually agreed on a solution based on a historical reference period. In 2006, trade policies for bananas imported into the European Union will transition to a tariff-only system. In the meantime, the European Union will establish quotas and an import licensing system based on historical trade shares that should increase prospects for Latin American banana imports. Imports from former colonies of EU member nations will still get preference.

Full implementation of this system depends on WTO members granting the European Union waivers of the GATT provisions that prohibit the preference of ACP countries' banana imports. Beginning on July 1, 2001, the United States suspended the trade sanctions on the European Union that had been previously

authorized by the WTO. The European Union was charged with the task of creating a proposal to the Council of Ministers that would adjust the quantities of bananas in the various quotas, increasing marketshare for Latin American producers and protecting access to the market for the ACP countries. The United States pledged to work to secure approval from the WTO for the European plan.

Some contention is based on the commercial interests of EU and U. S. business and government policies. The single biggest trade sanctions claim is seen in an EU complaint dealing with the U. S. Foreign Sales Corporation (FSC -Winestock). This tax policy is provided for under the Deficit Reduction Act of 1984, which is the successor legislation to the Domestic International Sales Corporation of 1971 (Smith). An FSC is a separate foreign corporation that is incorporated in an approved jurisdiction outside the United States, electing with its shareholders' consent to be treated as an FSC. This export tax benefit enables U.S. exporters to consider between 15% and 30% of their export income as tax exempt and is estimated to save U.S. companies approximately \$4 billion annually (Eurecom). In an FSC, for each qualifying sale made by a firm to foreign customer, the firm pays a commission, determined by special transfer pricing rules, to the FSC. The commission is a tax-deductible expense to the firm. About one third of the commission income is taxable income to the FSC. The net income of the FSC is distributed back to the U.S. firm as a tax-exempt dividend (Smith). The European Union lodged a complaint in 1998 that the FSC provisions are an export subsidy and are a violation of WTO regulations (Dreazen and Rogers). However, the United States has questioned why the European Union waited 14 years to complain about the regulations. The United States believes that this challenge may be in response to U.S. challenges to EU import regimes regarding bananas and beef (Dougherty). The European Union has said that the challenge was intended to improve equality in trade relations, but there is little evidence that European companies were pushing for the change. Because some European firms benefit from the FSC tax policy, they are not fully encouraging of the EU claim ("The FSC Bomb"). The WTO ruled that the U.S. tax exemption was in violation of trade regulations. In November of 2000, Congress repealed the exemption and passed a fix-it bill that rewrote the legal basis for the program; the new law gives the same tax benefits as the original FSC program, but it extends the provision to a certain proportion of income from exporters' foreign operations. It also eliminates the need for U.S. firms to set up an off-shore firm by simply exempting income earned overseas from U.S. taxes rather than having an exemption for exports only (Dreazen and Rogers). The new law broadened the scope of the beneficiaries for the FSC's, with the hope that the WTO could be convinced that the policy was no longer dependent on exports. However, the WTO still felt that the policy was too export related and was contrary to the WTO agreement on subsidies (Smith). The new laws "provide illegal export subsidies, violate the trade body's

agricultural agreement, and discriminate in favor of U.S. goods in breach of WTO rules" (Osborn and Denny). After the WTO ruling against the new FSC policy, the European Union requested the authority to impose \$4 billion in retaliatory duties on U.S. goods. The United States filed an appeal in August of 2001 with the WTO, which was considered unlikely to be successful. However, the appeal allowed time for negotiations between the disputing sides to avoid punitive sanctions being placed on the United States (Alden). The European Union published an indicative list of retaliatory sanctions with 46 general categories; a detailed list with specific products would be compiled after the final WTO ruling. If the United States does not do away with the FSC tax policy, sanctions will be imposed in the form of 100% penalty tariffs on imports of U.S. goods up to the value allowed by the WTO (Winestock). The United States has said that if sanctions are imposed, it will respond by bringing cases against the European Union to the WTO ("The FSC Bomb"). The resulting escalation of the situation would be harmful to the trade relationship between the two sides. On January 14, 2002, the WTO threw out the U.S. appeal. At this point, both sides have 60 days to present arguments to a WTO arbitrator who will rule on any permitted retaliatory tariffs by the end of March (Mortished).

The resolution of both of these cases, the FSC tax exemption case in particular, hopefully will set a precedent for cooperation between disputing parties in settling trade conflicts. While neither dispute was settled through multilateral negotiations, and there was evidence of noncompliance with WTO rulings in both cases, both sides were willing to work together after the final rulings to avoid escalation of the situation into a full-blown trade war.

Conclusion Reached:

Through the illustrations provided by past trade disputes that have been resolved under the WTO's dispute settlement mechanism, it is evident that some modifications must be implemented in the process. One option is to make the existing settlement process streamlined and efficient. A system involving permanent panelists and a speeding up of the process wherever possible will make the overall process more efficient. A permanent panel would create a team of experts who are familiar with the dispute settlement process and are readily available to review trade disputes. Because the panel would have experience in dealing with the procedures specified by the WTO, it would be able to move through those procedures quickly and arrive at rulings in an efficient manner. Clarification of the policies on the sequencing, arbitration procedure on the level of suspension of concessions, and the establishment of policies to lift suspension of concessions would also improve the overall processes. All parties involved in the dispute and its resolution would be aware of the actions involved in resolving a trade dispute. Another option is to place importance on negotiation with less emphasis on the procedural aspects of the settlement mechanism. Member nations, as well as the WTO itself, have expressed the view that

consultation is a more effective resolution tool than litigation. However, only 32 out of 203 cases had been settled outside of the WTO panel process for settling disputes by July 2000. Nations should clearly define their advocacy of negotiation in this process for it to attain prominence in the settlement proceedings. Negotiations could be conducted under the auspices of the WTO or independent of any official guidance from an outside authoritative body. Nations have differing opinions on which of these situations is more favorable to the settlement of disputes. The United States has proposed early, bilateral consultations before the disputing nations go to the WTO. It advocates the use of neutral, third party mediators or panels. The European Union has stated that mediation should occur within the parameters of the WTO because it believes that outside consultations have no enforcement capacity.

Value of Project:

Trade is a fundamental part of today's global economy. Healthy trade relationships allow countries to specialize in producing items best suited to their resources while acquiring other products that they do not produce from nations that specialize in those products. Trade also broadens the market that countries are able to target, resulting in greater and more comprehensive commerce. Aside from these theoretical benefits of trade, it is also advantageous for countries to form trade relationships because they can increase the income of those nations. For example, the Uruguay Round is estimated to increase the income of the United States by \$42 billion each year, and NAFTA has produced gains of between \$10 billion and \$50 billion with tariff cuts of \$14.2 billion (Office of the United States Trade Representative). The need for an efficient and effective means of settling trade conflicts is integral to maintaining healthy trade relationships and the economic advancements created through those relationships.

Works Cited:

- Alden, Edward. "US to Appeal on Tax Break Ruling." *Financial Times* (London) 11 October 2001, World News: 13.
- Bahree, Bhushan, and Matt Murray. "WTO Ruling Promises to Deepen Tension in U.S. Europe Trade Ties." *Wall Street Journal* 8 April 1999: A15.
- Burghardt, Gunter. "Economic and Political Relations Between the European Union and the United States." 7 May 2001. <http://www.eurunion.org/news/speeches/2001/010507gb.htm>. 6 November 2001.
- Dougherty, Carter. "WTO Nixes U.S. Trade Subsidy; Ruling Against Tax Law Poses Risk of \$4 Billion Sanctions." *The Washington Times* 23 June 2001: A1.
- Dreazen, Yochi J., and David Rogers. "House Clears Tax Credit for Exporters — Passage of Bill Repeals FSC, Puts Firms in Compliance with Global Trade Laws." *Wall Street Journal* 15 November 2000: A2.
- Eurecom: *Monthly Bulletin of European Union Economic and Financial News*. September 2000. <http://www.eurunion.org/new/eurecom/2000/eurecom0900.htm>. 6 November 2001.
- "Monkey Business." *The Economist*. 14 November 1998: 82.
- Mortished, Carl. "EU Wins Appeal in US Trade Dispute." *The Times*

(London) 15 January 2002: Business Section.

"New Developments Complicate Banana Dispute." *Logistics Management and Distribution Report* April 1999: 95.

Office of the United States Trade Representative. "Benefits of Trade: Summary of Key Data Points on Benefits to Families of NAFTA and the Uruguay Round." 19 September 2001.

www.ustr.gov/new/summarydata.html. 27 March 2002.

Osborn, Andrew, and Charlotte Denny. "WTO backs Europe in Row over Tax Breaks for US Finns." *Manchester Guardian Weekly* 29 August 2001, Finance: 14.

Smith, Jim. "Offshore, and Off the Hit List." *Airfinance Journal* December 2000: 33-35.

"The FSC Bomb." *Financial Times* (London) 28 June 2001, Leader Section: 20.

Winestock, Geoff. "EU Aims for Huge Sanctions on the U.S.—Claim of \$4.04 Billion Made to WTO Is in Response to Tax Break in Dispute." *Wall Street Journal* 20 November 2000: A2.

Wielard, Robert. "Europe Wants Ties with U.S. Based on Less Talk, More Vision." *Associated Press* 9 April 2001.

www.wto.org. 12 December 2001.

Faculty Comments:

Ms. Walker's faculty mentor, Gary D. Ferrier, had high praise for her work. He said:

Economists have long recognized that trade is beneficial as it allows trading parties to specialize in their areas of comparative advantage, thus increasing total production of goods and services as well as consumption. In the latter part of the 20th century, numerous international agreements were entered into to facilitate trade. However while society as a whole gains from open trade, some individuals or groups may lose in the short run and thus have incentives to limit trade. International trade agreements typically provide means to dispute restrictions on trade. In spite of this, trade dispute resolution is often a long, drawn-out affair that ends ambiguously.

Ms. Walker's thesis examines the trade dispute resolution mechanism that existed under the General Agreement on Tariffs and Trade as well as those that exist under the GATT's successor, the World Trade Organization. Her conclusion is that the mechanisms are ineffective.

Ms. Walker's honors research carefully walks readers through the tedious dispute resolution mechanisms of the GATT and WTO and discusses the shortcomings of the mechanisms. Ms. Walker then illustrates the ineffectiveness of the GATT and WTO dispute settlement mechanisms with examples of disputes between the United States and the European Union. Finally, Ms. Walker offers recommendations on how to improve both the timeliness and credibility of dispute resolution.

Overall, Ms. Walker's research offers a clear and concise overview and critique of the status quo with regard to the resolution of trade disputes and offers some compelling means for improving the process.

Professor of Accounting Deborah W. Thomas sees Ms. Walker's work as affecting taxation. She says:

I first met Erin Walker when I served as a faculty sponsor for the first group of Bodenhamer Fellows on their trip to Washington, D.C. Ms. Walker's performance during the past four years has proved that her selection as a Bodenhamer Fellow was well deserved. She has tackled intellectual challenges by pursuing two majors in different colleges while maintaining high academic standards. Ms. Walker was a student in my Fundamentals of Taxation class last year, in which I was able to observe her work ethic and academic ability first hand. She has been a student leader, both within the Walton College as a Student Ambassador and for the University in student government. Ms. Walker has been a valuable member of the University of Arkansas community.

Ms. Walker's choice of thesis topic reflects her interest in both business and international relations. She is investigating the effectiveness of the World Trade Organization in dealing with international trade disputes. Ms. Walker focuses on recent cases, particularly the case between the United States and the European Union over banana trade, to evaluate the WTO procedures for resolving disagreements. This is an important topic as the global economy expands and more friction develops among the domestic interests of participating countries. In the area of taxation, this has been seen most recently with a WTO ruling requiring that the United States revise its international tax system.

Hoyt Purvis, Professor of International Relations, is also interested in Ms. Walker's work. He remarks:

I am pleased to be working with Erin Walker on her undergraduate honors research project on trade disputes between the United States and the European Union and the role of the World Trade Organization.

Ms. Walker has chosen a topic that in some respects brings together her unique combination of academic interests: accounting and international relations, with an additional concentration in European Studies.

She has identified and tackled a difficult but important topic and has gone about it in her usual thoughtful, serious, and persistent manner. I have been impressed by the way in which she has immersed herself in the complexity of regulatory issues involving the World Trade Organization and various issues in dispute between the United States and the European Union. She has been able to develop a good understanding of how these issues develop and what means there are for dealing with them as well as some of the implications for the future of U.S.-European economic relations.

Erin Walker has excelled as a student and has been willing to take on challenging subjects, as is evident from this research project. I am confident that the final product of Ms. Walker's work will represent a significant contribution to understanding what is involved in these trade disputes, the role of the WTO, and what all this could mean for the future of trade and economic relations between the United States and the European Union.