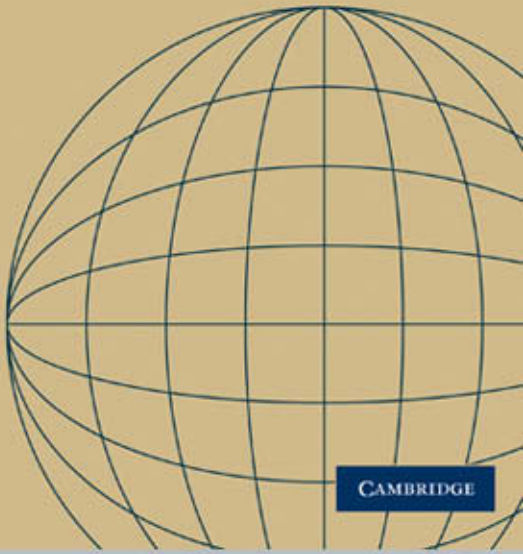
ALI

The WTO CASE LAW of 2009

LEGAL AND ECONOMIC ANALYSIS

Edited by
Henrik Horn and Petros C. Mavroidis



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This book is the seventh report of the American Law Institute (ALI) project on World Trade Organization Law. The project undertakes yearly analysis of the case law from the adjudicating bodies of the WTO. These studies cover a wide range of WTO law: this volume focuses on the year 2009. Each case is jointly evaluated by well-known experts in trade law and international economics. The contributors critically review the jurisprudence of WTO adjudicating bodies and 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 interpretation of the law or in the law itself. The studies do not cover all issues discussed in a case, but they seek to discuss both the procedural and the substantive issues that form the 'core' of the dispute.

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Foreword

This is the seventh volume analyzing legal decisions of the World Trade Organization for publication by The American Law Institute (ALI) and the Cambridge University Press. The WTO decisions, most of them from the Appellate Body, demonstrate a gradual process of creating trade law doctrine that applies one of the world's most important treaties to significant economic disputes. We believe that the contributions made by economists and lawyers in describing and criticizing the WTO's outcomes and the reasoning that supports them are a step toward the establishment of a body of international law that is now, and will increasingly be, essential to a world economy based on huge cross-border trade. Our books have now analyzed all the important WTO decisions issued in the first decade of the twenty-first century.

The ALI is also at work on books that propose governing principles for trade law. In 2008, we published *The Genesis of the GATT*, by Professors Douglas A. Irwin, Petros C. Mavroidis, and Alan O. Sykes. In the next year, we expect to publish a comprehensive analysis of the principle of nondiscrimination in international trade, with particular attention to the economics of trade agreements. The volume will discuss nondiscrimination with regard to both border instruments (GATT Article I) and domestic instruments (GATT Article III (national treatment)).

We appreciate the intellectual and administrative leadership of Professors Henrik Horn and Petros Mavroidis, the creative scholarship of the authors of these essays, the valuable comments and criticisms from expert professors and engaged professionals, and the financial support we have received from The Jan Wallander and Tom Hedelius Foundation and from the Milton and Miriam Handler Foundation.

Lance Liebman
Director
The American Law Institute

Introduction

HENRIK HORN AND PETROS C. MAVROIDIS

This volume contains five reports on the World Trade Organization (WTO) case law of 2009, written in the context of the American Law Institute (ALI) project *Legal and Economic Principles of World Trade Law*, which aims to provide systematic analysis of WTO law based on both economics and law. Each report in the volume is written jointly by an economist and a lawyer, and each discusses a separate WTO dispute. The authors are free to choose the particular aspects of the dispute they wish to discuss. The aim is to determine for each dispute whether the Appellate Body's (or occasionally the Panel's) decision seems desirable from both an economic and a legal point of view, and, if not, whether the problem lies in the interpretation of the law or the law itself.

Earlier versions of the papers included in this volume were presented at a meeting in Geneva in June 2010, and we are very grateful for the comments at the meeting provided by Robert L. Howse and Frieder Roessler. We would also like to thank all of the other meeting participants for providing many helpful comments, and the WTO for providing a venue for the meeting.

Our sincere thanks also go to The American Law Institute, particularly to Director Lance Liebman, President Roberta Cooper Ramo, former President Michael Traynor, Deputy Director Stephanie Middleton, and former Deputy Director Elena Cappella, all of whom have been instrumental in bringing this project about. We would further like to express our gratitude to Nina Amster, Judy Cole, Todd David Feldman, Sandrine Forgeron, and Marianne Walker of the ALI's staff for providing very efficient administrative and editorial help. Finally, we are extremely grateful for financial support from the Milton and Miriam Handler Foundation, The Jan Wallander and Tom Hedelius Research Foundation, Stockholm, and the WTO Secretariat (especially Alejandro Jara and Patrick Low) for helping us with the organization of the meeting at the WTO headquarters.

Turning to the content of the volume, the year of 2009 saw relatively few disputes being adjudicated and then coming to an end. As always, anti-dumping was a common theme among those that did, and the zeroing issue was raised again in these disputes. In their paper, **Hoekman** and **Wauters** review the WTO Appellate Body (AB) Reports on *United States–Zeroing* (*Article 21.5 DSU – EC*), and *United States–Zeroing* (*Article 21.5 DSU – Japan*). The AB found that the United States had not brought its anti-dumping measures into compliance with the WTO Anti-Dumping Agreement as it continued to use zeroing in annual reviews of

anti-dumping orders. The authors argue that this conclusion – based on a complicated discussion of what constitutes a 'measure taken to comply' – could have been reached through a much simpler and more direct argument. Continued noncompliance by the United States generates costs to traders targeting the United States and the trading system more generally. They further argue that, from a broader WTO compliance perspective, consideration should be given to stronger multilateral surveillance of anti-dumping practice by all WTO members and to more analysis and effective communication by economists regarding the costs of zeroing and anti-dumping practices more generally.

The zeroing methodology is also discussed in the contribution by **Prusa** and **Vermulst** in their comment on *United States – Continued Existence and Application of Zeroing Methodology*. They note that this is the eighth AB Report in which some aspect of zeroing was adjudicated. As in the prior cases, the AB again found the US practice inconsistent with several aspects of the WTO Anti-Dumping Agreement. The authors point out that the novelty in this dispute was the EC attempt to broaden the concept of what constitutes an appealable measure. The EC challenged whether a WTO decision regarding zeroing could apply to subsequent proceedings that might modify duty levels, and it asked the AB to decide whether the United States' continued use of zeroing in the context of a given case was consistent with WTO obligations. The AB stated that in its attempt to bring an effective resolution to the zeroing issue, the EC was entitled to frame its challenge in such a way as to bring the ongoing use of the zeroing methodology in these cases under the scrutiny of WTO dispute settlement. The AB then cautiously applied the new perspective to US zeroing practice.

Other disputes raised more novel issues. For instance, the Panel Report on *China–Intellectual Property Rights* was the first Report focusing on China's policies with respect to enforcement of intellectual property rights. The Report, discussed by **Saggi** and **Trachtman**, addressed three main issues: first, the relationship between China's censorship laws and its obligations to protect copyright under the WTO Agreement on Trade Related Intellectual Property Rights (TRIPS); second, China's obligations under TRIPS to ensure that its customs authorities are empowered to dispose properly of confiscated goods that infringe intellectual property rights; and, third, whether China's volume and value-of-goods thresholds for application of criminal procedures and penalties with respect to trademark counterfeiting or copyright piracy comply with TRIPS requirements for application of criminal procedures and penalties. In the authors' view, international trade agreements are generally intended to cause states to internalize policy externalities. The policy externalities that arise from domestic decisions regarding intellectual property protection may deprive foreign intellectual property owners of the monopoly profits that they would otherwise derive from intellectual property protection. In connection with intellectual property protection, even a state that lacks 'traditional' market power on world markets may be able to impose terms-of-trade externalities on other states by reducing its protection

of intellectual property below the global optimum. For this reason, and because of the international public-goods aspects of intellectual property, states have incentives to undersupply intellectual property protection. At least in part, TRIPS seems to be an attempt to reduce these policy externalities. All contracts, and all international treaties, are incomplete. This case involves, in the authors' view, some good examples of treaty incompleteness. Incompleteness can arise from circumstances of uncertainty regarding the possible tradeoffs, and the optimal balance, between different goals, including state autonomy in censorship on the one hand and internalizing policy externalities in intellectual property protection on the other. The authors analyze the possibility that it might be efficient to allow states broad discretion over censorship. Alternatively, in connection with the requirement for criminal penalties, incompleteness can arise from uncertainty regarding the particular industry structure that might be involved, and what would constitute production of 'commercial scale' for that industry. The authors also question the rationale for the limitation on the use of nonviolation complaints in connection with the TRIPS, since nonviolation complaints may be used to reduce the possibility that states will use discretion, such as that granted with respect to censorship, in a manner that is inconsistent with the rationale for that discretion – so as to defect from the general commitment to provide copyright or other intellectual property rights.

Another highly interesting dispute was *China–Publications and Audiovisual Products*, where a series of Chinese restrictions on the importation and distribution of certain 'cultural' or 'content' goods and services were found to violate GATT, GATS, and China's Accession Protocol. The AB Report in this dispute is analyzed by **Conconi** and **Pauwelyn**. The authors review the definition of what is a 'good' (is a 'film' a good or a service?) and the extent to which GATT Article XX exceptions can justify violations under WTO instruments other than the GATT itself. In the case at hand, the issue was whether this GATT provision could serve as an exception justifying deviations from obligations assumed under the Chinese Protocol of Accession. This was the first time that WTO adjudicating bodies had to address this particular issue. The authors argue that trade volumes are unlikely to rise significantly as a result of this ruling, as it does not affect China's right to keep out foreign films and publications if China finds them objectionable. However, foreign producers of audiovisuals can now gain potentially large economic rents by being able to export and distribute their products into the Chinese market. Finally, the authors discuss the issue of the protection of cultural goods and review the recent literature on trade and culture that has put forward economic arguments to justify, under some conditions, the protection of cultural goods. The authors include in their comment an extensive discussion of the AB findings regarding violations of China's Protocol of Accession, an issue that is gaining pace in WTO dispute-settlement practice.

Grossman and **Sykes** discuss the Report on *United States – Subsidies on Upland Cotton* (*Recourse to Arbitration by the United States under Article 22.6 of the*

DSU and Article 4.11 and Article 7.10 of the SCM Agreement). In the authors' view, the case raises a range of interesting issues regarding the rationale for retaliation in the WTO system and the proper approach to its calibration. The authors entertain the following questions in this context: Should the approach to retaliation differ in cases involving prohibited or actionable subsidies? When should cross-retaliation be allowed? Should retaliation be based only on the harm to the complaining nation, or to other nations as well? And, most importantly, what economic content can be given to the standard of countermeasures 'equivalent to the level of nullification or impairment'? Grossman and Sykes point to a number of puzzling features of the DSU. For instance, the fact that the DSU allows WTO members to maintain illegal measures for an extended period of time without suffering any formal sanction suggests that the system is designed neither to 'ensure compliance', nor to ensure 'efficient compliance' (and its corollary 'efficient breach'). Furthermore, they see no economic rationale in using the amount of the subsidy as a basis for determining the amount of retaliation; nor do they see any valid economic reason why the approach to retaliation should differ in subsidies cases generally, or in prohibited-subsidies cases in particular. But Grossman and Sykes identify certain restrictive assumptions under which it makes economic sense to allow the retaliator to reduce the value of its imports by an amount equal to the value of its lost exports due to the violation. At the same time, the authors note that the use of prohibitive tariffs for purposes of retaliation is puzzling, as these tariffs cannot in general restore lost welfare for the complainant – nonprohibitive tariffs that enhance the terms of trade seem to make more sense. Their analysis suggests that the same information required to compute the nonprohibitive tariffs that will produce an equal trade-volume effect could instead be used to compute the tariffs that would offset the terms-of-trade loss due to the violation. Such an approach seemingly holds more promise as a way to approximate the level of retaliation that would restore the welfare of the complainant.

US Compliance with WTO Rulings on Zeroing in Anti-Dumping

United States–Zeroing (EC); United States–Zeroing (Japan)
Article 21.5 DSU Implementation Reports

BERNARD HOEKMAN
World Bank and CEPR
JASPER WAUTERS

Abstract: This paper reviews the WTO Appellate Body Reports on *United States–Zeroing (EC)* (Article 21.5 DSU – EC) (WT/DS294/AB/RW, 14 May 2009) and *United States–Zeroing (Japan)* (Article 21.5 DSU – Japan) (WT/DS322/AB/RW, 18 August 2009). The Appellate Body found that the United States had not brought its anti-dumping measures into compliance with the WTO Anti-Dumping Agreement as it continued to use zeroing in annual reviews of anti-dumping orders. We argue that this conclusion – based on a complicated discussion of what constitutes a 'measure taken to comply' – could have been reached through a much simpler and direct argument. Continued noncompliance by the United States generates costs to traders targeting the United States and the trading system more generally. We argue that from a broader WTO compliance perspective consideration should be given to stronger multilateral surveillance of anti-dumping practice by all WTO members and to more analysis and effective communication by economists regarding the costs of zeroing and anti-dumping practices more generally.

Introduction

This paper reviews the WTO Appellate Body (AB) Reports on *United States–Zeroing (EC)* (Article 21.5 DSU – EC) (WT/DS294/AB/RW, 14 May 2009)[1] and *United States–Zeroing (Japan)* (Article 21.5 DSU – Japan) (WT/DS322/AB/RW,

The paper is a contribution to The American Law Institute project on the case law of the WTO, led by Henrik Horn and Petros Mavroidis. We thank Marco Bronckers, Chad Bown, and Tom Prusa for helpful discussions and Henrik Horn, Rob Howse, Petros Mavroidis, and participants in the June 7, 2010 American Law Institute conference in Geneva for comments on the first draft. The views expressed are personal and should not be attributed to our employers.

1 Appellate Body Report, *United States – Laws, Regulations and Methodology for Calculating Dumping Margins ('Zeroing') – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS294/AB/RW and Corr.1, adopted 11 June 2009.

18 August 2009).[2] These disputes concerned the manner in which the United States implemented – or failed to implement – the WTO rulings relating to the prohibition of zeroing in anti-dumping investigations and reviews. The main legal issue dealt with in these compliance cases was what prospective implementation means in the context of a retrospective system of administering anti-dumping measures.

As the United States is the only country with such a system, the Reports are very specific to the US situation and are limited to the question of implementation in the context of anti-dumping measures. The Reports are nonetheless of interest in that they provide further insight into the approach taken by the AB in assessing compliance with WTO rulings. In the two Reports, the AB found that the United States was not in compliance, in that any action taken after the expiry of the 'reasonable period of time' (RPT) for implementation of previous AB Reports, whether a legal determination of the amount of duties due or the simple collection of duties, must be consistent with the WTO Anti-Dumping (AD) Agreement.

In what follows, we first summarize the disputes (Section 1), the Panel Reports (Section 2), and the appeals and the AB Reports (Section 3). In Section 4, we discuss the reasoning in the AB Reports. We argue that the Appellate Body conclusion could have been reached in a much more direct way rather than after a lengthy and unnecessarily complicated discussion of what constitutes a 'measure taken to comply'. Given extensive prior analysis of the technical aspects of zeroing, in Section 5 we focus on the available evidence on the economic impact of (continued) US zeroing. As the practice potentially affects all exporters to the United States, we argue that the chilling effect of continued use of zeroing may be nontrivial. Moreover, continued use of zeroing can be expected to lead to both WTO-legal retaliation in the future by affected WTO members and, potentially more important, emulation by other countries. As anti-dumping is increasingly used by developing countries, we argue that from a broader WTO compliance perspective consideration should be given to strengthening multilateral surveillance of anti-dumping practice around the world to make the effects of zeroing and other methodologies on anti-dumping margins more transparent. Section 6 concludes.

1. The dispute

This dispute concerns the manner in which the United States implemented a number of rulings by the WTO in respect of the use of zeroing in anti-dumping investigations and reviews. In the context of the dispute known as *US–Zeroing (EC)*, the European Union (the 'EU') challenged the use of zeroing both as such, and as applied by the United States in the specific context of a large number of original investigations and reviews relating to different products from the EU. The

2 Appellate Body Report, *United States – Measures Relating to Zeroing and Sunset Reviews –Recourse to Article 21.5 of the DSU by Japan*, WT/DS322/AB/RW, adopted 31 August 2009.

dispute known as *US–Zeroing* (*Japan*) concerned a similar challenge by Japan of the use of zeroing as such, and as applied by the United States in the context of a number of original investigations and reviews relating to a number of steel-related products such as ball bearings from Japan.

The question of zeroing has been at the heart of many Panel and Appellate Body Reports. It essentially relates to the way in which dumping margins are calculated in the context of anti-dumping measures. In order to determine whether a product has been dumped, the export price of the product will be compared to its normal value, which is the comparable price for which the like product is sold in the ordinary course of trade on its domestic market. This comparison will normally involve a large amount of transactions. When 'zeroing', an investigating authority will not allow transactions in which the export price was actually equal to or higher than the normal value (no dumping) to offset the transactions in which the export price was below the normal value (dumping). In other words, if there are 100 transactions, 50 of which are dumped because the export price is 10 % lower than the normal value and 50 of which are not dumped because the export price is 20 % higher than the normal value, dumping will be found to exist, even though, on average, the margin of dumping was below zero. The margin of dumping will be determined on the basis of the first 50 transactions, as a 'zero' margin will be assigned to the latter 50 transactions, even though their margin was actually negative (–20 %). As negative margins cannot be used to offset positive margins, a finding of dumping is more likely and the amount of the margin of dumping will be inflated.

The Panel in its Report on *US–Zeroing* (*EC*) found that the United States had acted inconsistently with Article 2.4.2 AD Agreement as regards the 15 original investigations at issue. The Panel considered that this was so because 'USDOC [US Department of Commerce] did not include in the numerator used to calculate weighted average dumping margins any amounts by which average export prices in individual averaging groups exceeded the average normal value for such groups'.[3] The Panel also found that, in the context of original investigations, the zeroing methodology as such, and thus independent of any specific application, was inconsistent with Article 2.4.2 AD Agreement.[4] However, the Panel considered that zeroing was permissible in the context of administrative reviews. The AB reversed the Panel on this and held that by using zeroing in the administrative reviews, the USDOC had violated Article 9.3 AD Agreement and Article VI:2 GATT.

3 Panel Report, *United States – Laws, Regulations and Methodology for Calculating Dumping Margins* ('*Zeroing*'), WT/DS294/R, adopted 9 May 2006, as modified by Appellate Body Report, WT/DS294/AB/R, DSR 2006:II, 521 (*US–Zeroing* (*EC*)), para. 7.32. Furthermore, having adjudicated the claims of the EC under Article 2.4.2 AD Agreement, the Panel considered it unnecessary to rule on its claims under Article 2.4 AD Agreement.

4 Panel Report, *US-Zeroing* (*EC*), para. 7.106.

Similar issues arose in the *US–Zeroing* (*Japan*) case, where the Panel found that the use of zeroing in the context of weighted-average-to-weighted-average comparisons ('model zeroing') by the USDOC in the context of original investigations is 'as such' inconsistent with Article 2.4.2 AD Agreement because the dumping margin so calculated does not take into account all comparisons between the normal value and the export price. The Panel also held that by applying model zeroing in the anti-dumping investigation of imports of certain cut-to-length carbon-quality steel products from Japan, the United States had infringed Article 2.4.2 AD Agreement. This aspect of the Panel's findings was uncontroversial.

In respect of zeroing in the context of transaction-to-transaction comparisons ('simple zeroing'), the Panel considered that this could be permissible and was overturned on appeal. The AB found that zeroing while using the transaction-to-transaction comparison method in original investigations is inconsistent with Article 2.4.2 AD Agreement:

> In the light of our analysis of Article 2.4.2 of the Anti-Dumping Agreement, we conclude that, in establishing 'margins of dumping' under the T–T comparison methodology, an investigating authority must aggregate the results of all the transaction-specific comparisons and cannot disregard the results of comparisons in which export prices are above normal value.[5]

Therefore, it held that the USDOC violated Article 2.4.2 AD Agreement by using zeroing in the transaction-to-transaction comparison method in original investigations.[6]

The AB reversed the Panel's findings in respect of the permissibility of zeroing in the context of reviews, ruling that zeroing is not permitted in the context of any type of review. In particular, the AB found that the United States had violated Articles 9.3 and 9.5 AD Agreement and Article VI:2 GATT by maintaining simple zeroing in *administrative reviews* (also known as 'periodic reviews') and *new-shipper reviews*.[7] The AB also held that zeroing in administrative and new-shipper reviews is inconsistent with the fair-comparison requirement of Article 2.4 AD Agreement. As a result, it held that the United States had acted in contravention of its WTO obligations by applying simple zeroing in the 11 administrative reviews in

5 Appellate Body Report, *United States – Measures Relating to Zeroing and Sunset Reviews*, WT/DS322/AB/R, adopted 23 January 2007, DSR 2007:I, 3 (*US–Zeroing* (*Japan*)), para. 137.

6 The Appellate Body also found that this method of dumping-margin calculation is not unbiased or even-handed and accordingly zeroing in transaction-to-transaction comparisons violates the fair-comparison requirement. Consequentially, the Appellate Body reversed the Panel's decision in this regard and held that the United States infringed Article 2.4 AD Agreement by maintaining simple zeroing in original investigations.

7 The Appellate Body considered that dumping and dumping margins can only exist at the level of a product and that this equally prohibits zeroing in administrative reviews as the dumping margin acts as a ceiling for the total amount of anti-dumping duties that can be collected in any type of duty-assessment system.