

## Concept paper

*This paper is intended to serve as a basis for discussion with the European Parliament, the Council and with other Members of the WTO, in response to the conclusions of the European Council of 28 June 2018, which invited the European Commission to propose a comprehensive approach to improving together with like-minded partners, the functioning of the WTO in crucial areas, including the dispute settlement and the Appellate Body in particular (paragraph 16 of the conclusions). **It is without prejudice to the final position of the European Commission on the matters described within.***

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### WTO modernisation

#### Introduction to future EU proposals

The European Council of 28-29 June 2018 gave the Commission a mandate to pursue WTO modernisation in pursuit of the objectives of making the WTO more relevant and adaptive to a changing world, and strengthening the WTO's effectiveness.

The EU remains a staunch supporter of the multilateral trading system and firmly believes that the WTO is indispensable in ensuring free and fair trade. The multilateral system has provided the basis for the rapid growth of economies around the world and for the lifting of hundreds of millions of people out of poverty. It has been the guarantor of trade at times of growing tensions and the backbone of the international system of economic governance. Even at a time of the harshest economic conditions during the great recession, it has helped avert recourse to the trade wars that have fuelled economic decline in the past. As such the health and centrality of the multilateral system needs to be preserved. Its marginalisation, weakening and decline have to be prevented at all costs.

Unfortunately, the rules-based multilateral trading system is facing its deepest crisis since its inception. For the first time, the basic tenets of the WTO, both in setting the essential rules and structure for international trade and in delivering the most effective and developed dispute settlement mechanism of any multilateral organisation, are threatened.

The crisis is set to deepen further in the coming months, as more unilateral measures are threatened and imposed, leading, in some cases, to countermeasures, or to mercantilist deals. In parallel, as more Appellate Body members leave office while the new appointments are being blocked, the dispute settlement system will soon fall into paralysis, rendering enforcement of the rules impossible. That would equate to a 20-year step backward in global economic governance. It would mean going back to a trading environment where rules are only enforced where convenient and where strength replaces rules as the basis for trade relations.

This development constitutes a major risk for the EU, both for the stability of the political order and for the sustainability of economic growth. The EU economy is highly integrated with global value chains and depends on predictable, rules-based international trade for both imports and exports.

For this reason, there is an urgent need to move the current debate on a positive path focusing on the modernisation of the WTO. It is clear that 23 years after the creation of the organisation and the conclusion of the Uruguay Round, the multilateral system is in need of change. While the broader WTO membership may have different views regarding the particularities of this change, it is unquestionable that a discussion needs to take place on the question of how to make the WTO relevant again.

For the EU, the current crisis and the ongoing marginalisation of the WTO have their roots in the inefficiencies of the current system. The WTO's negotiating function has not been able to deliver any significant improvements in the trade rulebook apart from the agreements reached on Trade

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Facilitation and Export Competition. The system remains blocked by an antiquated approach to flexibilities which allows over 2/3 of the membership including the world's largest and most dynamic economies to claim special treatment. The WTO's monitoring function is crippled by ineffective and repetitive committee procedures which are based on insufficient transparency. And, the core of the dispute settlement system is being challenged, with the distinct possibility of its paralysis in the near term. These problems are compounded by the broader geo-strategic developments. In essence, since 1995 the world has changed; the WTO has not.

In this broader context, the EU believes that a modernisation of the WTO is urgently needed. The following three papers covering (1) rulemaking and development; (2) regular work and transparency; and (3) dispute settlement set out the direction of a possible modernisation effort.

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### WTO modernisation

#### Future EU proposals on rulemaking

##### ***Background***

The European Council of 28-29 June 2018 gave the Commission a mandate to pursue WTO modernisation in pursuit of the objectives of (1) making the WTO more relevant and adaptive to a changing world, and (2) strengthening the WTO's effectiveness. Modernising the WTO's rulemaking activities form the central pillar of this process.

##### **Broader context and the focus of EU efforts**

The WTO also has the objective of facilitating rulemaking. Unfortunately, this has only materialised to a very limited extent. Despite an institutional structure designed to help advance discussions, the WTO's negotiating function has largely been blocked and is now effectively paralysed. There are multiple reasons for this situation including, in particular, divergent interests, the extreme difficulty in arriving at consensus decisions by all 164 Members and the current approach on development. In this context, any modernisation discussion has to cover both the substantive side and the process side of negotiations.

##### **Overall objective for modernisation**

The objective is to update the rules and to create the conditions for the rules to be updated. In practice this means:

- Substance: address issues that are key to global trade as it evolves.
- Process: move the organisation towards a model of negotiations where individual issues can be built up by interested Members under the auspices of the WTO toward eventual agreement by some or all Members forming integral part of the WTO framework .

##### ***Future proposals***

###### **I. Proposals for future rulemaking activities in the WTO**

While the EU should continue to pursue the issues that form part of the existing Doha mandate, there is an urgent need to broaden the negotiating agenda with the objective of creating rules that: rebalance the system and level the playing field; address market access, discrimination and regulatory barriers in all sectors of the economy; and strengthen the contribution of trade to addressing the sustainability objectives of the global community. This should build upon a number of initiatives already launched in Buenos Aires to reduce the costs of trade and go together with a broader reflection on development.

###### **A. Creating rules that rebalance the system and level the playing field**

Economic operators in a number of countries increasingly benefit from targeted and significant market-distorting government support that is often channelled through state-owned enterprises. While the provision of industrial subsidies can in certain cases constitute a legitimate policy tool, their use may also carry significant risks for global trade as they can disrupt production processes, affect business performance and skew the competitive field. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) is the main tool for disciplining industrial subsidies. However, it has not been as effective as necessary to curtail certain practices that have emerged in

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recent years. Indeed, its application has revealed a number of gaps and ambiguities that need to be addressed as a matter of urgency.

In this context the EU should pursue the following proposals aimed at disciplining the use of industrial subsidies and the activities of state-owned enterprises.

### **i. Improve transparency and subsidy notifications**

The lack of comprehensive information on subsidies provided by Members is one of the biggest shortcomings in the application of the current system. Although the SCM Agreement already requires Members to notify their subsidies, the level of compliance is poor and has deteriorated in recent years, to the extent that as of end of March 2018 over half of the membership (90 Members) had not made any notification<sup>1</sup>. Yet, without transparency in subsidies, Members cannot review each other's actions and face significant obstacles in seeking enforcement of the rules. This greatly weakens the value of the substantive disciplines.

The rulemaking in this area should focus on creating incentives for WTO Members to fully comply with their notification obligations. The EU has already identified ways to improve transparency and subsidy notifications<sup>2</sup>, for example, the creation of a general rebuttable presumption according to which if a subsidy is not notified or is counter-notified, it would be presumed to be a subsidy or even be presumed to be a subsidy causing serious prejudice.

### **ii. Better capture SOEs**

State-owned enterprises (SOEs) are, in a number of countries, an instrument through which the state decisively governs and influences the economy, often with market distortive effects. However, the growth and influence of SOEs in recent years is not yet matched with equivalent disciplines to capture any market-distorting behaviour under the current rules.

Subsidies granted to SOEs are already captured by the SCM Agreement, in the same way as any other subsidy granted by the state. With regard to instances where SOEs themselves grant subsidies, the SCM Agreement captures them through the concept of a "public body". However, this has been interpreted in a rather narrow manner, which allows a considerable number of SOEs to escape the application of the SCM Agreement. The EU therefore should propose a clarification of what constitutes a public body, on the basis of a case by case analysis to determine whether a state-owned or a state-controlled enterprise performs a government function or furthers a government policy, as well as how to assess whether a Member exercises meaningful control over the enterprise in question.

In addition, the EU should propose rules capturing other market-distorting support provided by SOEs when used as vehicles to pursue government economic policies rather than focusing on their own economic performance, including inter alia, transparency with regard to the level and degree of state control in SOEs.

### **iii. Capture more effectively the most trade-distortive types of subsidies**

The SCM Agreement provides for two categories of prohibited subsidies, namely subsidies contingent upon export performance and subsidies contingent upon the use of domestic over imported goods. All other subsidies are actionable: they are permissible, unless the complaining country shows that the subsidy had an adverse effect on its trade interests. However, the latter is

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<sup>1</sup> Document G/SCM/W/546/Rev.9

<sup>2</sup> Document TN/RL/GEN/188

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quite often a challenging exercise and therefore a number of egregious types of subsidies that heavily distort international trade, such as those contributing to the overcapacity plaguing several sectors of the economy, cannot be captured sufficiently under the current rules.

The rulemaking in this area should aim at subjecting the most harmful types of subsidies that are in principle permissible under the current rules to stricter rules. This could be achieved for example by expanding the list of prohibited subsidies or by creating a rebuttable presumption of serious prejudice similar to the lapsed Article 6(1) of the SCM Agreement. Types of subsidies that could be subject to such stricter rules include, for example, unlimited guarantees, subsidies given to an insolvent or ailing enterprise with no credible restructuring plan or dual pricing.

### **B. Establishing new rules to address barriers to services and investment, including in the field of forced technology transfer**

Following the Joint Statements agreed in Buenos Aires, work is already ongoing in the areas of domestic regulation, e-commerce and investment facilitation but further efforts will be needed to address gaps and to update the WTO rule book.

#### **i. Need to address market access barriers, discriminatory treatment of foreign investors and behind the border distortions, including as they relate to forced technology transfer and other trade distortive policies**

The multilateral rule-book on investment, whether in services or other sectors of the economy, needs to be updated. The GATS covers investment in the area of services via Mode 3. Nonetheless, many WTO Members still maintain broad reservations or exclusions. Sectors outside of services (such as investment in manufacturing or mining) are not covered (although services incidental to mining and incidental to manufacturing are covered). The TRIMS only contains a limited set of disciplines relating to discriminatory measures/quantitative restrictions regarding trade in goods.

Forced technology transfer, where foreign operators are directly or indirectly forced to share their innovation and technology with the state or with domestic operators, has emerged as a major trade irritant. There are a number of provisions in the current WTO rule book in GATT, GATS, TRIMS and TRIPS, that should help to address forced technology transfers. However, the scope of application of these provisions (including in terms of commitments taken by the parties) is limited and therefore insufficient to address some of the most important sources of problems such as requirements prohibiting or limiting foreign ownership (e.g. joint venture requirements or foreign equity limitations). New rules are also needed to address administrative review and licensing processes based on unclear rules, and processes allowing for wide discretion (e.g. marketing approvals) as well as licensing restrictions (where foreign investors are limited in setting market-based terms when negotiating their technology licensing agreements). Certain rules in areas such as trade secrets should also be reinforced, notably as regards enforcement. For example, investors are faced with difficulties to get effective protection before the administration and courts against unfair commercial use and unauthorised disclosure of trade secrets.

Thus, besides the specific rules to address forced technology transfers, the EU should propose new rules that would complement the existing disciplines. The new rules would introduce disciplines that would enable us to improve overall market access conditions for foreign direct investment (both in the services and non-services sectors) as well as address distortive and discriminatory practices including legal form restrictions and performance requirements (such as the sourcing or production of goods or services locally) in a more comprehensive manner.

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There is also a clear need to address behind the border discriminatory practices by reinforcing national treatment obligations and developing strong domestic regulation disciplines ensuring non-discriminatory and transparent regulatory and enforcement processes in the services and non-services sectors.

### **ii. Need to address barriers to digital trade**

Digital trade, or trade enabled by electronic means, is nowadays pervasive throughout the economy, covering both trade in services and in goods and enabling transactions performed completely online as well as facilitating physical transactions. As a consequence, establishing disciplines covering digital trade is important to remove unjustified barriers to trade by electronic means, to bring legal certainty for companies, and to ensure a secure online environment for consumers. Crucially, there are important cross-linkages to addressing forced technology transfers (such as disclosure of source code requirements). Again, new disciplines should cover not only trade in services, but apply to all economic sectors.

### **C. Addressing the sustainability objectives of the global community**

Finally, it is crucial to bring the WTO and its trade agenda closer to citizens and ensure that trade contributes to the pursuit of broader objectives set by the global community, in particular as regards sustainability. The Sustainable Development Goals agreed by the world's leaders in 2015 already set out a detailed set of actions that need to be pursued, many of them with strong links to trade.

At the current moment, the only SDG issues that is actively being negotiated in the WTO is the elimination of the most harmful fisheries subsidies, which is however also an area of negotiations clearly mandated by the Doha Declaration. More can and should be done by the trade community.

Consequently, the EU should over the coming months prepare a detailed analysis of the SDG targets and identify ways in which trade policy could contribute to achieving them. The EU should then together with other Members actively pursue putting forward these issues for exploration and discussion in the WTO.

### **II. Proposals for a new approach to flexibilities in the context of development objectives**

The WTO was founded with development at its centre, underpinned by the fact that free rules-based trade contributes to growth and development. However, the current debate promotes the view that global trade rules are somehow an impediment to development and therefore that developing countries need to be exempt from current and future rules; in fact the opposite is true. The current distinction between developed and developing countries, which allows no nuance, no longer reflects the reality of the rapid economic growth in some developing countries. The result is that the developing country group now includes some of the world's top trading nations, who have significant economic differences from other members of this group and who in some cases even present a level of development which surpasses that of certain Members who are designated as developed in the organisation. This lack of nuance and its consequences with regard to the special and differential treatment question has been a major source of tensions in the WTO and an obstacle to the progress of negotiations: the demand for blanket flexibilities for two thirds of the WTO membership dilutes the call from those countries that have evident needs for development assistance, leads to much weaker ambition in negotiations and is used as a tool to block progress in, or even at the beginning of, negotiations.

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The EU fully supports the view that developing countries should be allowed the assistance and flexibilities they need to meet their development goals. Nevertheless, change is needed in the organisation regarding how flexibilities are crafted and implemented with a view to ensuring that flexibilities are made available to those Members who actually need them. In order to advance this debate, the EU should propose the following:

**(a) Graduation:** Members should be actively encouraged to "graduate" and opt-out of SDT, whether horizontally or agreement by agreement. In the interim, Members should be encouraged to clarify in which areas they actually use existing flexibilities and to present roadmaps detailing when they would expect to be able to assume all the obligations stemming from the WTO agreement. This could form an integral part of a Member's TPR process.

**(b) Special and Differential Treatment (SDT) in future agreements:** while acknowledging the need for particularly flexible treatment of LDCs, flexibilities available to other Members should move away from open-ended block exemptions toward a needs-driven and evidence-based approach that will ensure that SDT will be as targeted as possible. Various approaches can be used, which should satisfy the following principles:

- the agreement in question will eventually be *universally implemented*, so that the core rights and obligations will apply to everyone and any exceptions will be time-bound;
- *in-built flexibility* in the form of additional commitments going beyond a core set of provisions should cater for differences among Members
- the flexibilities available in any agreement should be *proportional* to the number of Members participating and the ambition of the agreement.

There are a number of tools that can be used to implement these proposals, for example, differentiation, graduation mechanisms, grace periods and assistance linked to implementation.

**(c) Additional SDT in existing agreements:** Though existing SDT provisions in current agreements should not be contested, when Members request additional SDT this should be done only on the basis of a case-by-case analysis, on the basis of:

- a clear identification of the development objective that is being affected by the rule in question;
- an economic analysis of the impact of the rule and of the expected benefits of its relaxation;
- an analysis of the impact of the requested flexibility on other WTO Members;
- a specification of the time period for which flexibility is requested and of its scope of application (one Member, a group of Members or all developing country Members).

Depending on the outcome of this analysis, various approaches can be used to consider additional flexibilities.

### **III. Proposals to strengthen the procedural aspects of the WTO's rulemaking activities**

The blockage of the WTO's negotiating function confirms the need for flexibility in terms of negotiating approaches. This reflects the concept of flexible multilateralism, where Members interested in pursuing a certain issue which is not yet ready for a full multilateral consensus, should be able to advance the issue and reach an agreement if its benefits are made available to all other Members on an MFN basis. However, other ideas should be explored as well with a view to strengthening the negotiating function and helping build political engagement and support for multilateral negotiations.

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In this regard, the EU should pursue the following issues:

- **Multilateral negotiations:** Maintain support for full multilateral negotiations and outcomes in areas where this is possible.
- **Plurilateral negotiations:**
  - In areas where multilateral consensus is unattainable, actively support and pursue plurilateral negotiations which should remain open to all Members to join and whose results will be applied on an MFN basis.
  - Explore the feasibility of amending the WTO agreement so as to create a new Annex IV.b. which would contain a set of plurilateral agreements that are applied on an MFN-basis and which could be amended through a simplified process.
- **Role of the secretariat:** the EU should put forward a proposal for a Ministerial Decision which strengthens the role of the WTO Secretariat in support of various negotiating processes as well as in the implementation and monitoring functions.
- **Building political support:** the EU should explore with other Members possible ways of building greater political support and engagement in the WTO, including possible options as to the frequency of Ministerial Conferences as well as ways of intensifying Senior Officials processes.

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### WTO modernisation

#### Future EU proposals on regular work and transparency

##### ***Background***

The European Council of 28-29 June 2018 gave the Commission a mandate to pursue WTO modernisation in pursuit of the objectives of (1) making the WTO more relevant and adaptive to a changing world, and (2) strengthening the WTO's effectiveness. Making the WTO's regular work and monitoring function more effective is a key component of this process.

##### ***Broader context and the focus of EU efforts***

With its negotiating function paralysed and its dispute settlement system challenged, the WTO post-MC11 is in an existential struggle to remain a credible basis for trade relationships. The so-called regular work in the WTO's councils and committees – i.e. the work that is neither related to negotiations nor dispute settlement – can be such a basis to some extent and does useful work, but its potential is generally underutilised. Making this regular work respond more effectively and efficiently to the real interests of stakeholders would help keep the WTO relevant at a time where solutions to the negotiating and dispute settlement functions are being sought.

##### ***Overall objective for modernisation***

The long-term objective is to enable the WTO to achieve more concrete results in terms of i) ensuring transparency about Members' trade measures, ii) solving specific trade concerns before they get to litigation state and iii) incrementally adjusting the WTO rulebook, where necessary.

##### ***Future proposals***

###### **I. Transparency and notifications**

A fundamental task of the WTO is to monitor whether Members implement the WTO agreements properly and whether they make their trade policies transparent by following WTO notification rules. This monitoring is done in the regular WTO councils and committees as well as the Trade Policy Review Body.

While the EU invests significant resources to make complete and timely notifications, several of our top trading partners do not comply sufficiently with notification obligations. As a result, their trade practices remain opaque, which makes it impossible to monitor compliance with WTO rules and seek their enforcement. Where EU firms cannot get the information on how to access markets, they cannot compete with domestic firms on an equal footing.

In order to remedy this long-standing problem, the EU proposes to improve or establish the following practices regarding notifications:

- More effective committee-level monitoring: All committees overseeing WTO agreements with notification obligations regularly review individual notifications and Members' general performance. These reviews, however, are not effective enough in closing gaps, partly because the Secretariat is not allowed to make qualitative assessments and Members are not held accountable to explain the reasons for their underperformance. The gaps are of particular concern in the area of trade in goods.

As a first step, the EU proposes that each committee overseeing notification obligations on trade in goods explores, under the oversight of the Council for Trade in Goods, how to make notification reviews more effective and interactive, e.g. by i) introducing a requirement for Members to explain reasons for delays and provide a substantive reply to comments; ii)

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allowing the Secretariat to make more qualitative assessments both on notifications and on replies to comments received; iii) publishing both comments on notifications and replies thereto on a single, public database managed by the WTO; and iv) putting non-compliant Members more on the spot in meetings as well as written reports. This could be complemented by a horizontal review of the situation under the authority of the DG.

- Incentives for improving notification compliance: The EU acknowledges that numerous WTO Members, particularly small developing countries, have limited resources for meeting notification obligations and deadlines. While acknowledging these constraints, it should be borne in mind that notifications form a central part of the monitoring processes of the WTO and may provide advantages to the notifying Member itself as it may contribute to stimulating reflection about administrative coherence domestically. Significant resources already exist for assisting Members who experience capacity constraints to meet their notification obligations, including in the form of WTO technical assistance.

The EU proposes to examine, together with other WTO Members and the WTO Secretariat, whether improvements in the provision of assistance are necessary. The EU also encourages making more use of workshops and dedicated informal discussions at committee level to share information and best practices, and to disseminate the results more widely. Further, improvements in a Member's notification practice should be showcased and lauded more in meetings, reports and TPRs.

- Sanctions for wilful and repeated non-compliance: A distinction needs to be drawn between, on the one hand, lack of capacity to prepare notifications and missing deadlines for a justifiable reason and, on the other hand, systematic obfuscation. The latter is a serious breach of the spirit and rules of the multilateral trading system but, at present, has no consequence for the Member in breach beyond being exposed to complaints by others.

The EU considers that instruments are needed to enforce notification compliance where capacity constraints are not the issue and proposes to work with other WTO Members, including the United States who recently made a proposal in this regard<sup>3</sup>, on developing sanctions which are effective, fair and commensurate. Such sanctions could include, inter alia, exposing non-compliant Members to stronger criticism at a political level and in public and limiting certain rights related to participation in WTO proceedings (e.g. chairing WTO bodies, seeking replies from other Members).

- Counter-notifications, i.e. notifications made by a Member on behalf of another, are a potentially powerful instrument available in various agreements. They are, however, hardly used, partly because preparing them requires a significant amount of research and intelligence.

The EU proposes to i) cooperate more with like-minded Members in preparing joint counter-notifications, ii) explore how the WTO Secretariat could be involved more, whilst guarding its neutrality towards Members, and iii) strengthen the consequences of a Member being subject to a counter-notification.

- Strengthening the Trade Policy Review Mechanism (TPRM): Even though the TPRM has no mandate to assess Members' compliance with WTO rules, it is a useful tool for peer pressure. Moreover, the vast amount of information on Members' trade policy measures which is gathered both through the reviews of individual Members and the biannual global trade monitoring reports feeds into the work of other committees. A particular asset is that the Secretariat can do its own research when preparing its reports and use information from

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<sup>3</sup> Communication from the United States: Procedures to enhance transparency and strengthen notification requirements under WTO Agreements (JOB/CTG/10/REV.1)

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other Members to highlight measures even if they have not been notified – provided that the Member under review does not object to this information being included in the report.

Bearing in mind that improvements to the functioning of the TPRM can only be negotiated during an appraisal of the TPRM (the last appraisal took place in 2016 and there is no date yet for the next one), the EU proposes to increase the effectiveness of the TPR exercise by empowering the Secretariat to go further in assessing notification performance in its report for a Member's review. The information on notifications could be expanded into a separate chapter and made more informative by systematically highlighting qualitative aspects of compliance and describing how the Member's notification performance has evolved since the last review.

### **II. Solving market access problems**

Raising awareness on trade irritants and seeking clarifications from the Member applying them is an essential part of the work of numerous committees. Despite the significant amount of time and resources that the EU and some like-minded Members put into raising these irritants, the outcomes are slim for a number of reasons. Most importantly, not giving satisfactory replies – or not giving a reply at all – does not have real consequences for a Member, beyond being put on the spot for the duration of the agenda point. The result is repetitive meetings in which speaking points get recycled.

The EU proposes to make the pre-litigation problem solving of the WTO more effective by:

- Developing rules that oblige Members to give substantive replies within specific timeframes to written questions by other Members or to specific trade concerns raised by other Members in a Committee meeting; and
- Strengthening cross-committee coordination on market access issues (i.e. making sure that the various measures criticised at CTG level are coherently followed up on in the TRIMS, TBT and Market Access Committee, for example), with the help of the Secretariat.

### **III. Adjusting the WTO rulebook incrementally**

The regular WTO councils and committees also have the ability to incrementally adjust and clarify the WTO rulebook outside the negotiations. While there are examples of such incremental adjustments (e.g. the catalogue of instruments available to manage SPS issues adopted by the SPS Committee on 2 March 2018, the CTG decision of 2012 on notification procedures for quantitative restrictions or the 2000 Decision of the TBT Committee on principles for the development of international standards), decisions with real consequence are rare. Often, the WTO's ability to adjust its rules through committee work hinges on the mandate of the committee concerned: While some bodies like the TBT and SPS Committees are mandated to further the TBT and SPS Agreements, other bodies are limited to monitoring and implementing the agreements they oversee.

More incremental adjustments could help demonstrate that the WTO is able to evolve even though its negotiating function is not delivering the expected results. The EU proposes to assess, agreement by agreement, whether targeted proposals could be put forward for advancing WTO rules. Such proposals could either be topics which were part of the DDA negotiations or new ideas, should reflect the interests of stakeholders and be able to get traction among WTO Members.

### **IV. Downsizing ineffective committees**

The flipside to investing more resources into the work of some committees would be deactivating those that are running idle. There are several bodies which were created to address specific issues of interest to a group of Members at a particular moment in time, but which proponents no longer feed with input. Deactivating would not necessarily mean shutting these bodies down completely, but putting them to rest – like the Working Groups on the Singapore issues. Alternatively, the number of

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meetings could be reduced, as was done in the case of services bodies where only the Council for Trade in Services meets regularly whereas its subsidiary bodies are only convened upon explicit request by a Member.

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#### Future EU proposals on dispute settlement

##### Introduction

This paper examines possible approaches in order to follow up on the European Council conclusions of 28 June 2018. The European Council underlined, in a context of growing trade tensions, the importance of preserving and deepening the rules-based multilateral system and stated that the EU is committed to working towards its modernisation. The European Council invited the Commission to propose a comprehensive approach to improving, together with like-minded partners, the functioning of the WTO in crucial areas, including "more effective and transparent dispute settlement, including the Appellate Body, with a view to ensuring a level playing field." (paragraph 16 of the conclusions)

##### Context

###### The nature of the current crisis

The dispute settlement function of the WTO is at grave danger, and swift action by Members is needed to preserve it.

If the United States' blockage of Appellate Body appointments continues, it will undermine the WTO dispute settlement at the latest by December 2019. At that point in time, there will be less than 3 Appellate Body members left, which is the minimum number required for the Appellate Body to hear an appeal. Without a functioning Appellate Body, any party to the dispute may attempt to block the adoption of panel rulings (by appealing it), so – if no action is taken – this may undermine the operation WTO dispute settlement as a whole.

###### What explains the blockage of appointments?

After initially blocking the appointments for reasons related to the "ongoing transition in the US political leadership",<sup>4</sup> as from August 2016 the United States focused on the so called issue of Rule 15 of the Working Procedures for Appellate Review, pursuant to which the Appellate Body may authorize its outgoing members to complete the disposition of pending appeals. The United States has repeatedly stated in DSB meetings that it is not in a position to support the launching of the selection processes for new Appellate Body members and that it "consider[s] that the first priority is for the DSB to discuss and decide how to deal with reports being issued by persons who are no longer members of the Appellate Body."<sup>5</sup> Since then, the United States repeatedly reiterates that it "remains resolute in its view that Members need to resolve that issue as a priority".<sup>6</sup>

While this appeared at first to be the only concrete concern raised in relation to the appointment procedures, in recent months, the United States has also voiced a number of other concerns relating to the functioning of the Appellate Body. These concerns were voiced notably in the meetings of the Dispute Settlement Body. This includes the issue of 90 days provided for in Article 17.5 of the DSU that was discussed at length at the initiative of the United States in the DSB meeting on 22 June 2018. This also includes concerns with Appellate Body findings that, in the view of the United States, were not necessary for the resolution of the dispute<sup>7</sup>.

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<sup>4</sup> See for instance the US statement in the DSB meeting on 19 June 2017;

<sup>5</sup> US statement in the DSB meeting on 31 August 2017.

<sup>6</sup> See the US statement in the DSB meeting on 22 June 2018.

<sup>7</sup> See United States at the DSB meeting on 29 September 2017 on DS442, in the DSB meeting on 22 November 2017 on DS477/478 and on 28 May 2018 on DS486

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The "US concerns with WTO dispute settlement" have recently been summarized in the President's 2018 Trade Policy Agenda<sup>8</sup>. Some of these concerns had already been formulated under the previous US administrations and some of these concerns (like the issue of Rule 15) are new.

This document enumerates the following "examples of concerns with the approach of the Appellate Body" (emphasis added), or in other words certain cross-cutting issues:

- i) "Disregard for the 90-day deadline for appeals";

The US essentially criticises the AB for not respecting Article 17.5 of the DSU, according to which "[i]n no case shall the proceedings exceed 90 days." In the US view, this raises the concerns of transparency, inconsistency with "prompt settlement of disputes", and uncertainty regarding the validity of the report issued after 90 days.

- ii) "Continued service by persons who are no longer AB members" (i.e. Rule 15);

The US essentially claims that the Appellate Body "does not have the authority to deem someone who is not an Appellate Body member to be a member". In the view of the US, Under the DSU, it is the Dispute Settlement Body, not the Appellate Body, that has the authority and responsibility to decide whether a person whose term of appointment has expired should continue serving.

- iii) "Issuing Advisory Opinions on Issues Not Necessary to Resolve a Dispute"

The US points to "the tendency of WTO reports to make findings unnecessary to resolve a dispute or on issues not presented in the dispute". They point in particular to "one egregious instance" where "more than two-thirds of the Appellate Body's analysis – 46 pages – was in the nature of obiter dicta."<sup>9</sup>

- iv) "Appellate Body Review of facts and review of a Member's domestic law de novo";

The US criticises the Appellate Body's approach to reviewing facts. Under Article 17.6 of the DSU, appeals are limited to "issues of law covered in the panel report and legal interpretations developed by the panel." Yet, in the view of the US, the Appellate Body has "consistently reviewed panel fact-finding under different legal standards, and has reached conclusions that are not based on panel factual findings or undisputed facts". In US' view, this is particularly the case for Appellate Body review of panel findings as to the meaning of domestic legislation (which should be an issue of fact).

- v) "Appellate Body claims its reports are entitled to be treated as precedent".

The US claims that the Appellate Body has asserted its reports effectively serve as precedent and that panels are to follow prior Appellate Body reports absent "cogent reasons." which has no basis in the WTO rules. The US puts forward that "[w]hile Appellate Body reports can provide valuable clarification of the covered agreements, Appellate Body reports are not themselves agreed text nor are they a substitute for the text that was actually negotiated and agreed."

In addition, the US has formulated a more substantive concern with the "adding or diminishing of rights and obligations" by the Appellate Body in various disputes. This is exemplified by concrete Appellate Body rulings on the following issues: the interpretation of the notion of "public body" under the Subsidies Agreement, the interpretation of the non-discrimination obligation under Article 2.1 of the TBT Agreement, certain interpretations relating to safeguard measures (notably on "unforeseen developments"), outcomes in the cases launched by the EU against the Byrd amendment (giving the proceeds from anti-dumping/countervailing duties to US industry) and on Tax Treatment for "Foreign Sales Corporations" (that was considered to be an export subsidy). In the

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<sup>8</sup> <https://ustr.gov/sites/default/files/files/Press/Reports/2018/AR/2018%20Annual%20Report%20I.pdf> at pp. 22-28.

<sup>9</sup> This is a reference to the Appellate Body report in Argentina –Measures Relating to Trade in Goods and Services (DS453).

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view of the US, the findings in those disputes departed from the relevant WTO agreements as negotiated.

### EU position:

Without prejudice to EU position on whether the concerns formulated by the United States are well founded, this paper explores avenues in which addressing these concerns could lead to the improvement of the system, while preserving and further strengthening its main features and principles.

In order to achieve balance, this paper also explores other potential improvements. In particular, in 2016, following the US' veto against the re-appointment of one Appellate Body member, there was a wide recognition that a systemic solution was needed in order to preserve the independence and impartiality of Appellate Body members. Indeed, the non-reappointment of an Appellate Body member for reasons related to the content of particular rulings has created a situation in which there may be doubts as to whether decisions of particular Appellate Body members are influenced by such threat of non-reappointment. This situation is not tenable and needs to be addressed systemically.

These various solutions should be seen as part of one package. In particular, the strengthening of the independence of the Appellate Body and its members allows for introducing an additional mechanism for their interaction with the WTO Members without fear that such interaction may unduly influence their decisions.

### **Future proposals**

The EU should put forward a comprehensive proposal to address the concerns raised by the WTO Member blocking the Appellate Body appointments, where this may improve the functioning of the system, while preserving and further strengthening the main features and principles of the WTO dispute settlement system. This proposal will – in a first stage, and in order to unblock the appointments - aim at improving the efficiency of procedures, at creating conditions for a better interaction between the Appellate Body and the WTO Members while at the same time strengthening the independence of the Appellate Body. In a second stage, substantive issues concerning the application of WTO rules would be addressed.

#### **I. First stage: comprehensive amendment of the provisions of the DSU relating to the functioning of the Appellate Body addressing all points of concern with the "approach" of the Appellate Body**

This amendment could include the following elements. A deeper reflection would be needed to define the exact scope and nature of these amendments:

##### i) Article 17.5 of the DSU and the issue of 90 days

Changing the 90-days rule in Article 17.5 of the DSU by providing an enhanced transparency and consultation obligation for the Appellate Body. In particular, Article 17.5 could be amended to provide that "In no case shall the proceedings exceed 90 days, unless the parties agree otherwise".

The Appellate Body would need to consult with the parties early in appellate proceedings (or even before the appeal is filed) if it estimates that the report will be circulated outside 90 days. If there is no agreement of the parties on the exceeding of this timeframe there could be a mechanism pursuant to which the procedure or working arrangements for the particular appeal could be adapted to ensure the meeting of the 90-day timeframe. For example, the Appellate Body could propose to the parties to voluntarily focus the scope of the appeal, set an indicative page limit on the

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parties' submissions or it could take appropriate measures to reduce the length of its report. This could also include the publication of the report in the language of the appeal only, for the purposes of meeting the 90-day timeframe (the translation to the other WTO languages and formal circulation and adoption would come later).

It should however be clear that those changes – such as the consultation obligation –cannot impact on the (negative consensus) adoption procedure in Article 17.14 of the DSU nor on the validity of late Appellate Body reports.

In addition, the following changes would have a positive impact on the timeframes of appellate review:

- Increasing the number of Appellate Body members from 7 to 9. This would help increasing the efficiency of the Appellate Body while improving the geographical balance on the Appellate Body after the accession of important Members since 1995. Also, the internal organisation of the Appellate Body could be improved (for instance three divisions of three members could hear an appeal at any time, without overlaps with regard to the membership of these divisions).
- Providing that the membership of the Appellate Body is a full time job (currently, *de jure*, pursuant to the DSB decision WT/DSB/1, it is a part time job). This would improve the efficiency of the Appellate Body. This would need to be accompanied with appropriate changes in the employment conditions (remuneration, pension etc.).
- Expansion of the resources of the Appellate Body Secretariat could also be considered as an accompanying measure (this would not require any change in the DSU).

### ii) Transitional rules for outgoing Appellate Body members

Codifying Rule 15 (or similar) in the DSU, thereby addressing head on the US concern that this Rule was not approved by WTO Members. For example the DSU could provide that an outgoing Appellate Body member shall complete the disposition of a pending appeal in which a hearing has already taken place during that member's term.

### iii) Findings unnecessary for the resolution of the dispute

Modifying Article 17.12 of the DSU, according to which the Appellate Body "shall address each of the issues raised" on appeal. For instance, it could be added "to the extent this is necessary for the resolution of the dispute". This would address concerns about Appellate Body making long "advisory opinions", or "obiter dicta", not necessary to resolve the dispute. Indirectly, this would also address the concern related to Article 17.5 DSU (90 days).

### iv) The meaning of municipal law as the issue of fact

It could be clarified that "issues of law covered in the panel report and legal interpretations developed by the panel" do not include the meaning of the municipal measures (even though they do and should include their legal characterisation under the WTO law). To that end, a footnote could be added to Article 17.6 of the DSU "For greater certainty [...]"

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### v) The issue of precedent

Providing for regular exchanges between the Appellate Body and WTO Members (e.g. annual meetings), on top of the Members' right, in Article 17.14 of the DSU, to express views on Appellate Body reports when they are adopted. This would provide an additional "channel of communication" where concerns with regard to some Appellate Body approaches could be voiced (for example treating previous rulings as precedents, no evolution of case-law). Indeed, the WTO Membership would have a chance to comment on more systemic issues or on trends in the jurisprudence in meetings unrelated to the adoption of particular Appellate Body reports. At the same time, this change would not be inconsistent with the independence of the Appellate Body members, especially if they were not, in any event, eligible for re-appointment (see below the proposal for one but longer term). Adequate transparency and "ground rules" for such meetings could also be put in place, in order to avoid undue pressure on Appellate Body members.

### vi) Independence of Appellate Body members

Providing for one single but longer (6-8 years) term for Appellate Body members. This would address the EU concern (and that of the vast majority of the WTO Membership) with respect to the independence of the Appellate Body. It would also improve the efficiency of the Appellate Body (there would be certainty about the length of one's term and a longer term would allow to benefit from the experience on the job).

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The amendments envisaged above would all concern Article 17 of the DSU.

It is not the intention to pursue other matters, such as these that are being pursued in the context of the DSU review negotiations. Indeed, the approach would be to proceed with the amendments swiftly, so issues that are known to be controversial should be avoided.

Such amendments could be made pursuant to the applicable (simpler) amendment procedure in Article X:8 of the WTO Agreement, according to which amendments to the DSU can be decided by the Ministerial Conference, on a proposal from any WTO Member. The decision is taken by consensus and amendments would take effect upon approval by the Ministerial Conference. In the intervals between meetings of the Ministerial Conference, amendments could be approved by the General Council (see Article IV:2 of the Marrakech Agreement).

At EU level, a Council decision pursuant to Article 218(9) TFEU would be required for joining such consensus. The Council would act by qualified majority (Article 16(3) TEU), on a proposal from the Commission.

## **II. Second stage: addressing substantive issues**

As set out above, the US takes issue with the interpretations developed by the Appellate Body ("overreach") especially, but not exclusively, in the trade defence field.

Without prejudice to the EU position on the alleged "overreach" by the Appellate Body, it is pointed out that the substantive rules as such can be modified or interpreted by the WTO Membership in accordance with the relevant procedures.

In the second stage, once the AB appointment process has been unblocked, WTO Members would engage in discussions on such possible changes or authoritative interpretations.