Dispute Settlement in the Free Trade Agreement of the Americas: There *Is* A Better Way

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I. Introduction

Three broad categories of international dispute settlement are relevant for purposes of economic integration in the Western Hemisphere.

The first is private-to-private dispute resolution, generally involving contractual disputes, between parties who are separated by national borders. You have heard from the other panelists about arbitration and other alternative dispute resolution methods in this area, and I have nothing useful to add to their remarks. This kind of dispute resolution is important, but equally important are dispute settlement mechanisms that involve governments as parties.

The second category is government-to-government dispute settlement, the kind that occurs within the WTO system and under NAFTA Chapter 20 today. These disputes involve differing interpretations of treaty obligations undertaken by the governments involved.

The third category is private-to-government dispute settlement, which occurs in several contexts under the NAFTA. Examples are investment disputes, handled under NAFTA Chapter 11, and disputes over antidumping and countervailing duty measures, which are handled under NAFTA Chapter 19.

The title given to this panel discussion is "Dispute Settlement: There Has to Be a Better Way." I took that title seriously in preparing these remarks. It is generally assumed that economic integration in the Western Hemisphere, through an FTAA or otherwise, will build on the formula already in place for the NAFTA. Yet now is a time when, for a variety of political and other reasons, we can look critically at the NAFTA template. And certain aspects of that template, especially in the area of dispute settlement, are flawed in ways that will only cause greater problems if they are not corrected as we

move forward. Getting dispute settlement right will be critical to ensuring that the full benefits of an FTAA are realized for firms and workers throughout the Americas.

II. Government-to-Government Dispute Settlement

The CFTA's general dispute mechanism, which was set out in Chapter 18 and largely copied into NAFTA Chapter 20, worked fairly well in allowing the governments to resolve disagreements over what they had written into the agreement they signed in 1988. The mechanism was a "hard" one, meaning that a losing government had to alter any measure found to be inconsistent with the CFTA or face authorized trade retaliation. Governments could not, as they were then able to do in the GATT system, block the adoption of panel reports they did not like. So panels essentially had the last word in defining each country's international obligations. Yet, the two governments used, and lived with, the Chapter 18 mechanism.

The NAFTA Chapter 20 version contains some innovations, such as allowing each government to select panelists for a given case from the other country's roster of trade experts. In general, though, it is the same mechanism. Although it appears to be well-designed, it is difficult to judge because it has not yet been used since the NAFTA took effect in 1994.

The one case that is underway is a dispute over Canada's "tariffication" of import quotas on dairy and poultry products. Based on the press reports, there are two noteworthy aspects of this case. First, the case was held up initially because of delays in completing rules of procedure for Chapter 20 cases. Second, the parties had some difficulty in naming panelists and wound up selecting a European as chairman of the panel when they could not agree on a fifth expert from the U.S. or Canadian roster. While I have not spoken to officials involved in the selection process, this suggests to me that there may still be some suspicion about panelists voting along national lines rather than acting as neutral judges.

The case is reported to be a sensitive one politically in both countries, perhaps especially in Canada. In any event, this raises at least some question over whether the binational panel process established under Chapter 20 commands the confidence and respect necessary for an adjudicatory mechanism to work successfully. This is something to watch as we move forward.

Perhaps the key question is how the three governments will respond to adverse decisions holding that their policies or practices are NAFTA-inconsistent. Governments need not comply with adverse panel rulings, but, if they do not comply, they risk retaliation that will be authorized under international law. This gives the Chapter 20 panels, which are supranational bodies, some degree of effective influence over each NAFTA government's policies. You may recognize this as the "sovereignty" issue we heard so much about in the context of the Uruguay Round and the WTO. Adherence to panel decisions will likely be related to the degree of confidence inspired by the Chapter 20 system as a whole. The system will have to be seen to work for, as well as occasionally against, all three NAFTA parties.

III. Private-to-Government Dispute Settlement

The issues presented by private-to-government dispute settlement are more complex. Here, private litigants are lined up against governments, challenging sovereign government decisions.

Chapter 11. One example is investor-state disputes handled under NAFTA Chapter 11. Chapter 11 sets out a series of substantive rules governing each party's treatment of investors and investments from the other NAFTA parties. It also establishes a dispute settlement process available to investors who believe those substantive rules have not been followed. As with Chapter 20, there are not enough results yet to evaluate the success of this mechanism.

Chapter 11 contains some innovations, however, for which the negotiators may have gotten too

little credit. Perhaps the most important of these is relinquishment of the so-called "Calvo doctrine" with which I assume most of you are familiar. NAFTA governments are now subject to dispute settlement in investment cases, at the election of the investor, through commercially-accepted mechanisms such as ICSID (the International Centre for Settlement of Investment Disputes) and UNCITRAL (the United Nations Commission on International Trade Law). Furthermore, in principle, a host government's failure to comply with a valid arbitral award is actionable under NAFTA Chapter 20. (This would depend of course on the investor's government being willing to bring the case.)

One issue that cannot be forgotten is how national governments are organized to assist their citizens in taking advantage of the NAFTA's investment rules. I am not familiar with the Canadian or Mexican structures, but there are some jurisdictional overlaps that make the U.S. Government's organization perhaps less than ideal for prosecuting expropriation claims under Chapter 11. The lead agency in such a case would be the Office of the U.S. Trade Representative, but the State and Treasury Departments have a significant role that can complicate matters and lead to foreign policy concerns being weighed more heavily relative to trade concerns. U.S. investors seeking to take full advantage of their Chapter 11 rights need active and coordinated support from their government.

In any event, the Chapter 11 mechanism deserves high marks or at least the benefit of the doubt until we gain more experience.

Chapter 19. The same cannot be said of Chapter 19, the second example of private-to-government dispute settlement in the NAFTA. This is an extremely problematic mechanism that has already failed its appointed task and is likely to continue doing so. What happened here is that a dispute settlement mechanism was substituted for an agreement by the parties (rather than being set up merely to plug holes in an agreed set of rules which the parties had accepted). This was a mistake we should not replicate in the FTAA process.

Chapter 19 provides for appellate review by binational panels to consider claims that agency

decisions in antidumping and countervailing duty cases violated the national law under which they were rendered. For those of you fortunate enough not to know what antidumping and countervailing duties are, they are special, additional customs duties collected when imported merchandise is found to be priced at less than "fair value" or to benefit from foreign government subsidies. Dumping and subsidization are defined under international law to be unfair trade practices and are subject to offsetting duties under the laws of many importing nations including all three NAFTA countries. Decisions by the national agencies that enforce these laws are normally subject to judicial review, just like any other administrative determination, in the importing country's national courts.

The NAFTA parties did not set any special substantive rules for dumping and subsidies, or for the offsetting duties available under their national laws. What they did, however, was to replace judicial review in national courts with review by international panels. The members of these panels are drawn from rosters of trade experts maintained by the exporting and importing countries. And their job is to determine whether the importing country's laws were correctly applied.

What the NAFTA does, in other words, is to task an international body with resolving questions of national law. Normally you would expect an international panel to be given an international standard to enforce. Then there would be a reason to have an international body decide the dispute. You can't very well ask one disputing government or the other to determine what the international obligation is. Yet here, the panels simply step into the shoes of national courts. As it turns out, they have not been able to do so effectively.

The history of Chapter 19 to date is a discouraging one, and unfortunately there is not time today to go into much detail. The bottom line is that the panels have proved incapable of behaving like courts. They have overruled agency decisions because of substantive disagreement and without proper deference to the agencies as called for in the treaty. There have also been severe problems with panelist conflicts of interest, which may be inevitable given that the rosters consist mostly of practicing trade

lawyers and not of judges who are insulated by life tenure.

To make matters worse, panel decisions must be automatically implemented by the national government agencies concerned, with no intervening political review. Unlike normal international dispute settlement, like what I described under Chapter 20, the Chapter 19 system directly infringes the sovereignty of all three NAFTA countries. This factor formed the basis for the U.S. Justice Department's warning to Congress in 1988 that the system violates the U.S. constitution.

The result, unfortunately, is a crisis of legitimacy for the Chapter 19 system and a significant drag on the good will necessary to make the NAFTA as a whole function smoothly. Meanwhile, there is no progress toward a substantive agreement within the NAFTA on dumping and subsidies or on the rules for offsetting duties.

IV. Lessons for the FTAA

The NAFTA's successes and failures contain important lessons that we should not hesitate to apply in the FTAA process even if it means substantially changing the current template. It is essential that dispute settlement mechanisms be soundly formulated in order to ensure that the full benefits of an FTAA to businesses, consumers and workers throughout the Americas are realized.

Substantive rules. The first lesson I would draw sounds deceptively simple: In any given area, we need to work until we get a substantive international agreement, and we must not substitute a dispute mechanism for such an agreement. This is especially true if the dispute mechanism is a binding one, in which case it is likely to do much more harm than good.

The NAFTA Chapter 20 mechanism enforces substantive treaty obligations such as national treatment and tariff bindings. The Chapter 11 mechanism enforces substantive rules such as freedom of establishment, freedom to repatriate profits, and freedom from expropriation. Chapter 19 contains no

such substantive standards.

The NAFTA's labor and environmental side accords, incidentally, suffer from the same basic defect as Chapter 19. I am not saying it is wrong to link these issues to trade negotiations and trade rules. But the side agreements as drafted basically focus on whether the enforcement of national laws in these areas is "adequate." A more meaningful international standard is needed.

I believe the problem we are witnessing here flows from honest efforts to deal with difficult "next generation" trade issues such as environmental policy, competition policy, and labor standards. Finding it difficult to forge international standards, negotiators are crafting agreements that instead focus on the "correct" enforcement (in the case of Chapter 19) or the "adequate" enforcement (in the case of the side accords) of national laws. This formula basically assumes that national laws contain sound standards, and that we can be content to empower international panels to sit in judgment of each government's enforcement of its own standards. This is a misguided approach that will lead, and is leading, to greater problems rather than usefully addressing problems.

What do I mean by substantive standards? I will give you a few examples. An international agreement could provide that environmental enforcement must result in lead in the ambient air that is no more than X parts per million. Similarly, an agreement could state that enforcement efforts must result in X dollars (or pesos) being collected in fines each year or X individuals -- polluters or cartel members, for example -- being put in prison.

These examples are coarse, but you get the idea. They are international standards that a panel could enforce. By contrast, if a treaty simply tells panels to demand "correct" or "adequate" enforcement of national law, you have something that panels cannot usefully enforce and you wind up with a mess. This problem is only exacerbated if the panels' decisions are binding or self-executing.

Hard vs. soft dispute mechanisms. The second lesson is that the "hardness" of an agreement's various dispute mechanisms -- that is, the extent to which the rulings of dispute bodies are binding or

self-executing -- is a pretty good indicator of how serious the parties to that agreement are about integrating their economies.

It is useful in this regard to compare the NAFTA, which relies on hard dispute settlement, with the agreement among the Mercosur countries. The Mercosur pact may be more ambitious in some respects, but its dispute mechanisms are reported to be essentially political or diplomatic rather than adjudicatory. In other words, the conclusions of expert panels are not necessarily adopted or implemented by the participating governments. Rather, implementation becomes an issue for negotiation.

The WTO agreements follow the adjudicatory model, which may set a helpful example and demonstrate to all trading nations that the benefits of a definitively rules-based system outweigh its costs. What remains to be seen is whether the nations of the Western Hemisphere are prepared to accept an adjudicatory model for resolving disputes under an FTAA whose rules would, presumably, go even further than the WTO's. Time will tell.