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Lessons to the DSU from the US-China Trade War and Proposal of Reforms

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Abstract: In the context of globalization, people pay more attention to the role of international economic organizations in managing transnational trade relations. The US-China trade war has critically impacted the global economy and significantly influenced the international trade pattern. The Dispute Settlement Understanding (DSU), an essential section under the World Trade Organization(WTO), failed to function during the US-China trade war. Using the US-China trade war as the entry point to review the US-China trade relations under the WTO, this paper first evaluates the deficiencies of the DSU. Then it raises some reform suggestions in relatively practical aspects. The main intention of reforms is to provide a more concise and complete negotiation platform for solving transnational trade disputes.

Keywords: trade war, unilateral retaliation, dispute settlement understanding (DSU), reform

1. Introduction

China and the United States have been engaged in a trade war since 2018, which has continued to escalate; the tension seemed irreversible. Under the background of global economic governance, the impacts of trade wars between great powers on international trade are more than imagined. The World Trade Organization (WTO) has not prevented or mitigated the malicious increase in tariff barriers between the US and China; whether it properly functions are contested - are people expecting too much from international economic organizations? The limited roles played by WTO during the US-China trade war suggested that it is valuable to review the part of the critical international institution during the trade frictions between the US and China, and possible reforms are required. This article intentionally focuses on the role of Dispute Settlement Understanding (DSU), which is a critical component in the WTO system. Considering the outcomes of the US-China trade war and the unexpected influence on the global trade market, which needs a long time to restore, a robust dispute-solving mechanism is needed more than ever to maintain international trade stability and maintain global economic order under a worldwide environment of uncertainty.

This article will first introduce the background of the DSU and US-China dispute history, followed by possible impetuses to trigger the trade war. Then, it will review how two big powers undermined the functions of DSU at the beginning of the US-China trade war, implicating that the existing DSU system is less effective than expected. Based on defects, this article will suggest two potential aspects of reform: 1) providing a supervising mechanism for preventing unilateral retaliation; 2) improving justification of existing settlement procedures. Due to the interconnectedness of every economy, it is hard to manage the international outcome of the trade war between great powers unilaterally. The

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DSU must restore and improve the function of the dispute platform to provide states with an opportunity to negotiate and consult.

2. The DSU and Trade Dispute History of US-China

Intriguingly, the formation of the DSU was a deal and a bargaining result between the US and other GATT members. The intensification of the notorious "Section 301" law in 1988 allowed the US to impose unilateral trade sanctions against other members whenever the US government determined they violated their GATT obligations or were acting unreasonably toward US trade [1]. The United States agreed to adjudicate all WTO-based Section 301 complaints in exchange for other GATT governments creating a new and procedurally tighter dispute settlement system [1]. To some extent, the DSU was adopted as a result of concession. Due to the US's predominant and excessively leading power, the DSU at the beginning could not function independently and could be influenced by states' intentions. This feature indicates the US's position in the new dispute settlement system and, to a large extent, foreshadows the inefficiency and futility of the settlement procedure during the excellent power dispute.

Among the provisions of the DSU is the establishment of a coherent and predictable timetable for consulting and enforcing WTO obligations aimed at reducing trade barriers and price distortions [2]. The core objective of the DSU system is to try to ensure and enhance the certainty and predictability of multilateral trading relations through the dispute-resolving. The institutional value of any DSU clause is to ensure that the rights and obligations of all members under the agreements covered by the WTO can be proven to be meaningful. In a usual WTO procedure for dealing with trade disputes, the implementation phase consists of the following stages: First, once a panel or the Appellate Body (AB) has found that the trade measure complained of by a Member violates its obligations under the relevant agreement, the board or the AB will suggest that the Member is voluntarily correct or modify the offending trade policies. Generally speaking, it is from this point that the enforcement procedure for WTO rulings begins. The entire enforcement procedure includes setting a reasonable period for the losing party to comply with the verdict, monitoring enforcement, reviewing enforcement at the request of a complaining Member, and invoking remedies such as mandated retaliation in the event of non-compliance, all of which are designed to ensure prompt compliance by the losing party with its obligations.

Since 1995, the WTO dispute settlement system has been widely used, and its outcome has been impressive [3]. A total of 607 consultation requests were circulated to WTO members between 1 January 1995 and 31 December 2021, 52 WTO members initiated at least one dispute, and 61 members responded to at least one dispute [4]. According to WTO statistics, 90 members have participated as third parties in proceedings between two or more other WTO members. 111 members have participated in dispute settlement as parties or third parties [4]. The increasing scope and range of countries participating in the transitional dispute-solving system and the increasing willingness of members to engage and use the settlement mechanism are the salient improvements of the DSU. From 1995 to 2003, developing country members, particularly upper-middle-income countries (about 22%), accounted for 39% of all disputes [3]. This evidence has shown that more countries, excluding the dominant Western economies, can get in touch with the dispute mechanism and protect their benefits and rights. Thus, it is reasonable to expect the DSU to function effectively in the trade dispute in the future. However, to what extent the DSU works as a good negotiation and trade dispute-solving platform is still contested, especially for the economic conflicts between great powers. The US-China trade ties, consequently, the evoke of the financial conflict is a critical case to study and explore.

Looking into the history of US-China trade relations, there is a high frequency of trade disputes. Since 2006, China's official stance claimed it would use the WTO's dispute settlement body (DSB) to settle trade conflicts properly; therefore, China and the US began actively and aggressively utilizing

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the DSB's litigation process [5]. Until 2018, the US government complained about Chinese practices 23 times in the WTO; the win-loss record is 20-0 [6]. This record shows China's relatively lukewarm and negative response from the DSU. Results of US-China disputes are usually resolved eight months after the DSU panels begin; however, when panels must provide written reports of decisions, the process takes more than three times as long [6]. The intense litigation between the two countries reflects the successive trade conflicts and the increase in trade protectionist measures as a result, which to some extent, paved the way for the outbreak and escalation of the trade war. US's concerns include Chinese forced technology transfer on its multinational companies, discriminatory licensing requirements, investment restrictions, weak intellectual property protection, government support for industries, and subsidization of excess capacity [7]. China's claims are mainly about the American use of trade remedies, for example, antidumping and countervailing duties, constraining its exports [5].

Tao Liu and Wing Thye Woo [8] argued that three major concerns drove the US to initiate the trade and economic sanctions towards China and they are (a) concerns that cumulative trade deficit with China has negatively affected US job creation; (b)concerns that China was using illegal and unfair methods to obtain American technology through forced technology transfer and insufficient intelligence property protection; (c) concerns that China seeks to undermine US national security and thus its hegemonic power in the international stage. Thus, we could see that the outbreak of trade could result from accumulating historical problems between the US and China. It is evident that the US justified its economic sanctions with national interests and security and depicted China as the one who grows itself by violating the international monetary order. Liu and coauthors [8] have proposed that China's rise as a symbol of the trend of multi-polarization will undermine US's capability as a global hegemony and has heightened US concern for its national security. To a large extent, the Sino-US trade war has more political dimensions than economics. In this case, national interests have become the primary concern to states, and thus the role of DSU as an intermediate agent is limited.

The trade war's most serious outcome might be the global economy's uncertainty. Constant tariff changes can increase tension and thus weaken consumers' confidence in consumption and investment. As a result of uncertain future expectations, companies may delay investment plans and lower output growth [9]. By reducing investors' exposure to the equity market and credit supply, global uncertainty can also hinder productivity and long-run output growth [9]. However, people's attention on the interstate trade dispute settlement system is more than necessary due to the overwhelming impacts of the US-China trade war. Transnational economic disputes need global organizing, which might provide mutual negotiation and cooperation opportunities.

3. Lessons from the US-China Trade War

Tariff retaliations and counterretaliations resulting from the US-China trade war were not subject to multilateral trade rules and procedures [10]. The hidden danger mentioned above, the Section 301 law of the United States, was the critical factor at the beginning of the US-China trade war. Referencing Section 301 of the Trade Law of 1974, the US could take measures against trading partners who abused their trading activities to the US's detriment [10], and it enables the president to act immediately without waiting for the result of the WTO dispute [5]. Section 301 was the legal standpoint for the US to trigger the tariff escalation towards China. In April 2018, the US announced tariffs on approximately 50 billion dollars of Chinese imports throughout the machinery, mechanical appliances, and electrical equipment sectors [5].

On the other hand, China defended its retaliation against the US using Article 47 of its Foreign Trade Law 2004, and it imposed about the same number of tariffs on US imports. The taxes imposed by both sides still escalated throughout 2018 and 2019; in the midterm of 2019, the US imposed a 200-billion-dollar tariff with up to 25% duty on Chinese goods, whereas China imposed a 60-billion-

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dollar tax with up to 25% duty on the US goods [11]. It is essential to make sense that each side's importers will be affected and pay for the vicious tariffs. From an overall social welfare aspect, the extra costs are the unwanted outcomes for both countries, undermining the production efficiency and the Pareto optimality.

Both sides use their own domestic and commercial law to justify their actions. They ignored, whether intentionally or not, procedures for dispute settlement provided in DSU article 23: WTO members shall 'not decide to the effect that a violation has occurred, that benefits have been nullified' except through recourse to dispute settlement, and the determination shall be consistent with the findings of Appellate Body reports [12]. US and Chinese actions have questioned whether the current DSU settlement rules and procedures are timely and sufficient for countries to resolve disputes. When the US believes other countries undermine its interests severely, it might prefer to go head-to-head through direct negotiations and the threat of actual, punitive tariffs, which is more viable. The urgency of pursuing national interests for great powers sometimes outweighs the willingness to follow the justification. This may suggest that the DSU failed to provide a normative platform when encountering great powers conflict and needs to find a way to increase its accountability and deterrence effects.

On the other hand, China has unwittingly collaborated with the US in undermining the multilateral trading system by reacting outside the DSU framework [13]. According to Qin [13], China's unilateral retaliation has morally damaged its legal case against the Section 301 tariffs because of an inadequate understanding of the underlying rationale of DSU Article 23. To some extent, China's radical reaction is partly because of the rigorous defense of its nationalism and motivated by the perception that the US was intentionally curbing its rise. This may imply that the DSU needs to work as a supervisor and advisor to push Members to follow and understand DSU agreements to reduce the likelihood of unilateral retaliation.

From the lessons of the US-China trade war, it is hard to say that there have been winners after tariff retaliation and vicious confrontations. The undesirable outcomes of conflicts provide the impetus to find a way to mitigate the tension, especially when that tension is related to national security and interests. Since the DSU, as an intermediate institution for handling trade disputes, has worked for more than 20 years, people expect it could play a more effective role and increase the chance of obtaining win-win outcomes between big powers in future trade disputes. As a result, reforms of the DSU are required.

4. Proposal for Reform

There is still a political dimension to the operation of the DSU, and the influence of the major powers (particularly the US and China in this case) on the DSU is reflected in the procedures of the appellate body and its enforcement procedures. Under those circumstances, a more judicial reform of the DSU may affect the interests of these countries and the differences between the major powers and between developed and developing countries as to how, to what extent, steps and processes the DSU should move towards judicialization are the reason for the intense debate on DSU reform and the difficulty of reaching a coherent outcome. Therefore, from a pragmatic point of view, the most likely results of the DSU reform are those provisions that have become established in practice and could be further elaborated. As mentioned above, the whole dispute settlement process contains several stages. Based on the lessons from the US-China trade war, the proposal for reform in this article will mainly focus on consultation and implementation aspects. Instead of directly empowering the DSU or enhancing the judicial system, reforms aim to strengthen the mediator role of the DSU by providing more space for negotiation. The reform also targets to ensure the effectiveness of settlement results which helps to build a neutral and valid image of the DSU to states.

Focusing on the long-term goal of having a mandatory and swift dispute settlement combined with

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the lessons from the US-China trade war, this article argues that the DSU needs reform in two main aspects: 1) establishing an additional mechanism targeting unilateral retaliation; 2) increasing justification of exiting settlement procedures. The DSU needs to play a more valuable and aggressive role in pushing and supervising the losing party to fulfill its obligation, enhancing its accountability and deterrence effects.

4.1. The Consultation Mechanism for Preventing Unilateral Retaliation

As discussed above, the DSU should have managed unilateral retaliation in the first place, which let the harmed state get into an impasse between waiting for the verdict and protecting itself timely. If there is a mechanism that could intervene before the broken state chooses to violate Article 23, the subsequent settlement steps will be much easier to process. This design intends to bring the disputants into the negotiation phase in advance and provide a pre-processing platform for states to settle in. This intervention mechanism could be led by the WTO Director-General, which has multilateral legitimacy [13] and is complemented by a consultative panel. The role of the WTO Director-General is to persuade and ensure the involvement of disputants; the duty of the consultative meeting, in brief, is to provide suggestions about possible solutions and implications of improper actions. The recommendations may include informal reports about the analysis of the status quo rather than the final decision about the dispute. In the US-China trade war case, this intervention could have helped Beijing understand the applicable law and the grave implications of violating Article 23 with the assistance of WTO Secretariat staff [13]. This mechanism serves as a conciliatory and mediatory body to adjust the tension and provide information at the beginning of trade conflicts.

To counter the potential threat of a trade war, the intervention of this mechanism must include mandatory Member participation to overcome the member-driven feature of the DSU [13]. As a result, this intervention could, to some extent, reduce the likelihood of counterretaliation. The enforcement mechanism needs to ensure the Member's compliance with Article 23. It might include a set of consequences for violating, for example, temporary suspension of its right to enjoy trade preferences within the WTO. Another essential feature of the enforcement mechanism is flexibility. The procedure to start this mechanism must be simple. The optimal situation is that the agency could activate automatically when unilateral malicious action occurs, which can win as much time as possible for the harmed state to take rational consideration. Thus, the main aim of this pre-setting mechanism is to find opportunities for conditions to calm down and make sound foreign policy decisions that require a broader range of information.

4.2. Increase Justification of Existing Settlement Procedures

(1) Clarify and strengthen implementation procedures

The DSU needs to move towards greater clarification and justification, enhancing its adjudicative function and enforcement effectiveness. The institutional value of any DSU clause is to ensure that the rights and obligations of all members under the WTO's covered agreements can be proven effective. To be specific, two main areas are considered in this article. The first is to clarify and strengthen implementation procedures. Article 21.5 mentions that when disagreement exists regarding whether measures taken to "comply with recommendations and rulings have been consistent with the covered agreement," such dispute "shall be decided through recourse to these dispute settlement procedures, including, wherever possible, resort to the original panel" [12]. Three main issues have been raised in practice: firstly, what "these dispute settlement procedures" consist of as provided for in the provision; secondly, whether a decision of a panel under this Article is subject to appeal; and thirdly, the question of the operability of "resort to the original panel" in the form of an ad hoc panel of experts, as mentioned above. Thus, the ambiguity of Articles in practice must be

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overcome to justify DSU's function.

The improvements may include enhancing DSU's formal procedure control over disputes and adjudication results. First, "these dispute settlement procedures" could consist of mandatory consultations for both sides, meaning that the DSU has the responsibility to pressure them into negotiations. Second, the appealability of Article 21(5) decisions may be considered. Article 21(5) deals with the critical issue of determining enforcement measures. As the trial process often involves steps that did not appear in the original panel proceedings, they are no less important than the actual expert panel proceedings. It is reasonable to consider the appealability. Both actions are designed to enhance the formalization of the DSU enforcement procedures, aiming to clarify the settlement procedure and the power of DSU as a mediator.

(2) Improve the effectiveness of remedies

On the other hand, the effectiveness of remedies also needs to be confirmed. According to Article 19, the panel or the AB can only make recommendations: "it shall recommend that the Member concerned bring the measure into conformity with that agreement" and how the Member concerned should implement the recommendations [12]. To a large extent, Members as sovereignty states can choose to comply with requests or rulings of the DSB. The logic behind this is that the WTO trusts that the Member concerned will abide by the WTO award or recommendation in good faith and on time, thus giving the losing party considerable freedom of choice regarding how to comply. Although it protects the sovereignty of the losing party, it fails to stand for the winning party's rights and reduces the deterrent effects of violating the WTO agreement. Possible measures to ensure the effectiveness of the DSU result of imposing remedies may include determining in advance the level of loss of benefit and damage and increasing the mandatory provisions for compensation. The first round of panels could choose the annual loss and damage arbitration. One step closer, the traceability of remedies could also be enhanced. When the dispute is resolved, the suspension of rights or other obligations authorized by the DSB on losing parties should be comparable to the level of loss or damage of winning parties from the date of establishment of the panel. When a case involves a developing state against a developed state, the negotiation of compensation between parties to the dispute is primarily influenced by their respective strengths. The developing country cannot negotiate salary, or the payment amount is disproportionate to the damage suffered. Thus, some developing countries proposed the suggestion of including monetary compensation.

Some scholars argue that monetary compensation will disincentivize the protracted tendencies of losers during trade disputes, thereby increasing members' confidence in approaching the WTO to settle trade disputes [10]. Under the context of a US-China trade war, the inclusion of monetary damages would give each party hope for the possibility of recovering economic losses and injuries caused by the unfair trading activities of the other party [10]. Monetary compensation can deter members who may pursue their economic interests by violating the original multilateral trade environment, as it will increase the costs of breaking. Thus, monetary compensation not only serves as fair reparations but also boosts members' confidence in the system and prevents another catastrophic trade war [10]. Both measures aim to increase the feasibility of remedy and thus to ensure the accountability of dispute results. In addition, it may reduce the likelihood of malicious economic activities among Members since costs are high and a rational decision-maker needs to consider. The aim of those measures

5. Conclusion

This article explores the potential for the DSU to enhance its capability to settle international trade disputes based on the lesson from the US-China trade war. The reform of the DSU rules has been an essential issue for WTO since it is expected to manage great powers' economic conflicts. Although the space left for the DSU is limited when the trade dispute is related to national interest issues, it still

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can play a more valid role as a neutral intermediate mediator. This article focuses on the justification of DSU procedures and suggests that an additional mechanism targeting unilateral retaliation might be needed in reform. The measures mentioned in this article are intended to expand DSU's ability to manage disputes and exert pressure on negotiation, including more legitimacy and some compulsory requirements for members to guarantee that bilateral or multilateral talks and consultations can be implemented as expected. However, the extent to which states are willing to concede their authority to the DSU will need to be discussed and negotiated. It is over-optimistic to expect members to sacrifice their interests to embrace the cooperation fully; the reforms here aim to provide information and time for states to make rational choices. All WTO members at least need to leave space for the open discussion of DSU reform. Only when the DSU is working timely and effectively are states willing to pursue the dispute through WTO rather than act unilaterally.

Under the recent escalation of interstate tension and negative expectation of the future global economy, the DSU's reform is much more urgent. It is reasonable to expect that states could find more opportunities to cooperate with a robust dispute settlement mechanism under the WTO frame. The greater the willingness of countries to cooperate, the greater the likelihood that economic strife will not become a zero-sum game. This expectation may be better achieved with the complement of other international institutions. Negotiations among states on those reforms are necessary to allow international cooperation to reshape the DSU's functions to be more reliable. Furthermore, international organizations must keep their relative independence, thus restoring confidence in transnational cooperation to prevent international conflicts.

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