5

EC – Bed Linen
European Communities – Anti-dumping Duties on Imports of Cotton-Type Bed Linen from India*

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1 Introduction

As comprehensively argued elsewhere in this volume,[1] the WTO's anti-dumping provisions reflect political compromises that mask an underlying lack of consensus on the value and purpose of an antidumping regime at the national level. This is an old story that has been long argued in academic and policy circles. What is noteworthy recently is the significant increase in the use of trade remedies, especially by developing economies. As a result, while the post-Uruguay Round period is generally marked by greater economic openness resulting from various forms of trade liberalization, the use of trade remedies is no longer primarily the province of OECD economies. Indeed, the introduction and use of trade remedies is proliferating around the world.[2]

As we discuss in greater detail herein, it is difficult to make economic sense of the core purposes of the anti-dumping provisions, except in the rare instances of true predation. Of course, there are other non-economic efficiency motivations that may help to explain the rule framework – such as protection of domestic producers, a sense of "unfairness," or the view that this method of helping those hurt by imports is a necessary price or safety valve for nations that are taking steps in the direction of market opening.

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[1] See, Howse and Neven, *Argentina – Ceramic Tiles.* [2] See, Prusa (2001).

The GATT produced a fairly large number of anti-dumping disputes but few of the panel reports were adopted and implemented.[3] The WTO dispute settlement process has seen a large number of anti-dumping cases brought before it – some forty-five disputes as of this writing, which places anti-dumping as one of the primary areas generating disputes. The WTO anti-dumping rules are highly procedural in nature, designed to give flexibility to varying national practices within a framework that imposes a certain degree of procedural transparency as well as comparability on national dumping and injury methodologies. Put concretely, panels do not investigate *de novo* whether dumping, injury, and causation have occurred but rather review whether or not the national administrating authority has complied with the international obligations contained in the WTO Agreement with respect to those elements of its investigation.

This area of dispute settlement is also one of the handful of substantive areas that has generated a particularly high degree of controversy, not surprisingly within those jurisdictions that have lost in dispute settlement. A specific, but recurring, expression of concern is that the WTO panels have failed to give appropriate deference to national practices, which deference is a key and uniquely highlighted feature of the anti-dumping rules as reflected in the standard of review contained in Article 17.6 therein. Allegations of over-reaching or judicial activism can imply a systemic defect and deserve close scrutiny. Indeed, public perceptions about the WTO dispute settlement system overall have been framed – perhaps disproportionately so – by the anti-dumping cases.

This study summarizes and critically reviews one anti-dumping dispute brought before the WTO concerning the European Communities Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India, euphemistically referred to herein as *EC – Bed Linen*. This case involves the methodology used by the EC with respect to anti-dumping duties in imports of cotton-type bed linen. The discussion that follows undertakes a three-step analysis. In these three steps we seek to distinguish different levels of economic and legal analysis, beginning with the most general and turning in sequence to the more specific legal and economic issues raised by the *EC – Bed Linen* dispute.

First, we consider the economic basis for the WTO provisions that are at the heart of this dispute. More specifically we ask: What are the underlying

[3] According to Horlick and Clark, of seven GATT panels brought under the anti-dumping Code, only three have been adopted and of those only two have been implemented. See, Horlick and Clark (1997), p. 313.

goals of the various WTO provisions touched upon in the Bed Linen case, and are the goals themselves sensible from an economic perspective?

Second, we present and evaluate the key factual and legal elements of the case, focusing primarily on the legal issues raised by the case in its final disposition, e.g. whether at the Panel or the Appellate Body (AB) level, that seem particularly important to understanding the stated legal and economic logic of the case.[4] More specifically we ask: Have the reviewing Panels and the AB applied the law consistently, mindful of WTO precedent? Are the panelists and the AB doing what they state they are doing? Are the judgments well-grounded in legal argument? Is there ambiguity in the applicable law, as drafted? If so, how is it resolved – e.g. with deference to national measures, or through judicial license?

And third, we consider and evaluate the particular legal and economic issues and methodologies raised by the dispute. More specifically we ask: In light of the underlying goals of the relevant WTO provisions, and taking them as given, was the resolution of the substantive economic issues around which the case revolved based on sound economic principles?

2 General economic analysis

The *EC – Bed Linen* case raises several levels of questions from an economic perspective. A first-level question is: What are the goals of the various WTO provisions touched upon in this case, and are the goals themselves sensible from an economic perspective? This is the question that we take up in this section. A second-level question is the following: In light of these goals, and taking them as given, was the resolution of the substantive economic issues around which the specific case revolved based on sound economic principles? This second-level question will be taken up in section 4, after the legal aspects of the case have been fully presented and evaluated in section 3.

What, then, are the goals of the various WTO provisions touched upon in this case? We attempt to answer this question in two steps. First, we consider Article VI GATT itself, within which the basic right of member governments to impose anti-dumping duties is described. Second, we consider the specific articles of the WTO Agreement on Implementation

[4] Most recently in November 2002, a 21.5 panel report was released concerning India's complaint that the EC's adjustment measures did not comply with the Dispute Settlement Body's ruling in the original dispute. This report focuses primarily on details of the revised EC methodology for calculating the dumping margins, on cumulation and on injury calculations. It is not discussed in any detail herein.

of Article VI (the Anti-dumping Agreement) that became the key areas of dispute in this case, namely, Articles 2.4.2 and 2.2.2.

Article VI of GATT begins by stating that "the contracting parties recognize that dumping, by which products of one country are introduced into the commerce of another country at less than the normal value of the products, is to be condemned if it causes or threatens material injury to an established industry in the territory of a contracting party or materially retards the establishment of a domestic industry." This statement appears to suggest that the goal of Article VI GATT as it relates to anti-dumping duties (Article VI GATT provides as well for countervailing duties) is, if not to discourage or prevent outright the practice of dumping in international trade, then at the very least to provide governments with the ability to shield their producers from the effects of dumping with extraordinary tariff responses.[5]

The tariff responses to dumping provided for in Article VI GATT are extraordinary not so much because they permit governments to raise tariffs above their bound levels in the face of import-induced injury – there are a variety of other "safeguard" provisions that might be utilized by a WTO member government to achieve this – but because they allow for *discriminatory* tariffs to be imposed and do not provide for the government of the country from which the dumped exports originate to seek *compensation*.

From a standard economic perspective, it is very difficult to make sense of the goal suggested by a reading of Article VI GATT. Unless dumping is truly predatory, which in practice appears rarely to be the case,[6] there is no standard efficiency rationale for the position that dumped imports should be treated any differently by a government than imports that are not dumped. Dumped or not, a given volume of imports will have the same impact on prices and incomes in the domestic economy once it crosses the border: why, then, should a government be permitted to respond to imports that are not dumped in one way (e.g. an Article XIX GATT "safeguard" action) but be granted the use of a special response (anti-dumping duties) when those imports are dumped?[7]

[5] The interesting drafting history of GATT's anti-damping provisions are discussed in Jackson (1969), pp. 401–24.

[6] See, for example, Shin (1998).

[7] Hence in standard formal economic models, governments exhibit no special concern for dumped imports as compared to imports that are not dumped, and this is true whether these governments are taken to be interested only in achieving maximum national income or are allowed to be sensitive as well to distributional/political economy concerns (e.g.

Of course, the citizens of a country may decide that dumping is simply "bad" or "unfair" in an ethical sense. These citizens might then ask their government to prevent such imports from entering the domestic market, if these dumped imports contribute to overall import volumes that materially injure producers in the domestic economy. This feature of preferences, like consumer preferences more generally, would typically be viewed as sovereign in economic analysis, and so economic arguments cannot be utilized to so clearly and directly assert that dumped and non-dumped imports should be treated the same in this case.[8] Indeed, from this broader perspective, if enough member-governments agree with this sentiment, then a reason for these governments to provide extraordinary tariff responses to dumped imports within the articles of the GATT/WTO could arise.[9] One might interpret the statement at the beginning of Article VI GATT as reflecting something like this kind of sentiment on the part of member governments.

To see how this broader perspective could provide a reason for permitting extraordinary tariff responses to dumped imports within the articles of GATT, let us suppose that member-governments do share this sentiment, but let us suppose further that there were no Article VI GATT. In this setting, if dumped imports began entering into a country's market and started contributing to overall import volumes that materially injure domestic producers, the government of this country might be compelled (by its citizens) to block the dumped imports at the border. But with no discriminatory means to do so at its disposal, the government would have to make use of one of the non-discriminatory safeguard provisions of the GATT/WTO, and could be compelled to eliminate all injury-causing imports with a safeguard action, when all it really wanted to do was prevent the dumped imports from entering its markets. From this broader perspective, the logic of a provision such as Article VI, which provides for

concerns that might give rise to a disproportionate emphasis on producer interests beyond that implied by economic efficiency).

[8] One might argue that at a minimum a more "cosmopolitan" view should be insisted upon, so that if dumping into the domestic market is deemed unfair when it is done by a foreign firm then one should insist that it should also be deemed unfair when it is done by a domestic firm, and therefore antidumping actions against the former should also consistently apply to the latter. However, imposing such a cosmopolitan viewpoint on the citizens of a country goes against the spirit of accepting preferences as sovereign, and so we do not impose it here.

[9] A similar line of argument might be developed for countervailing duty responses to subsidized exports, though in this regard it is interesting to observe that the language of Article VI GATT does not "condemn" foreign exports that benefit from foreign government subsidies in the way that it condemns foreign exports that are dumped.

a discriminatory tariff response in this circumstance, might be understood.[10]

A key question then becomes: Do the particular features of the tariff response allowed by Article VI GATT make sense from this broader perspective? As we have just illustrated, the ability to respond selectively on a discriminatory basis to dumped imports could make sense in this context.[11] But what about the lack of compensation provisions associated with the imposition of anti-dumping duties? As we observed above, this is a second distinguishing feature of anti-dumping duties. As we now argue, this feature is not easily justified even from this broader perspective, and the incentives created by this feature may help to explain an underlying reason for the central problem with anti-dumping actions within the GATT/WTO system, namely, the apparent tendency of member-governments to abuse these actions for protectionist purposes.

The essential point is simple. Compensation provisions in the GATT/WTO play a dual role. On the one hand, these provisions allow member-governments that suffer nullification or impairment as a result of the policy actions of another member-government to achieve some restitution. From this vantage point, it would seem strange to require that a first government compensate a second government for the loss of market access when the former raises its tariffs to prevent the latter's firms from dumping into its markets, given that dumping is viewed as unfair by the member governments.[12] But from the point of view of achieving efficient international policy outcomes, there is a second role for compensation that is potentially important: by seeking compensation, the second

[10] The logic of permitting a discriminatory response to dumping might also be understood from the perspective that such a response could help to protect third-country exporters from having their access to a foreign market eroded by dumped competing exports. On the general importance for the GATT/WTO of rules that can prevent the erosion by third parties of negotiated market access concessions, see Bagwell and Staiger (forthcoming).

[11] This is not to say that the ability to impose discriminatory tariffs comes without a cost. There are a number of possible costs associated with deviations from non-discrimination that could be relevant (see, for example, Bagwell and Staiger, 2002, Ethier, 2002, and Horn and Mavroidis, 2001. It is simply that the costs of the discrimination would have to be judged against the possible benefits as described above.

[12] The importance of the distinction between provisions that allow extraordinary tariff measures in response to "fair trade," such as Article XIX, and those that allow extraordinary tariff measures in response to "unfair trade," such as Article VI, is emphasized in the AB report (section IV) on *Line Pipe from Korea*. Our point here is that, while distinct features across these provisions may be warranted along some dimensions (e.g. whether discrimination is permitted), a distinction may not be warranted along the dimension of compensation.

government can force the first government (that takes the original policy action) to face more completely the full costs of its decision. This role for compensation can be important if governments are to face the "right" incentives when making their policy decisions, i.e. the incentives that lead them to make policy choices that are efficient from a world-wide perspective.[13]

Within the context of the GATT/WTO, compensation for the nullification or impairment of a previously negotiated market access concession has generally been interpreted to take one of several forms. The preferred form is the offer of an additional market access concession on other goods, so that the "overall" level of market access is maintained. But when this proves to be not feasible, the fallback is the withdrawal of equivalent concessions by the nullified party, so that the "balance" of market access concessions established by the original negotiation is maintained through measured retaliation.

As a consequence of this line of thinking, it may be argued that a basic problem with the provisions that permit the imposition of anti-dumping duties is that they suspend the general compensation/retaliation principle that otherwise permeates the GATT/WTO.[14] This lack of required compensation may in turn help explain why it is evidently so tempting for governments to find myriad ways to "over-utilize" anti-dumping protection: this is one route to protection where GATT/WTO rules do not require governments to face the full costs of their actions. An implication of this line of argument is that disputes over anti-dumping actions might be mitigated – because the underlying incentives of governments to misrepresent the circumstances that warrant anti-dumping duties would be reduced – if some form of compensation/retaliation rights were created when anti-dumping duties are imposed.[15]

While it may sound far-fetched and impractical to suggest that some form of compensation/retaliation rights should be created when

[13] By "efficient from a world-wide perspective," we mean efficient in light of the objectives of each of the member governments. When such efficiency is achieved, there is no further alteration in the policies of the member governments that could serve the objectives of one of them without hindering the objectives of another.

[14] An analogous argument for compensation could apply to countervailing duties. See also note 9 above.

[15] We observe that even the anti-dumping investigation process by itself can offer protection to import-competing producers (see Staiger and Wolak, 1994, and also Prusa, 2001), and so in principle the idea of requiring compensation could be extended to investigations even when they end in a negative finding. In practice however, the argument for compensation would be strongest when anti-dumping duties are imposed.

anti-dumping duties are imposed, when viewed from the perspective of actual anti-dumping practice the suggestion may be less dramatic than it first appears. This is because some compensation is often involved in the resolution of anti-dumping investigations, and so the suggestion above can be restated as a recommendation to make compensation/retaliation a more explicit, calibrated, and systematic feature of the anti-dumping rules.

For example, it can be said that compensation is taken by the exporters when an anti-dumping case ends in a "price undertaking" in which exporters agree to raise prices and no duty is imposed. Similarly, a form of compensation is present when anti-dumping investigations end in the imposition of voluntary export restraints (as in the US steel experience of the 1980s). And finally, one possible interpretation of the proliferation of anti-dumping laws and actions around the world documented by Prusa (2001) is that this new use of anti-dumping actions by the traditional targets of anti-dumping duties represents a blunt instrument for exacting compensation from the traditional users of anti-dumping actions by "retaliating" with anti-dumping actions of one's own.

From this perspective, compensation/retaliation is already and increasingly very much a part of anti-dumping actions. But as the above examples suggest, this compensation/retaliation is not provided for and governed in an explicit, systematic, and calibrated way by GATT/WTO rules. The economic arguments above suggest that, as it has done to great effect in other areas, it is conceivable that the GATT/WTO could harness retaliation and convert it to a tool of international order in the area of anti-dumping actions.

We next consider the specific articles of the Anti-dumping Agreement that became the key areas of dispute in this case, namely, Articles 2.4.2 and 2.2.2. Here we simply observe that these articles represent detailed attempts by the member-governments to spell out the methodologies that are acceptable for determining when anti-dumping actions may be taken and what level of actions are appropriate. Presumably, the reason that member-governments have felt the need to "micro-manage" the methodologies that may be used to determine if anti-dumping actions are warranted and the appropriate level of these actions is that, given the room, governments will find ways to abuse the opportunity to take anti-dumping actions for protectionist purposes.

While these articles (and the other articles of the Anti-dumping Agreement) can therefore be given a sensible interpretation within the

context of Article VI, the fact remains that member-governments have evidently not felt the need to spell out to nearly the same degree the conditions under which provisions that permit more reciprocal re-imposition of protection – through the accompanying use of compensation – may be invoked. These provisions include the temporary safeguards provided for in Article XIX GATT as well as the permanent "escapes" provided in the renegotiation provisions of Article XXVIII GATT .[16] Presumably, it is understood that the right of compensation goes a long way toward making the decision to re-impose protection "incentive compatible," thereby obviating to some degree the need for detailed rules covering the circumstances under which such actions may be taken.

3 Factual and legal claims

3.1 Introduction and overview

This case, brought by India, involves the methodology employed by the European Communities with respect to certain anti-dumping duties imposed on imports of cotton type bed linen. The dumping analysis went as follows: the EC undertook a sample of Indian exporters and also created a reserve sample in the event that companies in the sample refused to cooperate. In the sample, one of the five companies was found to have sales in the home markets that were appropriately representative; however, these were outside the ordinary course of trade. As a result, the "normal value" for all of the Indian producers was calculated on the basis of constructed value, which is provided for under Article 2.2.2 of the Anti-dumping Agreement.

The EC based its calculation of administrative, selling, and general costs and of profits on the amounts for the one company that was found to have sales of the same merchandise, although outside the ordinary course of trade. With respect to the injury analysis, the EC undertook a sample of domestic producers comprising seventeen EC companies.

The reviewing Panel concluded that the EC actions were inconsistent with various provisions of the Anti-dumping Agreement. Specifically, the EC was found to have acted inconsistently with its obligations under

[16] It is interesting to observe in this regard that the WTO Agreement on Safeguards couples the suspension of compensation rights for the first three years of a safeguard action (Article 8.3) with a more detailed set of rules to which safeguards qualifying for this exemption from compensation must conform, suggesting a trade-off perceived by the member-governments between provisions for compensation and detailed rules for re-imposing protection.

Articles 2.4.4, 3.4 and 15 of the Anti-dumping Agreement in determining the existence of anti-dumping margins on the basis of a methodology that incorporated the practice of zeroing; failing to evaluate all relevant factors having bearing on the state of the domestic industry; considering information for producers not part of the domestic industry; and failing to explore possibilities of constructive remedies before applying anti-dumping duties.[17] The EC appealed and India cross-appealed certain issues.

The AB focused on two sets of issues:

- First, whether the Panel erred in finding that the practice of "zeroing" as applied by the EC, is inconsistent with Article 2.4.2 of the Anti-dumping Agreement; and
- Second, whether the Panel erred in finding that the method for calculating amounts for administrative, selling, and general costs and profits provided for in article 2.2.2(ii) of the Anti-dumping Agreement may be applied where there is data for only one other exporter or producer; and in calculating the amount of profits under that provision, whether a Member may exclude sales by other exporters or producers that are not made in the ordinary course of trade.

3.2 A key issue: the practice of zeroing

Let us first examine the issue of "zeroing" and its consistency with Article 2.4.2 of the Anti-dumping Agreement. Article 2.4.2 explains how domestic investigating officials must proceed when establishing the existence of dumping. It states, in the pertinent part, that

> The existence of margins of dumping during the investigation phase shall normally be established on the basis of a comparison of a weighted average normal value with a weighted average of prices of all comparable export transactions or by a comparison of normal value and export prices on a transaction to transaction basis. A normal value established on a weighted

[17] See AB Report para. 4. In addition, the panel found that the EC actions were not inconsistent with the Anti-dumping Agreement with respect to calculating the amount for profit in constructed normal value; considering all imports from India as dumped in the analysis of injury caused by dumped imports; considering information for producers comprising the domestic industry but not among the sampled producers in analyzing the state of the industry; examining the accuracy and adequacy of the evidence prior to initiation; establishing industry support for the application; and providing public notice of its final determination. There were a number of procedural issues considered by the Panel that were not reviewed on appeal. These are not discussed herein.

> average basis may be compared to prices of individual export transactions if the authorities find a pattern of export prices which differ significantly among different purchasers, regions or time periods, and if an explanation is provided as to why such differences cannot be taken into account appropriately by the use of a weighted average to weighted average or transaction to transaction comparison.[18]

Article 2.4.2 therefore establishes two alternative methodologies: (1) that the investigating authorities compare the weighted-average normal value with a weighted average of all comparable export transactions, or (2) by a comparison of normal value and export prices on a transaction basis.

Zeroing, as practiced by the EC, involved identification of the product, which in this case was different models or types of cotton type bed linen, and determining a weighted-average normal value and a weighted-average export price for each *model*. The EC then compared the weighted-average normal value with the weighted-average export price. For some models, the normal value was higher than the export price and in those cases the export price was subtracted from the normal value and a "positive dumping margin" for each model was determined. For some, the normal value was less than the export price, and by subtracting the export price from the normal value for these models, the EC established a "negative dumping margin" for each model. Obviously in this latter category, dumping had not occurred since the export price was greater than the normal price.

When establishing the overall-dumping margin for the product as a whole, the EC undertook a two-stage analysis, and added up the amounts that it calculated as dumping margins. Any negative dumping margin was treated as a "zero." After adding up the positives and the zeroes, the EC would then divide this sum by the cumulative total quantity to come up with the average weighted dumping margin of that product.[19]

A simple example can help to illustrate the broad features of the EC's zeroing methodology. Suppose that, for the purpose of the export transactions under investigation, there are three models, or "types," of bed linen, labeled type 1, type 2 and type 3. Let us call v_1 the weighted-average normal value of type 1, v_2 the weighted-average normal value of type 2, and v_3 the weighted-average normal value of type 3. Similarly, let us call p_1 the weighted-average price of type 1, p_2 the weighted-average price of type 2, and p_3 the weighted-average price of type 3. Finally, let

[18] Para. 50. [19] Para. 47.

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us call e_1 the value of export transactions for type 1, e_2 the value of export transactions for type 2, and e_3 the value of export transactions for type 3.

According to the EC methodology, in a first stage the margin of dumping for each type of bed linen is calculated. Letting d_1 denote the dumping margin for type 1, this is calculated as $d_1 = v_1 - p_1$ for type 1. For types 2 and 3, the analogous calculations are, respectively, $d_2 = v_2 - p_2$ and $d_3 = v_3 - p_3$. If, say, for type 1, the weighted-average price were below the weighted-average normal value, then we would have $p_1 < v_1$ and therefore $d_1 > 0$: in stage 1 the EC would calculate a positive dumping margin for bed linen of type 1. Similarly, if for type 2 the weighted-average price were below the weighted-average normal value, then we would have $p_2 < v_2$ and therefore $d_2 > 0$: in stage 1 the EC would calculate a positive dumping margin for bed linen of type 2. But suppose for type 3 the weighted-average price were *above* the weighted-average normal value: then we would have $p_3 > v_3$ and therefore $d_3 < 0$, and in stage 1 the EC would calculate a *negative* dumping margin for bed linen of type 3.

The issue of zeroing arises in the second stage of the EC methodology, where these type-specific margins are combined in order to calculate an overall margin of dumping for the product under investigation. One approach would be to combine these type-specific margins using export shares as weights to calculate a trade-weighted average of the type-specific margins. Letting D denote the overall margin of dumping calculated under this first approach, we would have

$$D = [(e_1d_1) + (e_2d_2) + (e_3d_3)]/[e_1 + e_2 + e_3].$$

Notice that in the numerator of D, the positive margins for types 1 and 2 (d_1 and d_2) are added together with the negative margin for type 3 (d_3). For this reason, under this first approach, positive dumping margins on some types of the product can be offset by negative margins on other types of the product when calculating the overall margin of dumping for the product under investigation.

But this is *not* what the EC methodology does. Instead, under the EC's "zeroing" methodology negative margins are treated as "zeroes" in this second-stage calculation. Consequently, according to the zeroing methodology, d_3 – which recall is negative – would be set to zero. Letting Z denote the overall margin of dumping calculated under the EC's zeroing approach, we would have

$$Z = [(e_1d_1) + (e_2d_2)]/[e_1 + e_2 + e_3].$$

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Notice that in the numerator of Z, only the positive margins for types 1 and 2 (d_1 and d_2) are present: the negative margin for type 3 (d_3) is excluded from the calculation (d_3 is set to zero). For this reason, under the EC's zeroing approach, positive dumping margins on some types of the product *cannot* be offset by negative margins on other types of the product when calculating the overall margin of dumping for the product under investigation. As a consequence, in our simple example (but more generally as well, as long as there are some negative margins so that some zeroing takes place), it must be that the EC's zeroing approach leads to a higher calculated overall margin of dumping for the product under investigation than would be calculated in the absence of zeroing (i.e. as a simple statistical matter, it must be that $Z > D$).

The Panel found that the methodology, which included zeroing negative margins, was inconsistent with Article 2.4.2 of the Anti-dumping Agreement.[20] The EC contested this point and argued Article 2.4.2 required a comparison with the "weighted average of prices of all comparable export transactions" which is not the same as requiring a comparison with a weighted average of all export transactions. The EC argument hinged on the term "comparable" and it argued that Article 2.4.2 provides no guidance on how the margins for each type or model should be combined. The EC argued that zeroing takes place at a second stage in the analysis and that the Panel failed to give proper weight to this comparability element in Article 2.4.2.

The AB interpreted the margins of dumping to which Article 2.4.2 refer to be margins of dumping for a product – in this case cotton-type bed linen. It further held that it saw nothing in Article 2.4.2 that suggests a necessary two-stage process nor a distinction between types or models of the same product on the basis of these two stages. It recalled the methodology of Article 2.4 that states the comparison of weighted average normal value will be compared "with a weighted average of all prices of comparable export transactions."

Importantly, the AB agreed with the interpretation of the Panel that by zeroing the negative dumping margins, the EC did not "take fully into account the entirety of the prices of some export transactions . . . Instead, the European Communities treated those export prices as if they were less than they were. This, in turn, inflated the result from the calculation of the margin of dumping." The AB further argued that a comparison between export price and normal value that does not take fully into account the

[20] See Panel Report, para 6.119.

prices of all comparable export transactions (including the practice of zeroing) "is not a fair comparison between export price and normal value as required by Article 2.4 and Article 2.4.2."[21] Hence, the AB upheld the Panel's finding that the practice of zeroing "when establishing the existence of margins of dumping as applied by the European Communities is inconsistent with Article 2.4.2."

3.3 Methods for calculating margins under Article 2.2.2 of the Agreement.

Another central issue on appeal had to do with the Panel's interpretation of Article 2.2.2(ii) of the Anti-dumping Agreement. Article 2.2 provides that the margin of dumping for the product may be determined by comparison of the export price of the product with a constructed normal value consisting of the cost of production of the product in the country of origin plus a reasonable amount for administrative, selling, and general costs as well as for profits. Article 2.2.2 sets out how these are calculated.[22]

The first issue under Article 2.2.2(ii) of the Anti-dumping Agreement is whether the method of calculating administrative, selling, and general costs and profits can be applied where there is data for only one other exporter or producer and a second issue reviewed by the AB was whether in calculating the amount for profits, a Member may exclude sales by other exporters that are not made in the ordinary course of trade. India

[21] See para 55. On the question of comparability, the AB noted that the product definition was cotton-type bed linen. The EC argued that its interpretation of Article 2.4.2 of the Anti-dumping Agreement was a "permissible interpretation" within the meaning of Article 17.6(ii) of the Anti-dumping Agreement. The Panel disagreed and the AB confirmed their finding.

[22] The Article states: "For purpose of paragraph 2, the amounts for administrative, selling and general costs for profits shall be based on actual data pertaining to production and sales in the ordinary course of trade of the like product by the exporter or producer under investigation. When such amounts cannot be determined on this basis, the amounts may be determined on the basis of:

> (i) The actual amounts incurred and realized by the exporter or producer in question in respect of production and sales in the domestic market of the country of origin of the same general category of products; (ii) the weighted average, of the actual amounts incurred and realized by other exporters or producers subject to investigation in respect of production and sales of the like product in the domestic market of the country of origin; (iii) any other reasonable method, provided that the amount for profit so established shall not exceed the profit normally realized by other exporters or producers on sales of products of the same general category in the domestic market of the country of origin.

appealed the findings of the Panel on these two issues and the AB reversed the Panel findings.

On the first issue, the Panel concluded that Article 2.2.2(ii) may be applied where there is data concerning profit and administrative, selling, and general costs for only one other producer or exporter; and further that under this same Article sales not in the ordinary course of trade are excluded from the determination of the profit calculation of a constructed normal value.[23]

As noted, the AB reversed the Panel findings on these two points. Looking at the language of Article 2.2.2(ii), the AB noted that it refers to "the weighted average of the actual amounts incurred and realized by other exporters or producers." In the AB's view, this use of the plural in the article precludes including the singular case. Moreover, the very phrase "weighted-average" cannot be calculated on the basis of only one exporter or producer. In the AB's view, in contrast to the Panel, this weighted-average methodology is the indispensable feature to the calculation method[24] and it is not a concept that is relevant where there is not information from more than one other producer to be considered.

On the question of the exclusion of profits that are not made in the ordinary course of trade, the AB again looked to the language of Article 2.2.2(ii) which states that administrative, selling, and general costs and profits are determined on the basis of "the weighted average of the actual amounts incurred and realized by other exporters or producers" and noted that this does not make exceptions or qualifications regardless of whether those amounts are incurred and realized on production and sales in the ordinary course of trade or not.[25] The AB drew support for this textual interpretation given that the method set out in Article 2.2.2(ii) is one of three alternative methods that can be applied when the administrative, selling, and general costs and profits cannot be determined by the principal method which is set out in the chapeau of Article 2.2.2, which refers to "actual data pertaining to production and sales in the ordinary course of trade."[26] Hence, the AB interpreted this to mean that sales not in the ordinary course of trade are to be excluded when calculating amounts for administrative, selling, and general costs and profits.

By reversing the Panel findings on these two points, the AB concluded that the EC acted inconsistently with Article 2.2.2(ii) of the Anti-dumping Agreement on these points.

[23] See para. 6.75 of the Panel Report and para. 6.87. [24] See para. 75.
[25] See para. 80. [26] See para. 82.

3.4 *Legal and policy questions*

In our view, the Panel and the AB got it right that the zeroing methodology as utilized by the EC in this case served to inflate margins and thus produced results inconsistent with the obligations set out in the Anti-dumping Agreement. Yet whether one agrees or disagrees with that conclusion, the legal reasoning utilized by the Panel and the AB to reach that conclusion deserves some further scrutiny. In particular, we focus on the treatment of zeroing as well as the deference standard that was applied in this case.

As discussed above, the practice of zeroing was reviewed in the context of Article 2.4.2 of the Anti-dumping Agreement. It is interesting to recall that in the pre-Uruguay Round period, the 1979 Antidumping Code provided fairly detailed guidance on margin calculation methods. It did not specify however whether comparisons should be made on a transactional basis, a weighted-average basis or some combination of these methods. During the Uruguay Round, a number of nations sought to require margin calculations to be made on a consistent basis (e.g. either transaction to transaction or average to average) rather than a mixture of methodologies such as weighted averages for home market and individual export transactions for the export market prices. Some GATT members argued that the mixed methodology of zeroing any individual export transactions that exceeded the weighted-average normal value resulted in a statistical bias in favor of finding dumping margins. Defenders traditionally claimed that transactional review was, however, necessary to prevent "targeted dumping" aimed at specific types, models, geographic areas, etc.[27]

The resulting Article 2 sets some conditions on the use of transaction price comparisons, but it also retains some ambiguity with respect to transaction by transaction analysis. It does not specifically mention the practice of zeroing. As noted, the basic framework requires either average or transaction price comparisons. Administrators are somewhat circumscribed in their actions in that the provision does not permit methodologies to be combined unless there is some evidence of a "pattern" of export prices that "differs significantly" among different purchasers, regions or time periods. These terms are not further defined.

The *EC – Bed Linen* dispute actually does not illustrate the specific problem that informed the crafting of 2.4.2. Instead, it involved the use of weighted average to weighted average zeroing comparisons but applied a two-step methodology of zeroing. The AB focused primarily on the point

[27] See, Stewart (1993), Kim (2002).

that the EC could not claim that different models of one product are not comparable for purposes of margin analysis and further that it could not exclude some prices when the Anti-dumping Agreement spoke of "all comparable" transactions. In this sense, the AB ruling is not definitive on the issue of zeroing. The AB report seems to hold for the proposition that the EC approach to zeroing prevents a "fair comparison" as required by Articles 2.4 and 2.4.2. We do not read the opinion as stating that zeroing is prohibited.[28] However, the scope for zeroing appears to have been narrowed.

Turning to the question of the standard of review, the EC argued that since the Panel did not find zeroing as such to be impermissible under Article 2.4.2 of the Anti-dumping Agreement,[29] the Panel's determination was inconsistent with the legal standard of review contained in the Anti-dumping Agreement. The standard of review is contained in Article 17.6 of the Anti-dumping Agreement which states that:

> (i) in its assessment of the facts of the matter, the panel shall determine whether the authorities' establishment of the facts was proper and whether their evaluation of those facts was unbiased and objective. If the establishment of the facts was proper and the evaluation was unbiased and objective, even though the panel might have reached a different conclusion, the evaluation shall not be overturned;
>
> (ii) the panel shall interpret the relevant provisions of the agreement in accordance with customary rules of interpretation of public international law. Where the panel finds that a relevant provision of the Agreement admits of more than one permissible interpretation, the panel shall find the authorities' measure to be in conformity with the Agreement if it rests upon one of those permissible interpretations.

As is well known, during the Uruguay Round, negotiations over this provision of the Anti-dumping Agreement were especially delicate and have been characterized as a "deal breaker" issue.[30] The resulting compromise was intended by its advocates to constrain the standard of review

[28] Indeed, the practice of zeroing has surfaced in another anti-dumping case, *US – Steel*, but in that case Korea did not claim that the zeroing of margins when the subperiods were recombined was a violation of 2.4.2. The *EC – Bed Linen* case also raises an interesting question about the status of zeroing. Having found the zeroing practice as utilized by the EC to be inconsistent with the Anti-dumping Agreement, are other jurisdictions utilizing comparable zeroing techniques also in violation of Article 2.4.2? Are such WTO members under an affirmative obligation to reform their own practices? Since there are a number of other jurisdictions that may deploy an analogous methodology, this question is not merely theoretical. An interesting paper by Natalie McNelis raises and explores this question in some detail. See, McNellis (2002).

[29] See, Panel Report, para. 6.116

[30] See, Croley and Jackson (1996).

applied by a WTO panel and suggest a different and more specific standard than that contained in Article 11 of the DSU.[31]

There are essentially two prongs to 17.6, the first speaks to the standard of review to be applied to the factual features of the case (e.g. requiring the administering agencies to establish facts properly and to evaluate them in an unbiased and objective manner) and the second, 17.6(ii), speaks to the standard of review that should be applied with respect to legal interpretation. The methodology for reaching an interpretative judgment on this second prong is textually ambiguous. Some experts have argued that it bespeaks a two-step process whereby the panel must first consider whether the provision at issue produces more than one interpretation. If not, the panel "must vindicate the provision's only permissible interpretation. If, on the other hand, the panel determines that the provision indeed admits of more than one interpretation, the panel shall proceed to the second step of the analysis and consider whether the national interpretation is within the set of 'permissible' interpretations. If so, the panel must defer to the interpretation given to the provision by the national government."[32] While the operation of 17.6(ii) is not fully clear, it appears to have been introduced to provide a certain additional degree of latitude to national authorities.[33]

In *EC – Bed Linen*, the factual prong of 17.6 was not actively examined by the panel. With respect to the second prong, the panel explicitly noted that it was charged with interpreting the Anti-dumping Agreement in accordance with the customary rules of interpretation of public international law as set out in the Vienna Convention.[34] The AB did not give this issue much in-depth examination. For the AB, given that the Panel had recognized its interpretive responsibility, it deferred to the

[31] According to Horlick and Clark (1997), the US made several efforts during the Uruguay Round to significantly narrow the scope of review by a dispute panel with respect to anti-dumping duties. These proposals were strenuously resisted by most other countries and the US eventually had to "relax its position significantly, and, in the end, achieved agreement on language that essentially codified existing panel practice concerning the standard of review," p. 317.

[32] Ibid., p. 200.

[33] Some US anti-dumping advocates have characterized the second part of this legal prong as akin to a "reasonableness" standard, whereby panels are provided an opportunity to defer to an administering authority's interpretation of the Anti-dumping Agreement but are not required to do so. But this "reasonableness" interpretation is not universally accepted among experts and indeed the term itself was advanced by the United States and not accepted during the Uruguay Round negotiations. See, Rosenthal and Vermylen (2000) and Horlick and Clark (1997).

[34] See, Panel Report 6.46.

Panel's reasoning[35] and said that "it appears clear to us from the emphatic and unqualified nature of this finding of inconsistency that the Panel did not view the interpretation given by the European Communities of Article 2.4.2 of the Anti-dumping Agreement as a 'permissible interpretation' within the meaning of Article 17.6(ii) of the Anti-dumping Agreement. Thus, the Panel was not faced with a choice among multiple 'permissible' interpretations, which would have required it, under Article 17.6(ii) to give deference to the interpretation relied upon by the European Communities."[36]

Thus, even though the applicable provision of the Anti-dumping Agreement did not speak of the practice of zeroing as such, the AB concurred with the Panel's interpretation that the EC practice produced results that were inconsistent with the obligations set forth in the Anti-dumping Agreement. This legal reasoning does not suggest to us that the WTO Panel failed to consider whether the interpretation advanced by the EC was within the sphere of a permissible interpretation. The AB's review and treatment of the interpretive standard was not sufficiently detailed in this case, however, to shed much light on how best to operationalize the degree of deference implicated by 17.6(ii). It was considered by the AB in somewhat greater detail in earlier cases.[37]

4 Specific economic analysis

We now consider and evaluate the particular legal and economic issues and methodologies raised by the dispute. More specifically we ask: In light of the underlying goals of the relevant WTO provisions, and taking them as given, was the resolution of the substantive economic issues around which the case revolved based on sound economic principles? The central substantive economic issue of this case concerns the details of measuring the margins of dumping, and in particular the issues of (i) whether the practice of "zeroing" is permissible, and (ii) how the amounts for

[35] See, Panel Report Para 6.46. [36] See, Panel Report 65.

[37] An earlier case, *US – Hot Rolled Steel*, considered 17.6 somewhat more in depth. In that case, the AB held that the 17.6(ii) does not conflict with the DSU Article 11 and explained that the second sentence of 17.6(ii) posits the possibility that under customary rules of interpretation two or more interpretations of an applicable provision would be permissible but that such an interpretation would be considered after applying the rules of the Vienna Convention. See, paras. 58–62. Some experts have suggested that relevant provisions of the Vienna Convention may not allow multiple permissible interpretations, but this is a debate that we cannot fully develop herein. See, Vermulst and Graafsma (2001).

administrative, selling, and general costs and for profits should be measured in calculating the "constructed normal value."

From an economic perspective, the resolution of the issues around which this case revolved appears somewhat twisted. More than anything else, this may illustrate the difficulty of writing rules in an attempt to constrain governments to act "appropriately," but leaving them with the incentive (as discussed in section 2 above) to act inappropriately. In this environment, governments will seek new ways to "game the system," and there is no realistic set of rules that can be written down to prevent this. The Panel and the AB are then left with the difficult task of finding ways to interpret the rules so that they achieve the desired intent, which is to say the Panel or the AB must act to "complete" this incomplete contract. While the findings in this case appear sensible from the point of view of preventing what would seem to most economists to be "abusive" protectionist practices, the arguments offered by the AB to support the decisions can also sound quite arbitrary from an economic perspective.

On the question of whether the practice of "zeroing" is permissible, this appears to be a circumstance in which the explicit rules for calculating dumping margins (as contained in Article 2.4.2 of the Anti-dumping Agreement) leave some ambiguity as to what is permissible. In this case, the EC chose to use a methodology for calculating margins (zeroing) which, while undeniably leading to higher margins than would be calculated if zeroing were not employed (see our discussion in section 3), the EC nevertheless argued was within the permissible methods according to the rules.

On strictly economic grounds, it is difficult to evaluate formally the merits of zeroing, though as we have indicated in section 3 it is clear that, for any given distribution of prices within a product line, as a statistical matter zeroing leads to greater calculated margins than would be calculated in its absence. The difficulty in evaluating formally the economic merits of zeroing can be traced back to the lack of general clarity as to exactly why dumping is to be "condemned" in the first place.

For example, suppose one adopts the perspective that the prevention of predatory pricing is at the heart of anti-dumping actions. Then it might be argued that the practice of zeroing could be justified, because otherwise a firm could engage in "targeted dumping": that is, it could set low predatory prices on some models of a product that were especially close substitutes to the models sold by the local competitors it was attempting to drive out, and then "mask" its predatory pricing ("positive dumping margins") with high

prices ("negative dumping margins") on other models of that product that were less-close substitutes with the models sold by its competitors.

As we have described in section 3 above, absent the zeroing methodology, this firm's negative margins would offset its positive margins in the calculation of the overall dumping margin for the product, and by pricing this way a savvy predator might avoid the penalty of anti-dumping duties altogether when zeroing is not permissible. In this case, the practice of zeroing can "unmask" the predator. However, if firms routinely set prices on some models of a product so as to "cross-subsidize" sales of other models of that product, then zeroing would mistakenly identify this normal business practice as dumping. In this case, the practice of zeroing can allow "innocent" (i.e. non-predatory) firms to be made the target of anti-dumping actions.

From this perspective, the problem with zeroing is that, while it could be beneficial in making anti-dumping actions a more effective tool for preventing predatory pricing, it carries with it the associated risk that a firm could be inappropriately penalized with anti-dumping duties even when its product line as a whole is priced so as to earn "its normal value." Therefore, if one adopts the perspective that dumping is to be "condemned" because it is often predatory, and that the prevention of predatory pricing is therefore a serious task of anti-dumping actions, then the merits of zeroing depend on the relative importance of these benefits and risks.

On the other hand, if one rejects this perspective, as many economists do, on the basis of the available evidence suggesting that predatory dumping is rare in practice (see note 6), then the merits of zeroing can be formally evaluated only once an alternative reason for condemning dumping is articulated (as, for example, in the discussion of section 2 above). This is because, in the absence of such an articulation, any formal evaluation of the merits of zeroing would by necessity begin from the position that anti-dumping actions should not be permitted by the WTO in the first place, a starting position that would in large part trivialize the evaluation of the merits of zeroing.

The difficulty, then, is that there is no widely accepted formal framework that implies a role for anti-dumping actions, and that therefore provides a perspective from which the economic merits of zeroing can be formally evaluated. Hence, it is difficult to evaluate formally the economic merits of zeroing, because there is not an accepted understanding of why dumping is to be "condemned" in the first place.

Interestingly, the possibility that the kind of predatory "targeted dumping" described just above might justify the zeroing methodology was

considered by the AB (paragraph 62) and dismissed, largely because the AB suggested that "... if the European Communities wanted to address, in particular, dumping of certain types or models of bed linen, it could have defined, or redefined, the *product* under investigation in a narrower way" (AB Report, paragraph 62). But the reasoning of the AB on this point may be too simple, because it suggests the possibility that the product under investigation could always be defined narrowly enough to "surgically remove" the targeted dumping. The problem with this possibility is that it suffers from the same basic problem as zeroing: "innocent" (i.e. non-predatory) firms could be made the target of anti-dumping actions, in this case simply by defining the product under investigation in a sufficiently narrow fashion to include only those types or models of the product for which the firm's margins were positive.[38]

In the end, with regard to the EC's practice of zeroing, the AB seems to have found fault with the internal inconsistencies of the EC's defense of its methodology, and in particular with its insistence on seeing "... the physical characteristics of cotton-type bed linen in one way for one purpose and in another way for another."[39] A reasonable interpretation of the AB's approach to this determination is that such internal inconsistencies belie an effort to stay within the broader intent of these rules, and indicate instead an (awkward) attempt by the EC to pick and choose methodologies for their protectionist effect.

On the question of how the amounts for administrative, selling, and general costs and for profits should be measured in calculating the "constructed normal value," a central issue was whether a weighted average of administrative, selling, and general costs can be calculated for only one producer. The AB concludes that this is not possible, stating: "First of all, and obviously, an 'average' of amounts for SG&A and profits *cannot* be calculated on the basis of data on SG&A and profits relating to only *one* exporter or producer ... In short, it is simply not possible to calculate the

[38] In fact, in some ways the problem associated with zeroing would be exacerbated under the AB's suggestion, in the sense that the calculated overall margin on this narrower range of models would be higher than the overall margin calculated under zeroing. This can be seen with reference to our example in section 3 above. There we showed that, under zeroing, the overall margin of dumping for the product under investigation was given by $Z = [(e_1 d_1) + (e_2 d_2)]/[e_1 + e_2 + e_3]$. Adopting the AB's suggestion of defining the product more narrowly to include only those models for which the margin was positive, the overall margin (denoted by A) would be calculated as $A = [(e_1 d_1) + (e_2 d_2)]/[e_1 + e_2]$, from which it follows that $A > Z$.

[39] AB Report, p. 19.

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'weighted average' relating to only one exporter or producer."[40] Of course, it *is* possible, though trivial, to calculate the weighted average relating to only one exporter or producer: it is defined simply as the amounts for administrative, selling, and general costs and profits for that producer or exporter.

Presumably the underlying logic for why it might be sensible to disallow such calculations when there is only one other exporter or producer is more subtle, and has something to do with the view that data taken from a single other producer or exporter could introduce a large element of idiosyncratic "noise" into the cost calculation, while data taken from a weighted average of a (preferably large) number of other producers or exporters is less likely to reflect the idiosyncrasies of any one producer or exporter. And the more variability there is in the approved methods for calculating costs under the rules, the more room there will be for governments to "game the system" by choosing the approach that best suits their protectionist incentives. In this way, the finding of the AB on this matter may appear sensible, though the particular reasoning by which it supported this decision appears curious.

5 Concluding observations on the legal tests and economic analysis

Let us now consider, in brief, the relationship between the legal rules and economic assessments of the dispute. As noted earlier, there is room for ambiguity in the treaty text that governments can utilize. In a narrow sense, this case suggests that the rules provide a sufficient basis for adjudicators to evaluate whether the particular methodology used by the national authority inflates margins and whether the national procedures are generally consistent with the overall Anti-dumping Agreement. From an economic perspective, however, this case, not unlike certain other anti-dumping cases, points up the conceptual problems of the Anti-dumping Agreement.

This analysis has suggested that one possible approach to shift incentives away from excessive – or unrestrained – use of anti-dumping procedures would be to introduce compensation provisions into the legal texts of the GATT/WTO anti-dumping rules. We have not attempted herein to assess the political feasibility of this or any other reform proposal, but the logic of the basic suggestion follows from a simple economic observation:

[40] Ibid., p. 23.

by having the right to seek compensation, countries can force a government that takes an original policy action to face more completely the full costs of its decision. This is important if governments are to face the "right" incentives when making their policy decisions.

At a broad level, this observation identifies an important role for compensation within the GATT/WTO system. The lack of required compensation may help explain why it is evidently so tempting for governments to find myriad ways to "over-utilize" anti-dumping protection: anti-dumping procedures provide one route to protection where GATT/WTO rules do not require governments to pay the full costs of their actions. While speculative, of course, this suggests that WTO disputes over anti-dumping actions might be mitigated – because the underlying incentives of governments to initiate cases in circumstances that do not warrant anti-dumping duties would be reduced – if some form of compensation were required when anti-dumping duties are imposed.

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