Reforming GATT Adjudication Procedures: The Lessons of the DISC Case

Robert E. Hudec

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Reforming GATT Adjudication Procedures: The Lessons of the DISC Case*

Robert E. Hudec**

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I. INTRODUCTION

DISC stands for Domestic International Sales Corporation, a tax avoidance device enacted in 1971 to reduce income taxes for United States exporters.¹ Early in 1972 the European Community brought a lawsuit charging that DISC was an export subsidy that violated the General Agreement on Tariffs and Trade (GATT).² The United States responded by filing three

* © 1988 by Robert E. Hudec.
** Melvin C. Steen Professor of Law, University of Minnesota.
2. GATT, a multilateral trade agreement, was originally concluded in
counterclaims charging that, if DISC violated GATT, so did the income tax laws of France, Belgium, and the Netherlands. The four lawsuits, collectively known as the DISC case, were a landmark event in the development of GATT law. The litigation dragged on for over twelve years, reaching impasse at almost every stage of the proceedings and finally ending with an outcome that satisfied almost no one. Most observers view the DISC case as the largest and most conspicuous failure in the history of GATT's litigation procedure. Because the DISC case


The text of the General Agreement has been amended several times since 1947, most recently in 1965. The official current text, together with an appendix listing all amending protocols, is published by GATT in *The Text of the General Agreement on Tariffs and Trade*, U.N. Sales No. GATT/1986-4 (1986). A more widely distributed edition of the current official text is a 1969 printing issued as Volume IV of the GATT's official document series. See 4 Contracting Parties to the General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents (1969) [the series, annual editions of which are called Supplements, will hereinafter be cited as GATT, BISD]. All citations to GATT in this Article are citations to the current official text.

The term GATT also describes the international organization that administers the General Agreement. GATT has a Secretariat of several hundred people, a building in Geneva, a rather elaborate organizational structure of committees and other working bodies, and an agenda of meetings daily throughout the year. As this Article will show, the GATT's business also includes a lively practice of adjudicating legal disputes among its members.


3. Four GATT documents giving the reports of the various panels in the DISC case are cited infra note 78.

GATT LITIGATION

is often the only example of GATT law enforcement known to outsiders, its reputation has been responsible for a widespread belief among policy makers that GATT law is not an effective regulatory instrument.

At present the GATT is in the early stages of a major new trade negotiation called the Uruguay Round, in which reform of GATT litigation procedures has been declared a major objective. The memory of the DISC case continues to exert an influence over the participants in these negotiations. To the extent these perceptions are inaccurate or incomplete, they could cause participants to miss the target—to set expectations for GATT law that are too low, or to address the wrong problems in trying to strengthen it. It is a good time to set the record straight about what actually happened in the DISC case, and why it happened.

This Article seeks to present a complete record of the DISC case from beginning to end. It tries not only to scrape away misperceptions, but also to bring to light the many good lessons that present-day negotiators can draw from this rich and varied lode of GATT legal experience.

A. THE ORIGINS OF THE DISC LEGISLATION

The DISC legislation arose out of the deteriorating trade and payments position of the United States in the late 1960s and early 1970s. In August 1971 the United States responded to the crisis by abandoning its promise to redeem United States...


The leading work on the DISC case itself is a 1978 article by Professor Jackson written just shortly after the panel decision. See Jackson, *The Jurisprudence of International Trade: The Disc Case in GATT, 72 Am. J. INT'L L. 747 (1978).*

5. The Uruguay Round of trade negotiations was opened in September 1986 by a Ministerial Declaration signed in Punta del Este, Uruguay. See GATT, BISD, 33d Supp. at 19-52 (1987) (containing text of Declaration and decisions defining negotiating agenda). The agenda is the most ambitious ever undertaken by GATT. In addition to conventional negotiations on trade barriers, including what promises to be the first serious effort to reduce distortions in agricultural trade, the agenda calls for a comprehensive review of the legal and institutional framework of GATT and a sweeping new initiative to extend GATT legal disciplines to international transactions in services and to certain trade-related issues of intellectual property rights and foreign investment policies. For a summary of the issues, see CONGRESSIONAL BUDGET OFFICE, THE GATT NEGOTIATIONS AND U.S. TRADE POLICY (1987); THE URUGUAY ROUND: A HANDBOOK ON THE MULTILATERAL TRADE NEGOTIATIONS (J. Finger & A. Olechowski eds. 1987).
dollars for a fixed quantity of gold. At the same time, it announced a package of other trade and payments measures designed to improve its balance-of-payments position. The proposed DISC legislation was one element of the package.

DISC was an effort to encourage exports by lowering income taxes on profits from exporting. The new law achieved this objective in the following rather roundabout manner: it invited exporters to create a separate domestic corporation, a DISC, that would have no assets, no employees, and no business function other than lowering taxes. The law then permitted exporters to run export sales through the DISC by selling export goods to the DISC and then having the DISC resell them to the ultimate foreign buyer. Profits from the two-step sale could then be divided between the DISC and its parent company, according to one of several statutory formulas. The profits attributed to the parent would be taxed as ordinary income to the parent. One-half of the profits attributed to the DISC would be deemed distributed back to the parent company, which would pay income tax on them as well. No tax would be paid on the other half of the DISC's profits. This tax liability would be deferred.

Deferral was a tricky concept. It did not mean that the exporter's income tax liability for the other half of the DISC's profits was being totally forgiven. It meant that the liability was merely being suspended for as long as the profits were retained inside the DISC and were used only for export-related business. No interest was charged on this suspended liability, nor was there any limit on how long deferral might last. After some hesitation business executives and their accountants began to ignore the contingent tax liability and to treat the yearly tax savings as permanent gain that could be reported as corporate earnings. Under the 1971 version of the law, most United

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9. See id. at 452-61.

10. Id.

States exporters could defer taxes on up to 25% of total export profits. Under a less generous version enacted in 1976, the average deferral was about 17-18%.

The DISC law was more than an emergency balance-of-payments measure. More than a year before the August 1971 crisis, the United States Treasury Department had proposed DISC as a tax reform measure, arguing that DISC was needed to correct competitive disadvantages United States exporters were experiencing due to differences between United States and foreign tax laws. Although several disadvantages were mentioned at the time of DISC’s enactment, the United States used only one as a justification for DISC in the GATT lawsuit that followed: the higher income taxes that United States exporters were being forced to pay due to differing tax treatment of “tax-haven” export transactions.

A tax haven is a country that offers low or zero income tax

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12. The original 25% deferral could be achieved under a formula of the original statute allocating half of all export income to the DISC and deferring taxes on half of that. See I.R.C. § 994 (1982).

13. In 1976 the DISC law was amended so that tax benefits were confined to profits earned on increased imports—that volume of exports which exceeded 67% of the average volume of exports during a four-year base period beginning seven years before the tax year in question. Tax Reform Act of 1976, Pub. L. No. 94-455, § 1061, 90 Stat. 1649 (codified as amended at I.R.C. § 995 (1982 & West Supp. 1988)). In 1982 the law was amended again to reduce the share of DISC income eligible for tax deferral from 50% to 42.5%. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 204(a), 96 Stat. 423 (codified as amended at I.R.C. § 291(a)(4) (West Supp. 1985)). The United States estimated in a statement to the GATT Council that the amended DISC resulted in deferral of approximately 17-18% of total export income. GATT Doc. C/M/159 (June 29-30, 1982 mtg.) at 8; see also STAFF OF SENATE COMM. ON FINANCE, 98TH CONG., 2D Sess., DEFICIT REDUCTION ACT OF 1984: EXPLANATION OF PROVISIONS 633 (Comm. Print 1984) [hereinafter 1984 SENATE REPORT].


15. The long-standing complaint about “border tax” adjustments, the accepted practice of remitting value-added and other such taxes on exported goods and of imposing such taxes on imports, received almost equal attention during the process of enactment. See Jackson, supra note 4, at 750-51. The author found no mention of this justification in the documents of the GATT lawsuit.

16. See, e.g., GATT Doc. C/M/87 (May 29, 1973 mtg.) at 5 (United States testimony before GATT that “DISC provisions merely extended to United States exporters a type of tax treatment comparable to that which was available to exporters . . . in many other countries.”).
rates to certain firms doing business there, often to foreign-owned firms the government seeks to attract. Exporters use tax havens in much the same way that DISCs were designed to be used. They set up a branch or wholly owned subsidiary corporation inside the tax-haven country. They then sell export goods at the lowest possible price to the tax-haven branch or subsidiary, which resells the goods to the ultimate foreign buyer. The sale to the subsidiary is normally just a paper transaction, with the goods moving directly from the exporter to the ultimate foreign buyer. The purpose of the fictitious sale-resale transaction is to shift some of the export profits to the branch or subsidiary in the tax-haven country, where local tax laws impose little or no income tax. If the tax laws of the home country do not intrude, the exporter realizes a tax saving which, according to United States estimates at the time, could be as much or more than the savings resulting from tax deferral under DISC.\textsuperscript{17}

The income tax laws of many countries did in fact permit exporters to reduce taxes on export income by employing tax-haven export transactions. Following what is called the "territoriality" principle, these laws did not tax income earned outside the country’s territory, nor did they impose more than a token tax on foreign earnings remitted to the home country.\textsuperscript{18} The United States Internal Revenue Code did not allow such tax savings, however. Under a 1962 amendment to the Internal Revenue Code known as Subpart F, United States exporters were required to pay income taxes on the export income of tax-haven subsidiaries that conducted no manufacturing in the tax-haven country.\textsuperscript{19} Because of Subpart F, most United States exporters were paying greater income taxes on their export income than were tax-haven exporters from countries following

\begin{flushleft}
\textsuperscript{17} See GATT Doc. C/M/159 (June 29-30, 1982 mtg.) at 8 (United States Statement).

\textsuperscript{18} The territoriality principle is discussed in detail in the panel reports on the French, Belgian, and Netherlands laws. See infra note 78.

\textsuperscript{19} Revenue Act of 1962, Pub. L. No. 87-834, § 12, 76 Stat. 1006-27 (codified at I.R.C. §§ 951-964 (1982)). Before 1962 United States exporters had been able to benefit from tax-haven transactions, provided they were constructed in a certain way. Unlike some European tax laws that do not tax the income of a company’s branches in other countries, United States law would not treat the income of a tax-haven entity as separate from the parent’s unless it was a separate corporation incorporated abroad. And unlike some European laws that allow the parent to repatriate the foreign profits without being taxed, United States law treated repatriated profits as taxable income to the parent. To escape income taxation, the tax-haven subsidiary’s income had to remain abroad.
\end{flushleft}
the territoriality principle. The DISC legislation was meant to correct this relative disadvantage.20

The fact that DISC was rooted in a concern for tax parity would be of critical importance in the GATT litigation that followed. Because the United States Treasury Department believed strongly in the legitimacy of this objective, it would defend DISC with an intensity considerably greater than governments normally expend on ordinary beggar-thy-neighbor trade measures. Indeed, the United States would never yield on the legitimacy of DISC's basic purpose.

Unfortunately, in pursuing this tax parity objective the United States government could not resist trying to capture a small additional advantage as well. The simplest way to restore tax-haven benefits for United States exporters would have been to repeal the relevant provisions of Subpart F, thereby restoring the exporter's ability to exclude the income of foreign subsidiaries operating in tax-haven countries. Instead, the new law created a domestic tax haven—the DISC—and limited the tax benefits to sales made through that domestic entity. The reason for establishing a domestic tax haven was to reduce the outflow of dollars by keeping all export profits within the United States.21 The domestic character of DISC distinguished it from tax-haven benefits available under the territoriality principle. The distinction would be DISC's undoing in GATT.

B. THE GATT LEGAL PROBLEM

The DISC law raised an issue of conformity with the United States's legal obligations under the GATT. GATT Article XVI:4 prohibits governments from granting subsidies on the export of industrial products:

[C]ontracting parties shall cease to grant either directly or indirectly any form of subsidy on the export of any product other than a primary product which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.22


21. See Jackson, supra note 4, at 751.

22. GATT, BISD, Vol. 4, at 27. The term "primary product" is defined in Annex I to the text of the General Agreement as "any product of farm, forest or fishery, or any mineral, in its natural form or which has undergone such processing as is customarily required to prepare it for marketing in substantial
In GATT law the term *subsidy* has never been expressly defined. Its core concept is a government-created advantage that distorts the recipient’s market behavior in favor of the subsidized transaction. A 1960 report adopted by the GATT Contracting Parties concluded that selective “remission” or “exemption” of income taxes with respect to export sales was a subsidy on exports under Article XVI:4. The DISC’s potentially infinite “deferral” of income taxes on export sales appeared to have the same purpose and the same effect. Although Article XVI:4 was in force for only seventeen countries in 1971, the United States was one of those seventeen.

There were three possible defenses to the charge that DISC violated Article XVI:4. The most obvious was the claim of substantial economic equivalence: DISC merely gave United States exporters the same tax benefits that exporters in other countries derived from tax-haven transactions under the territoriality principle. Under the territoriality principle, however, exporters could shield income from taxation only to the extent they could demonstrate that the income was earned by some economic activity located abroad, whereas the DISC law required no such foreign activity. The success of this first defense would depend on whether this domestic-foreign distinction made any difference.

The other two possible defenses were of a more technical character. One was weak, the other strong. The weak technical defense was based on the fact that DISC merely deferred tax liability, rather than granting an outright “exemption” or “remission”—the terms used to describe prohibited tax subsidies in the 1960 GATT report. The defense was weak because the distinction was almost wholly lacking in substance. The deferral of taxes on DISC income was intended to create exactly the same sort of market-distorting economic incentive as

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volume in international trade.” *Id.* Ad Art. XVI, § B, ¶ 2, at 68. A different obligation exists with regard to export subsidies on primary products. GATT Article XVI:3 provides that governments should “seek to avoid” using such subsidies in general, and that they must not use subsidies that result in the subsidizing party having “more than an equitable share of world export trade in that product.” *Id.* at 26-27. Although DISC applied to exports of primary as well as nonprimary products, no claim that DISC violated Article XVI:3 was ever made.


24. The history leading to adoption of GATT Article XVI:4 by only a part of the GATT membership is discussed in J. JACKSON, supra note 2, at 372-74. The drafting history of Article XVI:4 is described at length *infra* notes 99-120.

25. See *supra* notes 16-20 and accompanying text.
an outright exemption. Moreover, it was actually having that effect, because most United States exporters were treating the tax saving from deferral as though it was a permanent exemption. The only real question raised by this defense was whether the GATT's legal process would have enough decision-making capacity to cut through the smokescreen.

The stronger technical defense arose from the seldom noticed condition in Article XVI:4, which prohibits an export subsidy only when it "results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market."26 Demonstrating this price effect—referred to as the bilevel pricing requirement—requires showing that the export price of the subsidized product is lower than its domestic price and the price difference "results" from the subsidy. In most cases each element of this price effect is extremely difficult to prove.

Proving that export prices are lower than domestic prices is seldom easy, because for any product there are usually many transactions at different prices in both markets, each having distinctive characteristics such as quantity, credit terms, and delivery times that could justify part or all of the price difference. Proving that a lower export price is the "result" of an export subsidy is even more difficult. Most export prices are set by market forces in the buyer's country. If exports occur, they will occur at that market price, whether or not there is an export subsidy. In most cases, therefore, the only effect of an export subsidy will be to increase the volume of exports by increasing the profitability of sales at the going price. Moreover, even in those cases when an export subsidy can have a causal effect—that is, when the price in the export market is too low to cover costs by itself—it is extremely unlikely that an income tax subsidy like DISC could have such an effect, because relief from income tax liability can almost never change a losing transaction into a profitable one.27

Notwithstanding its nearly insurmountable proof requirements, the bilevel pricing defense had one glaring weakness. It made no sense as a matter of policy. The reason for barring ex-

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27. The one case in which income tax subsidies could have a two-price effect is the case in which the lower export price would yield some profit but not an adequate rate of return. A lower income tax rate possibly could raise the rate of return on exports to a point equal to or greater than the rate of return on higher-priced domestic sales, in which case the income tax subsidy would be inducing lower-price export sales.
port subsidies was that they harmed producers in the importing
country. An export subsidy could create such harmful effects
whether or not it caused lower export prices, simply by increas-
ing the volume of exports. At the time the DISC case began,
most of the countries obligated under Article XVI:4 shared this
view. Just a few years later, in 1979, they would in fact elimi-
nate the bilevel pricing requirement by adopting a new Subsi-
dies Code in which Article XVI:4 would be rewritten without
it.28

The bilevel pricing defense would thus pose a classic test
for the GATT legal system: a norm that is clearly stated in the
legal text, opposed by an equally clear consensus that the norm
is wrong.

II. FROM COMPLAINT TO LEGAL RULING: 1971-1976
A. GATT IS TOLD TO MIND ITS OWN BUSINESS

The DISC case began in an atmosphere of major crisis. The
United States repudiation of its promise to redeem dollars
in gold shook the world trading system, and the shock was fur-
ther magnified by the package of other trade distorting mea-

28. The Subsidies Code is the shorthand title for the Agreement on Inter-
pretation and Application of Articles VI, XVI and XXIII of the General
Agreement on Tariffs and Trade [hereinafter Subsidies Code], 31 U.S.T. 513,
56-83 (1980), and in THE TEXTS OF THE TOKYO ROUND AGREEMENTS, U.N.
Sales No. GATT/1986-5 (1986) [hereinafter TOKYO ROUND TEXTS]. The Subsi-
dies Code is a side agreement among approximately 30 of the GATT's most im-
portant member countries—all the developed country members, most of whom
were signatories of Article XVI:4, and about 10 key developing countries, most
of whom were not. Although called an “interpretation,” in practical terms it
supplants Articles VI and XVI in legal relations among signatories, tightening
some obligations and adding others.

The Article XVI:4 obligation on export subsidies is found in Article 9:1 of
the Subsidies Code. Article 9:1 says, without qualification, “Signatories shall
not grant export subsidies on products other than certain primary products.”
GATT, BISD, 26th Supp. at 68 (1980); TOKYO ROUND TEXTS, supra, at 64.
29. See supra note 6 and accompanying text.
cussed at another special Council meeting on September 16th.\textsuperscript{32}

The initial United States notice to GATT on August 16th had mentioned DISC as one of the emergency measures being proposed,\textsuperscript{33} but at the Council meeting the following week, the United States delegation changed course and tried to block further discussion of DISC. The United States's opening statement failed to mention DISC. At the end of the meeting, governments agreed to appoint a working party to investigate "measures in the United States Programme of a non-monetary nature which have a direct impact on international trade."\textsuperscript{34} The United States stated that it would agree to the working party, but only on the understanding that the "programme" to be investigated would be the list of measures discussed in its opening statement—the list that did not include DISC.\textsuperscript{35}

When the working party met, other governments refused to exclude DISC from the discussion. The European Community and Canada contended that DISC would be GATT-illegal,\textsuperscript{36} and Switzerland and Sweden added the warning that an economy-wide tax benefit like DISC, once enacted, would be next to impossible to repeal.\textsuperscript{37} The working party recorded its discussion of the DISC proposal in a separate GATT document.\textsuperscript{38} The United States objected to the working party discussion of DISC, objected to the issuance of the GATT document recording the discussion, and objected to the Council's subsequent decision to "take note" of the document.\textsuperscript{39}

The conspicuously uncooperative attitude of the United States was apparently due to a jurisdictional problem in Washington. In the United States government, as in most others, a jurisdictional line exists between matters that belong to the finance ministry (the Treasury Department) and those which be-

\textsuperscript{32} The report of the working party was divided into three documents: a report on the 10% tariff surcharge that the United States had imposed August 15, 1971, GATT Doc. L/3573 (Sept. 13, 1971), reprinted in GATT, BISD, 18th Supp. at 212-23 (1972); an exchange of views about DISC, GATT Doc. L/3574 (Sept. 13, 1971); and a report on the proposed Job Development Tax Credit, GATT Doc. L/3575 (Sept. 13, 1971). In the Council meeting that followed, the Council "adopted" the surcharge report and "took note" of the latter two documents. GATT Doc. C/M/72 (Sept. 16, 1971 mtg.) at 4-5.

\textsuperscript{33} GATT Doc. L/3567 (Aug. 16, 1971) at 2.

\textsuperscript{34} GATT Doc. C/M/71 (Aug. 24-25, 1971 mtg.) at 20.

\textsuperscript{35} \textit{Id.} at 21.

\textsuperscript{36} GATT Doc. L/3574 (Sept. 13, 1971) at 1-2.

\textsuperscript{37} \textit{Id.} at 2.

\textsuperscript{38} GATT Doc. L/3574 (Sept. 13, 1971).

\textsuperscript{39} \textit{See id.;} GATT Doc. C/M/72 (Sept. 16, 1971 mtg.) at 4-5.
long to the trade ministry (the Office of the United States Trade Representative). Trade ministries have jurisdiction over trade measures, and they deal with their problems in GATT. Finance ministries deal in the more elite area of fiscal and monetary matters and take their problems to international fora such as the Organization for Economic Cooperation and Development (OECD) or the International Monetary Fund (IMF). Finance ministers tend to outrank trade ministers and so tend to dictate where the jurisdictional line is drawn. In this case the United States Treasury Department viewed DISC as an exercise of Treasury Department responsibility—the elimination of economic frictions due to the interface of national tax systems. Treasury officials had their own system of international relations for dealing with such issues. They did not need the GATT to tell them how to do their job.

The Treasury Department eventually had to bow to the United States's international obligations requiring that export subsidies, including tax subsidies, be dealt with in GATT. It did so only grudgingly, however, and only on its own terms, making the sort of demands on GATT that finance ministries usually make when dealing with trade ministries. Within the United States government, the Treasury Department would insist on managing the GATT lawsuit itself. It would devise the

40. The OECD, which came into existence in 1961 as the successor to the Organization for European Economic Cooperation (OEEC), see infra note 116, is an organization of the world's developed countries devoted to economic policy issues ranging from economic forecasting to development assistance, including a substantial workload relating to tax policy questions of the kind involved in the DISC case. See M. CAMPS, “FIRST WORLD” RELATIONSHIPS: THE ROLE OF THE OECD (1984). The IMF, established in 1944, is the world’s primary institution, regulatory and financial, in the area of international monetary affairs. See A. HOOKE, THE INTERNATIONAL MONETARY FUND: ITS EVOLUTION, ORGANIZATION, AND ACTIVITIES, IMF PAMPHLET SERIES No. 37 (2d ed. 1982).

41. It would, for example, insist that the Treasury Department’s General Counsel argue all four cases before the GATT panel—the only time, to the author’s knowledge, that the United States has ever been represented by an outside department in such proceedings. Following the panel decisions in 1976, Treasury’s management of the case diminished, and by the 1980s it found itself on the outside, proposing that DISC be abandoned and being overruled by trade policy officials who insisted on continuing to defend DISC. See infra text accompanying notes 162-63, 178.

The documentary evidence of Treasury’s management of the case is not yet derestricted. The account here is based on confidential interviews with participants and observers. Owing to the frequently restricted nature of information pertaining to GATT litigation, the author does not cite individual interviewees by name.
strategy of bringing three countercomplaints against the territoriality tax systems of France, Belgium, and the Netherlands, a strategy that seemed to be motivated in large part by tax policy irritants lying outside the GATT's normal sphere of activity and which seemed at times to view the GATT legal process more as a hostage to these concerns than a forum for adjudicating them. Within GATT the Treasury Department would insist on making the GATT adjudication procedures measure up to finance ministry standards. It would demand that the four cases be treated as one case to be heard by the same panel at the same time, so that Treasury's point about the identity between DISC and the three European tax systems would be sure to be understood. Once that was done, Treasury would then insist that the panel include at least one tax expert—someone with the capacity to understand the finer points of international tax policy. The United States would not agree to participate until these demands were satisfied.

The refusal to talk about DISC in these early GATT meetings was a preview of the abnormal difficulties that would be encountered due to the divided responsibility for DISC within the United States government. The problem might have been anticipated. Governments act through their bureaucracies. The farther a particular bureaucracy is removed from the day-to-day workings of the international legal institution in question, the greater the difficulty that institution will have in influencing its behavior.

B. THE COMPLAINT AND THE COUNTERCLAIMS

The DISC law was enacted in late 1971 and came into force at the beginning of 1972. For other GATT governments, the first issue was whether to file a formal legal complaint or to continue exerting diplomatic pressure. Given the climate of GATT legal policy in early 1972, a legal complaint was by no means a foregone conclusion. The GATT was just emerging from a period of rather intense antilegalism. During the last half of the 1960s, the GATT's developed-country leadership had argued with increasing fervor that governments should settle trade problems by negotiation rather than by legal rulings.42

42. The antilegalist period and the efforts to reverse it in the early 1970s are recounted in R. HUDEC, supra note 2, at 216-40. For a contemporary account of the legal doldrums, see Hudec, GATT or GABB? The Future Design of the General Agreement on Tariffs and Trade, 80 YALE L.J. 1299, 1336-68 (1971).
As a consequence the GATT's adjudication procedures had been essentially dormant from 1963 to 1970.

The issue posed a particularly difficult choice for the European Community. The Community had been the chief proponent of the antilegalist point of view, partly out of conviction and partly out of concern to avoid GATT legal rulings against certain imperfections in its newly formed customs union. In keeping with this position, the Community had never before filed a GATT legal complaint. On the other hand, continued legal restraint was beginning to pose dangers. The United States had started to move away from the antilegalist position in the early 1970s, filing one GATT legal complaint in 1969, three in 1970, and three more in 1972. These lawsuits were, at least in part, a genuine effort to revitalize the GATT adjudication machinery to improve GATT rule enforcement.


44. GATT legal complaints are usually identified in indexes and in secondary literature by a title, chosen by the author, that gives the name of the defendant and a brief description of the practice complained of. (Formal GATT documents pertaining to a case sometimes use such titles, sometimes not.) Usually the "complaint" is the first public announcement of an intent to invoke the GATT's adjudication procedure. The titles and complaints of the United States's GATT lawsuits from 1969-1972 were: United Kingdom: Dollar Area Quotas, GATT Doc. L/3753 (Oct. 17, 1972); France: Import Restrictions, GATT Doc. L/3744 (Sept. 12, 1972); European Community: Compensatory Taxes on Imports, GATT Doc. L/3715 (June 30, 1972); Jamaica: Increase in Margins of Preference, GATT Doc. L/3440 (Sept. 18, 1970); Denmark: Import Restrictions on Grains, GATT Doc. L/3436 (Sept. 14, 1970); Greece: Tariff Preferences, GATT Doc. L/3384 (Apr. 16, 1970); Italy: Administrative and Statistical Fees, GATT Doc. L/3279 (Dec. 1, 1969).

According to the author's count based on unpublished data, GATT governments filed 165 legal complaints in the first 40 years of GATT's history (1948-1987), half of which were filed in the last 11 years. See infra note 75. Currently, three comprehensive lists of GATT legal complaints have been published, each using slightly different criteria to define legal claims: GATT, ANALYTICAL INDEX-NOTES ON THE DRAFTING, INTERPRETATION AND APPLICATION OF THE ARTICLES OF THE GENERAL AGREEMENT at XXIII-87 to -128 (1986); U.S. INT'L TRADE COMM'N, USITC PUB. No. 1793, REVIEW OF THE EFFECTIVENESS OF TRADE DISPUTE SETTLEMENT UNDER THE GATT AND THE TOKYO ROUND AGREEMENTS, App. I at I-1 to -32 (1985) [hereinafter USITC REPORT]; R. HUDEC, supra note 2, App. A at 275-96.

45. The lawsuits were also meant to serve a domestic political purpose, smoothing the way for new trade legislation by assuring Congress that the Administration was vigorously defending United States interests. The author interviewed several United States officials who worked on these cases, including some who served on the interagency committee charged with identifying legal
European Community was becoming a prime target of this new legal policy; two of the 1972 lawsuits were against the Community, and several other legal controversies were brewing, particularly in the sensitive area of agricultural trade. Continued legal restraint in the face of this aggressiveness might simply encourage more of it. Giving the United States a taste of its own medicine might be a better way to induce some moderation.

The European Community decided in favor of litigation. On February 4, 1972, the Community presented the United States with a request for bilateral consultations under GATT Article XXIII:1, the first step in a GATT lawsuit. The complaint had no immediate effect on the United States's legal ardor. After a brief delay, the United States responded in May by making a similar request for Article XXIII:1 consultations with France, Belgium, and the Netherlands, claiming that the territoriality features of their income tax laws resulted in at least the same tax subsidy to their exporters that DISC granted to United States exporters.

The strategy behind the three United States counterclaims appeared ambivalent, an ambivalence that was characteristic of DISC itself. On the one hand, the DISC was established policy, and, as a law enacted by the United States Congress, it had to be defended. On the other hand, no one had ever viewed DISC as optimal tax policy; it was an acknowledged evil made neces-

46. The two complaints, one against the Community and the other against France, are cited supra note 44. Most prominent among the legal controversies not adjudicated were an attack on the Community's system of preferential tariffs on citrus products for Mediterranean suppliers and several attacks on discriminatory association agreements with neighboring nonmember countries. See R. Hudec, supra note 2, at 232-33.


48. The consultation request was made bilaterally without notice to GATT. It is described in the Community's subsequent Article XXIII:2 complaint, GATT Doc. L/3851 (May 1, 1973).

sary by the evils of other tax laws. If tax policy experts could have had their way, they would have followed the Subpart F policy to the end, eliminating both DISC and the European territoriality systems.

On the face of it, the three United States counterclaims seemed primarily intended to defend DISC by linking it to the territoriality principle. Territoriality was a basic principle in the tax laws of many GATT countries; it governed taxation of every kind of foreign income and could not have been changed without major upheaval. If DISC could be shown to be equivalent to territoriality, the GATT would probably not be able to declare DISC illegal because countries that followed the territoriality principle would not be prepared to accept the same legal principle applied to themselves. Many elements of the United States legal position tended to confirm this primarily defensive strategy, for in defending DISC the United States frequently presented legal arguments that undercut the charges of legal invalidity made in its counterclaims.50

50. One of the most important DISC defenses undercutting the counterclaims was the bilevel pricing defense; the argument that bilevel price effects must be demonstrated would apply equally to the claim against the French, Belgian, and Netherlands income tax subsidies, so that the difficulty of demonstrating such price effects would tend to exonerate them as well. The United States's oscillating position on bilevel pricing is discussed in detail infra note 123.

Another DISC defense that undercut the counterclaims was the United States position on “nullification and impairment.” The complaints procedure of GATT Article XXIII is somewhat unusual in that the ultimate wrong is not that the other party has violated its obligations, but that “benefits under the Agreement have been nullified or impaired” by the conduct of the other party. 4 GATT, BISD at 39. Although this phrase can be read to suggest that GATT legal wrongs are actionable only if they cause economic damage, the GATT has generally rejected that view on the ground that economic damage is usually so difficult to prove that it would be difficult ever to make a clear legal ruling. The damage-only view was rejected clearly in a 1962 panel ruling that all GATT violations constitute “prima facie, . . . nullification or impairment.” Uruguayan Recourse to Article XXIII, reprinted in GATT, BISD, 11th Supp. at 95 (1963). The three United States counterclaims had employed the Uruguayan Recourse precedent, charging that the violations of Article XVI:4 amounted to prima facie nullification. See GATT, BISD, 23d Supp. at 124-25 (1977) (France); id. at 134 (Belgium); id. at 144-45 (Netherlands). In the DISC case, however, the United States tried to defend DISC by arguing that “nullification or impairment” required a showing of actual trade damage—a requirement which, if applied to the three counterclaims, would have torpedoed them as well. Id. at 112 (panel report on DISC).

A third defense of DISC that undercut the counterclaims was the United States's argument that the territorial tax systems of France, Belgium, and the Netherlands, and others as well, constituted “subsequent practices of the parties” under the principles of the Vienna Convention, so that GATT Article
On occasion, however, another voice appeared to be speaking for the United States, attempting to sustain the United States counterclaims at the expense of DISC. The United States repeatedly presented its case in terms of mutual illegality—"If DISC is illegal, then so are the European systems"—, suggesting a willingness to accept the conclusion that both were illegal. On occasion, the United States also seemed willing to place DISC at risk by pressing arguments against the legality of the European tax systems that undercut the legal defense of DISC.51

One of the irritants that drew United States officials into this more dangerous attacking posture was their conviction that the European tax systems were not merely permitting tax-haven operations, but were actively helping exporters to enlarge that tax advantage by adopting very generous "arm's length pricing" rules for tax-haven transactions. United States tax officials, who took some pride in their own fairly rigorous arm's length pricing rules,52 found it particularly irritating to be accused of subsidizing by tax officials who, they believed, were actively promoting even worse practices at home.53

As often happens when governments engage in international litigation, the United States never succeeded in working out a legal position that reconciled its conflicting objectives. The ambivalence in the United States legal position would play an important part in the stop-and-go quality of the litigation that followed. United States concessions would contribute to the legal finding against DISC, and a further series of conces-

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51. The chief example was a gamble that risked waiving the bilevel pricing defense for DISC in order to circumvent it in the three counterclaims. See infra text accompanying note 123.
52. The United States provision is I.R.C. § 482 (1982).
53. In interviews with United States officials connected with the case, the author was told that Treasury officials had a large dossier on European shortcomings in this area, including published administrative guidelines in France expressly calling for relaxation of arm's length pricing standards when export transactions were involved. To be sure, the DISC legislation had copied these practices by adopting arbitrary rules for allocating income between parent and DISC. See supra note 12.
sions would eventually lead to approval of that ruling. Yet the underlying strategy of defending DISC was never abandoned and would reemerge from time to time to throw the case back into deadlock just when it seemed ready for settlement.

All this was still in the future, however. First, the complaints had to move forward to adjudication. This would take almost four more years.

C. ESTABLISHING THE PROCEDURE

The two sets of bilateral consultations were not held until July 1972, a delay of several months caused by the United States's insistence on having its counterclaims discussed at the same time. By itself, the demand for parallel treatment may not have been unreasonable, for when a measure like DISC has been enacted expressly for the purpose of offsetting a perceived inequity in the practices of other governments, it is probably counterproductive to force the defendant government to treat its own measure in isolation from those it was meant to counter. What was ominous in this delay, however, was the underlying assumption that the United States was entitled to dictate the procedure.

The July 1972 consultations did not produce a solution. The European Community then allowed the issue to remain dormant for almost a year. The reasons for the delay were never explained. The Community may have had second thoughts about compromising its antilegalist position; it may have needed more time to coordinate positions with the tax authorities of France, Belgium, and the Netherlands; or it may simply have wanted to wait and see whether opposition to DISC within the United States government would lead to repeal for internal tax policy reasons.

54. Generally speaking, it is a mistake to use the amount of time taken in the early phase of a lawsuit as a measure of the adjudication procedure's efficacy. The value of speed depends on the nature of the government policy being challenged. If the policy is already cast in cement, the consultation will be a formality, and the quicker it is done the better. On the other hand, a GATT legal claim often creates an opportunity for reconsideration by the defendant government, and in these cases a too-rapid procedure will be counterproductive if it forces consultations before the government has time to change its policy.

55. From the beginning, DISC had engendered considerable criticism as a matter of tax policy. For example, the original 1971 law was criticised on the ground that it granted tax exemptions on all export profits, an unnecessary windfall for exporters which had no relation to whether or not they increased exports in the future. For a general summary of the criticisms against DISC,
The possibility the United States might repeal DISC for reasons of tax policy would arise again at several points in the proceedings, and each time it would cause GATT procedures to slow down. In the typical GATT lawsuit, the presence of vigorous domestic opposition to the challenged trade measure usually has the opposite effect, inciting the complaining government to press the GATT legal action more vigorously to provide additional ammunition for the domestic opposition. Whenever an assault on DISC was mounted in Washington, however, the Community would usually delay further GATT action, preferring, it seemed, to allow DISC to destroy itself.

On May 1, 1973, the Community stopped waiting and requested the Contracting Parties to rule under GATT Article XXIII:2 on its claim that DISC violated Article XVI:4. About two weeks later, the United States replied with its own Article XXIII:2 request, asking the Contracting Parties to rule on its three counterclaims charging the same violation against the income tax laws of France, Belgium, and the Netherlands.

It took three months for the parties to reach agreement on the procedure for handling these complaints. The Community requested that the normal procedure be followed by appointing a separate panel to rule on the legal issues in each complaint. Although the United States normally supported a complaining country's right to invoke the panel procedure, in this case it proposed deferring the litigation phase for six months so that a negotiating body, such as a working party consisting of all interested governments, could consider the general legal issue first. The United States explained that the practice of not taxing export income was common to many other tax systems, and so a negotiating body consisting of all interested parties might better be able to identify a general solution acceptable to

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56. GATT Doc. L/3851 (May 1, 1973).  
59. The year before, for example, the United States had requested a panel to consider certain European Community "compensatory taxes" that violated tariff bindings. GATT Doc. L/3715 (June 30, 1972). The Community admitted the violation and said a panel was not necessary because the taxes were already scheduled for removal in a few months. The United States insisted on the panel, however, "in accordance with the procedure traditionally adopted in cases where the parties concerned had not succeeded in settling their differences." GATT Doc. C/M/79 (July 26, 1972 mtg.) at 10-11. The Community prevailed.  
everyone.61

After a three-month impasse, the procedural deadlock was settled with an agreement to create a five-member panel to hear the four complaints.62 To keep the cases formally separate, the panel would be treated as four separate panels, but all four panels would have identical members, all four cases would be heard at the same times, and all four panel reports would be issued simultaneously.63 The panel would have at least one but not more than two tax experts.64

The result was a victory for the position that a complaining party has a right to adjudication of its legal claims by a panel. Yet the United States had also won its basic point by forging a procedural link between the DISC complaint and the three counterclaims. It had also won a small edge for its substantive theory by obtaining agreement to the appointment of tax experts to the panel. Their appointment, a distinctive departure from the normal GATT practice of appointing GATT delegates from neutral countries, would tend to support the United States view that the case turned on understanding the actual operation and effects of the tax laws in issue.

Most GATT governments were disturbed by the United States demands at this point in the proceedings. Although they usually expressed disagreement with the substance of the demands—the demand for linkage in particular—what primarily concerned them was the United States's refusal to go forward unless its various conditions were met. GATT adjudication procedures, like GATT decision making in general, are governed by the practice of consensus decision making. The parties themselves must agree to each step in the process—convening a panel, the panel's composition, its terms of reference, and so forth. Effective adjudication under these conditions requires that governments act with restraint and with respect for the other party's right to a legal ruling. In these early years following the antilegalism of the 1960s, such restraint and respect had not yet become very well established. The United States, for example, was experiencing rather serious problems in getting the European Community to go along with legal complaints.65

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61. Id.
63. Id.
64. Id.
65. For example, the United States had waged an ultimately unsuccessful campaign during 1969-1972 to obtain a legal ruling on certain of the Community's preferential agreements with nonmembers. See R. HuDEC, supra note 2,
The Treasury Department's list of nonnegotiable demands, however, raised the problem to a new level of attention, perhaps because it was now the United States abusing the process, or perhaps because the effect was so dramatic this time. As the DISC case dragged on for the next twelve years, roaming the GATT agenda like a cursed sailing ship, each new failure would remind governments of the high-handed demands that had thrown the case off course in the beginning.

The GATT's response to this particular problem in the DISC proceedings has been one of the better legacies of the DISC case. Governments still retain the veto powers of consensus decision making, but these veto powers are now subject to a more effective consensus about what should and should not be done in adjudication proceedings. The DISC case itself is one of the focal points of that consensus; conduct reminiscent of DISC-like tactics now brings a sharp and quick reaction. Another aspect of the consensus has been the emergence of standard ways of doing things, from standard procedures for establishing a panel to standard terms-of-reference for panels once they are appointed. The more a practice becomes standardized, the less room governments have, as a practical matter, to demand special and more favorable treatment. Finally, the Contracting Parties have undertaken to describe their adjudication practices in a written text and have even adopted a few new nonbinding procedural norms addressed to specific impediments in the process.

at 232-33. The general problem had come to the attention of the United States Congress. See H.R. Rep. No. 571, 93d Cong., 1st Sess. 66-67 (1973) ("Your committee is particularly concerned that the decisionmaking process in the GATT is such as to make it impossible in practice for the United States to obtain a determination with respect to certain practices . . . which appear to be clear violations of the GATT.").

66. In 1982 the Contracting Parties gave serious consideration to a proposal to remove the veto power of parties to the dispute. In the end, however, the proposal, known as "consensus-minus-two," was defeated, and the old practice was reaffirmed. See GATT, BISD, 29th Supp. at 16 (1983) ("The CONTRACTING PARTIES reaffirmed that consensus will continue to be the traditional method of resolving disputes; however, they agreed that obstruction in the process of dispute settlement shall be avoided." (text of 1982 Ministerial Declaration pertaining to dispute-settlement procedures)).


A companion reform to the 1979 Understanding was the adoption of sev-
The power of this new consensus is quite formidable. Governments still react to some GATT legal claims as outside the realm of the possible, but in no recent case has a government successfully opposed the appointment of a panel to hear such a claim.

D. Waiting for a Panel

GATT records contain no mention of the DISC case by either party between the July 1973 Council decision to establish the panel and November 1975 when the European Community first complained of the delay. It was not until February of 1976 that the five members of the panel were actually appointed. The panel consisted of three diplomats from GATT delegations in Geneva and two professors of public finance, one from the London School of Economics and one from the University of Turin.

The official explanation for the delay was the difficulty of locating tax experts who understood the case, were acceptable to the parties, and were willing to serve on the panel. Staffing the panel was undoubtedly difficult, as is demonstrated by the fact that the United States eventually had to settle for two tax experts who were both European nationals. It is extremely unlikely, however, that the search for panelists caused the full general separate dispute settlement procedures in the various Codes agreed to during the Tokyo Round. The Code procedures varied in rigor, but most tended to be more rigorous than the general dispute settlement procedures described in the 1979 Understanding and have since served as a model toward which all other GATT procedures gravitate. For a detailed description of the Code procedures, see Hudec, supra note 4, at 171-77.

The first efforts to implement the Tokyo Round reforms were not very successful, see infra note 184, and in response the Contracting Parties adopted a further set of procedural norms in a 1982 Ministerial Declaration. GATT, BISD, 29th Supp. at 13-16 (1983). These were followed by another reform in 1984 changing the process for selecting panelists. See infra note 76 and accompanying text. A precursor to all these written texts was a 1966 decision of the Contracting Parties establishing a more rigorous procedure to deal with legal complaints by developing countries. GATT, BISD, 14th Supp. at 18 (1966). The most comprehensive and best informed step-by-step account of current GATT panel procedures is Plank, supra note 4.

68. GATT Doc. C/M/110 (Nov. 21, 1975 mtg.) at 13; see also GATT Doc. SR.31/2 (Nov. 26, 1975 mtg.) at 14.
71. GATT Doc. SR.32/1 (Nov. 26, 1975 mtg.) at 14 (statements by GATT Director General and United States representative).
two-and-a-half-year delay. There were long periods when the Community did not appear very concerned about going forward. One reason may have been the appearance of another effort in Washington to repeal the DISC. Congress actually did legislate about DISC in 1975 and again in 1976, but the outcome of both efforts was only to reduce the level of the tax benefits.\textsuperscript{72} Another reason may have been the new round of GATT trade negotiations, the Tokyo Round, that was taking shape during these years.\textsuperscript{73} For most of 1974, its fate hung by a thread while the United States Congress debated the necessary negotiating authority. Pressing the attack on DISC while United States trade legislation was pending would probably have seemed like rather poor timing.\textsuperscript{74}

Although these two political factors probably had more to do with the delay than did the problem of finding panelists, the DISC case is still remembered as a case in which esoteric demands about the composition of a panel caused extraordinary delay. As another highly visible lesson about the evils of abusing the veto power, the remembered version has probably been useful. As GATT law matures, however, continued repetition of the lesson is beginning to do more harm than good.

The GATT at present has a serious problem of delay in finding panelists, but it has nothing to do with specialists. The problem is finding enough panelists of any kind, qualified and acceptable to the parties, within a reasonable time. GATT delegates from neutral countries were once the almost exclusive source of panelists, but in an increasingly interdependent world, the supply has dwindled as neutrality is less and less easily assumed. At the same time, the volume of GATT litigation has increased rather remarkably.\textsuperscript{75} As a consequence,

\begin{itemize}
\item \textsuperscript{72} Exports of certain scarce resources were excluded from DISC benefits by the Tax Reduction Act of 1975, Pub. L. No. 94-12, § 603, 89 Stat. 26, 64. The Tax Reform Act of 1976, supra note 13, limited DISC benefits to income from increased exports.
\item \textsuperscript{73} The Tokyo Round, known also as the Multilateral Trade Negotiations (MTN), was opened formally by a Declaration of Ministers Approved at Tokyo on 14 September 1973, reprinted in GATT, BISD, 20th Supp. at 19 (1974).
\item \textsuperscript{74} The United States law was not finally enacted until early 1975. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978 (1975).
\item \textsuperscript{75} Three comprehensive published lists of GATT legal complaints and lawsuits are cited supra note 44. An accurate measure of the surge requires using unpublished data that are more recent than published sources. According to the author's own count based on unpublished data, the following brief profile may be given. In the 40-year period between 1948, when GATT began operations, and the end of 1987, 165 GATT lawsuits have been filed, of which 105 were filed since 1970. The data for the cases since 1970 are:
\end{itemize}
many legal complaints have had to endure long delays while the GATT Secretariat has searched for qualified panelists who are not already serving on another panel or chairing a major GATT working body.

The GATT Secretariat has responded to this problem by trying to broaden the pool, first by proposing retired Secretariat officials as panelists, and more recently by creating a list of government-nominated candidates who are not government employees, such as retired government officials and academics.76 Similar lists of panelists have been assembled under most of the Tokyo Round Codes, in some cases containing quite specialized experts on technical subjects such as government procurement procedures. The Secretariat's pool of outsiders is not yet an adequate solution to the basic problem, but the experience has made the Secretariat far more capable in searching for panelists of all kinds, including DISC-type specialists. These days, specialists are no more difficult to find than any other panelist. If specialists are needed to adjudicate certain types of claims more effectively, there is no reason not to seek them out and use them.77

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*(DISC counted as 4 complaints, 4 panels.)

**(1987 data not complete)

76. The Contracting Parties authorized assembling the list of nongovernmental panel nominees because the problem of delay in selecting panelists was becoming critical. GATT, BISD, 31st Supp. at 9-10 (1985). The list was originally intended to act as a whip to make governments less demanding in challenging panelists. If the parties were unable to agree to a panel after 30 days, the Director General was given authority, at the request of one party, to select and appoint the missing panelist or panelists from the list. Id. at 10. Although several cases have missed the 30-day deadline, to the author's knowledge no government has yet requested that the whip be used. The Secretariat has found the list of considerable utility, however, as a pool of available panelists. In some 1987 panels, nongovernmental panelists were a majority, and in one case the entire three-person panel consisted of outsiders.

77. Specialists can make important contributions. GATT dispute settlement procedures do not give panelists many resources for information gathering, nor much time to educate themselves. For a variety of institutional reasons, government representation before panels is often not very helpful either. When issues requiring specialized knowledge arise, GATT panels must often rely in large measure on what the panelists bring to the problem.
E. THE PANEL RULING ON DISC

The five-member panel was in place in February 1976. The first hearing took place in mid-March, at which time the panel heard from the parties and also from Canada speaking in support of the complaint against DISC. The panel met again in late June to hear rebuttals and then held an *in camera* meeting in late July. The panel completed its work by what it described as a "postal procedure" and issued its four separate reports on November 2, 1976.78

The panel's report on the DISC complaint arrived at a carefully worded conclusion that "the DISC legislation in some cases had effects which were not in accordance with the United States' obligations under Article XVI:4."79 From the moment the report was issued, however, it was treated as a finding that DISC as a whole would have to be changed. No one ever requested a more precise definition of "some cases" or asked that the remedy be limited to them.80

Logically, the panel's conclusion hinged on two major issues. The first issue was whether, standing alone, DISC was inconsistent with the provisions of GATT Article XVI:4. This issue involved the validity of the two technical defenses, deferral and bilevel pricing, and the DISC report itself answered this issue by finding that neither defense was valid.81 The second issue was whether the existence of similar tax subsidies in the three European tax laws could somehow exonerate or otherwise justify DISC. The second issue collapsed when the panel ruled, in its other three reports, that the European tax laws were also inconsistent with GATT Article XVI:4.82 The DISC report itself never had to address the second issue, except to

78. GATT Docs. L/4422 (DISC), L/4423 (France), L/4424 (Belgium), L/4425 (Netherlands) (1977). All four reports were issued simultaneously on November 2, 1976. They are reprinted in GATT, BISD, 23d Supp. at 98 (1977) (DISC); id. at 114 (France); id. at 127 (Belgium); id. at 137 (Netherlands). Citation of the panel reports in this Article are to paragraph number and page citations in the GATT, BISD series.


80. There was one moment, in the first Council meeting, when the delegate of Argentina mentioned that the report "often referred only to some aspects" of the challenged laws and suggested that the panel's conclusions were "not final." GATT Doc. C/M/117 (Nov. 12, 1976 mtg.) at 9 (quotation from summary record). The delegate from Argentina never spoke in any of the subsequent Council meetings. No other delegate ever mentioned the matter.

81. See infra text accompanying notes 85-89, 96-127.

82. See infra text accompanying notes 133-36.
say that one violation did not justify the other.\textsuperscript{83} The substance of the DISC report, therefore, was the panel's rejection of the two technical defenses.

The panel's decision on each of the two technical defenses has been criticized quite severely on the ground that the reasoning behind each finding was vague, incomplete, and in several respects logically flawed.\textsuperscript{84} Although the shortcomings of the panel's analysis are evident, closer examination shows that these inadequacies were not the sort of failure they appeared to be. The vague and impressionistic wording of the DISC rulings was a decision-making technique that had been used in a substantial number of GATT panel decisions in the past, when it had worked quite well. The issue presented by this aspect of the DISC case is not so much whether the panel report itself was well or poorly reasoned, but rather, first, how this impressionistic technique of decision making actually worked, and second, whether it remains an effective technique in the GATT legal system of today.

1. The Deferral Defense

The most important issue with regard to DISC's gimmick of merely deferring tax liability was not whether deferral of tax liability was a subsidy, but how large a subsidy it was. There was no doubt that deferral of taxes without interest represented a subsidy to the extent of the foregone interest. A finding limited to the DISC's interest subsidy, however, would have substantially understated its actual value. Firms were treating deferral of taxes under DISC as though it were a complete exemption from tax liability, based on their judgment that deferral could in fact be extended in perpetuity, as the original DISC law had promised.\textsuperscript{85} This greater actual value made the difference between a minor technical violation and a serious violation with major commercial impact.\textsuperscript{86}

\begin{itemize}
\item \textsuperscript{83} GATT, BISD, 23d Supp. \textsection 79, at 114 (1977).
\item \textsuperscript{84} See, e.g., Jackson, supra note 4, at 764-72.
\item \textsuperscript{85} As things turned out, United States firms eventually concluded that deferral was not exactly identical to an exemption. In 1984 most firms were willing to pay a little something—supporting legislation that replaced DISC with the slightly more onerous requirements of the Foreign Sales Corporation (FSC) law—to wipe this deferred liability off their books entirely. See infra notes 191-99 and accompanying text.
\item \textsuperscript{86} In terms of the household economics used in political debate, the difference would have been seen as the difference between an interest-free loan of funds and an outright grant. In terms of first-year business economics, it was the difference between a no-interest loan of uncertain duration and a no-
Every interested GATT delegation probably recognized that deferral was just a smokescreen and was prepared to treat the DISC subsidy as tantamount to a full exemption. Whether the panel had a sufficient basis for making a formal finding to that effect was less clear. The United States insisted that the DISC's contingent tax liability created a material risk that minimized the subsidy's impact, and a government's representations about the meaning of its own laws could not be casually dismissed. Evidence for the contrary conclusion was not easy to come by because the subsidy's actual value turned on a political judgment about the likelihood that Congress would not change the law.

According to GATT lore, GATT panels are supposed to be good at this sort of practical judgment. Panelists are chosen not for their legal expertise—they are often not lawyers—but for their practical wisdom about real-world phenomena. The reality is somewhat different, however. When confronted with having to rule on the legality of another government's action, even pragmatic people begin to worry about the juridical soundness of what they are doing. Indeed, they probably worry more than well-trained lawyers would, for diplomats and other laypersons tend to have an exaggerated notion of the objective foundation required for legal conclusions.

GATT panels had confronted this problem often in the past, and they had typically taken a limited view of the kind of decisions they could make stick on their own authority. The caution was perhaps greatest in the early days of GATT, in the late 1940s and early 1950s, when the legitimacy of the GATT itself was a touch-and-go thing in many capitals. In response to these concerns, GATT panels and their Secretariat advisors had developed a style of vague, almost impressionistic decision making that merely suggested the adverse ruling, leaving it to subsequent review and enforcement proceedings to make something more out of it. This artful style of decision making had to some extent become institutionalized, in the form of a vocabulary and syntax passed from one generation of panel members and Secretariat staff to the next.

The DISC panel responded to its difficult evidentiary problem the way most GATT panels had in the past. It issued a re-

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87. This phenomenon is explored at length in R. HuDEC, supra note 2, particularly in several case studies at pages 99-190.
port that was vague as to exactly what the subsidy was and how large it was. The report said clearly that the foregone interest was a subsidy, but did not say whether DISC's tax deferral involved any other element of economic gain. The panel did add some elliptical remarks suggesting that the effects of the undefined subsidy were quite substantial and that these effects were intended:

The Panel noted that the United States Treasury had acknowledged that exports had increased as a result of the DISC legislation and the Panel considered that the fact that so many DISCs had been created was evidence that DISC status conferred a substantial benefit.

... The panel noted that the DISC legislation was intended, in its own terms, to increase United States exports...

That was all it said. The panel never stated clearly what conclusion it had drawn about the nature or the size of the subsidy, much less why.

Evasive decisions of this kind can certainly be criticized as poor legal craftsmanship. Oddly enough, however, the GATT experience up to the DISC case had been that such decisions worked rather well. They worked because the GATT member governments, to whom such decisions were addressed, usually knew or thought they knew the answer anyway. Governments would supply the missing parts of the conclusion in the reviewing process that followed, by treating the decision as though it had said clearly what in fact it had only implied. This technique worked particularly well during the first decade of GATT's existence, when the membership was small and cohesive and when most governments were still represented by delegates who had participated in drafting the General Agreement.

By the time of the DISC decision in 1976, the GATT was beginning to outgrow this ultracautious style of decision making. The need for caution had diminished, because most national governments had come to accept GATT and its law as a necessary part of the international order. The GATT's ability to work with cautious decisions had also declined, because the GATT's membership was no longer a small group of like-

89. Id. §§ 68-69, at 112. According to a subsequent European Community statement, as of September 1976, some 9090 DISCs had been created, approximately 75% of United States exports in fiscal 1976 had been channelled through DISCs, and United States estimates indicated that DISC had increased exports by $8 billion. GATT Doc. C/M/119 (Mar. 2, 1977 mtg.) at 12-13.
90. See R. HUDEC, supra note 2, at 99-190.
minded insiders. As was just seen, however, the DISC panel chose to follow the old impressionistic style of decision making anyway. Surprisingly enough, it still worked. The GATT membership did not need to be told explicitly that DISC's deferral arrangement was a sham, and the United States had enough sense not to argue against that consensus once the panel had ruled. The panel's few remarks indicating the necessary conclusion, inadequate though they were, said enough to remove the deferral defense from further consideration.

The more important question raised by this part of the DISC case is whether the impressionistic technique is still a valid and effective form of legal decision making at the present time. There is good reason to believe it is not. In the twelve years since the DISC decision, the issues of trade policy confronting the GATT have continued to grow more complex and more difficult. Although the GATT has managed to work out agreements dealing with many of the new issues, the present consensus on substantive matters is less solid than it was before, and the likelihood of resistance to legal rulings has risen accordingly. Effective consensus is still attainable in most cases, but it does not occur as easily or as spontaneously as it once did. In this more contentious environment, governments are more likely to take advantage of the gaps and the vagueness in impressionistic legal rulings, resisting adverse rulings by insisting on the letter of what is not said. This has already happened in a few recent cases.91

Another factor that has undercut the effectiveness of the traditional technique has been the greater attention now being paid to GATT's adjudication procedures. The past twelve years have witnessed an explosion in GATT litigation,92 and the effectiveness of that litigation has now become an important measuring rod of GATT's overall credibility. To defend GATT's credibility, governments have made repeated commitments during the past decade pleading to make GATT adjudica-

91. The clearest example was a pair of complaints brought by Australia and Brazil against the European Community's export subsidy on sugar. Both decisions are titled European Community: Refunds on Exports of Sugar and appear respectively in GATT, BISD, 26th Supp. at 290 (1980), and GATT, BISD, 27th Supp. at 69 (1981) [hereinafter Sugar decisions]. The cases are described in Phegan, GATT Article XVI.3: Export Subsidies and "Equitable Shares," 16 J. WORLD TRADE L. 251 (1982); Note, European Community Resistance to the Enforcement of GATT Panel Decisions on Sugar Export Subsidies, 15 CORNELL INT'L L.J. 397 (1982).

92. See data reported supra note 75.
tion work better. Under the spotlight of all this attention, impressionistic legal rulings have begun to look like legal failures—a tribunal unable to rule as effectively as governments have been promising. The GATT Contracting Parties recently reacted against such ambiguous decisions by adopting a new procedural norm expressly directing future GATT panels to make clearer rulings.

The importance of this change in GATT decision-making practice should not be exaggerated. Clearer and better reasoned legal decisions will not by themselves overcome opposition to an adverse legal ruling. The final outcome of GATT litigation still depends on the force of the consensus behind the ruling in question. The point is merely that GATT legal affairs have reached a stage at which clearer legal decisions are expected and are actually needed to build and maintain whatever consensus is possible. In this changed environment, the old impressionistic technique would most likely have the opposite effect of weakening consensus. If the DISC case were to be decided by a present-day GATT panel, a much clearer decision would have to be written.

93. The recent GATT decisions seeking to improve the functioning of the dispute settlement procedure are described supra notes 67 and 76.

94. GATT, BISD, 29th Supp. ¶ 4, at 14 (1983) ("The terms of reference of a panel should be formulated so as to permit a clear finding with respect to any contravention of GATT provisions and/or on the question of nullification and impairment of benefits."). The new procedural norm was adopted in reaction to several panel decisions that had seemed to avoid clear answers, including the two Sugar decisions cited supra note 91. It was given additional emphasis after a 1983 panel report failed to reach a conclusion regarding a Subsidies Code complaint by the United States against European Community export subsidies on wheat flour. See European Community: Subsidies on Export of Wheat Flour, reprinted in GATT Dispute Panel Report on U.S. Complaint Concerning EC Subsidies to Wheat Farmers, 18 Int'l Trade Rep. U.S. Export Weekly (BNA) No. 20, at 899 (Mar. 8, 1983). On the follow-up see GATT, BISD, 33d Supp. ¶ 16, at 201 (1987).

95. In a 1980 article, the author took the position that the old impressionistic technique could play a useful role by avoiding the head-on collisions invited by "wrong cases"—lawsuits making legal demands that cannot be met politically. Hudec, supra note 4, at 189-92. Viewing the issue again in the light of the developments in GATT adjudication over the past eight years, the author would not make the same judgement about a wrong case brought in the present-day GATT. A clear decision may still produce an undesirable collision between GATT law and an immovable policy, but the harm that an evasive decision would do to the respect for GATT adjudication would be as great. The more good decisions are made, the more harm inadequate decisions will do. For a recent work that reaches a similar conclusion, see Davey, supra note 4.
2. The Bilevel Pricing Defense

The issue of bilevel pricing presented the panel with an even more difficult decision-making problem—an express legal requirement that appeared impossible to satisfy literally, but which most GATT members considered to be wrong in the first place. The panel resolved this issue in the same way it resolved the deferral issue. It issued a report containing a few vague paragraphs suggesting that the bilevel pricing requirement had probably been satisfied in some cases and that DISC had therefore violated GATT Article XVI:4 “in some cases.” Once again, the answer worked. The panel had again said enough for the underlying consensus to attach, and from the moment it was issued, the panel report was treated as a clear ruling that the bilevel pricing requirement had been satisfied.

The panel’s decision on the bilevel pricing issue offers a particularly striking example of the power of consensus in GATT adjudication—the power that ultimately supplies the force behind legal decision making in GATT. Because the legal text stating the bilevel pricing requirement was so clear, there had to be a particularly strong consensus in opposition to the requirement to sustain a decision setting it aside. There was. The effect of this consensus was perhaps the most fascinating legal phenomenon of this entire twelve-year odyssey.

The consensus itself was not difficult to understand. The bilevel pricing requirement simply made no sense as a matter of policy. As pointed out earlier, export subsidies are equally harmful whether they induce lower prices or merely stimulate greater volumes at existing prices, and the latter effect is more common. The key to the puzzle was to understand why the bilevel pricing requirement had become part of the GATT legal text in the first place and how it happened that text and policy ended up in conflict. The story is rather unusual.

GATT Article XVI:4 was not part of the original GATT agreement of October 1947. The text had been drafted in 1946-1948, as Article 26(1) of the Charter of the International Trade Organization (ITO). Although the 1947 GATT agreement had

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96. See supra note 79 and accompanying text.
97. See supra note 80.
98. See supra notes 26-27 and accompanying text.
99. The text of ITO Charter Article 26(1) read:

No Member shall grant, directly or indirectly, any subsidy on the export of any product, or establish or maintain any other system, which subsidy or system results in the sale of such product for export at a price lower than the comparable price charged for the like product to
incorporated most of the ITO Charter's commercial policy provisions. Article 26(1) had been omitted from GATT due to its more controversial character. After the ITO Charter failed to be ratified, the GATT convened a special Review Session in 1954-1955 to consider what changes were needed to enable GATT to assume the ITO's role. The Review Session concluded that GATT would need to regulate export subsidies. Almost automatically, governments had turned to ITO Article 26(1) as an established legal text suitable for this purpose and added it to the General Agreement as Article XVI:4.

The bilevel pricing requirement in ITO Article 26(1) had

buyers in the domestic market, due allowance being made for [different conditions of sale etc.].


100. The GATT agreement used the standing ITO texts because it was, in effect, an advance installment of the ITO Charter, a provisional trade agreement that was supposed to be absorbed into the ITO after the ITO came into force. See GATT Article XXIX.

101. ITO Article 26(1) was controversial because it was both new to trade agreement practice and required terminating a great deal of existing subsidy practice. The United States was the principal opponent of including Article 26 in GATT, arguing that it would not accept the discipline of Article 26 without the full implementation of the ITO Charter as a quid pro quo. For the United States's position, see GATT Docs. GATT/CP.2/2/SR.5 (Aug. 19, 1948 AM mtg) at 4-5; GATT/CP.2/SR.6 (Aug. 19, 1948 PM mtg) at 4. For the decision of Contracting Parties, see GATT, BISD, Vol. 2 (1952) 39, at 43 (text of GATT Doc. GATT/CP.2/22/Rev.1 (Aug. 30, 1948)).

102. The ITO failed because the United States Congress was unwilling to ratify it during 1949 and 1950. President Truman withdrew it from consideration in December of 1950. Without United States participation, the ITO would have been meaningless. See Diebold, THE END OF THE ITO (Princeton Essays in International Finance No. 16, 1952).

103. For the report explaining the amendments to Article XVI decided upon, see GATT, BISD, 3d Supp. at 226-27 (1955).

104. Virtually every government proposal for the new export subsidies provision used the language of ITO Article 26(1). See, e.g., GATT Docs. L/264 (Oct. 28, 1954) (South Africa); L/273 (Nov. 9, 1954) (Denmark).

received little attention during the 1946-1948 ITO negotiations. It first appeared in the United States proposals which opened the negotiations and remained essentially unchanged from then on.\textsuperscript{106} The most likely reason for its easy acceptance was political rather than economic. The evidence indicates that the ITO Charter drafters fully understood that export subsidies could be economically harmful whether or not they caused lower export prices.\textsuperscript{107} Politically, however, the prohibition of export subsidies, even though it applied only to industrial exports and not agricultural exports, was a new and controversial idea in trade agreements. In all probability, therefore, the bilevel pricing requirement was understood to be a tactical concession, a way of limiting this disturbing new idea to cases in which the distorting effects of export subsidies were most visible. Conceivably, the purpose could even have been polite sabotage.

The original text that introduced the bilevel pricing rule was drafted by the United States, the country chiefly responsible for blocking incorporation of ITO Article 26 into the 1947 GATT.\textsuperscript{108} It is at least possible that the United States had lacked enthusiasm for the antisubsidy rule from the beginning and had inserted the bilevel pricing requirement as a way of eviscerating it.

The 1954-1955 Review Session drafters who reintroduced ITO Article 26(1) gave no indication that they appreciated the restrictive nature of the bilevel pricing requirement.\textsuperscript{109} To the contrary, virtually every reference to the new GATT Article XVI:4 indicated an assumption that the text prohibited all ex-


\textsuperscript{107} They would have certainly known this as a simple matter of common sense, but this knowledge is also reflected in Charter provisions. ITO Charter Article 25, for example, made it clear that the important characteristic of subsidies, including export subsidies, was their effect on volume of trade. The effect on volume is the only effect that ITO Article 25 requires to be reported.

\textsuperscript{108} See supra note 101.

\textsuperscript{109} The difficulty of meeting the bilevel pricing requirement is described supra text accompanying notes 26-27.
port subsidies on industrial goods, completely and without qualification. In the closing plenary meeting, for example, one delegate after another referred to Article XVI:4 as a “ban on subsidies of manufactured goods,”110 or a “total abolition of industrial [export] subsidies,”111 or concluded that “subsidization of the export of industrial goods was prohibited”.112

The same absolutist understanding of GATT Article XVI:4 was manifest in 1960 when, after a five-year delay, most developed-country governments finally agreed to put Article XVI:4 into effect as a binding obligation.113 At this time, the French government proposed that governments adopt an illustrative list of practices deemed to be export subsidies under Article XVI:4. The French delegation described the list as “a certain number of practices which would be prohibited under paragraph 4 of Article XVI.”114 The working party report approving the illustrative list likewise spoke as though the enumerated practices were prohibited without qualification.115

This curious tendency to ignore the bilevel pricing requirement can be traced to a change in government policy toward export subsidies. By 1955 most governments had overcome their initial caution about prohibiting export subsidies on industrial products and were now prepared to accept absolute prohibition. In fact, they had already done so in another forum. Most of the governments that would sign GATT Article XVI:4 were also members or participants in the Organization for European Economic Cooperation (OEEC)—the institution set up to coordinate the postwar economic reconstruction of Western Europe and to administer the Marshall Plan.116 In 1955, at the same time they were adopting the text of Article XVI:4 in GATT, these governments were also adopting a Decision of the

111. Id. at 7 (delegate of France).
112. Id. at 4 (delegate of Denmark). In 1988 a member of the United States delegation to the Review Session, commenting on a draft of this Article, said he could recall no discussion of bilevel pricing, within the United States delegation or elsewhere.
113. The 1955 amendment had added the text to the General Agreement, but had postponed giving it full legal effect. The convoluted history of bringing GATT Article XVI:4 into force is described in J. Jackson, supra note 2, at 372-74.
114. GATT Doc. L/1260 (Aug. 1, 1960) at 2; see also SR.17/3 (Nov. 4, 1960 mtg.) at 18 (delegate of France).
116. For a description of the origins and work program of the OEEC, see A DECADE OF COOPERATION: ACHIEVEMENTS AND PERSPECTIVES (1958) (9th Re-
OEEC Council obliging OEEC members to cease export subsidies on industrial products by the end of the following year.\textsuperscript{117} The OEEC obligation was absolute, containing no bilevel pricing requirement.

Despite its different language, Article XVI:4 seems to have been viewed as merely a repetition of the absolute OEEC obligation. GATT governments continued to treat the two subsidy obligations in parallel throughout the late 1950s. The OEEC's export subsidy obligation was not put into force until 1959 and 1960, the same time GATT Article XVI:4 became a legal obligation.\textsuperscript{118} Moreover, the illustrative list adopted by GATT in 1960 was a verbatim copy of a list attached to the 1960 OEEC obligation\textsuperscript{119} and was adopted explicitly for the purpose of ensuring that GATT obligations on export subsidies would be exactly the same as OEEC obligations.\textsuperscript{120}

The available documents do not make clear to what extent this convoluted negotiating history was known or put before the panel. Even with the full story before them, of course, the panel members would have found it impossible to strike the bilevel pricing requirement from Article XVI:4 simply on the ground that the drafters had not really meant to put it there. The panel needed a legally plausible theory for saying that the Contracting Parties had actually legislated their true purpose.

The European Community offered a legal theory that dis-
covered such a legislative act in the 1960 GATT decision adopting the OEEC’s interpretative list. Even though the interpretative list was, by its terms, merely an enumeration of certain practices that were to be considered export subsidies, the GATT decision approving the list treated the listed practices as though they had been prohibited absolutely. It was possible, argued the Community, to read the prohibitory tenor of the 1960 decision as a separate GATT decision—a decision actually prohibiting the enumerated practices in all cases. The 1960 decision could be viewed as a finding that subsidy practices enumerated on the list satisfied the two-price rule, or at least could be “presumed” to do so. There was not the slightest evidence, of course, that anyone in 1960 was actually thinking about the price effects of these practices. Nevertheless, since the delegates clearly did believe they were effecting an unqualified legal prohibition of these practices, it was not really inaccurate to ascribe to them the predicate thought needed to reach that conclusion.121

Applying this theory, the Community presented the panel with a legal analysis showing that DISC violated Article XVI:4: DISC’s tax deferral was equivalent to either an “exemption” or a “remission” of income taxes, practices that were listed in items (c) and (d) of the 1960 illustrative list; consequently, DISC could also be presumed to result in bilevel pricing.122

In reply, the United States took an interesting tactical gamble. The strongest defense of DISC would have been to reject the Community’s theory altogether and to insist that bilevel pricing had to be proved with specific evidence in every case. That position, however, would have doomed the United States counterclaims against the three European tax laws, for the United States had no better hope of actually proving bilevel


122. GATT, BISD, 23d Supp. ¶ 51, at 109 (1977) (DISC report). The Community went on to submit a variety of other proofs and arguments to show that the two-price requirement was satisfied, claiming that the burden was on the United States to prove the contrary, that United States businesses had affirmed in testimony before Congress that DISC had lowered their prices, and that the price effects could be shown by theoretical calculations. See id. ¶¶ 52-55, at 109-10.
pricing in any of those cases. The United States was not prepared to surrender the counterclaims this easily. Instead, the United States chose to gamble by accepting the Community's presumption theory, with a clever twist. In the words of the panel report,

The representative of the United States accepted that those tax practices which clearly fell within the 1960 illustrative list [that is, the "exemptions" from tax in the three European tax laws] did carry the presumption of bilevel pricing but that practices not in the list, including tax deferral [DISC], did not carry that presumption.123

The gamble did not pay off. The panel accepted the theory endorsed by both parties—that the 1960 illustrative list meant to create a presumption of bilevel pricing for the practices enumerated—but it declined to accept the United States argument that deferral was not on the list. It found that interest-free deferral of tax liability involved an "exemption" from taxation, at least to the extent of the interest foregone. Thus, DISC was subject to the presumption of bilevel pricing.124 In effect, the United States had just gambled away its best defense.

At this point, the panel's nerve faltered, and it retreated to a more complex conclusion. In an apparent effort to avoid resting the decision on the presumption theory alone, the panel announced that the presumption was not meant to be absolute125 and that the panel had to examine evidence of whether bilevel

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123. Id. ¶ 56, at 110. It appears the United States began to have second thoughts about this gamble very soon after making the concession. In the DISC case, the United States tried to prove that no bilevel pricing had occurred by arguing that subsidies seldom affect export prices because export prices are usually set by the market. Id. ¶ 57, at 110. It also argued that, according to GATT legal principles, income tax rates should have no effect on prices at all. Id. ¶ 58, at 110. The legal principle in question was the theory that indirect taxes—for example, a sales or value-added tax on the product—have the effect of raising prices, whereas direct taxes such as income taxes have no price effect and therefore cannot be adjusted for at the border without creating a distortion. Cf. GATT Arts. II:2(a), VI:4; Ad Art. VI. This part of the United States's argument was virtually a brief for a counterpresumption that income tax subsidies would never lead to bilevel pricing.

Then, when arguing the three counterclaims, the United States backed away from endorsing the presumption itself. It took the position that if the panel report on the DISC complaint adopted the presumption of bilevel pricing, and if the DISC report decided that DISC fit within the presumption, then the panel would have to find the same bilevel pricing presumption with regard to each of the three European systems. See GATT, BISD, 23d Supp. ¶ 43, at 124 (1977) (France); id. ¶ 30, at 134 (Belgium); id. ¶ 31, at 144 (Netherlands). In the end the United States seemed to occupy all three possible positions on the presumption of bilevel pricing—yes, no, and "you decide."


125. Id. ¶ 72, at 113.
pricing had actually occurred. The report then suggested, in extremely general terms, a finding that bilevel pricing had occurred:

The Panel considered that, from an economic point of view, there was a presumption that an export subsidy would lead to any or a combination of the following consequences in the export sector: (a) lowering of prices, (b) increase of sales effort and (c) increase of profits per unit. Because the subsidy was both significant and broadly based it was to be expected that all of these effects would occur and that, if one occurred, the other two would not necessarily be excluded. A concentration of the subsidy benefits on prices could lead to substantial reductions in prices. The Panel did not accept that a reduction in prices in export markets needed automatically to be accompanied by similar reductions in domestic markets. These conclusions were supported by statements by American personalities and companies and the Panel felt that it should pay some regard to this evidence.126

It was the tenuous quality of this analysis that forced the panel to limit its conclusion to the rather feeble finding that "the DISC legislation in some cases had effects which were not in accordance with the United States' obligations under Article XVI:4."127

As noted earlier,128 the panel ruling, flimsy as it was, worked. Indeed, the fact that it was so flimsy makes the power of the underlying consensus all the more impressive. Had it wanted to, the United States could have demolished the panel's finding on bilevel pricing.129 Yet, despite its quite vigorous resistance to accepting the panel's findings over the next six years, the United States never once criticized that finding.

The United States's conduct on the bilevel pricing issue deserves further consideration. It is possible that the tactical gamble taken by the United States contained an element of willing surrender. It stands to reason that the United States, or at least some part of its policy-making establishment, also wanted the bilevel pricing requirement ruled out of play. A rigorous bilevel pricing requirement was not really consistent with long-term United States policy objectives. At the time the

126. Id. ¶ 73, at 113. The reference to American personalities and companies referred to testimony before Congressional committees avowing that DISC had permitted reduction of export prices. Id. ¶ 55, at 109-10. One could legitimately question whether the credibility of witnesses arguing to preserve a tax benefit is high enough to permit their testimony to be used as evidence in an international proceeding.
127. Id. ¶ 74, at 113.
128. See supra notes 79-80 and accompanying text.
129. Professor Jackson's criticism of the logic gives a good account of what the United States could have argued. Jackson, supra note 4, at 768-71.
DISC case was being argued, the United States was setting out to lead the GATT’s Tokyo Round negotiations toward adoption of a new Subsidies Code that would strengthen the legal prohibition against export subsidies. A rigorous bilevel pricing requirement would have had exactly the opposite effect. While this hypothesis cannot be proved, it deserves to be noted. The power of consensus works in many ways, including from within.

3. The Outcome

The eventual outcome of the DISC panel report needs to be stated briefly here, with a more detailed autopsy to follow. The United States stated that it was willing to accept the panel’s ruling that DISC violated GATT Article XVI:4, provided that the other three panel reports finding the French, Belgian, and Netherlands tax systems also GATT-illegal were accepted at the same time. The United States held this position, off and on, for five years. Finally, in December of 1981, the United States agreed to accept all four reports subject to an “understanding” that overruled the findings against the three European tax laws by stating that territorial tax laws were consistent with Article XVI:4.

The 1981 understanding did not exonerate DISC, but it narrowed the finding of violation to the difference between DISC and the territorial principle—the domestic character of the DISC tax haven. In the end the United States complied with the GATT ruling by merely restructuring the DISC to eliminate this difference. A new law was passed in 1984 creating a new tax-haven corporation, called the Foreign Sales Corporation (FSC), which provided substantially the same tax benefits as DISC except that, to comply with the territoriality principle, it required taxpayers to run export sales through a foreign-based sales corporation. Despite considerable grumbling about whether FSC’s foreign characteristics were foreign enough to satisfy the territoriality principle, no government filed a GATT legal complaint challenging the new FSC law.

In sum, therefore, the practical significance of the DISC ruling was eventually limited by the way that GATT finally

130. GATT Doc. C/M/122 (July 26, 1977 mtg.) at 9-10.
131. See infra notes 171-72 and accompanying text.
132. A basic outline of the law creating FSC (pronounced “fisc”) is provided infra notes 189-200.
ruled in the other three cases. We now turn to that half of the DISC litigation.

F. THE PANEL RULING ON THE COUNTERCLAIMS

The panel wrote three virtually identical reports concerning the United States counterclaims against the tax laws of France, Belgium, and the Netherlands. In each case the panel ruled that tax advantages made possible by not taxing foreign-earned income under the territoriality principle were an export subsidy, and found, in the same words used in the DISC report, that the subsidy “in some cases had effects which were not in accordance with [the defendant’s] obligations under Article XVI:4.”

Given that the three European defendants had chosen not to assert the bilevel pricing defense, the only real issue in the three counterclaims was whether the failure to tax foreign earnings was an export subsidy in the first place. The key to the panel’s finding on this point was its decision to treat the two parts of the tax-haven transaction—the exporter’s initial export to its foreign alter ego and the alter ego’s resale to the ultimate buyer—as a single export transaction. The panel stated this conclusion elliptically by referring to the sale-resale process as an “economic process originating in the country.”

133. GATT, BISD, 23d Supp. at 114 (1977) (France); id. at 127 (Belgium); id. at 137 (Netherlands).

134. Id. ¶ 53, at 126 (France); id. ¶ 40, at 136 (Belgium); id. ¶ 40, at 146 (Netherlands).

The panel also agreed with the United States argument that tax laws that permit shifting of domestic-source income abroad by sales at less than arm’s length prices would constitute an additional tax subsidy, see id. ¶ 54, at 126 (France); id. ¶ 41, at 136 (Belgium); id. ¶ 41, at 146 (Netherlands), but it made no findings as to whether the French, Belgian, or Netherlands tax laws actually permitted such transfer pricing, and so made no finding of violation on this second claim.

135. The European Community’s argument in the DISC case that the 1960 illustrative list created a conclusive presumption of bilevel pricing, see supra text accompanying notes 121-24, logically extended to the type of tax exemption at issue in the three counterclaims. By not raising a bilevel pricing defense, the three individual defendants were accepting this position.

136. GATT, BISD, 23d Supp. ¶ 47, at 125 (France); id. ¶ 34, at 135 (Belgium); id. ¶ 34, at 145 (Netherlands) (emphasis added). The full statement of the panel report is as follows:

The panel noted that the particular application of the [territoriality principle by the defendant country] allowed some part of export activities, belonging to an economic process originating in the country, to be outside the scope of [its] taxes. In this way [the defendant] had for-gone revenue from this source and created a possibility of a pecuniary
The implication was that what went on outside the country—the resale—was also part of the same “process.” By not taxing the income from the second sale, therefore, governments were granting a tax exemption to the exporting process.

The Contracting Parties never accepted the three findings of a GATT Article XVI:4 violation. The three defendants, with broad support from other governments, refused to approve the reports and proposed they be set aside by the GATT Council. For five years the United States blocked every such effort, but then finally relented in 1981. The panel decisions were disposed of by a Council decision which, while accepting the three reports in form, added an understanding which overruled their main legal finding. The three cases then disappeared from the GATT agenda.

The three unaccepted legal rulings are the most prominent failures of the DISC litigation. The blame is usually attached to the panel itself, and to some extent its Secretariat advisors, for issuing a ruling that virtually no government would support. It is worth looking carefully at the nature of the legal issue to see what caused this to happen.

The United States argument that tax advantages under the territoriality principle were an export subsidy rested on their economic effects. The United States insisted that those tax savings had the same economic effect as any other export subsidy, equal to or greater than the economic effects of the tax savings under DISC. The economic analysis underlying this argument was difficult to refute. Everyone in the tax business knew that a territorial tax system could be used to make the taxation of export operations significantly lower than the taxation of identical domestic operations. It was also clear that those tax savings would induce a greater allocation of resources to exporting than would otherwise be the case. Even if this were not the purpose of the territoriality principle, it was demonstrably its effect.

Although the European defendants offered a number of conclusory arguments denying both the intent to subsidize and

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benefit to exports in those cases where income and corporation tax provisions were significantly more liberal in foreign countries.

137. See infra text accompanying note 172.
138. The full United States argument is summarized in each of the three panel reports. For the key points in this economic analysis, see, for example, paragraphs 18, 19, and 33 of the report on France, GATT, BISD, 23d Supp. at 117-18, 122 (1977).
139. Id.
the occurrence of any harmful economic effects, they never made a serious effort to dispute the United States's economic argument as such.140 Their only real answer to the United States position was that governments had clearly intended GATT Article XVI:4 to permit territorial tax systems and that economic effects just did not matter in the face of such clear intent. They based their argument primarily on the longstanding and widespread acceptance of the territoriality principle in world tax circles.141 The principle had already been well established when GATT adopted Article XVI:4 in 1955, and many GATT members, including the three defendants, had already been employing that principle for decades. It was simply impossible to believe, the European defendants argued, that GATT Article XVI:4 had meant to impose requirements that would have revolutionized world tax practice.142 There was not the slightest evidence that any signatory government even remotely envisioned such consequences.

In retrospect, both arguments were correct. The governments that adopted Article XVI:4 did not intend to force major changes in world income tax laws. By the same token, however, their decision not to disturb the territoriality principle left a large loophole in what was supposed to be a legal obligation prohibiting export subsidies.

The loophole made interpretation of Article XVI:4 quite difficult. Given the territoriality exception, it was not possible to read Article XVI:4 as expressing a straightforward policy against export subsidies. Moreover, since the exception for territorial tax systems was a matter of historical accident rather than policy, there was no economic policy explanation of why the line was drawn there rather than somewhere else. In other words, there was no ready answer to the repeated United States question, "If territoriality, why not DISC?"

With the benefit of hindsight, it is possible to see that

140. Each of the three reports contains a fair amount of rhetorical argument insisting that the respective systems are not assisting exports, see, e.g., GATT, BISD, 23d Supp. ¶ 20, at 118 (1977) (France), but none of the defendants denied the tax differential, and none refuted its anticipated economic effects. The Netherlands government actually agreed that special benefits were possible and tried to make this into a virtue by arguing that the territoriality system had the advantage of not interfering with the efforts of developing countries to attract foreign businesses by offering lower tax rates. Id. ¶ 19, at 141.
141. See, e.g., id. ¶ 21, at 131 (Belgium).
142. See id. ¶ 20, at 118 (France); id. ¶ 21, at 131 (Belgium); id. ¶ 21, at 141 (Netherlands).
GATT was willing, after years of conflict, to accept a rule that did draw a line between territoriality and DISC. Although the line is arbitrary in economic terms, there is a legal policy rationale that explains what GATT did. The GATT had no choice but to accept territorial tax systems, for governments simply would not agree to change them. Being forced to start from this position, GATT still had an interest in keeping the scope of that concession as narrow as possible, simply to keep the volume of trade-distorting export subsidies as low as possible. Requiring that only foreign tax havens be employed may have been arbitrary in economic terms, but it did serve the policy of limiting the subsidy, simply by making it more difficult for exporters to earn it. DISC was over the line because it allowed exporters to obtain subsidies more easily.

Should the DISC panel have been expected to make such a ruling? Current GATT opinion would not demand that panels make such rulings simply to conform to the political climate at the time. As presently viewed, GATT panels are expected to give an objective opinion of the law and the facts, even if they know that governments will reject such rulings. If the majority of GATT governments have changed their mind about the wisdom of a legal obligation, it is enough that panels establish what the existing law is, leaving it to governments to change the law by negotiation. Panels are not expected to rewrite the law to suit present attitudes. There is nothing blameworthy about rulings that are not accepted.

GATT opinion might be divided, however, about what objective legal analysis requires. One school of thought, reflecting Continental jurisprudence, would probably frown on decisions that subordinate the legal text to the negotiating history and to the pragmatic sort of legal policy rationale presented above. That point of view would have found no fault with the DISC panel’s largely economic analysis concluding that Article XVI:4 covered territorial tax laws. A more expansive view of correct legal analysis would disagree, arguing that negotiating background and legal policy are relevant sources of law that should be taken into account, particularly in an institution like GATT in which enforcement of legal norms largely rests on voluntary obedience to commitments undertaken in the past. The more realistic the panel’s appraisal of what the commitment was, the more powerful its ruling will be. Under this more expansive view, the panel’s ruling on the European tax laws would be
faulted for not taking account of the background to Article XVI:4.

If one accepts the broader view of GATT legal analysis, it remains to ask why the panel did not arrive at such a ruling. The actual reasons for the panel's ruling are not known. Speculation at the time centered on the assumption that the panel felt it had to rule DISC illegal to maintain the credibility of GATT legal discipline over export subsidies but could not do so while exonerating the three European laws because the United States would not accept a ruling that singled out DISC alone. If that was the reasoning, the problem with the decision lay in its starting point assumption that it was not possible to devise a legal theory distinguishing DISC that would be strong enough to withstand the expected United States resistance. The missing ingredient in that case would have been a more sophisticated legal imagination.

Alternatively, the panel could have concluded that Article XVI:4 really did outlaw territoriality. If so, the problem with the decision would have been an inadequate understanding of the relevant legal materials and their significance. The panel may not have given enough attention to the historical background showing that Article XVI:4 was never intended to affect territoriality. It may also have attached too much importance to the apparent economic policy suggested by the words of Article XVI:4. This latter type of miscalculation could well have been induced by the parties' decision to appoint tax experts to the panel, a departure from normal GATT practice suggesting that the legal problem turned on the sort of objective analysis tax experts could do.

Tracing the problems involved in the DISC ruling leads to one central conclusion. Finding the right answer to the nasty interpretative problem presented by Article XVI:4 would have required legal work of the highest order. The level of legal practice in panel proceedings would have had to provide the panel with a broad and sophisticated exploration of the issues, the data, the possible solutions, and the ramifications of those solutions. In 1976, however, GATT litigation procedure was just beginning to scrape off the rust that had accumulated during the antilegalist period of the 1960s. It was simply not ready to operate at this level.

Improving the level of legal practice requires time. Its

143. See supra notes 62-64 and accompanying text.
quality is a function of what all the participants do—government parties, Secretariat advisors, and panelists. The input of each party is affected by the input of the others. Thorough and careful presentation of issues leads to more thorough and careful decisions, and such decisions in turn set the standard for what kinds of information and analysis are expected from parties the next time around. Each participant must improve and be improved by the others.

One of the most important legacies of the DISC case in this regard was the creation of a separate legal staff within the GATT Secretariat. The problems of the DISC case had led the Secretariat to reexamine the “no lawyers” policy established by its first Director General Sir Eric Wyndham White and followed by his successor Olivier Long. When Arthur Dunkel became Director General in 1980, he decided that the old policy could no longer be followed. In typical GATT fashion, the idea of a Secretariat legal office had to be introduced very gradually. First there was just a legal advisor, a senior GATT official nearing retirement whose role was portrayed more like that of a historian–archivist than a lawyer. This was followed by a series of incremental changes in function and in personnel that eventually produced the present legal office, staffed now by four professionals who work with every panel. The creation of this office has had a major impact in raising both the quality of GATT panel decisions over the past decade and the quality of the legal practice before those panels. It may be the most important legacy the DISC case left behind.

With all its improvements over the past decade, the level of GATT legal practice still falls short of what is needed to deal effectively with difficult legal issues on a regular basis. GATT law contains a large number of legal texts like Article XVI:4 that paper over policy conflicts by suggesting larger obligations than the ones governments are actually prepared to assume. Moreover, as was true of Article XVI:4, many of these provisions strike compromises with existing practices in a way that offers no coherent theory to guide future application. As the volume of litigation grows, so do the number and difficulty of the legal problems presented by such texts.

Each part of the process can be improved. Panel selection is still ragged, and panelists would benefit from greater continuity and experience. The Secretariat legal staff could do more if it were larger. The level of government legal practice before GATT is particularly uneven, with many governments
still treating legal appearances as a diplomatic event. Raising
the level of GATT legal practice is definitely a reform objective
worth pursuing.

III. FROM LEGAL RULING TO FINAL OUTCOME:
1976-1984


As noted above, the four panel reports were issued si-
multaneously on November 2, 1976. The reports were then re-
viewed in six meetings of the GATT Council between
November of 1976 and March of 1978. The first five meet-
ings, until November 1977, ended in complete impasse.

The United States indicated it would accept the finding
that DISC was in violation of GATT, provided that the findings
against France, Belgium, and the Netherlands were accepted at
the same time. The three European defendants refused to
accept the rulings against themselves. They argued that GATT
Article XVI:4 had never been intended to outlaw territorial tax
laws. The European Community called for adoption of the
DISC report and proposed what amounted to a Council decision
overruling the other three reports. The United States re-

144. See supra note 78.
145. The summary records of the meetings, in chronological order, are:
GATT Docs. C/M/117 (Nov. 12, 1976 mtg.) at 6-10; C/M/119 (Mar. 2, 1977 mtg.)
at 12-18; C/M/120 (May 23, 1977 mtg.) at 8-11; C/M/122 (July 26, 1977 mtg.) at
9-13; C/M/123 (Nov. 11, 1977 mtg.) at 10-14; C/M/124 (Mar. 14, 1978 mtg.) at 16-
17.
146. The United States’s position was evident from the beginning but was
not stated in words of one syllable until the Council meeting of July 26, 1977.
GATT Doc. C/M/122, at 9-10.
147. The defendants’ positions were stated in carefully drawn memoranda,
almost legal briefs, written following the report. For France see GATT Docs.
C/97/Add.1 (July 21, 1977); C/97/Rev.1 (Mar. 21, 1977). For Belgium see
GATT Docs. C/98/Add.1 (Nov. 21, 1977); C/98 (Mar. 15, 1977). For the Nether-

The defendants argued in these memoranda that the panel’s treatment of
the two parts of the tax-haven transaction as a single transaction constituted
an incorrect definition of export. Their argument never addressed the eco-

148. Finding a procedural mechanism for overruling the panel report posed
something of a problem, for there were no precedents for this sort of action.
fused to separate the cases, emphasizing repeatedly that the European laws had the same economic effects as DISC.\textsuperscript{149}

The refusal to accept the respective panel reports presented a new and important problem for GATT dispute settlement. The rulings of GATT panels are not binding legal interpretations; they are merely reports to the GATT Contracting Parties or to its agent, the GATT Council, which alone have the power to make authoritative rulings.\textsuperscript{150} Before 1976, however, the GATT had produced approximately twenty third-party legal rulings, and in only one case, by then generally forgotten, had the Contracting Parties failed to adopt the ruling.\textsuperscript{151} This tradition of more or less automatic approval was regarded as critical to the objectivity of GATT's adjudicatory processes, for it seemed unlikely that political institutions like the GATT Council or the Contracting Parties could make legal rulings free from political influences. At the same time, however, governments had to recognize that errors do occur in every legal

Initially, the Belgian delegate had proposed calling the panel back into session to ask the panel to elaborate on the basis of its decision—a suggestion that sounded a bit like a court martial. \textit{See} GATT Doc. C/M/119 (Mar. 2, 1977 mtg.) at 16. The Community finally settled on asking the GATT Council to authorize its Chairman to give an opinion, after consulting with experts, about the legal conclusions disputed by the three defendants. \textit{See} GATT Doc. C/M/123 (Nov. 11, 1977 mtg.) at 13. A consensus in support of making this request to the Chairman would have been understood as agreement to overrule the three contested rulings; diplomats seldom call for a report unless they agree as to what it will say. The procedure that was actually adopted, five years later in December of 1981, was to negotiate the text of an "understanding" that would state a conclusion contrary to the report and that would be adopted at the same time the panel reports were adopted. \textit{See infra} notes 171-72 and accompanying text.

\textsuperscript{149} \textit{See}, e.g., GATT Doc. C/102 (Nov. 24, 1977).

\textsuperscript{150} GATT Article XXIII:2 gives the Contracting Parties the power to make rulings and to issue recommendations based thereon. The Contracting Parties have empowered the GATT Council to act for them, but neither the Contracting Parties nor the Council have ever delegated this power to make rulings to any tribunal. Parties would, of course, have the power to bind themselves to accept a panel report, although it is doubtful whether GATT would accept any role in trying to enforce such a bilateral commitment as such.

\textsuperscript{151} The number here is based the author's own classification, in R. HUDEC, \textit{supra} note 2, App. A at 275-96. The one exception was a 1956 panel report that ruled in favor of a West German complaint that Greece had impaired a tariff concession on phonograph records by classifying a new type of record (LPs) under a different heading with a higher rate. GATT Doc. L/580 (Nov. 2, 1956). The ruling was not adopted, due to objections by a number of developing countries. \textit{See} GATT Doc. SR.11/16 (Nov. 16, 1956 mtg.). The matter was eventually settled bilaterally by agreement on a compromise tariff rate for LPs. GATT Doc. L/765 (Nov. 29, 1957).
system and that some mechanism for appeal was necessary.152

The five deadlocked Council meetings that took place up to the end of 1977 represented a certain kind of appellate process in response to the various claims of error. As time went on, a consensus emerged among the countries who participated in the debate—mainly the developed countries who had signed GATT Article XVI:4. Virtually every delegation that spoke called for immediate adoption of the DISC report. Most also took the position that the other three cases required more time for reflection, which was the diplomatic way of suggesting that they were wrong.153 No one spoke in support of the United States position. By the end of the year, the United States was isolated.

This process appeared to be the only way to reconcile the need for some error-correcting procedure with the practice of consensus decision making. Claims of error would have to be debated until a consensus developed among the countries not party to the dispute. When the debate revealed broad agreement that an error had been made, the ruling would not be approved and might eventually be corrected or set aside. When the claim of error had no support, pressure would continue until the losing party conceded. Either case, of course, meant waiting until the isolated party was ready to give up. Whether the process worked effectively would depend on how often the GATT could reach consensus and how long it would take to wear down opposition to the consensus view.

If the DISC case had been resolved by this consensus-building process within the first year or so, the adjudication procedure would probably have been considered successful. The three counterclaims were not settled, however, until December 1981, and the ruling on DISC did not produce an undertaking to

152. With or without an appeal mechanism, the lack of any quality control in the Council’s review process also requires, in the author’s opinion, viewing “adopted” panel reports as something short of a formal legal ruling by the Contracting Parties—most likely, as a general approval of the recommended solution but not necessarily a binding approval of the legal reasoning stated in the report. Some sense of precedent normally attaches to these decisions, which is as it should be, but the legal quality of panel decisions over the years has not been good enough to merit more binding status.

153. Canada, Japan, Switzerland, and Austria took the position that DISC alone should be changed. GATT Docs. C/M/122 (July 26, 1977 mtg.) at 11-12, C/M/120 (May 23, 1977 mtg.) at 8-10. Only the Nordics stood aside, taking the rather vague position that normal procedures should be followed in all four cases. Id. C/M/122 at 12, C/M/120 at 9.
comply until October 1982. Obviously, these events proved that consensus decision making can subject GATT adjudication procedures to serious delay. If one retraces the agony of the approval process step by step, however, it will be seen that the causes of the delay were a series of rather unusual political situations that kept popping up to block one settlement after another. The political setting of the DISC case may not have been unique, but it was far from typical.

B. THREE EFFORTS TO RESOLVE THE ISSUES: 1978-1980

At the beginning of the review process, the possibility that the United States might repeal DISC due to opposition in Washington emerged once again. President Carter had promised to repeal DISC during his 1976 election campaign. In March of 1978, the United States delegation announced that President Carter had formally asked the Congress to repeal DISC entirely. At the same meeting, the United States also stated that it was presenting new proposals to France, Belgium, and the Netherlands to resolve the three counterclaims, implying the United States might be prepared to concede the legality of the territoriality principle. The United States delegation was still not willing to agree to formal acceptance of the DISC report, however.

The United States's initiative took the DISC cases off the GATT Council agenda while the repeal legislation was pending in Congress. That legislative effort was aborted in mid-1978 when it became clear that the prospects for Congressional approval were nonexistent, but by then GATT was entering the closing months of the five-year negotiating effort known as the Tokyo Round, and negotiations over a new Tokyo Round Subsidies Code were producing another type of progress toward a solution.

The Subsidies Code, adopted in early 1979, carefully took

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154. See infra notes 171-83 and accompanying text.
155. The promise occurred in a televised debate between Candidate Carter and President Ford. See N.Y. Times, Sept. 24, 1976, at A21, col. 3. The fact that the Carter Administration was considering repeal legislation was confirmed by the United States in the GATT Council meeting of July 26, 1977. GATT Doc. C/M/122 (July 26, 1977 mtg.) at 10.
158. See supra note 73.
no position on the DISC case, but it tended to affirm DISC's illegality by abolishing the bilevel pricing requirement, by including interest-free tax deferral in the list of prohibited tax subsidies, and by expressing a general policy to tighten the prohibition against export subsidies. With respect to the cases involving the three European tax systems, the Code also suggested a settlement of sorts. It affirmed the importance of the arm's length pricing requirement, a key United States concern in those cases, while on the other hand it affirmed that the Code's prohibition of export subsidies was not intended to limit "measures to avoid . . . double taxation," a common rhetorical shorthand for the territoriality principle.

In June of 1979, a few months after the Subsidies Code was adopted, a United States Treasury official took the process one step farther by negotiating a confidential settlement of all four cases. Even though the principles of the settlement had already been stated in the new Subsidies Code provisions, a public announcement was apparently deemed inadvisable, no doubt because approval of the Tokyo Round agreements was pending before Congress. The confidential settlement involved the following points: (1) the United States agreed that DISC as presently structured was GATT-illegal; (2) while the President's 1978 initiative to repeal DISC had failed and could not be introduced again until after the 1980 Presidential election, the United States would submit conforming legislation in 1981; (3) until then, the Community would leave the DISC report on the table and would not retaliate for lack of progress; (4) in the Spring of 1980, the United States would agree to a GATT decision adopting the three European reports separately from the DISC report, with an attached understanding that would overturn the central finding of GATT illegality by stating that Arti-

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160. The bilevel pricing requirement was abolished by being omitted from the export subsidy prohibition in Article 9:1 of the Subsidies Code. See GATT, BISD, 26th Supp. at 68. Interest-free deferral is mentioned in item (e) of the Illustrative List in the Code's Annex. See id. at 81. One example of the more general tightening was the exclusion of mineral products from the exception for "primary products," found in a footnote in Article 9. See id. at 68 n.7. For the original definition of primary products, see supra note 22.

161. The provisions appear in Annex A of the Subsidies Code, in footnote 2 to the Illustrative list, second and third paragraphs, immediately following the disclaimer regarding the DISC report. See GATT, BISD, 26th Supp. at 82 n.2 (1980).
Article XVI:4 did not prohibit territorial tax laws; (5) the Community would agree to a strong statement in the understanding supporting the United States's position on the importance of arm's length pricing rules.\(^{162}\)

Now it was the turn of the trade policy officials to disrupt the Treasury Department's handling of the process. In early 1980 the United States Administration repudiated the 1979 settlement as unauthorized.\(^{163}\) While there had in fact been a question as to the United States negotiator's authority—another episode in the jurisdictional maneuvering between the Treasury Department and the United States Trade Representative—the decision not to honor the settlement was in essence a new decision that the United States government could not, or should not, settle. The main factor was probably a political "could not." Legal control of subsidies, and particularly export subsidies, had become a central concern during the Congressional debates over ratification of the Tokyo Round agreements. The Carter Administration had persuaded the Congress to enact a substantial liberalization of the United States countervailing duty law\(^{164}\) in exchange for assurances that the new Tokyo Round Subsidies Code would bring about more effective legal regulation of subsidies in GATT. It just would not do, as the first demonstration of GATT's new legal rigor, to ask the Congress for legislation to implement a settlement surrendering a United States export subsidy while agreeing to do nothing about three European laws found to be export subsidies in the same lawsuit.

There was quite possibly also a political "should not" behind the United States's repudiation. Notwithstanding the

\(^{162}\) The agreement is generally known as the Hufbauer agreement. The text of the confidential GATT document recording of this confidential agreement was published in *Treasury View That DISC Violated GATT, Tax Notes*, Aug. 2, 1982, at 453.


\(^{164}\) Trade Agreements Act of 1979, tit. I, Pub. L. No. 96-39, 93 Stat. 144 (codified at 19 U.S.C.A. §§ 1671-1671f, 1675-1677g (1980 & Supp. 1987)). Countervailing duties are special additional duties imposed on subsidized imports that are found to cause material injury to a domestic industry. The chief liberalizing amendment in 1979 added the material injury requirement. GATT Article VI had required such laws to have a material injury requirement ever since 1947, but the nonconforming United States law had up to this point been excused by a grandfather clause for pre-1947 legislation of a mandatory character. See *Protocol of Provisional Application to the General Agreement on Tariffs and Trade*, Oct. 30, 1947, 61 Stat. pts. 5, 6, T.I.A.S. No. 1700, 55 U.N.T.S. 308.
glowing claims made for the Subsidies Code, the Code was in fact only a slightly dressed-up restatement of pre-1979 GATT subsidies law with a new and more forceful-looking adjudication procedure to back it up.165 The Code negotiations had revealed strong opposition to greater discipline over subsidies, with many governments, including the European Community, deeply committed to maintaining existing programs. Community export subsidies on agriculture, long a priority target of United States agricultural interests, had been labeled nonnegotiable by the Community. A prudent diplomat might well have wanted to delay playing the DISC card until the Community's behavior in response to the new Subsidies Code could be seen more clearly.

Repudiation of the 1979 settlement meant that, apart from the new Subsidies Code provisions, the two-year effort at informal settlement had come up empty. A second round of formal proceedings had become necessary.

C. DISC'S LAST STAND: 1980-1984

Formal consideration of the DISC cases returned to the agenda of the GATT Council in December of 1980. France, Belgium, and the Netherlands requested the Council to recognize that a de facto settlement had already been reached in the three counterclaims and to formalize that settlement in a Council decision. The proposed decision would adopt the three panel reports subject to an understanding that GATT Article XVI:4 does not prohibit territorial tax systems.166 The understanding, of course, would constitute a Council decision overruling the finding of GATT inconsistency in the three reports.

The United States asked for more time to consider the proposal, implying that it was not yet ready to abandon its position that DISC had to be treated the same as the other three tax laws. During the following twelve months, the European pro-


166. The three governments raised the issue in substantially identical memoranda, which recounted the history of the case and asserted that the United States had indicated a willingness to accept the legality of territorial tax systems. GATT Docs. C/114, C/115, C/116 (Dec. 8, 1980). The memoranda were discussed at the GATT Council meeting of December 18, 1980. GATT Doc. C/M/145 at 1-5.
posal was raised at six more Council meetings and each time it was deferred for further discussion. Third-country requests for time to study the proposed understanding caused a two-month delay in late 1981, but the main source of delay was the United States's renewed effort to defend DISC. United States policy, which had already started returning to this defensive position under the Carter Administration, appeared to have hardened with the change of Administration in early 1981.

The new Reagan Administration was undoubtedly confronting intensified political pressures against settlement. It had promised that it would defend United States trade interests more vigorously than the previous Administration—the perennial "No-More-Mister-Nice-Guy" pledge. Thus, it could not afford to begin its term of office by making a one-sided surrender of DISC. In addition, it had an extensive legislative agenda in which there would be no room for lower priority matters like DISC repeal for several years. Finally, as the United States began to file legal complaints under the Subsidies Code later in 1981, it became clear that the European Community intended to defend its own export subsidies in agriculture against all legal attacks under the new Code. The impending failure of the Subsidies Code made it seem all the more unwise to surrender DISC unilaterally.

In December 1981 the United States nonetheless agreed to a GATT Council decision approving all four reports, subject to an understanding. The understanding read:

The Council adopts these Reports on the understanding that with respect to these cases, and in general, economic processes (including transactions involving exported goods) located outside the territorial limits of the exporting country need not be subject to taxation by the exporting country and should not be regarded as export activities in

167. The summary records of the meetings, in chronological order, are: C/M/146 (Mar. 10, 1981 mtg.) at 7-9; C/M/148 (June 11, 1981 mtg.) at 2; C/M/149 (July 15, 1981 mtg.) at 2; C/M/151 (Oct. 6, 1981 mtg.) at 2-3; C/M/152 (Nov. 3, 1981 mtg.) at 2-3; C/M/153 (Nov. 6, 1981 mtg.) at 7-8.
168. The European Community reported that the United States had agreed to consider accepting a legal ruling against DISC as early as mid-1981. See GATT Doc. C/M/159 (June 29-30, 1982 mtg.) at 6. If so, Washington must have once again backed away.
170. The first United States complaint involved export subsidies on wheat flour. See infra note 184.
171. The decision was adopted at the Council meeting of December 7-8, 1981, GATT Doc. C/M/154 at 6-7.
terms of Article XVI:4 of the General Agreement. It is further understood that Article XVI:4 requires that arm's length pricing be observed . . . . Furthermore, Article XVI:4 does not prohibit the adoption of measures to avoid double taxation of foreign source income.172

While the December 1981 decision marked the end of the three counterclaims, the DISC case was far from over. That decision, it now appears, was actually a delicate compromise about the legal status of DISC. The understanding clearly exonerated the three European laws, and all governments understood this. Anyone familiar with the DISC case would have assumed that the understanding did not exonerate DISC, because the United States had never claimed that DISC was an exemption for income earned abroad. Moments after the reports and the understanding were approved, however, a rather bizarre colloquy occurred. The United States offered a unilateral explanation of what had just been agreed to, claiming that GATT Article XVI:4, as now interpreted by the understanding, required governments to tax only as much income from exports as would be taxed under a territorial system.173 The United States did not explain. What it meant, of course, was that DISC did not violate Article XVI:4 either, because it did not reduce income taxes by more than they would be reduced through tax-haven operations under a territorial system. The European Community and Canada immediately expressed their disagreement but did not pursue the matter. The colloquy was, in short, a way of announcing that the impasse over DISC itself had not been resolved. In agreeing to the December 1981 decision, the United States had only agreed to free the hostages, not to lay down its arms.

It took only ten months for the Contracting Parties to beat down this new United States defense of DISC based on the 1981 understanding, but it was a rather interesting ten months because both sides began treating the case with new energy. The final round commenced soon after the December 1981 Council decision, with demands from the European Community and Canada that the United States implement the DISC report by repealing its law.175 The United States, following through on

172. Id. at 6; see also GATT, BISD, 28th Supp. at 114 (1982) (quoting understanding).
174. Id. at 8-9.
175. The skirmishing began in the meetings of the Subsidy Code's committee of signatories. See GATT Doc. SCM/18 (Mar. 29, 1982) (Canadian request for formal notification of DISC).
its delphic pronouncement of December 1981, replied that the 1981 understanding had exonerated DISC as well. After several more preliminary skirmishes, the United States finally presented a full statement of its new theory in a long and highly technical legal brief on tax theory at the June 1982 Council meeting. The United States recalled that the 1981 understanding permitted a government to exempt from tax income derived from economic processes outside its territory. In the United States's view, every export transaction involves some profit from economic processes outside the country, even if the exporter does not act through a separate foreign entity. The DISC exemption, the United States explained, was just a fair rule-of-thumb way of separating out the foreign-earned part of export income and not taxing it.

No other GATT government supported the United States. Most had probably not even understood the June 1982 defense, but that did not matter. Governments had understood what they had voted for in the 1981 understanding, and it was not this. They had meant to exonerate territorial tax systems, but not DISC. It was yet another instance when the history of a GATT legal decision prevailed over an artful legal analysis of what it said.

This final round of United States resistance provoked the European Community into new efforts to increase the pressure. The Community proposed that the GATT Council adopt formal decisions declaring DISC to be in violation, ordering the United States to comply, and finding the situation ripe for retaliation by injured countries. Under GATT’s practice of consensus decision making, these decisions had no chance of being

176. GATT Doc. SCM/19 (Apr. 20, 1982).
178. GATT Doc. C/M/159 (June 29-30, 1982 mtg.) at 8-9. The United States supported its argument by citing (and, alas, explaining at length) numerous other provisions of United States corporate income tax law that allocated income between foreign and domestic jurisdictions in situations in which no separate foreign entity existed. According to GATT document C/M/159, the text of the United States statement “in extenso” is preserved in GATT document C/W/389/Supp.1, a document series that has not been derestricted. Id. at 8 n.1. The full text of the United States statement is also available in Tax Notes Microfiche Data Base, Doc. 82-7501 (July 19, 1982).
180. See GATT Docs. C/M/160 (July 21, 1982 mtg.) at 4 (description of deci-
adopted over United States opposition, but they did create new events that gave governments a new opportunity to express their views in a focused manner. The Community's proposed decisions sparked a lively debate at GATT Council meetings in May, June, and July of 1982.\(^{181}\) By July patience with the United States defense of DISC began to wear thin. Several delegations accused the United States of abusing the consensus practice. When these statements had no effect, the Chairman adjourned the meeting to determine if informal hammering in the corridors might produce some movement. When the meeting resumed, the only additional step that had been agreed to was a statement by the Chair that "it was the opinion of the majority of the Council members that the United States should take appropriate action to ensure that the DISC legislation was brought into conformity with the provisions of the General Agreement."\(^{182}\) When angered, the majority would express itself as a majority, but even then it would not call for a vote to force the Council to act.

The United States defense was fading, however, and by October of 1982 the United States was ready to give up and promise a new statute. The increasing strength of the GATT opposition might have precipitated this prompt retreat by itself, but other factors were also at work. One was the approaching GATT Ministerial Meeting in November 1982, which by October was already threatening to deny support for a United States proposal to establish a new agenda of GATT negotiations.\(^{183}\) A more important factor was an emerging crisis in the functioning of GATT adjudication generally. By October 1982 the United States was locked in five other bitterly contested GATT lawsuits against the European Community.\(^{184}\) The Community

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181. GATT Docs. C/M/157 (May 7, 1982 mtg.) at 13-18; C/M/159 (June 29-30, 1982 mtg.) at 5-13; C/M/160 (July 21, 1982 mtg.) at 2-9.


183. United States concern over success of the 1982 Ministerial meeting proved to be well founded, because the meeting failed to produce the decisions sought by the United States. See 7 Int'l Trade Rep. U.S. Import Weekly (BNA) No. 9, at 281 (Dec. 1, 1982).

184. Most of the GATT documents pertaining to the five cases remain restricted. The cases are described generally in USITC REPORT, supra note 44, at I-22 to -24, items 65, 66, 68, 69, 72. The cases were:

was using the United States position in the DISC case as a justification for similar blocking and foot-dragging behavior in each of these other lawsuits. The DISC no longer looked like a bargaining chip. It had become a stone around the neck of the entire United States policy to improve GATT legal discipline. 185

In July 1984 the United States announced that Congress had enacted legislation that replaced DISC with a new type of tax-haven export subsidy, FSC, that was consistent with the territoriality principle. 186 During the next year and a half, a desultory exchange of fire took place over the new FSC law, involving both challenges to the GATT legality of forgiving some $10 billion of deferred DISC taxes and questions as to whether the foreign activities required of FSC were the sort of extra-
territorial business activity for which tax exemptions were permitted under the 1981 understanding.\textsuperscript{187} These protests eventually faded away without further litigation and, as the silence lengthened, it became clear that the DISC case had at long last ended.\textsuperscript{188}

D. EVALUATING THE OUTCOME

What did the twelve years of DISC litigation accomplish? The 1984 FSC law\textsuperscript{189} is in many respects the measure of that accomplishment. Its significance has several dimensions. If publicly acknowledged respect for GATT law is the measure, the enactment of FSC law was a considerable achievement. For once the United States Congress passed a law whose only purpose, openly stated, was to bring United States law into conformity with GATT legal obligations.\textsuperscript{190} Even if the new law made no significant change in the underlying export subsidy, it was a precedent that affirmed the political legitimacy of changing laws to comply with GATT, a substantial contribution.

If the significance of the FSC law is measured by the sweat and toil expended on behalf of GATT legal demands, again the FSC earns high marks. Legislation restructuring tax advantages requires a long and painful process, and DISC–FSC was no exception. Businesses benefiting from DISC were reluctant to agree to any modification of benefits and had to be brought along inch by inch.\textsuperscript{191} Congress was even less enthusiastic, for legislators would gain nothing politically by voting for the law.

\textsuperscript{187} Questions about the GATT legality of FSC were raised even before the FSC law was passed. \textit{See} GATT Doc. C/M/171 (Oct. 3, 1983 mtg.). In late 1984 the European Community invoked GATT Article XXII consultations on FSC. \textit{See} GATT Doc. C/M/183 (Nov. 6-8, 20, 1984 mtg.) at 76. The parties met and exchanged views in early 1985. \textit{See} GATT Doc. SR.41/3 (Nov. 26, 1985 mtg.).

\textsuperscript{188} The last mention of DISC or FSC in GATT documents that the author has been able to find appeared in a report by the European Community on the GATT Article XXII consultations in November 1985. \textit{GATT} Doc. SR.41/3 (Nov. 26, 1985 mtg.).


\textsuperscript{190} \textit{See}, for example, the Senate Finance Committee's explanation of the reasons for FSC, described \textit{supra} note 185.

\textsuperscript{191} The quid pro quo that induced corporate taxpayers to accept the slightly more onerous FSC procedure in the end was the forgiveness of all deferred DISC tax liability. Although collection was highly unlikely, corporations were willing to pay a little something to remove the risk entirely.
Endless days of slogging were required to gather the necessary support.

If, on the other hand, the significance of the FSC law is measured by the policy change it effected, the accomplishment has to be rated mediocre at best. The announced purpose of the FSC law was to change the form of the DISC subsidy to make it GATT-legal, while changing its substance as little as possible. The new law accomplished these objectives.

First, the value of the subsidy remained nearly the same. Overall, the change from DISC to FSC was revenue neutral; FSC granted the same dollar amount of tax subsidy as DISC would have done. Individually, exporters received a tax exemption on approximately the same percentage of total export income they had received under DISC.

Second, although the GATT's territoriality exemption applied only to income earned from extraterritorial economic activity, Congress naturally tried to make the extraterritorial requirements as easy to meet as possible. Congress made them so easy to meet that the FSC's foreign activity requirements are largely a sham. The FSC does not have to be a separate foreign business operation, as is required under most territorial systems. All of the FSC's income-earning activi-

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192. In the cover letter accompanying the Administration's technical explanation of its FSC proposal, the United States Treasury Department announced four objectives for FSC that were to be the Administration's theme song throughout the legislative process: 'The bill was drafted with four objectives: to meet U.S. obligations under the GATT; to be revenue neutral with the DISC; to preserve to the extent possible the position of existing DISC users; and to provide incentives for small business. We believe the bill accomplishes these objectives.' Treasury Explains Foreign Sales Corporation Proposal, TAX NOTES, Feb. 6, 1984, at 440-41 (reprinting cover letter).

193. 1984 SENATE REPORT, supra note 13, at 661.

194. Generally, the minimum tax saving under FSC is 15-16% of export income, see 7 Fed. Taxes (P-H) § 30,681, at 30,700 [1988], as opposed to approximately 17% of income sheltered under DISC, see supra note 13 and accompanying text, and now provided for in the new interest-bearing DISC, see infra note 200.

195. The offshore requirements were, as might be expected, more or less negotiated with the affected business community. See, e.g., 18 Int'l Trade Rep. U.S. Export Weekly (BNA) No. 20, at 786 (Feb. 22, 1983).

196. During the meeting at which the GATT Council adopted the December 1981 understanding exempting territorial tax systems from GATT Article XVI:4, the delegate of Belgium, speaking for all three European defendants, expressed the following unilateral understanding of the exemption:

[The understanding does not exclude from the provisions of Article XVI the operation of differential tax practices based on the establishment of fictitious companies located abroad but where all their activities are directed from within the borders of the country of the parent]
ties can be performed by an agent under contract, and in most cases the agent is the parent corporation doing its export business as usual.\textsuperscript{197} The FSC’s foreign business location need only be a desk, a filing cabinet, and a telephone, and nothing prevents several other FSCs from occupying the same room. The FSC needs foreign records, a foreign bank account, one nonresident director, and management meetings abroad, but these can all be produced with minimal effort.\textsuperscript{198} Even the foreign expenditures required of the FSC or its agent–parent can be satisfied easily. The allocation rules for many expenditures such as transportation, risk insurance, and advertising make it possible to structure rather routine export practices so that their costs will be classified as foreign expenditures.\textsuperscript{199} And, indeed,

\begin{itemize}
  \item The tax legislation of the country of the parent company does not provide for full taxation of these activities.
  \item GATT Doc. C/M/154 (Dec. 7-8, 1981 mtg.) at 7 (quotation from summary record).
  \item See 1984 Senate Report, supra note 13, at 640, 646-47.
  \item The minimum office requirements are stated in Treas. Reg. § 1.922-1 (1987). The interpretation of the “foreign management” requirement also illustrates the minimalist approach. Although the regulations provide that all directors and stockholders meetings must be held outside the United States, a meeting can be held by telephone conference call, subject to compliance with local law, as long as a majority of the quorum (for example, two of five directors) are outside the United States during the call—with “outside” not being limited to the host country. Treas. Reg. § 1.924(c)-1 (1987).
  \item The easiest way FSCs are permitted to satisfy the requirement of foreign business activity (“foreign economic process” in GATT parlance) is for the FSC, or its agent–parent, to incur 85% “foreign costs” in two of five expense categories: (1) advertising and sales promotion; (2) processing customer orders and arranging for delivery; (3) transportation; (4) determination and transmittal of a final invoice or statement of account and the receipt of payment; and (5) assumption of credit risk. See I.R.C. § 924(d)(2), (e) (1987). Of these, transportation seems a particularly effortless way to incur foreign costs, because the Regulations treat the “foreign” share of FSC transportation costs as the ratio of a shipment’s mileage “outside U.S. Customs territory” to its total mileage, and then provide that “mileage outside U.S. Customs territory” begins at the point where goods are delivered to an international carrier. Treas. Reg. § 1.924(e)-1(c)(3) (1987). The assumption-of-credit-risk category appears even easier, because it permits the cost of insuring credit risk with an unrelated insurance company to be considered “foreign” whenever the buyer whose payment is being insured is foreign. Treas. Reg. § 1.924(e)-1(e)(2)(ii), 1.924(e)-1(e)(3) (1987). Advertising and solicitation could also be easy by taking advantage of the regulation providing that the cost of mailings, solicitations, and advertising is foreign if the audience to whom they are directed is foreign, even if prepared and sent from the United States. See Treas. Reg. § 1.924(e)-1(a)(1)(iii), (iv), (v), ex.(4) (1987).
  \item For an analysis focusing in greater detail on the easy ways out, see Note, The Making of a Subsidy, 1984: The Tax and International Trade Implications of the Foreign Sales Corporation Legislation, 38 Stan. L. Rev. 1327, 1344-47 & nn.109-16 (1986). See also id. at 1352-53 (concluding that FSC is subject to
\end{itemize}
“small FSCs” (those with under $5 million in export receipts) do not need to satisfy the foreign expenditure requirement at all.\textsuperscript{200} The provision for small FSCs clearly does not comply with the GATT’s territoriality exception, and the law’s definition of extraterritorial economic activity is not really conforming, either.

In substance, then, the DISC lawsuit changed very little. The United States won its major point that tax laws based on the territoriality principle had the effects of an export subsidy and that the United States was therefore entitled to create some sort of compensating export subsidy in return. The European Community prevailed to the extent of requiring that the compensating subsidy comply, at least in form, with the territoriality principle. Compliance with that principle, even if only in form, provides more of a limitation than existed under the wide-open domestic model for DISC, but not much more, especially when subsidies to smaller exporters are excused. The difference hardly seems worth twelve years of litigation.

One school of thought suggests that the final substantive result was not that important for the European Community. The Community’s primary interest in bringing and maintaining the lawsuit, that school argues, was to inflict a humbling legal experience on the United States. United States lawsuits against the Community throughout this period were numerous and irritatingly self-righteous. Without the occasional chastisement of its DISC failures, the United States legal policy could well have become unbearable, particularly as it might have affected the Community’s Common Agricultural Policy.\textsuperscript{201} Whether re-

\textsuperscript{200}. I.R.C. § 924(b)(2); \textit{see} 1984 \textit{SENATE REPORT, supra} note 13, at 657-59. Small exporters were also permitted to defer taxes by continuing to sell through DISCs, without any foreign presence, but the deferral is now limited to profits on the first $10 million of qualified export receipts, \textit{and} interest at the Treasury bill rate must be paid on the deferred taxes. I.R.C. § 995(b)(1)(E); \textit{id.} § 955(f)(1)(B).

\textsuperscript{201}. In another work the author argues that the legal policy behind another upsurge of European Community legal complaints after 1982 was essentially the policy described here—a policy of counterpunching to remind the United States that others could and would play the same game. Hudec, \textit{supra} note 47, at 26, 43-44. The United States legal onslaught that triggered the Community counterpunching of the 1980s is described \textit{supra} note 184 and accompanying text.

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\textit{GATT legal challenge due to minimal character of its foreign requirements). For a similar analysis, see Pastor, \textit{Foreign Sales Corporations: Cause for Deja Vu?}, 9 \textit{MD. J. INT’L L. & TRADE} 63, 94 (1985) (“Substantively, the foreign incorporation, foreign management and foreign economic process requirements [of FSC] are trivial modifications to the DISC provisions.”).}
It remains to ask why the substantive result of the DISC lawsuit was not any better. The poor result can, of course, be explained simply in terms of United States legislative politics. Once Congress creates a tax benefit for a broad segment of United States industry, the combined lobbying strength of all those industries makes it next to impossible to pass legislation taking the benefit away. The cost–benefit criticism of DISC—the huge revenue loss in exchange for a problematic impact on exports in a world of floating exchange rates—was a vastly more powerful political argument against DISC than were its GATT problems, and yet even this argument has been defeated over and over again.

It must also be noted, however, that the forces on the GATT side were never very strong. Governments may have reached a consensus that DISC was wrong, but once the territoriality exception to GATT Article XVI:4 was recognized, the demand to root out the underlying subsidy in DISC no longer had much force. Most governments recognized that the FSC subsidy did not correct the narrow legal problems that separated DISC from the European tax subsidies, but no follow-up complaint was forthcoming. The GATT no doubt found it difficult, after all this time, to work up much enthusiasm about the precise manner in which roughly similar export subsidies were being granted.

202. Even the Senate Finance Committee acknowledged the presence of GATT legal complaints about FSC before enactment. The Committee was concerned enough to say in its report: "In light of the considerable effort required to replace the DISC and the new burdens placed on the U.S. exporters, the committee expects the Administration to vigorously defend this legislation against any GATT challenge and to inform the committee immediately of all GATT developments relating to this legislation." 1984 SENATE REPORT, supra note 13, at 635.

203. The GATT's de facto acceptance of FSC has certain elements of a remedy based on a theory of nonviolation nullification and impairment. That theory is based on GATT Article XXIII:1(b), which provides that governments may bring complaints about nullification and impairment of anticipated benefits caused by actions of other governments, even when those actions are not in violation of GATT obligations. For a detailed discussion of this doctrine and the GATT experience under it, see Hudec, Retaliation against "Unreasonable" Foreign Trade Practices: The New Section 301 and GATT Nullification and Impairment, 59 MINN. L. REV. 461 (1975).

The United States established that territorial tax systems, though legal, impaired the no-export-subsidy benefits governments might expect to obtain from subscribing to GATT Article XVI:4. The normal remedy in a nonviolation nullification case, if it goes that far, is an excuse from one's obligations
The GATT response to FSC was also tempered by the growing breakdown of consensus over subsidy law generally. The United States had been trying to repair the breakdown in this area in 1982 when it accepted the DISC finding and agreed to implement it. For the most part, however, the lack of a solid consensus about subsidy law diminished the pressure GATT was able to mount against DISC from the beginning. The substantive disarray persists. In fact, it has worsened in the decade following the DISC decisions. One of the paradoxical facts about the DISC legal ruling is that, since 1975, it is the only legal complaint about export subsidies in which the GATT has made a ruling of legal violation and been able to have that ruling accepted and implemented. The root problem in subsidy sufficent to restore the balance of advantage—taking away from others as much as has been taken from you. It could be argued that GATT, through its de facto acceptance of FSC, has in effect excused United States obligations enough to permit this parody of a territorial tax system as compensation for the nullification of GATT Article XVI:4 benefits caused by territorial tax laws in Europe and elsewhere.

The analogy to a nullification and impairment remedy should not be pushed too far, however. The United States claim of impairment did not satisfy the unforeseeability requirement normally imposed in nonviolation cases involving tariff concessions. The United States knew that governments were practicing the territoriality system when GATT Article XVI:4 was adopted in 1955 and when it was put into force in 1960. Indeed, at that time its own pre-Subpart-F income tax law granted substantially similar tax benefits. The unexpected event that put United States exporters at a disadvantage was Subpart F itself; in effect, the United States impaired its own benefits.

It might be safer, then, to classify GATT's acceptance of FSC as an ad hoc arrangement, resting partly on elements of nonviolation theory and partly on institutional exhaustion after 12 years of litigation.

204. For sources describing the subsequent breakdown, see supra note 165. According to unpublished data collected by the author, the following, in chronological order, are the GATT complaints about export subsidies filed in the years since the DISC case:

- **European Community: Subsidies on Exports of Pasta Products** (March 1982 complaint under Subsidies Code; panel ruled 4-1 for United States; European Community and others blocked adoption of majority ruling), supra note 184.
- **European Community: Export Subsidies on Sugar** (April 1982
litigation has been, and remains, the absence of consensus.

IV. THE LESSONS OF THE DISC CASE: REPRISE

The first step in understanding the lessons of the DISC case is to appreciate its unusual difficulty. The case presented three major problems seldom found in ordinary GATT litigation. The first, which exerted considerable influence in the early stages of the case, was that DISC had its roots in an area outside the GATT's customary realm of trade policy. The tax policies underlying DISC had not been part of the GATT bargain, and the government custodians of that tax policy did not view themselves as answerable to the GATT's writ.

The second problem was a GATT legal norm that left a great deal to be desired in terms of coherence. On the one hand, GATT Article XVI:4 contained a bilevel-pricing limitation that no one believed in, while on the other hand its seemingly broad prohibition of export subsidies was subject to reservations about territorial tax systems that were nowhere advertised. Heroic efforts were required to overcome the bilevel-pricing limitation, only to have the basic prohibition reduced to a quibble about the form that income tax subsidies must take.

The third problem in the case was the deep schism within GATT over subsidy policy. The disagreement, which had been masked during the early postwar years, became more prominent as the DISC case progressed. By the end the fate of the DISC case had become a pawn in the much larger policy battle swirling around the 1979 Subsidies Code.

If the problem presented unusual difficulties, so did the state of the GATT legal system that was asked to deal with the problem. The early 1970s were a time of legal uncertainty. The

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European Community: Sugar Regime, GATT Doc. L/5309 (Apr. 8, 1982) (complaint by 10 smaller countries; not pursued).


Brazil: Subsidies on the Export and Production of Poultry (September 1983 complaint by United States under Subsidies Code; repeated consultations, suspended in 1984). See id.
tight little club of the 1950s was gone, and so were many of the conditions that permitted its delicate adjudication machinery to work. The GATT membership was now much larger. Its structure had been altered by the formation of the European Community, the rise of Japan, and the entry of enough new developing countries to form a majority. The antilegalist period of the 1960s had in some ways been a necessary breathing space, a sort of legal truce while GATT began to digest all these new constituents. The truce was just ending as the DISC case began in the early the 1970s. The legal order of this new GATT had not yet been defined.

The new GATT did have the legal traditions of the 1950s to work with, but they were rusty from disuse, unfamiliar to the new generation of trade policy officials, and not necessarily suitable anyway. Every point of decision had to be confronted again, if not as a new issue, at least as one open to argument. In this setting the DISC litigation was almost a kind of learning experience, a test case that allowed the new GATT to begin hammering out the kind of legal order it wanted. That the DISC case was thrown off course by the absence of settled answers is, of course, obvious. What really ought to be remembered, however, is its contribution to providing new answers.

For all its shortcomings, the DISC case did succeed in establishing the most important principle of the new GATT's legal order. By hanging on through year after year of frustrating defeats, the GATT established its commitment to adjudicating legal claims. The entire edifice of GATT dispute settlement rests on this commitment. Establishing it was one of the most important contributions of the DISC case.

Although the lesson was not appreciated at the time, the DISC case also demonstrated that the new GATT retained a surprising amount of the old GATT's decision-making capacity. The panel's ability to override the bilevel pricing requirement showed that GATT governments could still shape basic agreement over policy into an effective consensus capable of resolving difficult legal and factual issues. This accomplishment has tended to get lost amid the many failures of the DISC case. It is worth remembering, particularly during negotiations about the future of GATT litigation.

As for the procedural elements of the adjudication machinery, the most important lesson of the DISC case was the institution's need for settled practice. Building such practice takes
time and patience. So far, the improvements stimulated by the DISC case have come primarily from working on obstacles to effective adjudication one by one, trying out new ways around them, and then, if something works, doing it over and over again until it becomes part of every government's expectations. Although improvements continue to be made in the course of day-to-day GATT legal proceedings, governments should not expect any dramatic increase in such progress from the Uruguay Round itself. It is easy to legislate better procedures, but getting the new rules to take root is another matter.

Many procedural problems remain. The lack of an appeal structure or some other way of handling claims of legal error is as serious now as it was in 1976. So is the problem of establishing qualified tribunals within a reasonable time. The problems appear institutional, but dramatic institutional changes, such as permanent tribunals or permanent rosters of arbitrators, seem unlikely to be accepted in the foreseeable future. A better approach to these problems, at least for now, is simply to try to keep improving the quality of legal practice in GATT. Better inputs make better decisions, and good decisions are the best answer to both claims of legal error and disputes over the precise composition of the decision makers.

Good panelists make better decisions than not-so-good panelists, but the difference at the margin may not be as great as panelists would like to believe. The greatest improvement in the quality of GATT legal decisions over the past decade has come, not from creating better panels, but from creating a legal staff in the GATT Secretariat. The legal staff was a legacy of the DISC case, one of its lessons taken to heart. Reinforcing that legal staff is a logical extension of the lesson. It would probably be the most effective contribution to the quality of GATT legal practice in the immediate future. Individual governments could also contribute by continuing to strengthen the quality of their own participation.

If one views the DISC litigation as a learning experience of the new GATT's legal adolescence, one would have to say that GATT law has profited from the experience and is clearly stronger today because of it. It is well that this is so, because the problems confronting GATT adjudicatory practice are not getting any easier. Despite continuing efforts to resolve policy schisms and to write clearer legal norms, the litigation of the future will probably confront as many inadequate legal norms as it has in the past. More disquieting still is the fact that
GATT is about to undertake a legal task substantially more difficult than it has ever attempted before. Well, almost never before. What GATT is about to do is to ignore one of the major lessons of the DISC case, by taking on a new area of regulation, called "trade in services," that lies wholly outside the traditional realm of trade policy and which is guarded by a new cast of government officials who will probably have great difficulty in seeing why they should answer GATT's writ. If the DISC case could speak, it would certainly have something to say about this new enterprise. For starters, it would say, "Mind your step."