ECONSTOR
Make Your Publications Visible.

A Service of

ZBW Leibniz-Informationszentrum Wirtschaft
Leibniz Information Centre for Economics

Steinbach, Armin

Article

The WTO Dispute Settlement Procedure under Review - How to Induce better Compliance?

Aussenwirtschaft

Provided in Cooperation with:
University of St.Gallen, School of Economics and Political Science, Swiss Institute for International Economics and Applied Economics Research

Suggested Citation: Steinbach, Armin (2006) : The WTO Dispute Settlement Procedure under Review - How to Induce better Compliance?, Aussenwirtschaft, ISSN 0004-8216, Universität St.Gallen, Schweizerisches Institut für Aussenwirtschaft und Angewandte Wirtschaftsforschung (SIAW-HSG), St.Gallen, Vol. 61, Iss. 2, pp. 211-229

This Version is available at:
https://hdl.handle.net/10419/231101

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

WWW.ECONSTOR.EU

Mitglied der Leibniz-Gemeinschaft

The WTO Dispute Settlement Procedure under Review - How to Induce better Compliance?
Steinbach, Armin
Aussenwirtschaft; Jun 2006; 61, 2; ABI/INFORM Collection
pg. 211

Aussenwirtschaft, 61. Jahrgang (2006), Heft II, Zürich: Rüegger, S. 211–229

The WTO Dispute Settlement Procedure under Review – How to Induce better Compliance?

Armin Steinbach
University of Munich (LMU), Institute for Politics und Public Law

The article addresses recent observations on the participation and compliance records of WTO Member States under the dispute settlement system. Different approaches are discussed and particular regard is given to the optimization of incentives to abide by WTO rules. On the one hand, there has been a significant increase of small countries participation in WTO dispute settlement in recent years indicating a reduction of barriers to the initiation of disputes. However, the compliance records of small and large countries still exhibit considerable differences with regard to the respective incentives to fully comply with DSB decisions. Based on these findings, this paper deals with shortcomings in the enforcement mechanism and proposes appropriate remedies against power imbalances in the implementation process of WTO rulings.

Keywords: WTO dispute settlement, Power imbalance
JEL Codes: F 13

1 Introduction

The central objective of the Dispute Settlement Procedure in the World Trade Organization (WTO) is to induce compliance meaning the withdrawal of WTO-inconsistent trade measures.[1] There is, however, considerable debate among legal and economic scholarship as to the effectiveness of the dispute settlement system and its capability to provide accurate incentives in order to satisfy the ultimate goal of the Dispute Settlement Understanding (DSU).[2] Not surprisingly, this debate gained some vitality given the advent of the completion of the Doha-Round as the accurate forum to address a reform of WTO rules. In the past, critical voices focused on the phenomenon in dispute settlement that the system exhibits some bias to the detriment of small countries aggravated by the exercise of economic power of big countries.[3] In contrast to these findings, recent con-

1 Article 22(1) of the Dispute Settlement Understanding (DSU). This has also been ruled and confirmed by arbitration panels stating that "the purpose of [DSU] countermeasures [is to] induce compliance." WT/DS27/ARB, EC – Bananas, 9 April 1999, para.6.3.; see also WT/DS26/ARB, EC – Hormones (Canada), 12 July 1999, para. 39; WT/DS48/ARB, EC – Hormones (USA), 12 July 1999, para. 40.

2 See exemplarily and with further references DAVIES (2006, p. 31); HORN and MAVROIDIS (1999) CHARNOVITZ (2001, p. 807); PAUWELYN (2000, pp. 335, 345-346); HUDEC (2000 pp. 345–376).

3 BRONCKERS (2001, p. 61); BRONCKERS and VAN DEN BROEK (2005, p. 101); CHARNOVITZ, *supra* note 2, at p. 807; MAVROIDIS (2000, pp. 763, 816); HORN and MAVROIDIS (1999), *supra* note 2; BREUSS (2003 pp. 326, 345); BOWN (2004, pp. 27, 59/60); ANDERSON (2002, p. 10); PAUWELYN (2000), *supra* note 2, at 338.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

tributions have described the experience of the WTO Dispute Settlement as a success pointing at a successful implementation rate, a relative decline in US/EC dominance[4] as well as a significant degree of active participation by developing countries.[5] As the approaching end of the current negotiation round might give leeway to evolutionary developments in dispute settlement, the significance of appropriate means to address the shortcomings of the DSU must not be underestimated. Against this background, the objective of this paper is to re-discuss the shortcomings of the DSU taking into account recent dispute settlement observations and to highlight the necessity to adapt a few changes in the enforcement mechanism. To that end, first, the given pattern in participation and compliance records will be analyzed, then some economic models will be examined addressing the problem of power-based distortions. Finally, the article will formulate proposals aiming at the improvement of incentives towards compliance with DSB rulings.[6]

2 Participation and Compliance Record under the DSU

Ten years of dispute settlement experience in the WTO framework have revealed the phenomenon that developed and bigger countries have by far been the most active users of the Dispute Settlement System with the G4 countries accounting for over 56% of all complaints, whereas this trend has been declining in the past years.[7] At the same time, three-quarters of the membership has not invoked the dispute settlement since the establishment of the WTO, and within this group developing and least developed countries are dominantly represented.[8] Surprisingly, DAVEY (2005) observed a significant increase during the period from 2000 to 2004 in developing countries complaints accounting for 62% of the consultation requests, thereby doubling their relative share of initiations compared to the period between 1995 until 2000 exhibiting a share of about one-quarter of overall consultation requests.[9] However, the majority of those cases have involved developing countries respondents. Moreover, especially Latin American countries, notably Brazil and Chile, have invoked the DSU rules in order to settle disputes among each other. In

4 DAVEY (2005, pp. 17, 47).
5 LESTER and LEITNER (2004, pp. 169, 171); DAVEY (2005), *supra* note 4, at 25.
6 See for an overview of proposals for reform of the DSU VAN DEN BROEK (2003, pp. 127, 128); REIF and FLORESTAL (1998, p. 759); VAN DER BORGHT (1999, p. 1223).
7 LEITNER and LESTER (2004), *supra* note 5, Appendix 1, at 181.
8 BREUSS (2003, pp. 131, 132); BOWN and HOEKMAN, (2005, pp. 861, 862).
9 DAVEY (2005), *supra* note 4, at 24.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

addition, the recent increase in developing countries participation can to some extent be traced back to considerably more complaints raised by India and Korea. This positive development notwithstanding, developing countries still account only for 22, 5% of overall complaints.[10] A more country specific record presented by LEITNER and LESTER (2004) shows that it has been Middle Income countries which have seen an increase in complaints leaving more or less unchanged the number of complaints raised by low income countries.[11] Least Developed Countries still rarely invoke the rules of Dispute Settlement.[12]

Significant differences exist with respect to *compliance* with DSB decisions. Primarily, it can be observed that Least Developed Countries have had an exceptionally good compliance record in both the original GATT years[13] as well as in the WTO period. Until December 2005 eleven cases had successfully been brought by the European Union or the United States against developing countries or significantly smaller countries and in all of these cases, the losing party complied DSB ruling.[14] On the other hand, the US compliance record is less positive. Nineteen WTO cases have been initiated by small countries against the US during the first eleven years of WTO Dispute Settlement that reached the implementation stage. In only nine of those cases the United States appears to have complied with.[15]

10 LEITNER and LESTER (2004), *supra* note 5, Appendix 1, at 181.

11 LEITNER and LESTER (2004), *supra* note 5, Table 5, at 173. Income classifications are based on the World Bank's classification methodology.

12 LEITNER and LESTER (2004), *supra* note 5, Table 5, at 173.

13 HUDEC (1991), Table 11.18, at 305. According to HUDEC's statistics Least Developed Countries always complied at least partially with GATT rulings against them.

14 WT/DS146, WT/DS/175, India – Measures Affecting the Automotive Sector; WT/DS/155, Argentina – Measures on the Exports of Bovine Hides and the Import of Finished Leather; WT/DS50, India – Patent Protection for Pharmaceutical and Agricultural Chemical Products; WT/DS56, Argentina – Certain Measures Affecting Imports of Footwear, Textiles, Apparel and other items; WT/DS54, 55, 59, 64, Indonesia – Certain Measures Affecting the Automobile Industry; WT/DS79/1, India – Patent Protection for Pharmaceutical and Agricultural Products; WT/DS75, 84, Korea – Alcoholic Beverages; WT/DS126/1, Australia – Subsidies provided to Producers and Industrial Products; WT/DS90/1, India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products; WT/87/1, 110/1, Chile – Taxes on Alcoholic Beverages; WT/DS189, Argentina – Definitive Anti-Dumping Measures on Imports of Ceramic Floor Tiles from Italy.

15 Compliance in cases where complaint was brought by small countries: WT/DS/259, US – Definitive Safeguard Measures on Imports of Certain Steel Products; WT/DS2, WT/DS/4, US – Standards for Reformulated and Conventional Gasoline; WT/DS24, US – Restrictions on Imports of Cotton and Man-Made Fibre Underwear; WT/DS/33, US – Measures affecting Imports of Woven Wool Shirts and Blouses; WT/DS58, US – Import Prohibition of Certain Shrimp and Shrimp Products; WT/DS179, US – Anti-Dumping Duties on Stainless Steel Plates in Coils and Stainless Steel Sheet from Korea; WT/DS192, US – Transitional Safeguard Measure on Combed Cotton Yarn from Pakistan; WT/DS33, US – Measures Affecting Imports of Woven Wool Shirts and Blouses; WT/DS24, US – Restrictions on Imports of Cotton and Man-Made Fibre Underwear; the implementation period expires in March 2006 in WT/DS296, US – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMS) from Korea; at the time of this writing under review of a Panel pursuant to Art. 22 (6) DSU WT/DS267, US – Upland Cotton.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

With regard to the EC, so far there were two cases in which less powerful countries were involved on the complainant's side and prevailed but the EC refused to comply with the DSB decision for a long time.[16] In sum, these records indicate that there are differences in compliance between large and small countries. However, this point has recently been disputed by contributions claiming a very successful compliance record of dispute resolution[17] and pointing to an evident increase in developing countries participation in dispute settlement.[18]

3 Economic Approaches to Explain Participation and Compliance Records

How can these inconsistencies in evaluation of the compliance records be explained? To answer this question it will be necessary to analyze the economic approaches underlying dealing with the participation and compliance pattern under the DSU. The choice of economic approach has an impact upon the conclusions one can draw for a meaningful reform of enforcement mechanisms. One approach addresses this issue by using a simple probabilistic model of litigation. The idea is that the probability of encountering disputable trade measures is proportional to the diversity of a country's exports over products and partners.[19] This means that larger and more diversified exporters would be expected to bring more complaints than smaller and less diversified exporters. However, three of the main exporters – Canada, the EU and the USA – bring considerable more complaints than predicted by this simple incident-based model. In contrast, the other G4 country, Japan, files less complaints than expected. Thus, the model fails to explain the disproportionate number of complaints by some trading nations. Additionally, using GNP data in order to provide an explanation for the biased pattern of participation suggests

16 Ecuador was authorized to take countermeasures but refrained from doing so in EC-Bananas, WT/DS27/ARB/ECU, European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU, 24 March 2000. Brazil had brought a complaint against the EC in Poultry which had been finally settled through a mutual agreement, see WT/DS69, EC – Poultry; in two cases the period of implementation expires in March 2006: WT/DS299, EC – Concerning Measures on Dynamic Random Access Memory Chips from Korea; WT/DS290, EC – Protection of Trademarks and Geographical Indicators for Agricultural Products and Foodstuffs; in another dispute the EC has time until May 2006 to implement the DSB decision, WT/DS266, EC – Export Subsidies on Sugar; in one case the implementation period expired and Brazil contests EC compliance with the DSB ruling, WT/DS219, EC – Anti-Dumping Duties on malleable cast Iron Tube or Pipe Fittings from Brazil.

17 DAVEY (2005), *supra* note 4, at 45-48; he observed a successful implementation rate of 83 % in 181 disputes which started with a consultation request prior to 1 July 2002.

18 LESTER and LEITNER (2004), *supra* note 5, at 169–174; DAVEY, *supra* note 4, at 25.

19 HORN, MAVROIDIS and NORDSTRÖM (1999).

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

that the larger the national income of the country, the more it is over-represented as complainant, relative to the benchmark prediction.[20] There is a clear tendency for economically more powerful countries, as measured by GNP, to bring proportionally more complaints than their export diversity would suggest. The larger the national income of a country, the more it is over-represented in the number of complaints. However, this does not prove a power-based interpretation of the Dispute Settlement Procedure by itself. Such a finding would require furthermore that small countries would refrain from initiating WTO proceedings against big countries. That is not the case. Taking bilateral trade flows as the criterion to measure the difference between actual and expected number of bilateral disputes, the over-representation of big countries appears to be mainly due to intra-G4 complaints, and to a lesser extent a result of disputes between G4 countries and other countries.[21] Most important though, smaller countries initiate proceedings against G4 countries relatively often based on bilateral trade flows. It neither seems that G4 countries are targeting developing countries disproportionally often, nor that DC refrain from initiating dispute settlement proceedings against big countries.

In spite of all that, there is one crucial reason why it is not sufficient to limit the analysis to the number of initiations of proceedings under the DSU.[22] A high number of initiations of panel proceedings by developing countries against the G4 may merely indicate that the barriers to participation in the system have been reduced. The argument is that the tendency of a greater participation of developing countries in the DSP can, to a significant extent, be associated with the reform of the dispute settlement procedure under the WTO which is more "rules-oriented" compared to the "power-oriented" system of the GATT, promoting the participation of developing countries. Hence, it appears more accurate to move beyond consideration of the initiation of trade disputes involving developing countries and to provide an initial assessment of the economic resolution of these disputes instead.[23] This approach differs fundamentally from looking at barriers for the initiation of settlement proceedings as well as from common methods to evaluate the compliance record. In a recent contribution DAVEY (2005) takes the official settlement of a dispute as indicator for compliance. According to this concept, compliance occurs

20 HORN, MAVROIDIS and NORDSTRÖM (1999), *supra* note 19, at 18.
21 HORN, MAVROIDIS and NORDSTRÖM (1999), *supra* note 19, at 19.
22 Contributions focusing on this aspect are for example LEITNER and LESTER, *supra* note 5, at 171 et seq.; HORN, MAVROIDIS and NORDSTRÖM (1999), *supra* note 19; critical towards this approach BOWN (2004), *supra* note 3, at 61; BUSCH and REINHARDT (2003, pp. 719, 720).
23 BOWN (2004), *supra* note 3, at 61.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

once settlement has been notified to the DSB, or has been reached without notification or if the dispute has been dropped for legal or political reasons or because the offending trade-restrictive measure was removed.[24] The problem with this method of measuring compliance is that one cannot say if in economic terms the level of impairment has been removed as it limits its focus exclusively on the legal or formal outcome of a trade conflict. Since panels in WTO trade disputes are concerned with the economic question of market access and the conditions of competition in the sector under dispute[25], the better indicator for the effectiveness of DSU rules would be a measure taking into account the quantitative change in barriers to trade or the competitive conditions of the market under dispute. To that end, it appears more appropriate to take bilateral trade liberalization in the disputed sector before and after the resolution of the disputes as the measure of economic success in a particular case.[26] Using criteria of economic resolution in the analysis of dispute settlement, one sees that if the complainant receives sizeable exports from the developing country defendant, the complainant can make a credible retaliation threat that would generate costs to the defendant for its failure to liberalize.[27] In cases where the complainant does not attain any liberalization, the share of the defendant's exports received by the developing complainant is rather small as opposed to a high share in cases with positive liberalization.[28] The capacity to retaliate through trade policy can be determined by whether the retaliating country accounts for a sufficient amount of its trading partner's exports in a particularly important industry.[29]

This finding is supported by the excellent compliance record of Least Developed Countries and small countries mentioned above. Their record can plausibly be explained by pointing at the credibility of the threat of retaliation against them when being involved in a WTO dispute. On the other hand, the incentives provided by the system for big countries to comply are significantly lower as the mixed compliance record of EC and United States suggests. In conclusion, the evidence illustrates that the significant increase in initiations of disputes launched by developing countries should not be overestimated as they do not take into account the actual economic outcome of a dispute. Besides the size of an economy, other important determinants of economic resolution include the import

24 DAVEY (2004), *supra* note 4, at 45–48.
25 E.-U. PETERSMANN (1997, p. 141).
26 BOWN (2004), *supra* note 3, at 65.
27 BOWN (2004), *supra* note 3, Table 3 at 76, 77.
28 BOWN (2004), *supra* note 3, Table 1 at 67.
29 BOWN (2004), *supra* note 3, at 68; CHARNOVITZ (2001), *supra* note 2, at 816.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

dependency of the retaliator and the export dependency of the target, especially regarding trade between the two countries.[30] A highly import-dependent country may find it hard to use sanctions, and a highly export-dependent country may find itself vulnerable to the threat of sanctions. Hence, a country having a broadly diversified export pattern may be in a favorable position.

4 The Reform of the DSU Enforcement Mechanism

The above discussion suggests that shortcomings of DSU rules concern the economic outcome caused by the potential threat of retaliation as opposed to barriers to the initiation of a dispute. Because of that, the enforcement mechanism should be modified in a way that the set of incentives will result in a more balanced threat of countermeasures in order to yield an economic outcome of dispute resolution which is independent of a country's economic power. Being less vulnerable to potential retaliation, big countries are as a matter of fact favored due to the size of their economy and their capability to exercise pressure in trade disputes to achieve a favorable economic resolution. In contrast, when a developing country wins a dispute against a developed country which refuses to comply, the prevailing developing country can exert only scant pressure on the losing developed country.[31] Having a much smaller market, and importing goods and services that may well be important to their development, retaliation is usually not an effective option for developing countries.[32] Because it is a well-known phenomenon that retaliation means "shooting oneself in the foot" – implying that WTO members retaliating against the losing country impose additional cost on society[33] – two proposals have been put forward calling for the establishment of a system of mandatory compensation. The analysis will show that one of them is lacking sufficient compliance incentives. Currently, the DSU expresses a preference for compensation over suspension of concessions but notes that compensation is "voluntary"[34], and that both compensation and suspension of concessions are not preferred options to full implementation.[35]

30 CHARNOVITZ (2001), *supra* note 2, 816.
31 BRONCKERS (2001), *supra* note 3, 61; CHARNOVITZ (2001), *supra* note 2, 807; MAVROIDIS (2000), *supra* note 3, 816.
32 ANDERSON (2000), *supra* note 3, at 10.
33 BREUSS (2003), *supra* note 3, at 345.
34 Articles 3(8), 22(1), 22(2) DSU.
35 Article 22(1) DSU.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

If compliance is not achieved within the time period thus specified, the defaulting member can offer "compensation" until compliance occurs.[36]

4.1 Mandatory Financial Compensation

One proposal repeatedly voiced in the debate aiming at restoring the balance of powers between large and small countries calls for an obligation of monetary transfers or the imposition of monetary fines.[37] Instead of retaliation, countries guilty of illegal trade practices should pay a fine equal to the value of damages assessed by the panel.[38] If compliance really is the ultimate goal of the DSU, so goes the argument, then monetary damages are able to be more of an incentive for the non-complying government, given ever present budgetary constraints.[39] Retaliation is less compelling, as non-complying governments can shift the costs of retaliation on to a small and relatively powerless group of companies. Therefore, monetary fines would have the advantage that the burden really falls on the target nation increasing the incentive to comply for a government. Subsequently, the governments receiving the transfer should be obliged to give the money to the "innocent" companies which suffered the damages as a consequence of the WTO violations.[40] It is further emphasized that financial compensation would not be trade restrictive preventing the winning party from taking self-harming countermeasures.[41] The idea had already been brought up by Brazil and Uruguay in the 1960s asking for an "indemnity of a financial character" in complaints of developing against developed countries.[42] Indeed, this would give developing countries a favorable alternative to the imposition of retaliatory measures. However, many objections to this proposal were raised, including that "it was inconceivable that national legislatures would be willing to vote budgetary provisions for this purpose."[43] Another problematic consequence resulting from financial compensation would be the exclusion of third party interests, implying the violation of the most-favored-nation treatment. The

36 Article 22(2) DSU.

37 DAVEY (2005), *supra* note 4, at 322; HOWSE (2003, p. 5); VAN DER BORGHT (1999), *supra* note 6, at 1232; BRONCKERS and VAN DEN BROEK (2005), *supra* note 3, at 109–121; MERCURIO (2004, pp. 795, 841); BREUSS (2003), *supra* note 8, at 180; ANDERSON (2000), *supra* note 3, at 16.

38 International Financial Institution Advisory Commission (Meltzer Commission), Report March 2000.

39 BRONCKERS (2001), *supra* note 3, at 62; BRONCKERS and VAN DEN BROEK (2005), *supra* note 3, at 110–111.

40 BREUSS (2003), *supra* note 8, at 180.

41 Bronckers and van den BROECK (2005), *supra* note 3, at 110.

42 DAM (1970, p. 368).

43 DAM (1970), *supra* note 42, at 369, quoting the Report of the Ad Hoc Group on Legal Amendments to the General Agreement.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

bilateral compensation agreement between the US and the EC in US – Section 110 of the US Copyright Act illustrates that compensation is paid only on bilateral basis.[44] If no timetable for implementation is agreed upon, third parties whose rights and obligations are also being nullified and impaired by the offending measure will be forced to litigate their own case even if the violation of WTO rules had already been proven.

4.2 Mandatory Compensation in Terms of Trade Concessions

Closely related to the imposition of monetary fines is the proposal to make compensation compulsory.[45] This kind of compensation is different from financial compensation as it foresees that a country will offer additional trade concessions in another products category. The obvious advantage of trade compensation is that it liberalizes trade as opposed to generating additional trade barriers. Compensation in this context means action by the violator government to reduce trade barriers. Moreover, compensation is to be offered not only to the winning party, but to all WTO members in accordance with the most-favored-nation rule.[46] Therefore, compensation involves the lifting of trade barriers – such as tariff reduction or increases in import quotas – by the losing party. Arrangements for compensation thereby work to support free trade principles.[47] In pure economic terms, compensation in this form is simply trade liberalization by increasing economic welfare in the respondent country, in the complainant country, and even in third countries that export the products whose import barriers have been lowered.[48] Even if some third countries that import those or like products were to lose from a terms-of-trade deterioration, one knows from standard-gains-from-trade theory that the world as a whole will be better off economically.[49] In this regard, this approach would clearly be preferable to a system of retaliation and financial compensation. While the former implies self-harming effects for the retaliating countries, the latter avoids this adverse effect but does not create ad-

44 WT/DS160, US – Section 110(5) of the US Copyright Act; DAVIES (2006), *supra* note 2, at 39.

45 PAUWELYN (2000), *supra* note 2, at 345–346; HORLICK (2000); ROSAS (2001, p. 131, 144).

46 LÖWENFELD (1994, p. 486); since Article 22 (1) last sentence reads that "Compensation [...] shall be consistent with the covered agreements", it is concluded that the Most-Favored-Nation-Treatment also applies to cases where compensation is granted to the winning party. In WT/DS10/19, Japan – Taxes on Alcoholic Beverages, Japan offered compensation on an MFN basis.

47 PAUWELYN (2000), *supra* note 2, at 337.

48 In order to favor the winning party, however, the agreement on compensation is most likely to apply to products that are of exclusive or particular interest to the winning party. See, for example, the EC/US-Canada compensation negotiations in EC – Hormones.

49 ANDERSON (2000), *supra* note 3, 5.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

ditional positive trade effects. One has to admit though, that it will be hard to find and offer compensatory reductions since it requires certain sectors to grant access to the market in favor of foreign suppliers which will cause opposition among national traders. In this context, one should recognize that the political economy of trade policy is such that the political leadership of the country would lose from the unilateral reform – otherwise it would not have those import barriers there in the first place.[50] Another problematic point is that a specific segment that was initially not involved in the conflict would be obliged to shoulder the consequences of its government's refusal to abide by the DSB ruling.[51] However, although national traders certainly would be exposed to more competition implying negative effects for national industry, it must be taken into account that from an economic point of view trade compensation would still be favorable based on the Kaldor-Hicks criterion.[52] Also, it is hard to see why this additional burden for a specific group of national traders should be considered differently from trade concessions granted in the framework of multilateral negotiation rounds where trade concessions lead to significant losses for some industries as well. Since the adverse effect has its origin in unlawful conduct of national governments the most appropriate remedy for the claim of damages would be the invocation of domestic liability rules.[53]

4.3 Comparing Incentives towards Compliance

Weighing the pros and cons of financial and trade compensation suggests a preference for the latter. First, the argument of ever present budgetary constraints[54] as a mean for better incentives towards compliance once financial compensation has to be paid, can hardly convince considering that financial compensation is just money and could, therefore, in particular for large countries, not be a real effort to pay out. Just as former EC Commissioner and current Director-General of the WTO PASCAL LAMY said:

> "As long as you pay the penalties, you can go on as you are."[55]

50 Grossman and Helpman (1995, p. 675).
51 BRONCKERS and VAN DEN BROECK (2005), *supra* note 3, at 108.
52 The losses for national traders would be overcompensated by the gains for consumers thereby fulfilling the potential-compensation criterion.
53 As to EC liability on basis of Community Law it is argued that the lack of direct effect of WTO norms in the EC legal order does not exclude EC liability. Van Thiel and STEINBACH (2005, pp. 49-73).
54 BRONCKERS (2001), *supra* note 2, at 62.
55 See Press and Communication Service Brussels, No. 3036, 23 May 2000; see also Jackson (2004, p. 118, 109); for a different view see BRONCKERS and VAN DEN BROECK (2005), *supra* note 2, at 117.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

Thus, rich countries could buy themselves out of violations. Therefore, it appears questionable if financial compensation would create better incentives compared to a system of retaliation. At the end of the day, money can be passed on to taxpayers and could remain without political implications on government's constituency. Also the obligation to pay monetary compensation would increase the pressure upon poor countries with a small budget.

Second, greater incentives are expected to be provided by trade compensation since the traders of the product category in which trade is liberalized will exercise pressure on their government in order to see the concessions withdrawn. They are the ones who are facing higher competitive pressure and will attempt to keep the phase of compensation as short as possible. For reasons of domestic political economy it is likely that trade concessions will rather worry national governments than mere monetary obligations do.

Third, trade compensation is more likely to be favorable for less developed countries because the benefits are directly to national traders having easier access to the losing party's market, whereas in the case of monetary compensation it would depend on the government's willingness to pass the money to the traders. National governments cannot be told how to use the reparation they receive.[56] Although trade compensation would entail the disadvantage that exporters would not be reimbursed for their losses as compensation would likely occur in a product category that is not involved in the original dispute, it remains open to speculation if developing countries really would use the money to reimburse exporters' damages.

However, an enforcement mechanism providing for compensation creates new problems. The experience under the current regime shows that compensation happens rather rarely. One reason for this might be that the prevailing member has to agree not only to be compensated, but also to the specific amount of compensation which complicates negotiations.[57] Therefore, the DSU should allow the complaining party to obtain an independent decision from a WTO arbitrator about the level of nullification and impairment in order to determine the amount of compensa-

56 HORLICK has put forward that the winning government should be allowed to choose the products for compensation. HORLICK (2000), *supra* note 45, at 45.

57 Article 22 (1) and (2) DSU.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

tion.[58] This should occur before the end of the reasonable period of time in order to send a signal to the parties what level of compensation would have to be granted. More important though, the central problem inherent to any kind of mandatory compensation lies in the shift of enforcement execution to the violator. If compensation would be granted, the losing country would have greater control over procedures. Since monetary or trade compensation requires the cooperation of the losing country, the losing party may be tempted to cease such cooperation if once it finds that its conduct would be WTO-consistent and choose to disregard the outcome of a compliance panel which the winning party can establish if it doubts the appropriate compliance of the losing party.[59] With retaliation, on the other hand, the winning party can uphold its countermeasures until the WTO Panel decides that the new measures have been implemented satisfactorily. Thus, reliance on retaliation would be indispensable if compensation is not granted at all or just only partially granted.

4.4 The Reasoning for Multilateral Enforcement

If the losing country upholds its refusal to compensate or withdraws trade compensation without authorization of the arbitrators, multilateral enforcement should be considered.[60] As losing countries could decide to continue the WTO-incompatible conduct, retaliation may be necessary in spite of the self-harming implications of taking countermeasures. From an economic point of view, power imbalances in the enforcement of DSB decisions could be offset partially if the retaliation system were to provide for multilateral enforcement of DSB decisions. In instances of bilateral imbalances of retaliatory power, outcomes that are Pareto-superior are more likely to be achieved by multilateral trade agreements and third-party punishment than with bilateral trade agreements.[61] Therefore, in such instances a multilateral enforcement mechanism may be beneficial, because it allows a transfer of enforcement power across relationships that is not possible under bilateral enforcement. The reason is simple.

58 ROSAS (2001), *supra* note 45, at 144.

59 Article 21 (5) DSU.

60 In fact, already under the existing DSU collective DSB action in favor of a developing country is possible on grounds of Article 21(7) DSU which reads: "If the matter is one which has been raised by a developing country Member, the DSB shall consider what further action it might take which would be appropriate to the circumstance." Such a favorable action, however, requires a consensus of all WTO members, including the losing member, Article 2(4) DSU.

61 As demonstrated by MAGGI (1999, p. 190–214); see also KONG-PIN CHEN, CHENG-ZHON QIN and LARRY QIU, (2002, p. 3).

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

With bilateral agreements for deeper trade liberalization, the prevailing party (the less powerful one) is not able to punish the losing defendant (the more powerful one) with the efficiency required to deter further violations of the bilateral trade agreement. In contrast, a multilateral trade agreement combined with third-party punishment would create a much greater potential for effective punishment, thereby pushing for deeper liberalization. However, one characteristic of the current regime of DSU countermeasures is that only the complaining party that prevailed in a dispute – and not other WTO members – can impose such countermeasures. A member prevailing in WTO dispute settlement, therefore, has to bear by itself not only the cost of legal proceedings, but that of taking economically inefficient countermeasures.[62] This cost could only be made multilateral if some kind of collective action were possible through or by the DSB. In that case the enforcing entity would be the WTO as an organization that is authorized to delegate retaliation to a third-country.[63]

One should not ignore, however, that multilateral enforcement can cause adverse effects in political relationships. Considering a scenario in which the EU would take over the right to retaliate in place of a developing country against the US, one might easily imagine that this could generate new problems and trade animosity. Hence, this option should be restricted to a situation in which a country consistently refuses to compensate in terms of trade concessions or prematurely ceases compensation. As a remedy of last resort it should create sufficient incentives for a big country to be threatened by further retaliation potential. Insofar, the threat of additional trade conflicts could indeed promote the willingness to compensate.

4.5 Retroactivity

Finally, a significant impact on incentives towards compliance would certainly result from the account for past damages in terms of giving the awards retroactive effect. Article 19 DSU which reads "to bring its measures into compliance" has always been understood by GATT Members, authors of an illegal act, to have a purely *ex nunc* effect. Recurring to gen-

62 PAUWELYN (2000), *supra* note 2, at 345.

63 PAUWELYN suggests that any member could be authorized to suspend concessions equivalent to the damages it has suffered, even if that member did not bring the case. PAUWELYN (2000), *supra* note 2, at 345; considering the problem of multiple calculations he refers to the EC – Hormones case where the arbitrator basically used the same formula to calculate nullification in both the US and Canadian complaint.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

eral international law the Permanent Court of International Justice specified that reparation means to eliminate the consequences of the breach of duty and restore the situation to the *status quo ante.*[64] While compensation under general international law is retrospective in nature, compensation under WTO law seems to be of a prospective nature because it offers relief for the harm that the complainant will presumably suffer due to the lack of implementation. The basic elements of restitution – the consequences of a wrongful act must be effaced – are not retained in entirety under WTO law: the *status quo ante* is not restored. Thus, remedies are prospective and forward looking. There are, however, some exceptions to this principle on basis of which some elements of retroactive compensation could be introduced to the Dispute Settlement Procedure. In five disputes, all of them dealing with anti-dumping/countervailing duties, the panels departed in their findings from the standard *ex nunc* remedy and recommended revocation and reimbursement of illegally imposed duties.[65] So far, however, apart from these exceptions, WTO remedies have offered only prospective relief – in the best circumstances, an immediate withdrawal of the inconsistent measure upon the adoption of DSB recommendations and rulings. More probable, and strictly within legal bounds, the measure will be withdrawn only by the end of the "reasonable period of time". This constitutes also the point in time for the determination of prospective damages.

From an economic point of view, the purely prospective effect of the DSB decisions gives rise to considerable disincentives by unduly disregarding past damage.[66] For example, retroactivity may give strong compliance incentives by counteracting "hit and run" practices. In the absence of account for past damages violating countries may, for example, impose quantitative restrictions without withdrawing this measure until shortly before the decision of the Appellate Body. This reasoning is supported by evidence provided by DAVEY (2005), illustrating long lasting dispute settlement in safeguard cases. While safeguard measures are often removed quite promptly after the adoption of the DSB decision, the elapsed time between the imposition of the safeguard and the moment of its remove

64 Permanent Court of International Justice, Factory at Chorzow, PCJI, Jurisdiction, Judgment No. 8, 1927, Ser A No. 9, Claim for Indemnity, at 21: "It is a principle of international law that the breach of an engagement involves an obligation to make reparation in an adequate form." See also See Article 41 of the International Law Commission Draft Articles on State Responsibility.

65 MAVROIDIS (2000), *supra* note 3, at 775; see also the proposal of Mexico on the DSU review, TN/DS/W/23, 4 November 2002.

66 See also PAUWELYN (2000), *supra* note 2, at 339; *Mavroidis* (2000), *supra* note 3, at 783; GRANÉ, (2001, pp. 755, 770); BRONCKERS and VAN DEN BROEK (2005), *supra* note 3, at 121.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

usually exhibits a median time period of nearly three years.[67] Thus, in many instances safeguard measures are not removed much before their anticipated expiration. Aiming at the prevention of WTO-inconsistent conduct, the DSB decision must be associated with some form of damages to be paid to the WTO Members injured by the legal act, since the cessation of the illegal act has already occurred.[68] Moreover, the benefits a violating country may gain during the period before the DSB decision may possibly exceed the disadvantages caused by countermeasures. In such a scenario, the threat of future losses because of countermeasures would not be large enough to prevent this country from infringing WTO rules. Hence, purely prospective remedies hardly constitute a deterrent effect against potential violators. Guided by effectiveness considerations as well, so necessary to ensure that the WTO contract will be observed *(pacta sunt servanda),* retroactive remedies may be well conceivable in a number of circumstances.

As retroactivity might lead to large financial liabilities, one might consider introducing a limitation on the extent of retroactivity in terms of years or the amount of damages to be paid or limit compensation to certain obligations which are by their nature retroactive.[69] In particular, retroactive compensation should be an option in cases where *restitutio in integrum* is not possible either because the illegal act has expired by time (for example import restrictions with a limited application in time) or because the WTO violation occurred only once in the past as for the payment of illegal subsidies, antidumping, countervailing or safeguards measures. In these cases retroactive compensation has to be mandatory as it constitutes the only remedy to obtain reparation and to prevent WTO violators from "hit und run" practices. At the same time, to make sure that the account for past damages induces deterrence, reparations should at least exceed the economic gain the violator-country accrued by violating WTO norms.

5 Conclusion

Although the rules governing dispute settlements work relatively well as a mechanism that exercises discipline upon unilateral trade policies, there are considerable shortcomings that need to be addressed in the current

67 DAVEY (2005), *supra* note 4, at 50.
68 MAVROIDIS (2000, pp. 763, 783).
69 BRONCKERS and VAN DEN BROECK (2005), *supra* note 3, at 122.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

negotiation round and in the framework of the DSU review in order to ensure optimization of incentives to abide by WTO rules and equality between big and small member states. The significant increase in participation of small countries in WTO dispute settlement in recent years indicates a reduction of barriers to the initiation of disputes. At the same time, the compliance records of small and large countries still exhibit considerable differences with regard to the respective incentives to fully comply with DSB decisions. Arguing in favor of mandatory trade compensation as well as retroactive measures, this paper considers these remedies appropriate answers to the power imbalances in the enforcement of WTO rules as opposed to financial compensation. Total replacement of the current retaliation mechanism, however, does not appear desirable, in particular not in cases where losing countries do not meet their obligation to compensate. In these cases implementation of multilateral enforcement could serve as remedy of last resort. Needless to say, the political reality indicates that acceptance and implementation in the DSU review of some of these suggestions is unlikely. It corresponds to the common phenomenon that reasonableness of economic and legal findings is not necessarily reconcilable with political feasibility. Fundamental changes to WTO enforcement rules may require in a first step multilateral efforts towards strengthening the legitimacy of WTO rules in general, thereby promoting the acceptance of WTO rules. Once the merits of trading rules have become less disputable it will be increasingly difficult to justify the refusal of more effective enforcement remedies.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

References

ANDERSON, KYM (2000), *Peculiarities of Retaliation in WTO Dispute Settlement,* Discussion Paper 0207, Adelaide University.

BOWN, CHAD (2004), Developing Countries as Plaintiffs and Defendants in GATT/WTO Trade Disputes, *The World Economy* 27 (1), pp. 59–80.

BREUSS, FRITZ (2003), *Economic Assessment of WTO Dispute Settlement,* in: FRITZ BREUSS, STEFAN GRILLER and ERICH VRANES (Eds.), *The Banana Dispute: An Economic and Legal Analysis,* Vienna: Springer, pp. 131–181.

BREUSS, FRITZ (2003), *WTO-Streitbeilegung: Eine Ökonomische Perspektive,* Austrian Foreign Trade Yearbook.

BRONCKERS, MARCO (2001), More Power to the WTO?, *Journal of International Economic Law* 4 (1), pp. 41–65.

BRONCKERS, MARCO and NABOTH VAN DEN BROEK (2005), Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement, *Journal of International Economic Law* 8 (1), pp. 101–126.

BUSCH, MARC and ERIC REINHARDT (2003), Developing Countries and GATT/WTO Dispute Settlement, *Journal of World Trade* 37 (4), pp. 719–735.

CHARNOVITZ, STEVE (2001), Rethinking WTO Trade Sanctions, *American Journal of International Law* 95 (4), pp. 792–833.

CHEN, KONG-PIN, CHENG-ZHONG QIN and LARRY QIU (2002), *The Value of Multilateral Trade Liberalization and the Need for Third-Party Sanction,* Working Paper 14-02, Department of Economics, UCSB.

DAM, KENNETH (1970), *The GATT: Law and International Organization,* Chicago: University of Chicago Press.

DAVEY, WILLIAM (2005), The WTO Dispute Settlement System: The First Ten Years, *Journal of International Economic Law* 8 (1), pp.17–50.

DAVIES, ARWEL (2006), Reviewing dispute settlement at the World Trade Organization: a time to reconsider the role/s of compensation?, *World Trade Review* 5 (1), pp. 31–69.

GRANÉ, PATRICIO (2001), Remedies under WTO Law, *Journal of International Economic Law* 4 (1), pp. 755–772.

GROSSMAN, GENE and ELANAN HELPMAN (1995), Trade Wars and Trade Talks, *Journal of Political Economy* 103 (4), pp. 675–708.

HORLICK, GARY (2000), *Problems with the Compliance Structure of the WTO Dispute Resolution Process,* Paper Prepared for Conference at the University of Minnesota Law School.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

HORN, HENRIK and PETROS MAVROIDIS (1999), *Remedies in the WTO Dispute Settlement System and Developing Country Interests,* Discussion Paper No. 2340, World Bank.

HORN, HENRIK, PETROS MAVROIDIS and HAKAN NORDSTRÖM (1999), *Is the Use of the WTO Dispute Settlement System Biased?,* Discussion Paper No. 2340, Centre for Economic Policy Research.

HOWSE, ROBERT (2003), The WTO on Trial, *Foreign Affairs* 82 (1), pp. 130–140.

HUDEC, ROBERT (2000), Broadening the Scope of Remedies in WTO Dispute Settlement, in: WEISS, FRIEDL (Ed.), Improving the WTO Dispute Settlement Procedure, London: Cameron May Publishers, pp. 345–376.

HUDEC, ROBERT (1991), *Enforcing International Trade Law,* Salem: NH Butterworth.

JACKSON, JOHN H. (2004), International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or to "Buy Out"?, *American Journal of International Law* 98, pp. 109–123.

LESTER, SIMON and KARA LEITNER (2004), WTO Dispute Settlement 1995–2003: A Statistical Analysis, *Journal of International Economic Law* 7 (1), pp. 169–181.

LÖWENFELD, ANDREAS (1994), Remedies Along with Rights: Institutional Reform in the New GATT, *American Journal of International Law* 88 (1), pp. 477–488.

MAGGI, GIOVANNI (1999), The Role of Multilateral Institutions in International Trade Cooperation, *The American Economic Review* 89 (1), pp. 190–214.

MAVROIDIS, PETROS (2000), Remedies in the WTO Legal System: Between a Rock and a Hard Place, *European Journal of International Law* 73 (1), pp. 763–815.

MERCURIO, BRYAN (2004), Improving Dispute Settlement in the World Trade Organization: The Dispute Settlement Understanding Review – Making it Work?, *Journal of World Trade* 38 (5), pp. 795–854.

PAUWELYN, JOOST (2000), Enforcement and Countermeasures in the WTO: Rules are Rules – Towards a More Collective Approach, *American Journal of International Law* 94 (2), pp. 345–346.

PETERSMANN, ERNST–ULRICH (1997), *The GATT/WTO Dispute Settlement System: International Law, International Organizations and Dispute Settlement,* London: Kluwer 1997.

REIF, TIMOTHY M. and MAJORIE FLORESTAL (1998), Revenge of the Push-Me, Pull-You: The Implementation Process Under The WTO Dispute Settlement Understanding, *International Lawyer* 32 (2), pp. 755–788.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.

ROSAS, ALLAN (2001), Implementation and Enforcement of WTO Dispute Settlement Findings: An EU Perspective, *Journal of International Economic Law* 4 (1), pp. 131–144.

VAN DEN BROEK, NABOTH (2003), Power Paradoxes in Enforcement and Implementation of WTO Dispute Settlement Reports, *Journal of World Trade* 37 (1), pp. 127–162.

VAN DER BORGHT, KIM (1999), The Review of the WTO Understanding on Dispute Settlement: Some Reflections on the Current Debate, *American University International Law Review* 14 (4), pp.1223–1243.

VAN THIEL, SERVAAS and ARMIN STEINBACH (2005), *The effect of WTO Law in the legal order of the European Community: a judicial protection deficit or a real-political solution, or both?,* in: LANG, MICHAEL, JUDITH HERDIN and INES HOFBAUER (Eds.), *WTO and Direct Taxation,* Vienna: Linde, pp. 49–73.

Reproduced with permission of the copyright owner. Further reproduction prohibited without permission.