

NON-COMPLIANCE AND ULTIMATE REMEDIES UNDER THE WTO DISPUTE SETTLEMENT SYSTEM

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This article examines the question of non-compliance and ultimate remedies under the WTO dispute settlement system. When two members have a trade dispute settled by the WTO, the dispute settlement body issues a formal binding ruling; however, if a member does not comply, final enforcement remains problematic. The WTO authorizes countermeasures to be taken by individual states. These retaliatory provisions, however, fail on many counts: on effectiveness; on defeating the foundational principles of the WTO, such as free trade; by causing “double-injury” to those who win the case; on being “the epitome of mercantilism”; and lastly, on favoring a power-based system and undermining the rule-based system of adjudication. Arguably, the WTO has the best dispute settlement system of any international organization. Nevertheless, the WTO does not have the best compliance system. Reform is an urgent necessity for the continued stability and predictability of the entire regime.

I. INTRODUCTION¹

In the current age of globalization many factors, such as macroeconomic spillovers, global public goods and international externalities, foster international cooperation. States increasingly realize that they can be made better off by entering international cooperation agreements that curb their own behavior, or by establishing international organizations that have some power of governance and coercion. No organization has gone as far in this direction as the World Trade Organization (WTO). In addition to the rapidly increasing membership and the breadth of subjects covered by the WTO agreements, the most important change brought about by this organization is the attempt to create a strong institutional base to fulfill its mission. In this context the most critical role is played by the WTO's dispute settlement mechanism.

This dispute settlement system is the centerpiece of the WTO and can indeed be considered a "giant leap" in the field of public international law. "The dispute settlement mechanism of WTO is a central element in providing security and predictability to the multilateral trading system" says Article 3(2) of the Understanding on Rules and Procedures Governing the Settlement of Disputes. When the WTO agreement was signed in Marrakesh in 1994, the new procedures of implementing dispute settlement rulings were widely praised as a decisive and historic improvement over the procedures previously codified and practiced under the General Agreement on Tariffs and Trade (GATT), which was established in 1947. In 1997 the then Director-General of the WTO stated that the dispute settlement system is the WTO's "most individual contribution to the stability of the global economy." It was claimed that the establishment of the dispute settlement system was "likely to be seen in the future as one of the most important, and perhaps even watershed, developments of international economic relations of the twentieth century" (Jackson 1998).

If we both recall the drawbacks of the GATT procedures and compare the WTO provisions to the mechanisms by which other international organizations settle disputes among their members, these assertions do not seem unreasonable. Unlike many other international organizations, WTO members are subject to a dispute settlement system that has authority to issue legally binding rulings with significant political and economic consequences for its members. This dispute settlement procedure not only has great significance for international trade, but also has wider ramifications.

With globalization continuing apace, the points of interaction between states are increasing rapidly. Globalization denotes increasing economic integration resulting from the fall in transaction costs of doing business across space and across national borders. The fall in barriers to trade in goods, services, financial capital and ideas has been a consequence of declining transportation and communication costs, most recently because of the digital revolution, as well as trade, regulatory and policy reforms (Friedman 2002; Hardt and Negri 2000; Nye 2002; Stiglitz 2002). This process also generates more issues on which states can have different interpretations of their mutual obligations vis-à-vis other states. The dispute settlement mechanism set up by the WTO—with “courts,” compulsory jurisdiction, appellate procedures, and legally binding rulings—defines a model for amicable resolution of disputes between members that could also be adopted by other international organizations. It is a forerunner in attempting to find improved methods of handling inter-state disputes in an increasingly interdependent world.

Although it can be seen as an improvement over previous GATT provisions, the WTO dispute settlement mechanism has also been grappling with some procedural issues since its inception. This paper does not seek to examine all of the procedural issues that have arisen in the last seven years since the Dispute Settlement Understanding (DSU) was implemented. Rather,

the focus of this paper is on a specific question: what happens after the dispute settlement procedures have been completed (through the Panels, to the Appellate Body, and the Dispute Settlement Body) and the successful member finally has a legally binding recommendation in its favor, but the losing member decides not to comply with the final ruling issued against it? In other words, does the WTO ensure that members are given an adequate remedy in case of such non-compliance by the losing member?

According to the provisions of the DSU, the prevailing member can seek authorization from the WTO Dispute Settlement Body “to suspend the application to the member concerned of concessions or other obligations under the covered agreements” in case of non-compliance (DSU Art. 22:2). These provisions for countermeasures have already been invoked in many cases involving the largest players of the WTO. It was found that in case a losing member decided not to comply with the legally binding ruling against it, these remedies provided little relief to the winning complainant. Given that the largest members of WTO could not deploy these ultimate enforcement measures of DSU effectively, the prospects for developing countries or small economies are even bleaker.

Over three-fourths of the WTO’s members are developing countries, and thus this question assumes great importance for a large majority of the member states. If instances of non-compliance go unchecked and cannot be remedied, it may not be very long before the euphoria about the WTO’s “giant leap” withers away and serious questions are raised about the efficacy of the dispute settlement procedures.

The rest of the article is structured as follows. Section II briefly considers the GATT rules and practice on the subject. Section III analyzes the WTO rules and procedures. Section IV analyzes the WTO cases and practice. Section V analyzes the performance of these compliance

measures. Section VI suggests some possible alternatives to trade sanctions. (The words retaliation, sanctions and countermeasures are used interchangeably in this paper.) And finally, Section VII concludes.

II. GATT RULES AND PRACTICE

GATT provisions relating to dispute settlement procedures were very brief. These were in fact intended to be provisional and to be replaced by a more extensive Charter of the International Trade Organization, which was never established.² The main GATT provisions were defined in Article XXIII: 2. After an investigation and ruling in a trade dispute, the Contracting Parties could authorize a complainant country to suspend the application of concessions or other obligations that were deemed appropriate under the circumstances.³ This could be done by raising tariffs or by imposing quotas against imports from the losing party. Although retaliation was permissible, rebalancing of concessions remained the dominant solution during the GATT years. In fact no GATT-authorized retaliatory action was taken during its 47-year history.

There is only one instance in which the GATT authorized a Contracting Party to implement such countermeasures. The Netherlands was authorized to limit its imports of wheat flour from the United States to 60,000 tons. However, the Netherlands never exercised the option to retaliate and did not impose the flour quota against the United States. The possibility of countermeasures also arose in the so-called Superfund case.⁴ The panel decision went against the United States, and the report was adopted by the GATT Council. Thereafter, the EEC requested permission to adopt countermeasures against the United States, since the latter had not chosen to abide by the panel report. The United States was able to block the process. Decisions under the

GATT were taken by consensus of all the Contracting Parties which obviously granted the losing state an opportunity to block the process of dispute resolution.

Notwithstanding these two requests and one authorization to retaliate, no countermeasures were ever implemented under the GATT. The decision by the Netherlands suggests that it regarded the use of these retaliatory measures as futile. Robert Hudec's study of the implementation of panel reports in the GATT era shows that the complaining party received full satisfaction in 60% of the cases and partial satisfaction in another 29% out of the 139 complaints launched up until 1989 (Hudec 1993).⁵ The overall conclusion of his study was that the GATT record was rather satisfactory. The same is echoed by later studies (Jackson 2002).

There is no doubt that contracting parties showed concern in implementing Council recommendations during the GATT era. This was attributable to numerous factors, including reputation costs, concessions obtained through negotiations in other sectors of trade, or in non-trade matters such as foreign aid, technical assistance programs, and transfer of technology. The relative effectiveness of the GATT dispute settlement mechanism as compared to other international organizations is not an issue here. However, this record does not contradict the fact that the authority to impose sanctions was not the reason for compliance with GATT rulings. Nor can it distract from the fact that when a winning party faced non-compliance, countermeasures were hardly of any use in obtaining adequate remedy and provided hardly any safeguard to the injured party.

By the time the WTO started to appear on the horizon, the fundamental inadequacies of the GATT dispute settlement system had become evident. The principal complaints about the GATT dispute system can be summarized as follows: (i) disuse, (ii) delays in establishment of panels, (iii) delays in appointing panel members, (iv) delays in the completion of panel reports;

(v) uncertain quality and neutrality of panelists and panel reports, (vi) blocked panel reports and (vii) non-implementation of panel reports (Daves 1987).

III. WTO/DSU RULES

The WTO dispute settlement mechanism was established in 1994 with the specific aim of removing the weaknesses of the previous GATT years. The objective was to make the new system more effective and to correct the most commonly criticized feature of the GATT procedure—that a losing party could permanently evade compliance with little or no fear of adverse consequences. The new WTO dispute settlement mechanism consists of three or possibly five-member Panels (they can be interpreted as “courts” of first instance in the national legal system) and a standing Appellate Body. The Panels issue reports with findings and recommendations on a dispute, which is followed by an appeal process, if this is desired. In order to obtain legal status these reports also have to be adopted by the WTO’s Dispute Settlement Body (DSB), a political organ of all members based on the one-member-one-vote principle. The most significant feature of the WTO/DSU system is that it enables the complainant to have a Panel established, obtain a legally binding ruling from the Panel or Appellate Body, and obtain authority from the Dispute Settlement Body to retaliate without requiring the prior consent of the defending member. In other words, the GATT era “veto power” of a losing member state has been abolished.

Under the DSU, dispute resolution proceeds automatically, subject only to a consensus decision not to go forward, commonly known as the “reverse consensus.” If violation of the WTO rules is found, the DSB recommends that the member concerned “bring the measure into conformity” with the WTO agreement that has been violated (DSU Art. 19:1). Withdrawal of the

measure concerned is usually required. The DSU stipulates that “prompt compliance with recommendations or rulings of the DSB is essential in order to ensure the effective resolution of disputes to the benefit of all members.” If compliance is not achieved after a reasonable period of time the defaulting member can offer compensation, which usually involves the lifting of trade barriers by the defaulting member.

If no satisfactory compensation can be agreed upon and if the ruling is not implemented within a reasonable period of time, the prevailing member can request authorization for countermeasures. “A WTO member can now...become the object of economic sanctions, if the WTO adjudication bodies uphold the request of another member” (Hudec, 1999). Article 22:3 of the DSU allows WTO members to request authorization for countermeasures in the same sector, or in a different sector under the same agreement, or in a different sector altogether. There is an escalation of procedural obligations if the winning party wants to move away from imposing countermeasures in the same sector. Expedited arbitration is available to determine (i) what constitutes a reasonable period of time for implementation and (ii) what compensation or retaliation is reasonable.

Three procedural provisions have been added to address the shortcomings of the GATT. The first are the procedures and guidelines for establishing a compliance deadline, or “reasonable period of time” for compliance. The second are the “compliance review” procedures to be used when there is a disagreement over whether a losing member has complied with the DSB ruling. The third are procedures for the suspension of concession if the losing party failed to implement the WTO rulings or to satisfy the winning member by its implementation deadline. This article is mainly concerned with the third provision. Where the situation of non-compliance with the

legally binding ruling or recommendation arises, the key phrase “suspend...concessions or other obligations” in DSU Article 22:6 is the same as it was in previous GATT Article XXIII: 2.⁶

There are, however, two critical differences between Article XXIII: 2 of GATT and Article 22:6 of DSU. First, some of the political flexibility of the GATT system was eliminated in the DSU. The GATT wording states that the contracting parties “may” authorize suspension of concessions if the circumstances are “serious” enough, and in so far as the measures are considered “appropriate.” In contrast, the DSU states that after a reasonable period of time has elapsed the DSB “shall grant authorization to suspend concessions or other obligations” . The new procedures are thus not only mandatory but also remove the discretion to resist a suspension in “inappropriate” or less serious cases.

Secondly, there are differences in the extent or level of countermeasures. Under Article 22:4 of the DSU the authorized level of suspension is to be made “equivalent to the level of nullification or impairment.” The level is calculated by arbitrators, who determine the extent to which trade with the defending country is impaired because of the breach of WTO law. Strictly speaking, the word “equivalent” means that there is no question of punitive damages in the WTO context. Equivalence is to be judged by reference to the level of nullification and impairment. In the previous GATT regime the term used in place of “equivalence” was “appropriate.” Thus the new DSU imposes a strict standard of equivalence between damage incurred and the level of countermeasures.

On the whole these differences between GATT and WTO provisions point in two different directions. On the one hand, the DSU makes countermeasures automatic and mandatory, and on the other hand, it makes sure to limit the amount or extent of retaliatory remedies.⁷ It could be argued that the limitation of retaliatory measures recognized the fact that

such countermeasures only aggravate the violations of the object and purpose of the WTO. The DSU itself states that such measures “are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time.” It can also be argued that the increase in the *certainty* of imposition of retaliatory sanctions allowed for the mitigation of the level and extent of these measures.

From the point of view of *realpolitik* it seems that both of these changes serve the same purpose for larger members of the WTO: complainants would like to place maximum emphasis on improving the certainty of countermeasures against other states. Given this certainty, a threat against a smaller member of the WTO would be more than enough to ensure compliance under such conditions. In contrast, a respondent will be focused on limiting the extent of retaliation by other states, for fear that some *other* larger member obtains a favorable ruling.

IV. WTO/DSU CASES AND PRACTICE

Now we turn to the practice of the WTO. In the last seven years there have been four major cases of non-compliance and an additional case may soon be added to the list. The most notorious case of violation and non-compliance was the dispute about bananas, which involved complaints by Ecuador, Mexico, Guatemala and the United States against the European Community’s restrictions on the importation of bananas. It was held that the complex, discriminatory banana regime of the EU violated WTO rules in numerous ways, but the EU did not comply with the ruling. In the end, the United States gained authority to suspend tariff concessions, and the U.S. government took action immediately by imposing 100 tariffs on selected products from various EU countries.

Later Ecuador asked the DSB for Article 22 authority, which was granted and Ecuador was given the go-ahead to undertake suspensions equivalent to U.S.\$202 million. It did not, however, exercise this option.⁸ A winning member with a small economy has little or no option to ensure that the injury caused to it is reversed, compensated, or even prevented from re-occurring in the future. Even the United States, the largest economy in the WTO, could not escape the possible “double-injury” caused by the retaliatory imposition of 100 tariffs on selected goods imported from the EC.

A similar case revolved around the beef hormones dispute. Two complaints were launched by the United States and Canada against EU restrictions on the importation of meat produced with the aid of growth hormones. It was held that the EU ban on beef violates the WTO Agreement and the losing member was given a “reasonable period of time” of fifteen months to bring its food safety measures into compliance. When the EC failed to do so, the United States and Canada gained authority to suspend tariff concessions equivalent to U.S.\$116 million and Canada \$11 million respectively. Both governments promptly implemented these trade restrictions by imposing 100 percent duties on selected products from various EU countries. It should be noted that the parties in this dispute were not weak economies. Even so, when the losing party did not comply, the implementation of legally binding decisions could not be guaranteed by using retaliatory measures.

The WTO also authorized countermeasures in the case of a Canadian complaint about Brazilian subsidies for exports of regional aircraft. It was held that Brazil was using unauthorized export subsidies and the DSB gave Brazil a “reasonable period of time” of 90 days to bring its aircraft subsidies into compliance. After a panel found that Brazil had failed to do so, Canada gained authority to suspend tariff concessions equal to Canadian \$344 million. Canada has not

taken advantage of the authorization “apparently in part because of some concerns about its efficacy” (Jackson 2002).

In an important on-going case following an EU complaint, it has been held that certain U.S. tax provisions constitute an export subsidy, which violates WTO rules. The United States was asked to bring its tax policy into conformity with its obligations under the WTO agreements by withdrawing these subsidies.⁹ The EU contended that the United States had failed to withdraw the subsidies as required by Article 4.7 of the SCM Agreement and that it had thereby failed to comply with the DSB recommendations and rulings.¹⁰ Therefore the EU sought authorization from the DSB to impose tariffs. On 30 August 2002 the Arbitrators held that the EU request for a 100 per cent *ad valorem* charge on imports of certain goods from the United States in a maximum amount of U.S.\$4.043 billion per year constituted “appropriate countermeasures.”

In another recent case, Brazil filed a complaint (as part of a sequel) against Canada for granting export credits and loan guarantees to its regional aircraft industry and violating its WTO obligations. The Panel found that Canada had violated the Agreement on Subsidies and Countervailing Measures (SCM Agreement). In February 2002 the DSB adopted the Panel report, which required Canada to withdraw these subsidies. In May 2002 Brazil stated that Canada had not followed the ruling of the DSB and requested authorization to take appropriate countermeasures in the amount of US\$3.36 billion against Canada. On 17 February 2003 the Arbitrator in this litigation determined that the appropriate amount of countermeasures that Brazil could apply in accordance with Article 4.10 of the Subsidies Agreement was U.S.\$248 million. However, the Arbitrator conceded that a mutually satisfactory agreement between the two parties “would be the most appropriate solution in the dispute.”

V. ANALYSIS OF PROVISIONS

To assess the performance of the WTO-authorized countermeasures we need to consider their efficacy. If the purpose of such remedies is to promote compliance, we need to ask whether these measures ensure compliance with the legally binding rulings of the WTO. Judging compliance is sometimes subjective because few WTO disputes end in an authoritative determination of whether compliance has occurred. The two cases in which sanctions were actually employed, *Bananas* and *Hormones*, have not significantly promoted compliance. These cases involved the largest economies of the world, but even in these cases the winning member could not get compliance by relying on these provisions. In the *Netherlands* and *Aircraft* cases, the successful party did not even bother to exercise its option to apply countermeasures. However, the efficacy of these provisions, especially since they have only been used in two cases, may not be the critical factor in examining these rules.

It could be argued that the countermeasures in the WTO regime are not effective because they are not sufficiently strong. Such a view would call for making these sanctions more powerful. This would force WTO members to abandon their WTO-inconsistent practices, if countermeasures (or the threat thereof) were made more credible. Game theory suggests that a threat is credible if players know *ex ante* that it will materialize.

The fundamental issue, however, is that such countermeasures are inherently counter-productive. Retaliatory measures taken by members in accordance with WTO provisions are usually a withdrawal of concessions to the respondent's exports. In such cases the prevailing member's economy is not helped but further harmed by retaliation. This is the standard cost of protectionist barriers. Presently "the injured country then suffers twice—once from the restrictions on its exports, imposed by foreign governments, and again when tariffs or duties raise the

domestic cost of foreign goods selected for retaliation” (Meltzer 2000). Moreover, retaliation does not help the export industry that has been denied market access by the respondent. It is the prevailing party’s import-competing industries that enjoy temporary assistance because of the prohibitive retaliatory tariffs. In addition, the loser’s industries that are harmed by the complainant member’s retaliatory measures typically are not the same industries that benefit from the WTO-inconsistent measures. The winning member typically chooses sectors with a view to having the largest negative political impact on the losing government.

These provisions are self-defeating as far as the very object and purpose of the WTO is concerned, in that they are an example of mercantilist practice (Pauwelyn 2000). They are based on the premise that protecting markets is beneficial and that it can offset the “nullification or impairment” caused by the WTO-inconsistent measure and thereby force the losing member to comply with the rules. It is a paradox that the premier international organization established to promote free trade makes trade sanctions a basic tool of the system.

It is also worth recalling that one of the most powerful arguments made in favor of the WTO dispute settlement mechanism was that it was a move from a power-based to a rules-based system. It was claimed that “a particularly strong argument exists for pursuing gradually and consistently the progress of international economic affairs towards a rule-oriented approach. Apart from the advantages that accrue generally to international affairs through a rule-oriented approach—less reliance on raw power, and the temptation to exercise it or flex one’s muscles, which can get out of hand; a fairer break for the smaller countries, or at least a perception of greater fairness; the development of agreed procedures to achieve the necessary compromises—in economic affairs there are additional reasons” (Jackson 2002). But the reality at present is very different.

Prima facie there is a situation of perfect symmetry among different WTO members when it comes to adopting retaliatory sanctions, as these are limited to the value of the damage and do not extend beyond it. But this notion of sovereign equality of states before the law is undermined when issues of enforcement and implementation of international agreement arise. Such provisions depend directly on the relative economic might of the party adopting it. Countermeasures effectively mean exclusion from (or difficult access to) markets. By definition, countries depending on international trade will be hurt more, and this clearly favors larger economies. Here lies the deep unfairness of the system. The threat and economic impact arising when a developing country raises barriers against a large industrial economy is generally not significant.

An additional complicating factor in this context is the attraction of a particular market for exporters. A small economy can hardly survive without access to the larger, high-income, consumption-based economies of the United States or the EU. Therefore these WTO provisions clearly defeat the avowed purposes of promoting an adjudicative and “rule-based” dispute settlement mechanism. When the negotiations for compensation are initiated by a disproportionately weaker member, raw power politics comes into play with hardly any chances of compliance. Provisions of this nature effectively uphold the existing inequality between WTO members.

As a result, WTO members that can afford either to take or to accept countermeasures are in a good position. When acting as complainant parties, they can use the threat and/or imposition of countermeasures in order to induce compliance. When acting as defendants, they have the luxury of weighing the pros and cons of changing the domestic policies at stake or of simply

keeping their policies intact and accepting countermeasures. A study conducted by the World Bank has concluded that:

There is then a strong presumption that countries that are 'strong' in the sense of being able to impose significant losses on trading partners at relatively low costs for themselves, are better off in such a system. Again, developing countries are at a disadvantage, when considering the trade arena. These countries are often dependent on the countries to which they export for foreign aid, and are also politically and sometimes militarily dependent on them... Finally, there is yet another common asymmetry between developed and developing countries, which is the fact that the latter often receive tariff preferences from developed countries, but not vice versa. Since these preferences can be unilaterally withdrawn by the importing developed countries, it might appear as if they could be a source of leverage for the latter (Horn and Mavroidis 1999).

The critical point here is to keep the distinction between the DSU system itself and its ultimate compliance mechanism clear. The improvements made in the new dispute settlement system, both in contrast with other international organizations and with previous GATT rules, are indeed significant. They need to be further strengthened and reinforced. The focus here, however, is on the inadequacies of the ultimate compliance mechanism, as it imposes huge costs on the bigger players and is at the same time deeply unfair for the weaker, but more numerous, members of the WTO. If the rules and procedures uphold and reinforce the inequalities among WTO members, prospects for the long-term sustainability of such a mechanism are bleak. But if rules and laws can be effective and also bring about some semblance of equality among WTO members, the promise of the DSU system can indeed be realized.

VI. SUGGESTIONS FOR REFORM

The incidence of non-compliance is on the rise and gaining public attention. The need for reform is urgent and also well understood. The multilateral trade negotiations launched in Doha in November 2001 contain a commitment to reaching agreement on DSU improvements and clarifications. "We agree to negotiations on improvements and clarifications of the Dispute Settlement Understanding. The negotiations should be based on the work done thus far as well as

any additional proposals by members, and aim to agree on improvements and clarifications not later than May 2003, at which time we will take steps to ensure that the results enter into force as soon as possible thereafter” (Doha Declaration 2001).

Many alternatives to sanctions can be devised. The examples of human rights and environmental organizations, who rely more on transparency (or sunshine methods) and positive incentives, have been suggested for exploration and adaptation. In such a system, prompt compliance could be rewarded, thus creating an incentive for the member to adhere to the ruling. However, this may work only in a few cases, and the injured party may be tempted to take unilateral action in such cases, which may create more complications for the treaty system itself.

Monetary fines have also been proposed. The most prominent use of fines is found in the Treaty Establishing the European Community, where a penalty payment can be imposed against a member state that fails to comply with a judgment of the European Court of Justice (Art. 171).¹¹ In a recent development the United States is now proposing to:

...overhaul the way in which international trade rules are enforced, by instituting fines as an alternative to the traditional use of trade sanctions....The history of the World Trade Organization dispute mechanism has shown ‘traditional retaliation doesn’t work’...Trade sanctions have been ineffective...because they also hurt business in the countries that levy them (The Financial Times 2002).

The Meltzer Commission (2000) also proposed that "instead of retaliation, countries guilty of illegal trade practices should pay an annual fine equal to the value of the damages assessed by the panel or provide equivalent trade liberalization." Fines may work in the case of the European Community because of the huge transfers that take place between Brussels and the member states and the numerous other “confederal” linkages. Such transfers between the WTO and its members, however, are not common. Moreover, any effective and just fine ought to be tied to the size of the economy. If the fine is to be paid by a small developing country, it may create issues of macroeconomic and political stability in that country. There will also be strong

resistance to such proposals from the developing countries, who may have concerns regarding such “reparations.” Hence, fines may be of limited acceptability at the WTO.

Compensation has also been proposed. The DSU expresses a preference for compensation over suspension of concessions, but notes that compensation is voluntary. Compensation in this context means action by the defaulting government to reduce trade barriers, although it can also be financial. Monetary compensation to the complainant from the respondent may offer more scope for governments to target the transfers to achieve a more equitable outcome (and in the process to capture at least the full historical cost of the WTO-inconsistent measure to the complainant). Bhagwati has proposed that whenever a developing country wins its case before the WTO, it should be allowed to negotiate concessions from its developed WTO partner in a field other than the field where the illegal action took place. However, this proposal is unlikely to be effective. Negotiations between a weak member and a disproportionately strong member will re-introduce power-politics and will constitute a step away from the rule of law. The “spillover” into many other fields can in fact cost more to the weaker member than the benefits of any such negotiations.

It has been proposed by the World Bank study that consideration be given to the notion that other WTO members contribute to the cost of small countries taking retaliatory action, so as to reduce the risk of large trading states remaining WTO-inconsistent (Horn and Mavroidis 1999). But that assumes an exceptional and infrequent commonality of interests among WTO members. Many small states may never muster the courage to join in this collective action when the losing member is disproportionately strong and has an attractive market.

The best and most effective remedy would be to prohibit a member from invoking the jurisdiction of DSU unless it complies with the earlier ruling. After all, how can a member seek

assistance from an institution whose decision and authority it challenges by non-compliance with its rulings? Such a remedy would provide an incentive to the member to comply with the rulings but would not be so onerous as to provide it an incentive to break away from the international trade regime.

There is a need to balance the effectiveness of remedies against the possibility that a losing party may choose to secede from the system, if the measures are too onerous. At present the system leaves each member to fend for itself. The winning party is free to take whatever appropriate countermeasures it can afford to take against the defaulting party. In the end international law fades and the age-old rules of tit-for-tat and power-politics dominate.

VII. CONCLUSION

WTO countermeasure provisions fail on many counts: on effectiveness; on defeating the foundational principles of the WTO, such as free trade; by causing “double-injury” to those who win the case; on being “the epitome of mercantilism;” and lastly, on favoring a power-based system and undermining the rule-based system of adjudication.

In the pre-WTO era there was much support for the ‘tit for tat’ policy of retaliation. A powerful argument was made that

...there are good reasons why [DSB] should authorize retaliation more regularly. First, the novelty of retaliation will decrease with use and it will eventually be accepted as the normal consequence of an inability to resolve a dispute. This will lessen the poisonous effects that retaliation entails. Second, retaliation would improve the efficiency of the...dispute settlement system by encouraging speedy conflict resolution. Third, retaliation is fair because it reestablishes the balance of concessions between the two parties, a balance that is thrown into disequilibrium when one party has violated...rules. Fourth, and most important, retaliation will often occur anyway if disputes are not resolved. Given that this is the case, it would be desirable for [DSB] to exercise greater control over retaliation when it occurs (Daves 1987).

Today there is much less support for such retaliatory legal provisions. The increase in the number of cases of non-compliance and the number of cases in which countermeasures are being

invoked is an indicator of the dangers to the world trading regime. A big case between two large industrial countries can disrupt the system. Even the most ardent proponents of retaliatory sanctions, the ultimate compliance mechanism, are now having second thoughts and admitting that:

The problem is that retaliation is most useful in its threat stage...once you actually have to implement the retaliation, it may not be so useful anymore. If you actually retaliate and the other side decides it can live with the retaliation, then there may be no resolution of the dispute.... Given that retaliation makes both sides worse off because retaliation hurts importers and other people in a country's economy, it seems that it would be desirable to have some other mechanism for promoting enforcement....[non-compliance] presents a serious problem. Implementation of retaliation has served as a pressure relief valve - at the moment, tensions have been tamped down a bit. But long-term non-compliance with rulings will undermine the system. Particularly, it is likely to cause other members, less powerful members, to wonder why they should accept adverse decisions if the major players do not accept adverse decisions when they do not want to... (Daves 2001).

Reform is an urgent necessity for the continued stability and predictability of the entire regime. It may not come about quickly but the warning signals are there already. Many in the large industrial countries are now becoming uncomfortable with tariff sanctions and proposing alternatives.

The DSU itself is indeed a milestone in the history of international legal relations. It defined a benchmark for other international organizations and shows how systems can be crafted to constrain sovereign and equal states legally. In the present age of globalization, states are willing to trade part of their sovereignty for benefits received from coordinated efforts and international governance. Shallow integration is being followed by deep integration, which ranges from consultation, to coordination and harmonization, to confederation (Lawrence 1996). The points of friction between these members of the international community are also increasing by the same degree. In such a world, states need to devise new ways to resolve their disputes on the international

stage. With an improved and reformed institutional compliance mechanism, the DSU will take another giant step towards strengthening the rule of law in international relations.

NOTES

¹Mid-career MPA 2003, Kennedy School of Government, Harvard University, e-mail: asim_ali@ksg03.harvard.edu. I would like to thank Joel P. Trachtman, Professor of International Law, Andrew Mayock, and Magnus Feldmann, for their comments on an earlier version of this paper. The views expressed in the paper are, however, my personal views.

² Havana Charter of the International Trade Organization [hereinafter ITO Charter]. The ITO was designed to become a specialized organization of the United Nations, but the ITO treaty never entered into force. Instead the GATT served as the basis of international trade governance from 1948 to 1994.

³ There was, however, a clear difference between the two provisions. The ITO provisions specified an action that is “appropriate and compensatory,” while the GATT used the term “appropriate” only, arguably permitting a more extensive quantum or extent of retaliation.

⁴ *United States–Taxes on Petroleum and Certain Imported Substances*, BISD 136 (1988): Available on <www.wto.org>. United States legislation, known as the Superfund Act imposed a tax of 8.2 cents per barrel on domestic crude oil received at a U.S. refinery and a tax of 11.7 cents per barrel for petroleum products entered into the U.S. for consumption, use or warehousing. It was effectively conceded by the U.S. that the aforesaid tax violated the national treatment requirement of GATT. The U.S., however, put forward the argument that the tax differential was so small that its trade effects were minimal or nil and that the tax differential did not nullify or impair benefits occurring to Canada, the European Economic Community, and Mexico under the GATT. Canada, the EEC, and Mexico considered this defense to be neither legally valid nor factually correct. Hence the dispute.

⁵ This includes complaints that were considered valid, conceded as valid, settled or withdrawn despite their probable validity.

⁶ It may also be added that most of the WTO Agreements contain such provisions for suspension, but four of them do not. These four are the Agreement Establishing the WTO, the Agreement on Implementation of Article VI of the GATT 1994 (known as the Antidumping Agreement), the Agreement in Implementation of Article VII of the GATT 1994, and the DSU itself.

⁷ The WTO *Agreement on Subsidies and Countervailing Measures* (SCM) contains its own provisions on the issue. Article 4(10) of SCM allows WTO members to take countermeasures appropriate to the damage inflicted. A footnote to Article 4(10) of SCM explains that proportionate means not disproportionate. Moreover, the said Article 4(10) uses the term “countermeasures” and not “suspension of concession.”

⁸ Ecuador exempted the Netherlands and Denmark from the request for a suspension of concessions. In April 2001 the US and EC reached a settlement. The EC was also able to reach a settlement with Ecuador.

⁹ The President of the United States signed into law the “FSC Repeal and Extraterritorial Income Exclusion Act of 2000.” With the enactment of this legislation, the United States considered that it had implemented the DSB’s recommendations and rulings in the dispute and that the legislation was consistent with the United States’ WTO obligations.

¹⁰ The Panel established under Article 21:5 of the DSU (the “Compliance Panel”) found the ETI Act to be in violation of United States obligations under the SCM Agreement, the Agreement on Agriculture and Article III: 4 of the GATT 1994. The Appellate Body upheld these conclusions. The reports of the Compliance Panel and the Appellate Body were adopted by the DSB on 29 January 2002.

¹¹ Treaty Establishing the European Community, Art. 171.

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