Michelle Limenta

WTO RETALIATION

Effectiveness and Purposes

BLOOMSBURY

WTO RETALIATION

The central point of this book concerns three main issues: the problems of WTO retaliation, the question of the effectiveness of retaliation, and the purposes of retaliation. WTO retaliation is often deemed ineffective due to its inherited shortcomings. This book highlights the significance in identifying the purposes of retaliation prior to evaluating its effectiveness. Put differently, it refers to the purpose-based approach of effectiveness. It is a common understanding that the purpose of WTO retaliation is to induce compliance. This book, nevertheless, argues in favour of coexistence of the multiple purposes of retaliation, including reaching a mutually agreeable solution. These views are based on the extensive research conducted on the purposes of WTO retaliation, namely through interpreting Article 22 of the DSU; examining the remedies rules within the frameworks of public international law, and law and economics; and assessing the academic writings/debates as well as the statements of arbitrators. Finally, by evaluating a number of disputes involving WTO retaliation, this book demonstrates the reasonableness and soundness of WTO retaliation in light of its multiple purposes.

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Foreword

While the negotiation and subsequent creation of new rules in international law can be a long and difficult process, it is often only the end of the beginning. One of the more troubling aspects of international law is that once those rules are agreed upon, some parties do not comply with the rules. The WTO Dispute Settlement System is therefore often deservedly praised by many international lawyers not just for the fact that WTO members agree to its compulsory adjudication process, but also because the vast majority of the WTO Panel and Appellate Body Reports result in compliance. It is perhaps the most successful system of dispute settlement and compliance in international law when compared with the rest.

However, even the WTO system can be, and has been, tested by the rare cases when WTO members have not complied with the adopted reports. In such cases, *in extremis*, retaliation may be authorised by the WTO Dispute Settlement Body. Few legal scholars have really focused on this aspect of the WTO as, unlike the litigation process, which is transparent, little information about the diplomatic and political aftermath of the cases are readily available. Nonetheless, it has been accepted orthodoxy that the purpose of retaliation is to induce compliance and that this indeed does happen.

In this ground-breaking study, Dr Limenta questions this comfortable paradigm, providing a compelling alternative narrative through comprehensive research. She sets out the various possible purposes beyond inducing compliance, and analyses each one in light of the WTO jurisprudence on and experience with retaliation. Rather than relying on only one perspective, Dr Limenta looks at the issue through multiple perspectives and even multiple disciplines. She avoids quick impressionistic conclusions, so aptly illustrated by the parable of the blind men and the elephant, and instead focuses her attention on the elephant in the room—the cases of continued non-compliance in the WTO.

Indeed, as Dr Limenta points out, if retaliation is the only response to such continued non-compliance, we end up with a paradoxical equilibrium in the global trading system where the WTO actually authorises more trade barriers instead of facilitating the reduction of such impediments to trade. She therefore astutely suggests that retaliation cannot be about either inducing compliance (it does not in some difficult cases) or a rebalancing countermeasure, because it then undermines the whole system. The purpose she suggests must be more nuanced than that. Instead, she examines the purpose of the retaliation option in the WTO system and proposes instead that the

search for one purpose misses the point—the option of retaliation can have multiple equally valid purposes with the ultimate objective that the global system is strengthened rather than weakened. This she terms as a purpose-based approach of effectiveness.

Her ultimate conclusion that while inducing mutually amicable settlements is a valid purpose of retaliation as well, some settlements like those reached in the Clove Cigarettes and Upland Cotton disputes, and the provisional settlement agreed in the Hormones dispute, are problematic. These settlements are often not negotiated in the open, can be lacking in transparency and may affect other WTO members, particularly those from developing countries.

This book is a bold and sophisticated commentary by a young scholar publishing her first book. It bodes well for the future of the WTO and the global trading system that we are seeing the rise of such younger scholars, especially from developing countries, able to comment on the system and suggest new ways of seeing the issues. As developing countries play an ever-greater role in international trade, contributions such as these by Dr Limenta to the rule of law and our understanding of it will be increasingly important. We live in an imperfect world, and while it may be easy to suggest that the status quo is the 'best of all possible' systems, scholars like Dr Limenta highlight the need for the reconsideration of the accepted explanations and an urgency for the refinement of the system. It is good, but it can be better.

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Finally, I heartily thank my family for their unconditional and endless love, encouragement, care and support.

Table of Contents

List of Tables and Figures

List of Abbreviations

AB	Appellate Body
ACP	Africa, the Caribbean and the Pacific
ACWL	Advisory Centre on WTO Law
ASEAN	Association of Southeast Asian Nations
BITs	Bilateral Investment Treaties
CEPA	Comprehensive Economic Partnership Agreement
CDSOA	Continued Dumping and Subsidy Offset Act
DISC	Domestic International Sales Corporation
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
FSC	Foreign Sales Corporations
FTA	Free Trade Agreement
GATS	General Agreement on Tariff in Services
GATT	General Agreement on Tariff and Trade
GPA	Agreement on Government Procurement
GSP	Generalised System Preference
ICJ	International Court of Justice
ILC	International Law Commission
ITO	International Trade Organisation
LDC	Least-Developed Countries
MAS	Mutually Agreed Solution
MFN	Most Favoured Nation
MOU	Memorandum of Understanding
NAFTA	North American Free Trade Agreement
PCIJ	Permanent Court of International Law

RTA	Regional Trade Agreement
SCM	Subsidies and Countervailing Measures
SCVPH	Scientific Committee on Veterinary Measures relating to Public Health
SEOM	Senior Officials Meeting
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TPP	Trans-Pacific Partnership
TTIP	Transatlantic Trade and Investment Partnership
TRIPS	Trade-Related Aspects of Intellectual Property Rights
VCLT	Vienna Convention on Law and Treaties
WTO	World Trade Organization

1

Overview

> [T]o avoid economic warfare … This [international trade] organization would apply to commercial relationships the same principle of fair dealing that the United Nations is applying to political affairs. Instead of retaining unlimited freedom to commit acts of economic aggression, its members would adopt a code of economic conduct and agree to live according to its rules. Instead of adopting measures that might be harmful to others … countries would sit down around the table and talk things out. In any dispute, each party would present its case. The interest of all would be considered, and a fair and just solution would be found. In economics, as in international politics, this is the way to peace.[1]

I. INTRODUCTION TO WTO DISPUTE SETTLEMENT: THE BEST VOTE OF CONFIDENCE FOR THE MULTILATERAL TRADING SYSTEM

THE WORLD TRADE Organization (WTO) has its basis in the General Agreement on Tariff and Trade (GATT) 1947; and as the successor of the GATT, it has established more comprehensive agreements and rules. One of these is the effective protection and enforcement system under dispute settlement.

The provisions that have governed dispute settlement since GATT 1947 are Articles XXII and XXIII of GATT. Although neither provision refers to the term 'dispute settlement' nor provides a detailed procedure for disputes, they are the primary articles for dispute settlement. Article XXII contains the 'consultation' provision, and Article XXIII provides the 'nullification or impairment' rule. From these two 'simple' articles, the current WTO dispute settlement system, embodied in the Understanding on Rules and Procedures Governing the Settlement of Disputes, commonly referred to as the Dispute Settlement Understanding (DSU), has created the rules and procedures for the management of disputes.[2]

[1] President Harry S Truman, 'Address on Foreign Economic Policy', Speech at Baylor University, Texas, 6 March 1947 www.presidency.ucsb.edu/ws/?pid=12842.

[2] WTO, *A Handbook on the WTO Dispute Settlement System: A WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellate Body* (Cambridge, Cambridge University Press, 2004) 12; DSU, Art. 3.1.

The WTO dispute settlement system has been a success.[3] This is evidenced by a substantial number of requests for consultation submitted by WTO Members. Twenty years since the system came into being, there have been 497 WTO complaints or consultation requests made pursuant to the DSU.[4] Pascal Lamy, the former WTO Director-General, viewed this significant number as 'a vote of confidence' in the system.[5] To the contrary, other dispute settlement mechanisms provided under Regional Trade Agreements (RTAs) are hardly used. A number of them have not even been tested at all.[6]

In his speech to the United States Chamber of Commerce, Lamy promoted the 'hymn to compliance: consult before you legislate; negotiate before you litigate; compensate before you retaliate; and comply—at any rate'.[7] It delineates the practical value among the WTO Members that by establishing a dispute settlement system, WTO Members confirm that they are committed to their obligations under the WTO Agreement.

There are three primary stages in WTO dispute settlement: (a) consultations between parties to a dispute; (b) adjudication by panels and, if requested, by the Appellate Body; and (c) the implementation of the ruling.[8]

A. Consultations

The DSU clearly states that the aim of dispute settlement is to achieve a positive solution to a dispute.[9] It demonstrates a preference for solutions mutually acceptable to parties rather than solutions resulting from adjudication by a panel.[10] Therefore, the first stage in WTO dispute settlement is consultations between the Members concerned. Put differently, parties to a dispute must enter into consultations prior to requesting the establishment of a panel.

The rules and procedures of consultations can be found largely in Article 4 of the DSU. Article 4.3 provides that if a Member requests a consultation with another Member under a WTO covered agreement, the Member to which the request for consultation is made, unless mutually agreed, must

[3] WTO, 'Azevêdo Says Success of WTO Dispute Settlement Brings Urgent Challenges' News Item (Geneva, 26 September 2014) www.wto.org/english/news_e/spra_e/spra32_e.htm.

[4] WTO, 'Chronological List of Disputes Cases', www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm.

[5] WTO, 'WTO Disputes Reach 400 Mark', Press Release (Geneva, 6 November 2009) www.wto.org/english/news_e/pres09_e/pr578_e.htm.

[6] WTO (n 3).

[7] Pascal Lamy, 'Has International Capitalism Won the War and Lost the Peace?' Speech at the US Chamber of Commerce, Washington DC, 8 March 2001.

[8] WTO (n 3) 43.

[9] DSU, Art 3.7.

[10] P Van den Bossche and W Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn (New York, Cambridge University Press, 2013) 183.

reply to the request within 10 days after the date of its receipt. Parties to a dispute must also enter into consultation in good faith and with a view to achieving a mutually satisfactory solution. If the Member does not respond within 10 days after the date of receipt of the request, or does not enter into consultations within a period of no more than 30 days, or a period otherwise mutually agreed, the Member that requested consultations may proceed to request the establishment of a panel. The request for consultations is notified to the Dispute Settlement Body (DSB)[11] pursuant to Article 4.4. Consultations are confidential. This means that neither a third party nor the WTO Secretariat could be present at, or involved in, the consultations.

If the dispute is not resolved within 60 days of the receipt of the request for consultations, the complaining party may request the establishment of a panel to adjudicate matters.

B. Adjudication by Panels

Pursuant to Article 6.2 of the DSU, the request for the establishment of a panel must be made to the DSB in writing and must 'indicate whether the consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis for the complainant sufficient to present the problem clearly'. The Appellate Body in *EC—Bananas III* mentioned two reasons why a panel request should be sufficiently precise. First, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and secondly, it informs the defendant and third parties of the legal basis of the complaint.[12]

If a panel is requested, the DSB must establish it at the second DSB meeting at which the request appears as an agenda item, unless the DSB at the meeting decides by consensus not to do so.[13] This rule is commonly referred to as 'negative' or 'reverse' consensus.[14] The complaining party therefore has an assurance that the requested panel will be established if it so requests.

Article 8.1 of the DSU clearly provides that panels must be composed of well-qualified governmental and/or non-governmental individuals. They are also selected with 'a view to ensuring their independence of the members,

[11] The DSB consists of all the representatives of WTO Members meeting together, normally in Geneva. It has the authority to establish and adopt panels and the Appellate Body reports findings and/or the appealed results. It has also a function of monitoring and maintaining surveillance of the implementation of the rulings and recommendations. Finally, it has the authority to authorise retaliation in the case of non-compliance. See DSU, Art 2.1.

[12] *European Communities—Regime for the Importation, Sale and Distribution of Bananas ('EC—Bananas III (AB)')*, Appellate Body Report (adopted 25 September 1997) WT/DS27/AB/R [142].

[13] DSU, Art 6.1.

[14] It also applies in terms of the adoption of panel and/or Appellate Body reports and the authorisation of retaliation.

a sufficiently diverse background and a wide spectrum of experience'.[15] Citizens of Members whose governments are involved or participate in the dispute either as main parties or third parties are not allowed to serve on a panel concerned with that dispute unless the parties to the dispute agree otherwise. The WTO Secretariat maintains (and periodically revises) an indicative list of governmental or non-governmental individuals that may be selected as panelists. When the Secretariat proposes qualified individuals as panelists, the parties must not oppose such nominations unless there are compelling reasons.[16] However, in practice, Members use this provision quite broadly and oppose nomination frequently.[17] If the parties are not able to agree on the composition of a panel within 20 days of its establishment by the DSB, either party may request that the WTO Director-General determine the composition of the panel.

Once the panel is constituted, a panel must have the standard terms of reference as stated in Article 7.1 of the DSU, unless parties agree otherwise. The document referred to in the standard terms of reference in Article 7.1 is normally the request for the establishment of a panel. A panel may only consider a claim that falls within the panel's terms of reference.

Once the panel is composed, it hears written and oral arguments from the disputing parties. Third parties are also given the opportunity to be heard by the panel and to make written submissions to the panel. After considering their presentations, it issues the descriptive part (facts and arguments) of its report to parties to a dispute. Considering any comments from the parties, the panel submits an interim report (along with its findings and conclusions) to the disputing parties. Following a review period, the panel issues a final report to the disputing parties, and subsequently circulates it to all WTO Members.[18] If one of the parties is dissatisfied with the panel's decision, it may appeal to the Appellate Body.

C. The Implementation of Rulings

After the adoption of the report, the DSB requests the losing party promptly to bring itself into compliance with WTO law or to find mutually satisfactory adjustments. If the losing party fails to bring its measure into conformity within a reasonable period of time, the complaining party is entitled to negotiate compensation or, if there is no satisfactory compensation agreed

[15] DSU, Art 8.2.
[16] ibid, Art 8.6.
[17] WTO (n 3) 51.
[18] DT Shedd, BJ Murrill and JM Smith, 'Dispute Settlement in the World Trade Organization (WTO): An Overview' (2012) Congressional Research Service 7-5700 RS20088, 6, www.fas.org/sgp/crs/misc/RS20088.pdf.

within 20 days after the expiry of the reasonable period of time, to request the authorisation to retaliate.

An arbitration body might be established under Articles 21 and 22 of the DSU. The arbitration under Article 21.5 of the DSU (known as the compliance panel) is intended to resolve the question of compliance with the ruling and recommendation of the DSB. Additionally, arbitration under Article 22.6 of the DSU attempts to determine the level of retaliation and the possibility of suspending obligations under a different sector or agreement. In the *Bananas III* dispute, the procedural issue of 'sequencing' came out. The issue resulted from the lack of clarity in the DSU provisions related to the order of Articles 21.5 and 22.6 when a party to a dispute believes that another has failed to comply with the rulings. Article 21.5 provides that the compliance panel must issue a decision within 90 days of the request while Article 22.6 states that authorisation to retaliate shall be granted by the DSB within 30 days after the end of the reasonable period of time. A large number of WTO Members have put on the table a reform proposal to address the issue.[19] After *Bananas III*, the parties to a dispute usually conclude an ad hoc agreement on sequencing procedure. In some cases, the parties to a dispute agree to initiate the procedure under Articles 21.5 and 22.6 simultaneously and suspend the suspension of concessions under Article 22 until the completion of compliance arbitration proceedings under Article 21.5.[20] In other cases, the disputants agree to initiate Article 21.5 arbitration proceeding at first before resorting to arbitration under Article 22.6 on the understanding that the respondent will not object to the authorisation request to retaliate due to the expiry of the 30-day deadline.[21]

Interestingly, there are only a few disputes concerning the determination of the level of suspension of concessions (retaliation). This fact tells us that the respondent Members generally comply with adverse rulings. In other words, WTO compliance has a reasonably good record.[22]

II. PROBLEMS PRESENTED: RETALIATION, A FLAW IN THE SUCCESSFUL SYSTEM?

Despite the fact that they are few in number, there are concerns raised by non-compliance cases in WTO dispute settlement. What happens if, even

[19] WTO Ministerial Conference, Proposed Amendment of the Dispute Settlement Understanding—Communication from Canada, Costa Rica, Czech Republic, Ecuador, the European Communities and its member States, Hungary, Japan, Korea, New Zealand, Norway, Peru, Slovenia, Switzerland, Thailand and Venezuela, WT/MIN(99)8, 22 November 1999.

[20] WTO (n 3) 85.

[21] ibid.

[22] Wilson states that in nearly 90 per cent of the cases that the panel and/or Appellate Body found to be WTO violations, the Member found in violation of its WTO obligations has

after retaliation is imposed, the violator state continues its violation measure? What should parties do when compliance cannot be achieved? What if the violator state continues the violation but at the same time provides compensation to the injured state? Does WTO law allow a continued violation as long as the violator state wants to pay compensation or suffer retaliation? What happens if both parties agree on an amicable solution which is non-WTO compliant to end the dispute?

Concerns encountered by WTO retaliation, particularly those that raise the question of its effectiveness, are the key issue in this book. Retaliation is generally believed to be an instrument that has the effect of inducing the recalcitrant state to comply, therefore it is considered ineffective when it does little or nothing to induce compliance. To respond to the question of the effectiveness of WTO retaliation, this book refers to the purpose-based approach. With this intention, it posits that a rule or standard is deemed effective when it can achieve its purpose or objective. The problem is that neither the DSU nor the WTO treaty provisions stipulate explicitly the purpose of retaliation. These problems will be considered in more detail.

A. First Concern: The (In)effectiveness of WTO Retaliation

Many observers share a similar view that the effectiveness of WTO retaliation is questionable.[23] Steger, for instance, states that reform in WTO dispute settlement is not needed since the system can be improved through practices; it is on the area of implementation that most of the Members' attention should be focused.[24] She also takes the view that retaliation

indicated its intention to bring itself into compliance and in most cases has already done so. See B Wilson, 'Compliance by WTO Members with Adverse WTO Dispute Settlement Rulings: The Record to Date' (2007) 10 *Journal of International Economic Law* 397, 398–99.

[23] J Nzelibe, 'The Case against Reforming the WTO Enforcement Mechanism' (2008) *University of Illinois Law Review* 319, 321, 327–28; M Bronckers and N van den Broek, 'Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement' (2005) 8 *Journal of International Economic Law* 101; S Cho, 'The Nature of Remedies in International Trade Law' (2004) 65 *University of Pittsburgh Law Review* 763, 785–90; BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 152–53; B O'Connor, 'Remedies in the World Trade Organization Dispute Settlement System—The Bananas and Hormones Cases' (2004) 38 *Journal of World Trade* 245, 257–60; R Malacrida, 'Toward Sounder and Fairer WTO Retaliation: Suggestions for Possible Additional Procedural Rules Governing Members' Preparation and Adoption of Retaliation Measures' (2008) 42 *Journal of World Trade* 3, 17–27.

[24] DP Steger, 'Commentary on the Doha Round: Institutional Issues' (2005) 5 *Global Economy Journal* 1, 4–5. McRae also states that remedies and sanctions are the areas in WTO dispute settlement that need improvement. See also D McRae, 'Measuring the Effectiveness of the WTO Dispute Settlement System' (2008) 3(1) *Asian Journal of WTO and International Health Law and Policy* 1, 18.

is a blunt instrument that only powerful countries can use effectively.[25] Similarly, Mercurio provides three reasons why retaliation is an imperfect means of obtaining compliance. The first reason is that retaliation does nothing when the measure is too politically sensitive to be removed. The second reason is that a large suspension is self-destructive, and the last reason is that developing countries cannot utilise it against powerful developed countries.[26]

Bronckers and van den Broek also argue that retaliation offers no relief to those actually damaged, puts an inappropriate burden on innocent bystanders, and offers no appropriate relief to the injured party suffering as a result of the violator state's regime.[27] Other observers such as Charnovitz and Nzelibe point out that the retaliation scheme allows Members to fight protectionism with protectionism[28] and tends to punish consumers in the victim state and exporters in the violator state for the misdeeds of protectionists in the violator state, while leaving the protectionist that initiated the violation largely unaffected.[29] The tit-for-tat WTO retaliation, according to Malacrida, tends to undermine cross-border economic integration.[30]

A number of WTO Members also view the implementation stage of the dispute settlement system to be a relatively weak phase compared with other phases.[31] Mexico, for example, observed that 'the main weakness of the [DSU] was the excessive length of time that a Member could maintain a measure which had been found to be WTO-inconsistent without any consequences'.[32]

In responding to the question of the effectiveness of WTO retaliation, we need to identify first what 'effective' means. Chapter 4 below describes this quest to define the word 'effective'. However, in short, something is effective if it can achieve its purpose or objective. Consequently, to respond to the question of whether retaliation is effective or not, it is significant to identify the purposes of retaliation.

[25] ibid.

[26] B Mercurio, 'Improving Dispute Settlement in the World Trade Organization: The Dispute Settlement Understanding Review—Making It Work?' (2004) 38 *Journal of World Trade* 795, 840.

[27] Bronckers and van den Broek (n 23) 103.

[28] S Charnovitz, 'Should the Teeth be Pulled?: An Analysis of WTO Sanctions' in DLM Kennedy and JD Southwick (eds), *Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 622.

[29] Nzelibe (n 23) 325.

[30] Malacrida (n 23) 13.

[31] E Kessie, 'The "Early Harvest Negotiation" in 2003' in F Ortino and E-U Petersmann (eds), *The WTO Dispute Settlement System 1995–2005* (The Hague, Kluwer Law International, 2004) 142.

[32] DSB, *Special Session, Minutes of Meeting—Held in the Centre William Rappard on 13–15 November 2002,* TN/DS/M/6, 31 March 2003, 5.

B. Second Concern: Debates Regarding the Purpose(s) of WTO Retaliation

The arbitrators in *US—Byrd Amendment (Article 22.6—US)* recognised the importance of identifying the purpose of retaliation. They posited that 'a large part of the conceptual debate [suspension of obligations in the DSU] that took place in these proceedings could have been avoided if a clear "object and purpose" were identified'.[33] The arbitrators' statement also delineates their concern on the obscurity of the object and purpose of WTO retaliation. The DSU does not stipulate explicitly the purpose of retaliation under Article 22.[34] This has resulted in the existence of various views suggested by the arbitrators[35] and academics.[36] They are: (i) inducing compliance;[37] (ii) providing a means of obtaining some form of temporary compensation;[38] (iii) rebalancing;[39] and (iv) 'deterring inefficient breach but encouraging efficient breaches'.[40]

i. Inducing Compliance

Inducing compliance was mentioned as the purpose of WTO retaliation for the first time by the arbitrators in *EC—Bananas III (US) (Article 22.6—EC)*.

[33] *United States—Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Byrd Amendment (Article 22.6—US)')*, Decision by the Arbitrator (31 August 2004) WT/DS217/ARB/BRA [6.4]. On 31 August 2004, the WTO issued eight Article 22.6 arbitration decisions against the United States regarding the Byrd Amendment dispute. The reports are almost identical; thus for efficiency reasons, the references in this book are to the arbitrators report in respect of the retaliation request made by Brazil.

[34] Arbitrators in *US—Byrd Amendment (Article 22.6—US)* stated that 'it is not completely clear what role is to be played by the suspension of obligations in the DSU …'. See ibid.

[35] For instance, *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 ('EC—Bananas III (US) (Article 22.6—EC)')*, Decision by the Arbitrators (9 April 1999) WT/DS27/ARB [6.3]; *US—Byrd Amendment (Article 22.6—US)* (n 33) [6.3].

[36] For instance, J Pauwelyn, 'Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge, Cambridge University Press, 2010) 36–38; AO Sykes, 'Comment on Chapter 2' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge, Cambridge University Press, 2010) 70–72.

[37] *EC—Bananas III (US) (Article 22.6—EC)* (n 35) [6.3]; *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Gambling (Article 22.6—US)')*, Decision by the Arbitrator (21 December 2007) WT/DS285/ARB [4.112].

[38] *US—Byrd Amendment (Article 22.6—US)* (n 33) [6.3].

[39] D Palmeter and S Alexandrov, '"Inducing Compliance" in WTO Dispute Settlement' in DLM Kennedy and JD Southwick (eds), *The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 647.

[40] WF Schwartz and AO Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization' (2002) 31 *Journal of Legal Studies* S179, S181.

Ever since this purpose has been reiterated in most Article 22.6 cases except in *US—1916 Act (Article 22.6—US)* and *US—Byrd Amendment (Article 22.6—US)*. In *EC—Banana III (US) (Article 22.6—EC)*, the arbitrators agreed with the United States' argument that the temporary nature of compensation and suspension of concession indicates that the purpose of retaliation is to induce compliance.[41] In *Brazil—Aircraft (Article 22.6—Brazil)*, the arbitrators explained the appropriateness of a countermeasure 'if it *effectively* induces compliance'.[42] The arbitrators went beyond the 'appropriate' level of countermeasures by authorising punitive suspension on the basis of inducing compliance in the *US—FSC (Article 22.6—US)* and *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* disputes.[43] In *US—Gambling (Article 22.6—US)*, the arbitrators interpreted the meaning of the criteria of effectiveness in order to authorise the right of cross-retaliation.[44] They cited the conclusion of the arbitrator in *EC—Banana III (Ecuador) (Article 22.6—EC)* that 'the *effective* criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance'.[45]

ii. A Means of Obtaining Some Form of Temporary Compensation

The arbitrators started to recognise that WTO retaliation might have other purposes in *US—1916 Act (Article 22.6—US)*.[46] Furthermore in *US—Byrd Amendment (Article 22.6—US)*, while noting that the concept of inducing compliance has been referred to in past arbitrations, the arbitrators clearly stated that 'it is not expressly referred to in any part of the DSU' and that they 'are not persuaded that the object and purpose of the DSU… would support an approach where the purpose of suspension of concessions or other obligations pursuant to Article 22 would be exclusively to induce compliance'.[47] While the arbitrators did not 'exclude that inducing

[41] *EC—Bananas III (US) (Article 22.6—EC)* (n 35) [6.3].

[42] *Brazil—Export Financing Programme for Aircraft—Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('Brazil—Aircraft (Article 22.6—Brazil)')*, Decision by the Arbitrators (28 August 2000) WT/DS46/ARB [3.44].

[43] *Canada—Export Credits and Loan Guarantees for Regional Aircraft—Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)')* Decision by the Arbitrator (17 February 2003) WT/DS222/ARB [3.121]; *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('US—FSC (Article 22.6—US)')* Decision by the Arbitrator (30 August 2002) WT/DS108/ARB [5.52–57], [6.2].

[44] *US—Gambling (Article 22.6—US)* (n 37) [4.29].

[45] ibid [4.29] and [4. 84].

[46] *United States—Anti-Dumping Act of 1916, Original Complaint by the European Communities—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—1916 Act (Article 22.6—US)')*, Decision by the Arbitrators (24 February 2004) WT/DS136/ARB [5.4–5].

[47] *US—Byrd Amendment (Article 22.6—US)* (n 33) [3.74].

compliance is part of the objectives behind suspension', they took the view that 'at most it can be only one of a number of purposes in authorising the suspension of concession or other obligations'.[48] After all, the arbitrators concluded that '… [the requirement of equivalent levels] seems to imply that suspension of concessions or other obligations is only a means of obtaining some form of temporary compensation, even when the negotiation of compensations has failed'.[49] In other words, the arbitrators implied that the purpose of retaliation is to provide compensation.

iii. Rebalancing

Reciprocity is a principle of the GATT/WTO system and serves as a basis of negotiation. The Marrakesh Agreement establishing the WTO refers in its preamble to 'entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade'.

Since WTO agreements emerged from negotiations conducted on the basis of reciprocity, it is often argued that the purpose of retaliation is to rebalance this bargain.[50] Palmeter and Alexandrov, for instance, boldly argue that:[51]

> [The inducing compliance] doctrine is legally in error and is unwise from a policy perspective. The purpose of countermeasures in the WTO is not to induce compliance, but to maintain the balance of reciprocal trade concessions negotiated in the WTO agreements.

Another observer, Lawrence, does not argue against the purpose of inducing compliance directly. However, he admits that WTO remedies can achieve several purposes simultaneously; and 'the goal achieved most precisely is maintaining reciprocity'.[52]

iv. 'To Deter Inefficient Breach but to Encourage Efficient Breach'

Schwartz and Sykes developed this argument from political (public choice) and economic contracts perspectives. They suggest that WTO agreements are incomplete contracts among political actors and the metric of welfare for each signatory will not be money but the political welfare of its political officials.[53] Therefore, when the cost of political performance exceeds

[48] ibid [3.74].
[49] ibid [6.3] (emphasis added).
[50] T Sebastian, 'World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness' (2007) 48 *Harvard International Law Journal* 337, 370.
[51] Palmeter and Alexandrov (n 39) 647.
[52] RZ Lawrence, *Crimes and Punishments? Retaliation under the WTO* (Washington DC, Institute for International Economics, 2003) 47.
[53] Schwartz and Sykes (n 40) S184–85.

the benefit of performance (politically costly), the DSU allows a violator to continue a violation, as long as it compensates or is willing to bear the costs of the retaliation ('to encourage efficient breach'). In Schwartz and Sykes's view, formal sanction is not needed to induce a high level of compliance, owing to domestic pressures for compliance, reputational penalties, and unilateral sanctions that put pressure on parties to respect their commitments (to deter inefficient breach).[54] Thus, they conclude, the function of retaliation is 'to deter inefficient breaches but to encourage efficient breaches'.

III. WTO LAW IN RELATION TO OTHER LEGAL SYSTEMS

In order to provide a comprehensive assessment with respect to the purposes of WTO retaliation, there are two related legal disciplines that this book also looks at: public international law and private contract law in the perspective of law and economics.[55] Commentators and observers have various opinions concerning the relationship between WTO law and these areas of study.

A. WTO Law in Relation to Public International Law

The WTO is an inter-governmental organisation whose Members are actively engaged in international trade relations based on the agreements among themselves. In their trade interactions/relations, Members might perform an action or omission or both that negatively affects other Members' rights. Under public international law, such conduct can be considered as a wrongful act and every internationally wrongful act entails international responsibility. The provisions for international wrongful acts are laid down under the International Law Commission (ILC) Draft Articles. Public international law also provides provisions governing international treaties: the Vienna Convention on the Law of Treaties (VCLT).[56] These two general international law rules appear to interweave with WTO law.

As a multilateral trading system, the WTO sets up the rules of trade applied to its Members. The 'public international' character of WTO law

[54] ibid S204.

[55] As long as it is relevant, the reference to other disciplines is useful to provide a fuller picture. In practice, the panel and/or the Appellate Body have cited the decisions of the International Court of Justice (ICJ) to support their own decisions. For instance, the Appellate Body referred to the ICJ decisions to support its finding on the generic term 'natural resources' in Article XX(g) of GATT in the *US—Shrimp* dispute.

[56] Vienna Convention on the Law of Treaties 1969, done at Vienna on 23 May 1969, entered into force on 27 January 1980, United Nations Treaties Series Vol 1155, p 331.

raises the question of whether it is a part of international law or a self-contained regime.

What is a self-contained regime? The ILC draft report on fragmentation of international law finalised by Koskenniemi notes that self-contained regimes may be established from a set of rules and principles that apply as *lex specialis*.[57] Simma and Pulkowski state that the concept of a strong *lex specialis* is a self-contained regime.[58]

McRae argues from the traditional view that international trade law is considered outside the sphere of international law.[59] Several arguments are presented by McRae, such as the fact that trade law is 'technical' and its field is 'special', trade law is not seen as emerging from state practice but is seen more as the law of business transactions between individuals, and international trade law has nothing to do with sovereignty.[60] Pauwelyn criticises McRae's view by stating that:[61] 'Whereas McRae's first and second reasons … are convincing, this third reason is both misleading and erroneous. It falls into the very trap that McRae himself warned about, namely the trap for trade lawyers to portray "their" discipline as something "special"'.

Pauwelyn argues that McRae utilises a wrong benchmark to compare trade law with international law. He refers to, on the one hand, the traditional international law concept of 'co-existence', and on the other hand, the modern international law concept of 'co-operation' including GATT/WTO law. Thus, Pauwelyn concludes that McRae is not comparing international law with trade law, but old international law with new international law.[62]

i. WTO Remedies and Public International Law Remedies: Inclusive or Exclusive From the System?

Public international law offers several remedies for states injured as a result of internationally wrongful acts.[63] Some forms of the remedies are cessation

[57] M Koskenniemi, *Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law*, Report of the Study Group of the International Law Commission, A/CN.4/L.682/Add.1, 13 April 2006, 6.

[58] B Simma and D Pulkowski, 'Of Planets and the Universe: Self-Contained Regimes in International Law' (2006) 17(3) *European Journal of International Law* 483, 490.

[59] D McRae, 'The Contribution of International Trade Law to the Development of International Law' (1996) 260 *Recueil des Cours* 109; Van den Bossche and Zdouc (n 10) 60; J Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (New York, Cambridge University Press, 2003) 29–31.

[60] McRae (n 59) 115–17.

[61] Pauwelyn (n 59) 31.

[62] ibid 32.

[63] The basic rules of international law concerning responsibility of states for internationally wrongful acts are codified and formulated by the United Nations' International Law Commission in the ILC Draft Articles. Although the rules are codified in the 'Draft Articles', the United Nations General Assembly adopted resolution 56/83 which 'commends [the Draft Articles] to the attention of Governments without prejudice to the question of their future adoption or

of wrongful acts under Article 30 of the ILC Draft Articles, countermeasures under Article 49 of the ILC Draft Articles, and reparation under Article 31 of the ILC Draft Articles. Similar to public international law, the DSU provides several remedies under its framework. However, some characters and forms of the DSU remedies are different from those under public international law. For example, the DSU does not stipulate financial compensation in its text. Thus, the question is whether remedies under public international law overrule WTO remedies?

Article 55 of the ILC Draft Articles, reflecting the maxim *lex specialis derogat legi generali*, provides that the articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or its legal consequences are determined by special rules of international law. Thus, we must determine whether remedies under the DSU incorporating special rules (*lex specialis*) exclude the application of state responsibility under the general rules of international law.

Simma and Pulkowski provide that retaliation under Article 22 operate in a similar way to countermeasures, thus 'strong grounds exist for regarding the WTO rules on retaliation as *leges speciales vis-à-vis* countermeasures under general international law'.[64] Van den Bossche and Zdouc, at the same time, assert that by providing a detailed set of rules regarding the legal consequences of a breach of WTO law, the DSU has contracted out of the general rules of international law on state responsibility.[65]

In sum, the standpoint in this book is that WTO law is not a self-contained regime. In a number of cases, panels and/or the Appellate Body have applied or made reference to customary rules and general principles of international law. The question is to what extent does public international law play a role in WTO law? The panel in *Korea—Measures Affecting Government Procurement* interpreted the relationship between the WTO and public international law in a broader way than merely a relationship of interpretation rules. The panel stated that:[66] 'Customary international law applies generally to the economic relations between the WTO Members. Such international law applies to the extent that the WTO treaty agreements do not "contract out" from it'. In contrast, the United States challenged the insertion of the rules of public international law outside the customary rules of interpretation in WTO dispute settlement.[67] Nonetheless, it is not the intention of this book to resolve this issue. The main focus in this book lies

other appropriate action'. See *Responsibility of States for Internationally Wrongful Acts* GA Res 56/83, A/RES/56/83 (2001) (the ILC Draft Articles).

[64] Simma and Pulkowski (n 58) 521.

[65] Van den Bossche and Zdouc (n 10) 204.

[66] *Korea—Measures Affecting Government Procurement* ('*Korea—Procurement*'), Panel Report (adopted 19 June 2000) WT/DS163/R [7.96].

[67] DSB, *Minutes of Meeting—Held in the Centre William Rappard on 7 May 2003,* WT/DSB/M/149, 8 July 2003, 20.

on the application of customary rules of treaty interpretation ('contract in') and remedies under public international law ('contract out') in the context of WTO remedies.

B. WTO Law in Relation to Contract

Some commentators, particularly those who argue that compliance is not mandatory, provide contractual incompleteness of WTO agreements as their main argument. Green and Trebilcock, for instance, cite Bagwell and Trachtman who point out that WTO agreements are incomplete contracts and that compliance is not mandatory in all instances as the members have incorporated flexibility mechanisms to allow adjustments to new situations.[68] In short, the remedies are aimed at permitting breaches or adjustments when efficient, either on a political or a welfare basis. Similarly, Sykes and Schwartz utilise the public choice approach and refer to WTO agreements as contracts among the political actors. They assert that WTO agreements are incomplete contracts that encourage efficient performance of commitments while facilitating efficient breach of commitments.[69]

Other commentators are against these views. Fukunaga, for example, disagrees with the efficient breach theory by arguing that nothing in the DSU provides that the DSB can choose either to make recommendations or to award damages. She argues that recommendations are the primary remedy option; compensation and suspension of concessions are alternative remedies and are only available in the event that the recommendations are not implemented within a reasonable period of time.[70] Additionally, Cho points out that Sykes' analogy to a private contract creates a misunderstanding as to the real identity of the WTO legal system. He argues that the WTO is no more 'a mere *contract* among the contracting parties, but an independent *international organization* established by its members in order to envisage an integrated legal system for international trade'.[71] And therefore in his view, the concept of efficient breach is unacceptable under this legal system.[72] Steger also argues that the 'WTO Agreement is not a commercial

[68] A Green and M Trebilcock, 'Enforcing WTO Obligations: What Can We Learn from Export Subsidies?' (2007) 10 *Journal of International Economic Law* 653, 659.
[69] Schwartz and Sykes (n 40) S180–83.
[70] Y Fukunaga, 'Securing Compliance through the WTO Dispute Settlement System: Implementation of DSB Recommendations' (2006) 9 *Journal of International Economic Law* 383, 397.
[71] Cho (n 23) 783.
[72] ibid.

contract that countries can cancel whenever it suits them, nor is it "soft law" that is not binding on Members'.[73]

Assessment provided later on in this book is not intended to address the issue of whether or not WTO agreements bear a resemblance to a commercial contract, although both can have common features. It is, however, deemed useful to make a reference to a private law model that explains what remedies are used when rights are violated in the context of law and economics. Such reference can provide valuable insights in understanding the WTO remedial design where the substantive goals of retaliation might be found.

IV. THE OBJECTIVE AND PLAN OF THE BOOK

The effectiveness of retaliation in light of its purposes is still a largely unexplored area in the field of international dispute settlement. This book aims to undertake a comprehensive legal analysis to delve deeper into this fruitful area of scholarship. This in-depth study is conducted with reference to the relevant rules and case law of WTO retaliation found in the GATT, DSU and the Agreement on Subsidies and Countervailing Measures (SCM Agreement). It is also important to differentiate remedies in WTO dispute settlement discussed in this book and trade remedies such as anti-dumping and countervailing duties, which are not the focus of this book.

The organisation of this book is as follows. Chapter 2 offers an introductory background to the nature of WTO remedies in general and WTO retaliation in particular. It also provides a review of the history and basic principles of WTO retaliation from the GATT to the WTO. This chapter is important to the reader's understanding of WTO retaliation in particular, and WTO remedies in general.

Chapter 3 outlines the problems that give rise to the issue of efficacy of WTO retaliation. It looks at the challenges faced by developed and developing countries in imposing retaliatory measures. This chapter also evaluates critique of and proposals to reform WTO retaliation.

Chapter 4 establishes the nexus between 'effectiveness' and 'purposes' and explains the importance of purpose-based analysis in assessing the effectiveness of retaliation. Identifying the purpose or purposes of retaliation is not a simple task. This chapter discusses the debates and uncertainty in relation to the purpose or purposes of WTO retaliation.

Chapter 5 is the main chapter of this book. An extensive search of the purposes of retaliation is conducted in this chapter. The search is done through

[73] D P Steger, 'The Culture of the WTO: Why It Needs to Change' (2007) 10 *Journal of International Economic Law* 483, 490–1.

the interpretation of Article 22 of the DSU, an examination of the reference made by the arbitrators to the remedies of public international law, an analysis of WTO remedies rules in the perspective of law and economics, and an assessment of debates and an analysis of the statements of arbitrators related to the purpose of retaliation. This chapter eventually argues in favour of recognising the coexistence of the multiple purposes of retaliation, including reaching a mutually agreeable solution.

Chapter 6 seeks to explore a mutually agreeable solution as one of the final goals of retaliation. This chapter provides such an attempt by observing amicable solutions within the WTO dispute settlement system. In this regard, it looks at the settlements reached in the *Hormones*, *Upland Cotton* and *Clove Cigarettes* disputes. Finally, by evaluating WTO retaliation disputes, this chapter demonstrates the soundness of WTO retaliation in light of its multiple purposes. It discusses the implications of these findings for the system, and the way forward.

Chapter 7 is the final and concluding chapter of this book.

2

Retaliation in the Multilateral Trading System

> The principle of no right without a remedy has, however, a peculiar twist in the GATT. In an important sense Article XXIII gives a remedy without a right.[1]

OVERVIEW

DISPUTE SETTLEMENT IN the multilateral trading system has evolved and been strengthened by the advent of the WTO. The rules contained in the DSU eliminate several shortcomings in the GATT dispute settlement regime and offer clearer time frames and clearer dispute procedures.

Irrespective of how innovative the system is, the central interest for parties to the dispute is whether the system provides remedies and finality under its regime. This perspective goes along with the Latin legal maxim, *ubi jus ibi remedium* (where there is a right, there is a remedy).[2] Thus, a good dispute resolution system is one that offers certainty of legal rule, prompt and equal dispute procedures and reasonable remedies.

The DSU provides two types of remedies for violating WTO law: (a) a final remedy (compliance by withdrawal or modification of measures that are inconsistent with WTO law);[3] and (b) temporary remedies (compensation and suspension of concessions or other obligations, commonly referred to as WTO retaliation).[4] The relationship existing between final and temporary remedies is hierarchical in nature.[5] The basis of this hierarchy order is

[1] KW Dam, *The GATT: Law and International Economic Organization* (Chicago, IL, University of Chicago Press, 1970) 358.

[2] BA Garner (ed), *Black's Law Dictionary*, 7th edn, (Saint Paul, MN, West Group, 1999) 1695.

[3] DSU, Arts 3.7 and 19.1.

[4] ibid Art 22.

[5] JH Jackson, 'The WTO Dispute Settlement Understanding—Misunderstandings on the Nature of Legal Obligations (responding to Bello's article)' (1997) 91 *American Journal of International Law* 60, 63; S Charnovitz, 'The WTO's Problematic "Last Resort" against Noncompliance' (2002) 57 *Aussenwirtschaft* 409, 411–12; A Rosas, 'Implementation and

Article 19 of the DSU, which clearly establishes the preference for prompt compliance with recommendations and rulings of the DSB (final remedy). Only when Members fail to withdraw or amend the WTO-inconsistent measures by the end of a reasonable period of time does the DSU provide temporary remedies under Article 22.

I. TEMPORARY REMEDIES IN THE DSU

Compensation and retaliation are the temporary remedies for non-compliance.[6] Compensation has been agreed between disputing parties in relatively few cases.[7] The rationale for this less attractive option lies in the words of 'developing mutually acceptable compensation' and 'shall be consistent with covered agreements'.[8] Both of these phrases suggest that instead of being an automatic obligation of respondent states, compensation is voluntary and should be consistent with the principle of non-discrimination obligations under Article I:1 of the GATT 1994. Consequently, parties in dispute often neglect the compensation remedy and directly request authorisation to retaliate.

Retaliation is the eventual and most serious consequence a recalcitrant or non-implementing Member faces in WTO dispute settlement. Most observers perceive that it is problematic and economically harmful not only for the targeted Member but also for the Member imposing the measures. 'Shooting [oneself] in the foot' is a phrase used by observers in describing the self-defeating consequences of retaliation.[9] That being said, it is important

Enforcement of WTO Dispute Settlement Findings: An EU Perspective' (2001) 4 *Journal of International Economic Law* 131, 133–38.

[6] RE Hudec, 'Broadening the Scope of Remedies in WTO Dispute Settlement' in F Weiss (ed), *Improving WTO Dispute Settlement Procedures: Issues and Lesson from the Practice of Other International Courts and Tribunals* (London, Cameron May, 2000) 388.

[7] For example, *Japan—Taxes on Alcoholic Beverages—Mutually Acceptable Solution on Modalities for Implementation,* WT/DS8/20, WT/DS10/20, WT/DS11/18, 12 January 1998; *Turkey—Restrictions on Imports of Textile and Clothing Products—Notification of Mutually Acceptable Solution,* WT/DS34/14, 19 July 2001; *United Sates—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea—Agreement under Article 21.3(b) of the DSU,* WT/DS202/18, 31 July 2002; *United States—Section 110(5) of the US Copyright Act—Notification of a Mutually Satisfactory Temporary Arrangement,* WT/DS160/23, 26 June 2003. In the first three cases *(Japan—Alcoholic Beverages, Turkey—Textile, US—Line Pipe)*, both parties reached agreement concerning trade compensation; however, in the last dispute (*US—Copyright*), the compensation was agreed in the form of financial compensation. See also WJ Davey, 'Compliance Problems in WTO Dispute Settlement' (2009) 42 *Cornell International Law Journal* 119, 122.

[8] DSU, Arts 22.1 and 22.2.

[9] M Bronckers and N van den Broek, 'Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement' (2005) 8 *Journal of International Economic Law* 101, 104; LEFA Spadano, 'Cross-agreement Retaliation in the WTO Dispute Settlement System: An Important Enforcement Mechanism for Developing Countries?' (2008) 7 *World Trade Review*

to recall that the small number of retaliation disputes to date demonstrates that parties to a dispute generally comply with the rulings. Put differently, retaliation is the exception, not the rule.[10]

A. Compensation in GATT/WTO Dispute Settlement

During the GATT era, the term 'compensation' simply appeared in the 1955 Working Party Report and the 1979 Understanding, both of which noted that compensation should be resorted to only if the immediate withdrawal of the measure was impracticable, and it was seen as a temporary measure pending the withdrawal of the inconsistent measures.[11]

Neither the GATT nor the WTO provisions explicitly make reference to compensation in monetary form. In 1965, Brazilian and Uruguayan delegations proposed a provision for the inclusion of a financial element of compensation in the GATT.[12] However, their proposal was not accepted by the contracting parties.[13] In the current/ongoing Doha Development Agenda negotiations on the DSU, the least-developed countries and Ecuador have proposed monetary compensation as one of the WTO dispute settlement remedies.[14]

While there is no provision either in the GATT or WTO dispute settlement that defines compensation, it is usually in the form of trade compensation where a losing party offers increased trade concessions in terms of greater market access to a winning party. The nature of the compensatory concessions and the items to be offered, according to the 1965 Secretariat Note, are determined by the parties. Put differently, the specific matters of

511, 533; S Bermann, '*EC-Hormones* and the Case for an Express WTO Postretaliation Procedure' (2007) 107 *Columbia Law Review* 131, 149.

[10] WTO, *A Handbook on the WTO Dispute Settlement System: A WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellate Body* (Cambridge, Cambridge University Press, 2004) 82.

[11] GATT, *Report of Review Working Party IV on Organization and Functional Questions*, L/327, 22 February 1955, para 64 www.wto.org/gatt_docs/English/SULPDF/90680406.pdf; GATT, *Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance*, L/4907, 28 November 1979, para 4 of the Annex www.wto.org/english/docs_e/legal_e/tokyo_notif_e.pdf.

[12] GATT, *Proposal Submitted by the Brazilian and Uruguayan Delegations—Draft Decision on Article XXIII*, COM.TD/F/W/4, 11 October 1965 www.wto.org/gatt_docs/English/SULPDF/90560081.pdf.

[13] S Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* (The Hague, Kluwer Law International, 2009) 23.

[14] DSB Special Session, *Negotiations on the Dispute Settlement Understanding—Proposal by the LDC Group*, TN/DS/W/17, 9 October 2002; DSB Special Session, *Negotiations on Improvements and Clarifications of the Dispute Settlement Understanding—Proposal by Ecuador,* TN/DS/W/33, 23 January 2003.

compensation should be agreed between parties to a dispute, and it is not for the panels to adjudicate on those specific matters.[15]

In *EEC—Dessert Apples*, Chile argued that it was entitled to compensation since the EEC's restrictive measures distorted the 'competitive relationship that would otherwise have prevailed between Chilean suppliers and other suppliers on the Community market in the absence of such restrictions'.[16] The panel noted that 'there was no provision in the General Agreement obliging contracting parties to provide compensation'.[17] By recalling the 1965 Secretariat Note and the 1979 Understanding, the panel recognised the possibility for the EEC and Chile to negotiate compensation; however the panel declined to make a recommendation.[18]

In *US—Sugar Waiver*, the GATT panel, by referring to paragraph 4 of the 1979 Understanding, noted that a contracting party might choose to grant compensation to forestall the request for an authorisation of retaliatory measures, but the Understanding did not oblige it to do so.[19] In other words, the panel decided that compensation was optional and that it was up to the respondent to decide whether or not to compensate.[20]

Under the WTO dispute settlement system, Article 22.1 of the DSU provides that compensation is temporary, voluntary and shall be consistent with the covered agreements. Most observers consider that the latter characteristic (consistent with the covered agreements including the MFN (most favoured nation) principle) makes compensation less preferred or less attractive.[21] Since compensation is more within the meaning of trade benefit/openness on a preferential basis, by providing this benefit the respondent state is also required, under the MFN principle, to extend this benefit or advantage to other WTO Members. Consequently, parties have to select a sector of the respondent Member's trade that is less attractive for other Members, but nevertheless, significant for the complaining Member's trade.[22]

[15] Committee on Trade and Development, *Compensation to Less-Developed Contracting Parties for Loss of Trading Opportunities Resulting from the Application of Residual Restrictions—Note by the Secretariat,* COM.TD/5, 2 March 1965, para 10, www.wto.org/gatt_docs/English/SULPDF/90490120.pdf.

[16] *European Economic Community—Restrictions on Imports of Dessert Apples—Complaint by Chile,* GATT Panel Report (adopted 22 June 1989) L/6491—36S/93 [10.2].

[17] ibid [12.35].

[18] ibid [12.35–6].

[19] *United States—Restriction on the Importation of Sugar and Sugar Containing Products Applied under 1955 Waiver and under the Headnote to the Schedule of Tariff Concession,* GATT Panel Report (adopted 7 November 1990) L/6631—37S/228 [5.22].

[20] Shadikhodjaev (n 13) 22.

[21] AA Eleso, 'WTO Dispute Settlement Remedies: Monetary Compensation as an Alternative for Developing Countries' (2006) Bepress Legal Series Paper 1378, 12–14; B Mercurio, 'Why Compensation Cannot Replace Trade Retaliation in the WTO Dispute Settlement' (2009) 8 *World Trade Review* 315, 324–25; P-K Yang, 'Some Thoughts on a Feasible Operation of Monetary Compensation as an Alternative to Current Remedies in the WTO Dispute Settlement' (2008) 3 *Asian Journal on WTO and International Health Law and Policy* 423, 430.

[22] Shadikhodjaev (n 13) 22.

In practice, there are few disputes where Members have referred to trade and monetary compensations as a temporary remedy. For example in *Japan—Alcoholic Beverages II*, Japan provided compensation in the form of a tariff reduction on certain products to the United States, the European Communities and Canada as the complainants in the case.[23] In *Turkey—Textiles*, Turkey agreed to remove quantitative restrictions on certain categories of textile imports and carry out tariff reduction on certain chemicals from India, and the compensation would remain effective until Turkey's compliance with the DSB recommendations and rulings.[24] In *US—Line Pipe*, the United States and Korea agreed on a reasonable period of time for the United States to implement the DSB recommendations and rulings; if the measure had not been terminated by the end of reasonable period of time, the United States agreed to increase the in-quota volume of imports from Korea to a mutually acceptable level, pending the termination of the measure.[25] Additionally, *US—Section 110(5) Copyright Act* is an example of a dispute in which the parties agreed to financial compensation instead of tariff compensation. This dispute was originated by the complaint lodged by the Irish Music Rights Organization, which identified what it believed to be a very low remittance of royalties from the United States, given the popularity of Irish music and Irish musicians in the United States.[26] The European Communities decided to challenge exemption provisions provided for in section 110(5) of the US Copyright Act which allowed music to be played in public places without the payment of a royalty fee. The panel found that certain exemptions are inconsistent with WTO law. When the United States had failed to bring its inconsistent measures into compliance within the reasonable period of time, the European Communities requested an authorisation to retaliate pursuant to Article 22.2 of the DSU; however, they also sought an arbitral award pursuant to Article 25 of the DSU to determine the amount of monetary compensation for the three year period 1996–98.[27] Eventually, the European Communities and the United States reached a temporary solution whereby the United States agreed to make payment of moneys to a specific private body in the European Communities during the implementation period.[28]

[23] *Japan—Taxes on Alcoholic Beverages—Mutually Acceptable Solution on Modalities for Implementation* (n 7).

[24] *Turkey—Restrictions on Imports of Textile and Clothing Products—Notification of Mutually Acceptable Solution* (n 7).

[25] *United Sates—Definitive Safeguard Measures on Imports of Circular Welded Carbon Quality Line Pipe from Korea—Agreement under Article 21.3(b) of the DSU* (n 7).

[26] European Union, 'EU and US Agree on Temporary Compensation in Copyright Dispute', Press Release, 1P/01/1860 (Brussels, 19 December 2001).

[27] *United States—Section 110(5) of the US Copyright Act—Recourse by the European Communities to Article 22.2 of the DSU,* WT/DS160/19, 11 January 2002; WT/DS160/23 (n 7).

[28] European Union, 'EU and US Agree on Temporary Compensation in Copyright Dispute' (n 26).

Similarly, the United States and Brazil signed a Memorandum of Understanding (MOU) in 2010, which establishes a fund for technical assistance and capacity building related to Brazil's cotton sector. The annual fund payment would continue until either the United States passed the subsequent Farm Bill or they reached a mutually agreeable solution to the *US—Upland Cotton* dispute.[29]

B. What is 'Retaliation' in the Context of the Multilateral Trading System?

Retaliation (or countermeasures) in the multilateral trading system generally takes the form of the suspension of concessions or other obligations. Neither the text of the International Trade Organization (ITO) Charter nor the GATT nor the WTO DSU actually employs the term 'retaliation'. However, the word 'retaliation' was often used by the negotiators in the ITO and GATT meetings.[30] Moreover, the panel in *US—Certain EC Products* described the character of suspension of concessions as retaliatory in nature.[31] Most observers now utilise the term 'retaliation' in referring to the remedy under suspension of concessions. In his work on the terms of sanctions under WTO law, Charnovitz points out that it is not clear when retaliation becomes the general term for the action under Article XXIII.[32] However, Charnovitz notes that the repeated use of the term 'retaliation' in Kenneth Dam's book (*The GATT: Law and International Economic Organization*) may have popularised the term.[33]

While retaliation is often referred to as a 'trade sanction', the term of sanction here is not meant punitively.[34] In this book, two terms are going to be used interchangeably in referring to retaliation. They are suspension

[29] *Memorandum of Understanding Between the Government of the United States of America and the Government of the Federative Republic of Brazil Regarding a Fund for Technical Assistance and Capacity Building with respect to the Cotton Dispute (WT/DS267) in the World Trade Organization,* www.state.gov/documents/organization/143669.pdf.

[30] JH Jackson, *World Trade and the Law of GATT* (Indianapolis, IN, Bobbs-Merrill, 1969) 170–71; O Long, *Law and Its Limitations in the GATT Multilateral Trade System* (The Hague, Martinus Nijhoff Publishers, 1987) 66; WTO, *Guide to GATT Law and Practice* (1965) *Volume 2 Article XXII–XXXVIII* (Geneva, WTO, 1995) 693.

[31] *United States—Import Measures on Certain Products from the European Communities ('US—Certain EC Products')*, Panel Report (adopted 10 January 2001) WT/DS165/R [6.23].

[32] S Charnovitz, 'Rethinking WTO Trade Sanctions' (2001) 95 *American Journal of International Law* 792, 801.

[33] ibid.

[34] For example, Long states that neither punitive action nor direct coercion is provided for in the General Agreement. See Long (n 30) 66. McRae also notes that WTO compensation and retaliation are sanctions with a limited objective—they are not designed to punish a Member but to provide incentives for a Member to remove its inconsistent measures. See D McRae 'Measuring the Effectiveness of the WTO Dispute Settlement System' (2008) 3(1) *Asian Journal of WTO and International Health Law and Policy* 1, 8.

of concessions or other obligations and countermeasures. The terms 'retaliation' and 'suspension of concessions' are used interchangeably mostly in the context of the DSU, while the term 'countermeasures' is used in the context of the SCM Agreement and public international law in referring to retaliation.

II. LAW TO RETALIATE UNDER GATT AND WTO DISPUTE SETTLEMENT

Similar to compensation, retaliation is a temporary measure imposed in the event of non-compliance. As mentioned previously, retaliation is usually in the form of suspension of concessions or other obligations. Thus, unlike compensation, retaliation involves raising trade barriers. It is imposed on a discriminatory basis against the Member that fails to implement the recommendations or rulings. While it is applied selectively by one Member against another, it requires the DSB's approval.[35] This part discusses the law governing retaliation under the GATT and, later, under the WTO.

A. Retaliation Cases in GATT Dispute Settlement

There were two disputes during GATT dispute settlement where injured parties requested authorisation for retaliation: *US—Suspension of Obligations*[36] and *US—Superfund*.[37] In *US—Suspension of Obligations*, the Netherlands proposed an authorisation for a countermeasure in the form of an annual reduction of US exports of wheat flour.[38] The Working Party subsequently provided the amount that they deemed appropriate and authorised the suspension of obligations to the Netherlands.[39] However, the Netherlands did not impose such authorised suspension of obligations.[40] In *US—Superfund*, both Canada and the European Communities requested authorisation for retaliation; however, the request was blocked by the United States.[41]

Dam points out two reasons why the GATT parties avoided recourse to retaliation. First is the preference of contracting parties to act as conciliators rather than arbitrators and thus they had the tendency to postpone as long

[35] WTO (n 10) 81.

[36] *Netherlands Action under Article XXIII:2 to Suspend Obligations to the United States ('US—Suspension of Obligations')*, GATT Working Party Report (adopted 8 November 1952) L/61.

[37] *United States—Taxes on Petroleum and Certain Imported Substances ('US—Superfund')*, GATT Panel Report (adopted 18 June 1987) L/6175—34S/136.

[38] *US—Suspension of Obligations* (n 36) [1].

[39] ibid [7].

[40] Charnovitz (n 32) 802.

[41] J Pauwelyn, 'Enforcement and Countermeasures in the WTO: Rules are Rules—Toward a More Collective Approach' (2000) 94 *American Journal of International Law* 335.

as possible the imposition of retaliation.[42] Second is that retaliation may also result in harm to the retaliating party.[43] Due to the fact that authorised suspension of obligations was never utilised, the effectiveness of retaliation as a remedy was never tested during the GATT era.[44]

B. Substantive Rules of GATT Retaliation

GATT Article XXIII:2 lays down two requirements for the authorisation of the suspension of concessions or other obligations (retaliation) requested by the contracting parties. They are: (1) 'serious enough' condition; and (2) appropriateness.

What constitutes 'serious enough' can be derived from GATT practices. The first component of 'serious enough' is the existence of nullification or impairment.[45] The second component is that all endeavours to solve the problem through all other remedies have not proved successful.[46] Finally, the third component is that the retaliation action taken is to prevent serious economic consequences of nullification or impairment, or to restore the original situation.[47]

Determination of the appropriateness standard has proven to be quite problematic. For instance, a 1988 statement by the Legal Adviser to the GATT Director-General stated that in the case of Article XXIII, the wording ('appropriate') was wider, which meant that there was wider leeway in calculating the retaliatory measures under Article XXIII than under Articles XIX or XXVIII.[48] Consequently, the GATT Deputy Director in considering the EEC's request for the authorisation to retaliate against the United States stated that:[49]

> Article XXIII:2, unlike Article XXVIII, did not speak about equivalent concessions and therefore, it was not really a question of authorizing the withdrawal of equivalent concessions as such. That was why the Secretariat had pointed

[42] Dam writes that although the contracting parties in several cases have found nullification or impairment, they have avoided authorising retaliation, for instance in the Australian fertilizer case, the French compensatory tax case, and the French import restriction case. See Dam (n 1) 364.

[43] ibid 368.

[44] Charnovitz (n 32) 802.

[45] *Uruguayan Recourse to Article XXIII*, GATT Panel Report (adopted 16 November 1964) L/1923—11S/95 [13]; *United States Manufacturing Clause*, GATT Panel Report (adopted 15 May 1984) L/5609—31S/74.

[46] GATT Contracting Parties Ninth Session, *Report of Review Working Party IV on Organizational and Function Questions,* L/327, 22 February 1955, 63.

[47] ibid.

[48] Council of Representatives, *Minutes of Meeting—Held in the Centre William Rappard on 4 May 1988*, C/M/220, 8 June 1988, 35–36.

[49] Council of Representatives, *Minutes of Meeting—Held in the Centre William Rappard on 22 September 1988*, C/M/224, 17 October 1988, 19.

out that Article XXIII did not require that the amount of retaliation should be equivalent.

However, the Working Party in the *US—Suspension of Obligations* case interpreted it differently when they were instructed by the contracting parties to investigate the appropriateness of the measure which the government of the Netherlands proposed to take, having regard to its equivalence to the impairment suffered by the Netherlands as a result of the US restriction.[50] The Working Party stated that there were two issues to be considered. The first was whether in the circumstances, the measure proposed was appropriate in character; and the second was whether the extent of the retaliation proposed was reasonable, having regard to the impairment suffered.[51] In other words, the 1952 Working Party took the view that appropriateness in the context of Article XXIII referred to the character of the proposed measure and the amount that is reasonable having regard to its equivalence to the level of the impairment suffered.[52] Palmeter and Alexandrov, citing Hudec's book, point out the explanation of the Chairman of the Working Party that the word 'appropriate' in Article XXIII meant more than just 'reasonable' since it required the Working Party to take into account the desirability of limiting such action to the best calculated in the circumstances to achieve the objective.[53]

So, why did the Working Party believe that it was necessary to limit retaliation? Dam provides the best answer to this question by arguing that nowhere in GATT dispute settlement provisions could one find a reference to a punitive sanction for non-performance.[54] Dam notes that the principle, that the GATT as a whole is a system of reciprocal rights and obligations to be maintained in balance, means that the remedy provision is not understood in terms of sanctions; rather it is a system of reciprocal rights and obligations. Consequently, a failure to respect a tariff concession is not a transgression to be punished, but rather an event giving injured parties the privilege of suspending reciprocal concessions.[55] Dam states that the best example to support the argument underlying this principle is that the main interest of GATT is to make as many agreements to reduce tariffs as possible, instead of ensuring all commitments made are carried out.[56] Therefore,

[50] *US—Suspension of Obligations* (n 36) [2].

[51] ibid [3].

[52] D Palmeter and S Alexandrov, '"Inducing Compliance" in WTO Dispute Settlement' in DLM Kennedy and JD Southwick (eds), *The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 647, 648–49.

[53] ibid 649.

[54] Dam (n 1) 351–52.

[55] ibid 352.

[56] ibid 80. Dam states that it is better that 100 commitments should be made and that 10 should be withdrawn than that only 50 commitments should be made and that all of them should be kept.

punitive sanctions, arguably, might lessen contracting parties' interest in agreeing to further tariff concessions.

C. Substantive Rules of WTO Retaliation

The main provision concerning the rules and procedures of retaliation in the WTO dispute settlement system is stipulated in Article 22 of the DSU. Pursuant to Article 22, the injured party has a right either to negotiate mutually agreed compensation or to request authorisation for retaliation for the violator state's lack of compliance within a reasonable period of time. In practice, due to the fact that it is difficult to achieve agreed compensation between parties to a dispute, the complainant often relinquishes its right to negotiate compensation and directly requests the authorisation to retaliate.

The SCM Agreement sets forth 'special and additional rules' for retaliation in WTO dispute settlement.[57] The Agreement uses the term 'countermeasures' for retaliation. Article 4.7 of the SCM Agreement provides that when a panel finds the measure in question to be a prohibited subsidy, the panel shall recommend that the subsidising Member withdraw the subsidy without delay. If the prohibited subsidy is not withdrawn, Article 4.10 of the SCM Agreement provides that the DSB shall grant authorisation to the complaining party to take appropriate countermeasures. Article 4.11 of the SCM Agreement refers to arbitration under Article 22.6 of the DSU to determine whether the countermeasures are appropriate. Footnote 10 of the SCM Agreement states that 'this expression [appropriateness] is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited'.

The discussion of retaliation in this section is divided into two main parts. The first part explains retaliation pursuant to the DSU rules. The second part assesses the countermeasures under the SCM Agreement.

i. The Basic Elements of WTO Retaliation in the Multilateral DSU Framework

This part explores the characteristics of WTO retaliation as provided for explicitly and implicitly in the DSU, such as whether retaliation is prospective or retroactive in nature, or what the limitation level of retaliation is. In doing so, it makes a reference to relevant panels, the Appellate Body and

[57] *Brazil—Export Financing Programme for Aircraft—Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('Brazil—Aircraft (Article 22.6—Brazil)')* Decision by the Arbitrators (28 August 2000) WT/DS46/ARB [3.57]. In the arbitrators' view, the provisions of Art 4.11 of the SCM Agreement are special and additional rules.

the arbitrators' decisions which are a useful source to delve deeper into the elements of retaliation.

a. Retaliation is the Remedy of Last Resort and Suspension of Concessions and Other Obligations is the Form of Retaliation Provided by the DSU

Retaliation as a last resort remedy has two meanings. First, it is not the first preference in settling a dispute, and secondly there are no other remedies available beyond retaliation. The first meaning is expressed in Article 3.7 of the DSU, which established the remedial hierarchy. The order of preference is as follows: (1) bilateral settlement; (2) withdrawal of inconsistent measures; (3) compensation; and (4) retaliation.[58] Thus, it can be concluded that the preference in dispute settlement is positive settlement and retaliation, for a dispute reaching this phase and not being solved at an earlier stage in a constructive manner, is the exception.[59] The second meaning is demonstrated in Article 22.2 of the DSU. When the violator state fails to comply within a reasonable period of time (non-compliance), there are only two types of remedy available for the injured state: either compensation or the suspension of concessions or other obligations. The DSU does not provide any form of remedy where retaliation fails to cause the violator state to remove its inconsistent measures. Article 22 also points out that the form of retaliation under the DSU is the suspension of concessions or other obligations.

One of the issues in the *EC—Commercial Vessels* case was whether attempts to redress non-compliance by seeking other measures without having recourse to the DSU multilateral frameworks would contravene the DSU.[60] The panel considered that by adopting the Temporary Defensive Mechanism (TDM) regulation (a measure to redress the violation) in response to Korea's violation of the SCM Agreement without first resorting to the DSU, the European Communities acted unilaterally, and thus, such measures contravened Article 23.1 of the DSU.[61] Sebastian notes that the panel's reasoning in *EC—Commercial Vessels* also implies that suspension under non-WTO treaties, such as an expropriation of the Bilateral Investment Treaty, if taken to redress WTO violation, could contravene Article 23.1 of the DSU.[62]

[58] BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 142.

[59] WTO (n 10) 82.

[60] *European Communities—Measures Affecting Trade in Commercial Vessels ('EC—Commercial Vessels')*, Panel Report (adopted 20 June 2005) WT/DS301/R.

[61] ibid [7.220]–[7.222].

[62] T Sebastian, 'The Law of Permissible WTO Retaliation' in C Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (New York, Cambridge University Press, 2010) 90–91.

b. Retaliation is Temporary and Prospective in Nature

The temporary nature of retaliation is related to the fact that its application is conditional on the removal of the inconsistent measures by the violator state. Put differently, retaliation remains in place until there is compliance. Bermann criticises the lack of an explicit post-retaliation complaint procedure in the DSU, which could result in never-ending retaliation.[63] The *EC—Hormones* dispute is an example provided by Bermann. In this dispute, there was a disagreement between the European Communities and the United States and Canada concerning compliance by the European Communities, which resulted in the United States and Canada continuing to impose retaliation. Consequently, the European Communities brought a new dispute before the panel against the United States and Canada's continued suspension.[64]

Nothing in the DSU explicitly states that retaliation is a prospective remedy. However, Articles 19.1 and 21.3 of the DSU envisage panels' or the Appellate Body's recommendation to be prospective in nature.[65] Article 19.1 provides that the dispute panel and/or Appellate Body would recommend that the violator state brings its inconsistent measures into compliance; and Article 21.3 stipulates a reasonable period of time for the violator state to bring its inconsistent measures into compliance. According to Sebastian, if these articles are read jointly, they implicitly limit the scope of what the injured state may request.[66] The violator state is required to cease its inconsistent measure by the end of a reasonable period of time and cannot be required to make reparation for injury caused by an inconsistent measure which pre-dates the expiry of a reasonable period of time.[67] In short, retaliation is deemed 'prospective' due to its scope limitation, which merely covers the time period after the DSB grants authorisation, not the whole period of the inconsistent measure applied.[68]

In practice, however, several GATT/WTO panel decisions provided retroactive remedies. During the GATT era, for instance, a number of disputes which were related to subsidies and countervailing measures and antidumping resulted in the granting of retrospective remedies.[69] Those cases

[63] Bermann (n 9).

[64] *The United States—Continued Suspension of Obligations in the EC—Hormones Dispute ('US—Continued Suspension')*, Panel Report (adopted 14 November 2008) WT/DS320/R (2008) and *Canada—Continued Suspension of Obligations in the EC—Hormones Dispute* ('Canada—Continued Suspension'), Panel Report (adopted 14 November 2008) WT/DS321/R.

[65] G Goh and AR Ziegler, 'Retrospective Remedies in the WTO after Automotive Leather' (2003) 6 *Journal of International Economic Law* 545, 555.

[66] Sebastian (n 62) 93.

[67] ibid.

[68] WTO (n 10) 82.

[69] P Grané, 'Remedies under WTO Law' (2001) *Journal of International Economic Law* 755, 764.

were *Canada—Manufacturing Beef CVD*,[70] *US—Canadian Pork*,[71] *US—Softwood LumberII*,[72] *NZ—Finnish Transformers*,[73] *US—Cement*,[74] and *US—Swedish Steel*.[75]

In WTO dispute settlement, *Brazil—Aircraft* and *Guatemala—Cement* are two cases where the complaining party requested a 'retrospective' award.[76] Additionally, in the *Australia—Automotive Leather (Article 21.5—US)* case, despite the fact that Australia and the United States requested the withdrawal of the subsidy in a prospective way, the panel took the view that the prospective remedy proposed by Australia would be ineffective. Thus, the panel concluded that repayment in full of the prohibited subsidy was necessary in order to 'withdraw the subsidy' in this case.[77] The *Australia—Automotive Leather (Article 21.5—US)* panel report received many criticisms from WTO Members.[78]

[70] *Canada—Imposition of Countervailing Duties on Imports of Manufacturing Beef from the EEC*, GATT Panel Report (unadopted 13 October 1987) SCM/85 [15]. The Panel suggested that 'the Committee recommend that Canada terminate the outstanding countervailing duty order on manufacturing beef from the EEC, and that it refund any duties collected under that order'.

[71] *United States—Countervailing Duties on Fresh, Chilled, and Frozen Pork from Canada*, GATT Panel Report (adopted 11 July 1991) DS7/R—38S/30 [5.2]. The Panel recommended that 'the CONTRACTING PARTIES request the United States to either reimburse the countervailing duties corresponding to the amount of the subsidies granted … or to make a subsidy determination which meets the requirements of Article VI:3 and reimburse the duties to the extent that they exceed an amount equal to the subsidy so determined to have been granted to the production of pork'.

[72] *United States—Measures Affecting Imports of Softwood Lumber from Canada*, GATT Panel (adopted 27 October 1993) SCM/162 [415]. The panel recommended that the United States refund the cash deposits made during the period of application of its inconsistent measures.

[73] *New Zealand—Import of Electrical Transformers from Finland*, GATT Panel Report (adopted 18 July 1985) L/5814 [4.11]. The panel proposed to the Council that it address to New Zealand a recommendation to revoke the anti-dumping determination and to reimburse the anti-dumping duty paid.

[74] *United States—Anti-Dumping Duties on Gray Portland Cement and Cement Clinker from Mexico*, GATT Panel Report (unadopted 7 September 1992) ADP/82 [6.2]. The panel recommended that the United States revoke the anti-dumping duty order and to reimburse any anti-dumping paid.

[75] *United States—Imposition of Anti-Dumping Duties on Imports of Seamless Stainless Steel Hollow Products from Sweden*, GATT Panel Report (unadopted 20 August 1990) ADP/47 [5.24]. The panel suggested that the United States revoke the anti-dumping duties imposed and reimburse the anti-dumping paid. The United States did not agree with the retrospective corrective measures and refused to adopt the report.

[76] *Brazil—Export Financing Program for Aircraft*, Panel Report (adopted 20 August 1999) WT/DS46/R; *Guatemala—Anti-dumping Investigation Regarding Portland Cement from Mexico*, Panel Report (adopted 25 November 1998) WT/DS60/R. Nevertheless in both cases, panels did not issue specific recommendations requested by those complaining parties.

[77] *Australia—Subsidies Provided to Producers and Exporters of Automotive Leather—Recourse to Article 21.5 of the DSU by the United States*, Panel Report (adopted 11 February 2000) WT/DS126/RW, [6.47–8].

[78] DSB, *Minutes of Meeting—Held in the Centre William Rappard on 11 February 2000*, WT/DSB/M/75, 7 March 2000, 5–9.

Despite the fact that several panels' decisions provide for such retroactive relief, retroactive remedies, arguably, are not preferred by WTO Members. Palmeter and Mavroidis refer to the phrase 'today's complainant may be tomorrow's respondent' to explain why Members dislike retroactive remedies.[79] Additionally, Grané argues from the perspective of Members' sovereignty that such sovereignty would be impinged upon by stringent corrective remedies, which might result in states losing their interest in staying inside the system.[80] Recommendations for retroactive remedies are actually quite uncommon and depart from general practice in GATT and the WTO. For example, the GATT Panel in the *Norway—Trondheim* case concluded that 'no GATT practice instituted "retroactive compensation"'.[81] The WTO panel in *US—Certain Products from the EC* also stated that 'retroactive remedies are alien to the long established GATT/WTO practice where remedies have traditionally been prospective'.[82]

c. Retaliation Consists of a Certain Magnitude and Is Not Punitive

The WTO provisions provide several standards to determine the magnitude of retaliatory measures. First, Article 22.4 of the DSU stipulates that retaliation shall be equivalent to the level of nullification or impairment. Secondly, Article 4.10 of the SCM Agreement provides for an 'appropriate' standard for countermeasures against prohibited subsidies. Thirdly, Article 7.9 of the SCM Agreement states that the countermeasures in the case of actionable subsidies must be commensurate with the degree and nature of the adverse effects. Fourthly, Article XXVIII:3(b) of the GATT provides the standard of substantially equivalent concessions on retaliatory withdrawal measures. These standards tell us that the amount of retaliation should not be determined arbitrarily and punitive.

As stated by Ethier, the purpose of WTO dispute settlement is not to facilitate punishment, it is to constrain it.[83] Accordingly, retaliation under the WTO Agreement is not designed to be punitive. The availability of these standards is intended to limit retaliatory measures so that they do not become punitive sanctions. The non-punitive nature is primarily reflected in

[79] D Palmeter and PC Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure*, 2nd edn (Cambridge, Cambridge University Press, 2004) 165. For instance, in *Australia—Automotive Leather (Article 21.5—US)*, even though the United States was the winner, it provided a statement that it 'did not agree with every word of the Panel Report' and that 'the Panel's remedy went beyond that sought by the United States'. See WT/DSB/M/75 (n 78) 5.

[80] Grané (n 69) 770.

[81] *Norway—Procurement of Toll Collection Equipment for the City of Trondheim*, GATT Panel Report (adopted 13 May 1992) GPR.DS2/R [3.37] ('*Norway—Trondheim*').

[82] *US—Certain EC Products* (n 31) [6.106].

[83] WJ Ethier, 'Intellectual Property Rights and Dispute Settlement in the World Trade Organization' (2004) 7 *Journal of International Economic Law* 449, 451.

the 'equivalent' standard under Article 22.4 of the DSU. The SCM Agreement also does not justify punitive sanction. Mavroidis notes that the definition of 'proportionate' in the footnote to Article 4.10 of the SCM Agreement means not disproportionate, and therefore has the reasonable interpretation that punitive damages are excluded.[84]

Arbitrators in *EC—Bananas (Article 22.6—EC)* also considered that there is nothing in Article 22 that could be read as justifying punitive countermeasures.[85] Moreover, in *US—FSC (Article 22.6—US)* the arbitrators emphasised that nothing in the text or in the context of Article 4.10 of the SCM Agreement suggests an entitlement to punitive measures.[86]

In practice, Article 22.6 arbitrators normally determine the level of retaliation at a level much lower than that requested. Table 2.1 shows the level of retaliation requested and level of retaliation determined by the Article 22.6 Arbitrators in eight cases.

ii. Three Principles and Calculation Methods of Retaliation in the DSU

There are two primary claims that are requested or challenged by parties to the dispute in Article 22.6 arbitral proceedings. They are cross-retaliation and the determination of the level of retaliation. Accordingly, this part provides two main points of discussion. First, it discusses three principles which the requesting party should seek to satisfy before it is entitled to do cross-retaliation. Secondly, it explains the calculation methods of WTO retaliation such as the determination of counterfactual and the level of calculation.

a. Three Principles of Retaliation: Same-Sector, Cross-Sector and Cross-Agreement

Unlike its predecessor, the WTO has governed not only the area of goods but also those of services and intellectual property rights. Thus, considering the concessions or obligations to suspend, the DSU sets forth three main principles related to those areas under Article 22.3.

The first principle is that the complaining party should first seek to retaliate with respect to the same sectors in which nullification or impairment has

[84] PC Mavroidis, 'Remedies in the WTO Legal System: Between a Rock and a Hard Place' (2000) 11 *European Journal of International Law* 763, 805–06.

[85] *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 ('EC—Bananas III (US) (Article 22.6—EC)')*, Decision by the Arbitrators (9 April 1999) WT/DS27/ARB [6.3].

[86] *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('US—FSC (Article 22.6—US)')*, Decision by the Arbitrator (30 August 2002) WT/DS108/ARB [5.62].

Table 2.1: Level of retaliation requested and level of retaliation authorised

Cases	Level of retaliation requested (annually)	Level of retaliation authorised (annually)
EC—Bananas III (Ecuador)	US$450 million	US$201.6 million
EC—Bananas III (US)	US$520 million	US$191.4 million
EC—Hormones (Canada)	CDN$75 million	CDN$11.3 million
EC—Hormones (US)	US$202 million	US$116.8 million
US—FSC	US$4.043 million	US$4.043 million
Brazil—Aircraft	CDN$700 million	CDN$344.2 million
Canada—Aircraft	US$3.36 billion	US$247.797.000
US—Gambling	US$3.443 billion	US$21 million
US—Upland Cotton (Article 4.11 SCM Agreement)	US$3 billion	US$147.4 million for FY 2006, or, for subsequent years, to be determined by a certain methodology described in Arbitrators' decision
US—Upland Cotton (Article 7.10 SCM Agreement)	US$1.037 billion	US$147.3 million
US—COOL (Canada)	CDN$3 Billion	CDN$1,054.729 million
US—COOL (Mexico)	US$653 million	US$227.758 million

been found.[87] If the party considers that it is impracticable or ineffective to retaliate in the same sectors, the second principle applies, which is that the party may seek to retaliate in other sectors under the same agreement.[88] If the complaining party considers that it is not practicable or effective to retaliate in other sectors under the same agreement, and the circumstances are serious enough, the third principle provides that the complaining party may retaliate under another covered agreement.[89] In short, the three principles of retaliation are 'same-sector' retaliation, 'cross-sector' retaliation and 'cross-agreement' retaliation.

[87] DSU, Art 22.3(a).
[88] ibid Art 22.3(b).
[89] ibid Art 22.3(c).

The term 'sector' means:[90]

(i) with respect to goods, all goods;
(ii) with respect to services, those identified in the current 'Service Sectoral Classification List' (for instance business, communications, distribution, financial, health, and so forth);
(iii) with respect to TRIPS (Trade-Related Aspects of Intellectual Property Rights), each category of intellectual property rights covered in the first seven sections of Part II (for example copyright, patents, trademarks, geographical indications and so forth) or the obligations under Part III (enforcement obligations) or IV (acquisition and maintenance of intellectual property rights and related inter partes procedures) of the TRIPS Agreement.

In applying these three principles for cross-retaliation, the complaining party shall take into account:[91]

(i) the trade in the sector or under the agreement under which the violation or other nullification or impairment has been found, and the importance of such trade to the complaining party;
(ii) the broader economic elements related to the nullification or impairment and the broader economic consequences of the retaliation.

As regards 'the importance of such trade' to the complaining party, arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)* held that this criterion relates primarily to the trade nullified or impaired by the WTO-inconsistent measures.[92] Thus, in the arbitrators' view, the trade in its entirety (in this case, they are under the GATT and GATS (General Agreement on Trade in Services)) is of subsidiary importance.[93] In contrast, the arbitrators in *US—Gambling (Article 22.6—US)* held the view that 'the ordinary meaning of subparagraph (d)(i) suggests that a consideration of the entirety of "trade in the sector" under which a violation was found is pertinent'.[94] The arbitrators' view in *US—Gambling (Article 22.6—US)*, arguably, is more appropriate, because Article 22.3 paragraph 3(d)(i) does not distinguish between

[90] ibid Art 22.3(f)(i)(ii)(iii).

[91] ibid Art 22.3(d). The cross-retaliation provision does not apply to the plurilateral agreement on government procurement (GPA), see the GPA, Art XXII:7.

[92] *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 ('EC—Bananas III (Ecuador) (Article 22.6—EC)')*, Decision by the Arbitrators (24 March 2000) WT/DS27/ARB/ECU [84].

[93] ibid [128].

[94] *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Gambling (Article 22.6—US)')*, Decision by the Arbitrator (21 December 2007) WT/DS285/ARB [4.33].

trade of primary and subsidiary importance and the meaning of 'sector' in paragraph 3(f)(i) with respect to goods is all goods.[95]

With regard to the 'broader economic elements' and 'broader economic consequences of the retaliation', the arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)* stated that the former criterion primarily relates to the suffering of the complaining party as a result of the nullification or impairment. The latter criterion relates to the consequences not only for the respondent party, but also for the complainant party.[96]

As stated previously, in seeking cross-sector retaliation, a complainant party is required to demonstrate why retaliation in the same sector is 'not practicable or effective'. Additionally, to impose cross-agreement retaliation, a complainant party needs to demonstrate aggregate conditions: 'circumstances are serious enough' and cross-sector retaliation 'is not practicable or effective'. The arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)*, followed by the arbitrators in *US—Gambling (Article 22.6—US)* and *US—Upland Cotton (Article 22.6—US)*,[97] defined the word 'practicable' as 'available for application in practice as well as suited for being used in a particular case'.[98]

As regards the term 'effective', the arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)* looked at the term's ordinary meaning in the *Oxford English Dictionary* and highlighted that it connotes 'powerful in effect', 'making a strong impression', 'having an effect or result'.[99] Accordingly, the arbitrators believed that the thrust of this criterion is to ensure that the impact of retaliation is strong and has a desired result, namely inducing compliance.[100] Put differently, the arbitrators in this case viewed the objective of retaliation as inducing compliance and such objective can be achieved if retaliation is available in practice and powerful in effect.

In relation to the phrase 'circumstances are serious enough', the arbitrators stated that Article 22 does not provide any threshold for determining when circumstances can be considered 'serious' enough to justify retaliation. Thus, the arbitrators utilised the ordinary meaning of 'serious' and contextual guidance under Article 22.3(d) of the DSU.[101] Accordingly, to be considered as serious, circumstances must reach a certain degree of importance that is manifested in the provision of Article 22.3(d).[102] Similarly, the

[95] Shadikhodjaev (n 13) 71.
[96] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (n 92) [85–86].
[97] See *US—Gambling (Article 22.6—US)* (n 94) [4.29] and *United States—Subsidies on Upland Cotton—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('US—Upland Cotton (Article 22.6—US)')*, Decision by the Arbitrator (31 August 2009) WT/DS267/ARB/1 [5.71–2].
[98] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (n 92) [70].
[99] ibid [72].
[100] ibid.
[101] ibid [81], [121].
[102] Shadikhodjaev (n 13) 71–72.

arbitrators in *US—Gambling (Article 22.6—US)* were of the opinion that the 'circumstances' aspect assessment is to be made on a case-by-case basis and that the 'circumstances' that are relevant may vary from case to case.[103] However, the arbitrators also noted that the circumstances should be 'serious enough' when they reach a certain degree or level of importance.[104]

b. Calculation of the Level of Suspension: Counterfactual and Method of Calculation

In most arbitration proceedings the arbitrators, by referring to Article 22.4 of the DSU, determine that the level of suspension shall be equivalent to the level of nullification or impairment. Thus, the arbitrators generally determine at first the level of nullification and impairment. To calculate the level of nullification or impairment, the arbitrators have to compare the trade value of the current WTO-inconsistent situation with the trade value of a 'counterfactual' WTO-consistent situation. The counterfactual is a trade value in a situation that arguably would exist if the violator state had removed the WTO-inconsistent measure within a reasonable period of time.

The determination of the counterfactual is a hypothetical analysis by the arbitrators. McGriven notes that the use of the counterfactual can involve a fair degree of subjective assessment by the arbitrators.[105] Hudec also states that by simply announcing the 'correct' methodology and number with little explanation, the arbitrators' panel reports might be disappointingly obscure; however, as long as the parties are willing to accept the decision, it is politically acceptable.[106]

The choice of counterfactual in practice has been quite varied. In *EC—Bananas III (US) (Article 22.6—EC)*, the arbitrators selected a counterfactual (a global tariff quota and unlimited access for bananas from Africa, the Caribbean and the Pacific (ACP) at a zero tariff) that was quite different from several counterfactuals proposed by the United States, and provided no explanation for their choice of counterfactual.[107] The arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)* selected the same counterfactual as the one in *EC—Bananas III (US)* arbitration to ensure consistency and to prevent double-counting on the nullification or impairment carried by the United States.[108]

[103] *US—Gambling (Article 22.6—US)* (n 94) [4.108].

[104] ibid.

[105] BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 151.

[106] ibid 151; Hudec (n 6) 391.

[107] *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 ('EC—Bananas III (US) (Article 22.6—EC)')*, Decision by the Arbitrators (9 April 1999) WT/DS27/ARB [7.4–8].

[108] *EC—Bananas III (Ecuador) (Article 22.6—EC)* (n 92) [166].

In both *EC—Hormones (Article 22.6)* disputes, the arbitrators focused on the trade foregone due to the continuance of the existing ban on hormone-treated beef. The arbitrators calculated the detrimental effects by comparing annually the value of hormone-treated beef exports under the current European Communities-inconsistent measure with the value of hormone-treated beef exports which would take place in the European Communities if the measure was WTO consistent.[109] In these disputes, however, there were two possible relevant counterfactuals. First, there was the situation where the European Communities had withdrawn its inconsistent measure, and second, there was a situation where the European Communities maintained its import ban but supported it with a proper risk assessment as required by the Agreement on the Application of Sanitary and Phytosanitary Measures (SPS Agreement). The arbitrators selected the first counterfactual, and the European Communities did not contest it.[110] However, it is arguable that the choice of this counterfactual scenario affected the calculation of the level of nullification or impairment.[111]

The counterfactual in *US—Byrd Amendment (Article 22.6—US)* was the trade effect of the CDSOA (Continued Dumping and Subsidy Offset Act) disbursements. Here the arbitrators departed from the counterfactual applied in *EC—Bananas III* and *EC—Hormones* by applying an economic model, rather than the value of the violation itself, to assess to what extent the payments nullified and impaired benefit to the injured party.[112] In this case, the arbitrators also refused to include the calculation of the detrimental effects experienced by the third-country entities. The arbitrators stated that 'a Requesting Party may only request suspension of concessions or other obligations with respect to the trade effect caused by disbursements under the CDSOA relating to its own exports'.[113]

In *US—1916 Act (Article 22.6—EC)*, the arbitrators refused the European Communities' proposal on 'mirror' regulation. The arbitrators argued that it is impossible to determine the WTO consistency of a 'qualitative equivalence', thus it is essential to determine the trade or economic effect of the

[109] *European Communities—Measures Concerning Meat and Meat Products (Hormones), Original Complaint by Canada—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU ('EC—Hormones (Canada) (Article 22.6—EC)')*, Decision by the Arbitrators (12 July 1999) WT/DS48/ARB [42]; *European Communities—Measures Concerning Meat and Meat Products (Hormones), Original Complaint by the United States—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU ('EC—Hormones (US) (Article 22.6—EC)')*, Decision by the Arbitrators (12 July 1999) WT/DS26/ARB [43].

[110] ibid [37]; ibid [38].

[111] Sebastian (n 62) 101–02; Shadikhodjaev (n 13) 125.

[112] *United States—Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Byrd Amendment (Article 22.6—US)')*, Decision by the Arbitrator (31 August 2004) WT/DS217/ARB/BRA [3.77].

[113] ibid [4.16].

1916 Act on the European Communities in numerical or monetary terms (quantitative equivalence).[114] This case is quite unique, since after a reasonable period of time, no order under the 1916 Act had been in place against the European Communities' products. Thus, the arbitrators provided that the calculation method was to rely on the future situations. These were any final judgments that would be made against the European Communities' entities under the 1916 Act, and the situation that an award would be payable by the European Communities' entities to settle claims under the Act.[115] The arbitrators also refused to include the 'chilling effect' of the 1916 Act and the litigation cost in the calculation.[116]

The counterfactual in *US—Gambling (Article 22.6—US)* was rather controversial. In this case, the arbitrators provided that only a 'counterfactual that allowed remote gambling on horseracing but disallowed other types of gambling is plausible'.[117] By allowing the remote gambling on horseracing as the counterfactual, the arbitrators provided a WTO-inconsistent counterfactual scenario. Sebastian argues that it is hard to reconcile the US position that remote gambling must be banned to protect public morals with the counterfactual that permitted remote gambling on horseracing.[118] Thus, Ehring writes that the *US—Gambling* arbitration proceeding was a judicial disaster.[119]

iii. Countermeasures Under the SCM Agreement

The SCM Agreement provides rules on subsidies and countervailing duties in the multilateral trading system. A subsidy pursuant to the Agreement consists of three main elements which are as follows: (i) a financial contribution (such as a direct transfer of funds, a potential direct transfer of funds or liabilities, government revenue foregone or not collected, the provision by a government of goods or services other than general infrastructure, the purchase by a government of goods, government payments to a funding mechanism or entrustment or direction of a private body); (ii) by a government or any public body; and (iii) conferring a benefit.[120] The Agreement also distinguishes between three types of subsidies: prohibited, actionable and

[114] *United States—Anti-Dumping Act of 1916, Original Complaint by the European Communities—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—1916 Act (Article 22.6—US)')*, Decision by the Arbitrators (24 February 2004) WT/DS136/ARB [5.20–3].

[115] ibid [5.45], [5.58].

[116] ibid [5.72], [5.78].

[117] *US—Gambling (Article 22.6—US)* (n 94) [3.54].

[118] Sebastian (n 62) 104.

[119] L Ehring, 'The European Community's Experience and Practice in Suspending WTO Obligations' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (New York, Cambridge University Press, 2010) 261–64.

[120] SCM Agreement, Art 1.1.

non-actionable subsidies.[121] Prohibited subsidies are those contingent upon export performance or upon the use of domestic over imported goods.[122] Export subsidies and import substitution subsidies are prohibited under the SCM Agreement. Outside these prohibited subsidies, most subsidies are actionable, which means that they are not prohibited but are subject to challenge in the event that they cause 'adverse effects to the interests of other Members'.[123]

As mentioned previously, the SCM Agreement sets forth special and additional rules for dispute settlement which a Member can use to seek the withdrawal of the subsidy and the removal of its adverse effects. In the event of non-compliance, the injured party may request the DSB's authorisation to take countermeasures. This part elaborates on the features of countermeasures provided by the SCM Agreement.

a. The Meaning of Countermeasures

The SCM Agreement does not define what countermeasures are. However, the meaning of 'countermeasures' has been determined in practice. The arbitrators in *US—FSC (Article 22.6—US)* pointed out the dictionary meaning of countermeasures and stated that 'the dictionary definitions suggest that a countermeasure is essentially by reference to the wrongful action to which it is intended to respond'. Accordingly, this ordinary meaning suggests that 'a countermeasure bears a relationship with the action to be counteracted, or with its effects'.[124] The arbitrators, thus, decided that the term 'countermeasures' in the context of Article 4 of the SCM Agreement, is in line with its ordinary meaning and that these measures are 'authorized to counteract … a wrongful action in the form of an export subsidy that is prohibited *per se*, or the effects thereof' (emphasis added).[125] Therefore, the arbitrators concluded that the countermeasures can be utilised either to counter the measure at issue (neutralising the export subsidy), or to counteract its effect on the affected party, or both.[126]

Although the DSU and the SCM Agreement use different terms for retaliation, the arbitrators in *Brazil—Aircraft (Article 22.6—Brazil)* considered that the term 'countermeasures' may also include suspension of concessions or other obligations.[127] The arbitrators in *Canada—Aircraft Credits and*

[121] The third category, non-actionable subsidies, applied provisionally for five years ending 31 December 1999. The provisions were not renewed as no consensus has been reached. So from 1 January 2000, it is no longer in effect.
[122] SCM Agreement, Art 3.
[123] ibid Art 5.
[124] *US—FSC (Article 22.6—US)* (n 86) [5.4].
[125] ibid [5.5].
[126] ibid [5.6].
[127] *Brazil—Aircraft (Article 22.6—Brazil)* (n 57) [3.29].

Guarantees (Article 22.6—Canada) decided the same thing by stating that there is no restriction on the types of countermeasures under Article 4.10 of the SCM Agreement, however Brazil in this case requested the suspension of tariff concessions and other obligations as the countermeasures.[128]

b. What Constitutes 'Appropriate'?

A comprehensive definition of 'appropriateness' is essential to determine the level of countermeasures in the case of prohibited subsidies. The arbitrators in *US—Cotton (Article 22.6—US)* stated that the permissible level of countermeasures is mainly defined through the term 'appropriate' and the wording of footnote 9.[129] What constitutes 'appropriate' is quite unclear under the SCM Agreement. However, the arbitrators' decisions in several prohibited subsidies disputes elaborated on several elements of the 'appropriate' standard.

1. It Mainly Corresponds to the Amount of Subsidy Rather Than the Harm That Has Occurred

Brazil—Aircraft (Article 22.6—Brazil) was the first dispute where the meaning of 'appropriate' became the primary issue before the arbitrators. In this dispute, Canada did not request authorisation for the level of nullification or impairment, but for the amount of the prohibited subsidy. Canada argued that countermeasures are appropriate if they correspond to the amount of the prohibited subsidy granted. Brazil agreed the amount of subsidy as the starting point for the calculation of the appropriate level of countermeasures, but it should be adjusted according to numerous factors.[130]

The arbitrators were of the view that 'the reference to the fact that subsidies dealt with are prohibited can most probably be considered more as an aggravating factor than as a mitigating factor'.[131] Thus, they concluded that when dealing with prohibited subsidies, a level of countermeasures which corresponds to the total amount of the subsidy is 'appropriate'.[132] Palmeter and Mavroidis challenge this finding and argue that reference in footnotes 9 and 10 to the fact that the subsidies involved are prohibited does not constitute an aggravating or mitigating factor, but instead the use of the term

[128] *Canada—Export Credits and Loan Guarantees for Regional Aircraft—Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)') Decision by the Arbitrator (17 February 2003) WT/DS222/ARB*, footnote 82.

[129] *US—Upland Cotton (Article 22.6—US)* (n 97) [4.43].

[130] *Brazil—Aircraft (Article 22.6—Brazil)* (n 57) [3.30].

[131] ibid [3.51].

[132] ibid [3.60].

'prohibited' is more to distinguish prohibited subsidies from those that are actionable.[133]

The arbitrators in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* went further by finding that although the level of countermeasures is more appropriately determined on the basis of the amount of subsidies, the level of countermeasures does not have to be limited to such amount.[134]

2. It Allows More Leeway Than the Word 'Equivalent'

The arbitrators in *Brazil—Aircraft (Article 22.6—Brazil)* noted that 'equivalent' and 'appropriate' should not be given the same meaning, and that instead, the term appropriate should give more leeway than the word 'equivalent' in assessing the level of countermeasures.[135] While the arbitrators admitted that there may be a situation in practice where countermeasures equivalent to the level of nullification or impairment are appropriate, they argued that the concept of nullification and impairment is absent from Articles 3 and 4 of the SCM Agreement (prohibited subsidies provisions).[136] Accordingly, the arbitrators in determining the appropriate level of suspension stated that there is no legal obligation that the appropriate level of countermeasures should be based on the level of nullification or impairment.[137]

3. It is expected to have the effect of inducing compliance

In four arbitral proceedings on prohibited subsidies disputes, the arbitrators acknowledged that a countermeasure is appropriate if it induces compliance. In *Brazil—Aircraft (Article 22.6—Brazil)*, the arbitrators examined the term 'appropriate' by referring to its meaning in general international law and in the work of the International Law Commission (ILC) on state responsibility and thereby came to a similar conclusion to the arbitrator in *EC—Bananas III (Article 22.6—EC)* that 'a countermeasure is "appropriate" *inter alia* if it *effectively* induces compliance'.[138]

The arbitrators in *US—FSC (Article 22.6—US)* noted two things in assessing what may be deemed 'appropriate' countermeasures. First, the subsidy at issue should be withdrawn; and secondly, countermeasures should contribute to the withdrawal of the prohibited subsidy without delay.[139] Thus, the arbitrators in *Canada—Aircraft Credits and Guarantees*

[133] Palmeter and Mavroidis (n 79) 292.
[134] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (n 128) [3.91].
[135] *Brazil—Aircraft (Article 22.6—Brazil)* (n 57) footnote 51.
[136] ibid [3.57].
[137] ibid [3.48].
[138] ibid [3.44].
[139] *US—FSC (Article 22.6—US)* (n 86) [5.51–60].

(Article 22.6—Canada), with regard to Canada's statement that it did not intend to withdraw the subsidy and to the finding in *US—FSC (Article 22.6—US)* which stated that the prohibited subsidy should be withdrawn without delay, introduced an additional 20 per cent to the amount of the countermeasure in order to induce Canada to withdraw the subsidy.[140]

In *US—Cotton (Article 22.6—US)*, the most recent Article 22.6 arbitral proceeding on prohibited subsidies, the arbitrators found that inducing compliance seems to be the common purpose of retaliation in the WTO dispute settlement system including Article 22.4 of the DSU, but that this 'inducing compliance' purpose does not by itself provide a specific indication as to the permissible level of countermeasures.[141]

4. Not Disproportionate

Footnotes 9 and 10 of the SCM Agreement provide a substantive rule for the appropriateness standard of the countermeasures: it should not be disproportionate. However, the SCM Agreement does not provide further explanation concerning the meaning of disproportionate. Because of this uncertainty, the arbitrators in *Brazil—Aircraft (Article 22.6—Brazil)* had difficulty identifying the relationship between the second part of the sentence in the footnote ('in light of the fact that the subsidies dealt with under these provisions are prohibited') to the first part of the sentence ('this expression is not meant to allow countermeasures that are disproportionate'). The arbitrators in *US—FSC (Article 22.6—US)* by referring to footnote 9 to Article 4.10 of the SCM Agreement, provided a more certain explanation concerning the text in footnote 9. The arbitrators found that the footnote requires them:[142]

> to maintain a congruent relationship in countering the measure at issue so that the reaction is not excessive in light of the situation to which there is to be a response. But this does not require exact equivalence—the relationship to be respected is precisely that of 'proportion' rather than 'equivalence'.

Howse and Neven argue that the footnote can be read as setting an upper bound on the countermeasures and, at the same time, as emphasising the unlawful character of the prohibited subsidy; hence, it provides a warning against excessively low countermeasures.[143]

[140] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (n 128) [3.106–7].
[141] *US—Upland Cotton (Article 22.6—US)* (n 97) [4.112].
[142] *US—FSC (Article 22.6—US)* (n 86) [5.18].
[143] R Howse and DJ Neven, 'United States—Tax Treatment for "Foreign Sales Corporations" Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS108/ARB): A Comment' (2005) 4 *World Trade Review* 101, 106.

c. Justification of the 'Amount of Subsidy' Approach

In most arbitral proceedings on prohibited subsidies, the arbitrators have provided a calculation of countermeasures that corresponds to the amount of the subsidy. Observers use different terms for this approach. For instance, Shadikhodjaev in his book utilises the term 'violation value' approach, while Sebastian uses the term 'the amount of subsidy' approach, which is the opposite of the 'equality-of-harm' approach under Article 22 of the DSU.

The arbitrators have provided various justifications to support the approach that they employed. First, there was the non-existence of a reference to the concept of nullification or impairment in Articles 3 and 4 of the SCM Agreement, in contrast to Article 22.4 of the DSU.[144] Thus, the calculation of 'appropriate countermeasures' might not be based on the equivalent standard to the harm approach under the DSU. Such a calculation is possible as the arbitrators in *US—FSC (Article 22.6—US)* recalled that Articles 4.10 and 4.11 of the SCM Agreement are special and additional rules; and according to Article 1.3 of the DSU such special rules and procedures are to prevail over the rules and procedures under the DSU.[145]

Secondly, the arbitrators provided a comparison between Article 4.10 and Article 7.9 of the SCM Agreement. The arbitrators stated that the term 'appropriate countermeasures' under Article 4.10 for prohibited subsidies does not impose similar constraints to the term 'commensurate with the degree and nature of the adverse effects determined to exist' under Article 7.9 for actionable subsidies.[146] In other words, Article 7.9 provides a tighter restriction on calculation by imposing a requirement of proportionality between the countermeasures and the adverse effects of the subsidy.[147]

Thirdly, there is the justification under the concept of obligations *erga omnes* provided by the arbitrators in *US—FSC (Article 22.6—US)*. In this case, the arbitrators ruled that 'the prohibition on export subsidies is a *per se* obligation, not itself conditioned on a trade effects test'.[148] They argued that the emphasis is on the 'unlawful character of export subsidies' and 'the effect of upsetting the balance of rights and obligations between the parties', regardless of the 'actual trade effects'.[149] Furthermore, the arbitrators referred to the prohibition of export subsidies as an *erga omnes* obligation owed to each or every Member. Therefore, the arbitrators provided that[150] 'The United States had breached its obligation to the European Communities

[144] *Brazil—Aircraft (Article 22.6—Brazil)* (n 57) [3.46].
[145] *US—FSC (Article 22.6—US)* (n 86) [5.47].
[146] *Brazil—Aircraft (Article 22.6—Brazil)* (n 57) [3.49].
[147] Sebastian (n 62) 116; Shadikhodjaev (n 13) 103.
[148] *US—FSC (Article 22.6—US)* (n 86) [5.23].
[149] ibid [5.23].
[150] ibid [6.10].

in respect of all the money that it has expended, because such expenditure in breach … is the very essence of the wrongful act'.

In other words, the arbitrators took into account the harm to the entire membership (under the concept of obligation *erga omnes*) in calculating the level of appropriate countermeasures. The application of the concept of obligations *erga omnes* in this case is somewhat controversial. One of the issues is the insertion of general international law concepts into WTO dispute settlement.[151] In the DSB meeting, the United States addressed the arbitrator's declaration in paragraph 6.10 and noted 'the dubious quality legal analysis which, without foundation in the DSU, incorrectly and inappropriately purported to import into WTO jurisprudence the concept of *erga omnes*'.[152] Another issue is that the approach would not be proportional when there are multiple complainants seeking to take countermeasures. In *US—FSC (Article 22.6—US)*, the arbitrators were helped by the fact that the European Communities was the sole complainant. However the arbitrators realised that the consideration might be different in the case of multiple complainants.[153]

d. Commensurate Standard

Article 7.10 of the SCM Agreement provides that the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist. So far, there is only one dispute that has been brought to arbitral proceedings to determine the commensurate standard of countermeasures. In *US—Upland Cotton (Article 22.6 DSU and Article 7.10 SCM—US)*, the arbitrators examined the terms 'commensurate', 'the degree and nature' and 'the adverse effects determined to exist' separately. The arbitrators stated that commensurate does not require exact equality between the two elements being compared. It connotes a less precise degree of equivalence than exact numerical correspondence. However, it indicates a relationship of correspondence and proportionality between two elements, and this correspondence might be qualitative and quantitative.[154] The arbitrators' finding demonstrates that the 'commensurate' standard demands a higher degree

[151] In the DSB meeting, the United States challenged the insertion or application of the rules of international law outside the customary rules of interpretation into the WTO dispute settlement. It stated that 'Reliance on public international legal concepts outside of rules of interpretation was not permitted under either DSU provision, and the arbitrator had erred in importing this concept as a means to justify its award'. See DSB, *Minutes of Meeting—Held in the Centre William Rappard on 7 May 2003*, WT/DSB/M/149, 8 July 2003 [20].

[152] ibid.

[153] *US—FSC (Article 22.6—US)* (n 86) [6.27].

[154] *United States—Subsidies on Upland Cotton—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement ('US—Upland Cotton (Article 22.6 DSU and Article 7.10 SCM—US)')*, Decision by the Arbitrator (31 August 2009) WT/DS267/ARB/2, [4.39].

of correspondence than the 'appropriate' standard, but provides more flexibility in calculation than the 'equivalent' standard. Thus, the 'commensurate' standard stands somewhere between the 'appropriate' and 'equivalent' standard.

Furthermore the 'degree and nature' of adverse effects is needed in assessing the commensurateness of the proposed countermeasures.[155] The 'degree' of the adverse effect is a quantitative assessment, while the 'nature' is more a qualitative assessment. A qualitative assessment makes the countermeasures standard more flexible or less stringent than the 'equivalent' standard, which requires only quantitative assessment.[156] In the end, the arbitrators examined the term 'the adverse effects determined to exist' by referring to the specific 'adverse effects' within the meaning of Articles 5 and 6 of the SCM Agreement.[157]

III. RETALIATION IN REGIONAL TRADE AGREEMENTS

While this chapter focuses on retaliation in the multilateral trading system, looking at retaliation under RTAs that follow the WTO model can also add value to the overall discussion in this book. This book uses the term and definition 'RTAs' provided by the WTO, which defines them as reciprocal trade agreements between two or more partners, including free trade agreements and custom unions.[158] Additionally, since the analysis in this book is related to retaliation in the inter-state dispute settlement system, the evaluation of retaliation from the aspect of investor–state dispute settlement is excluded in this book.

The current trade negotiation round of the WTO is the Doha Development Agenda (DDA), which was launched in Doha, Qatar in November 2001. To date, the talks are still going on; there is no indication of when the round will be concluded.[159] The slow progress of the Doha Round has spawned a proliferation of bilateral and plurilateral free trade agreements (FTAs) around the world. The WTO RTA database currently lists 280 trade agreements in force.[160] A study conducted by Meltzer, for instance,

[155] ibid [4.47].
[156] Shadikhodjaev (n 13) 111.
[157] *US—Upland Cotton (Article 22.6 DSU and Article 7.10 SCM—US)* (n 154) [4.50].
[158] WTO, 'Regional Trade Agreements and Preferential Trade Arrangements', www.wto.org/english/tratop_e/region_e/rta_pta_e.htm.
[159] Then-WTO DG Pascal Lamy urged diplomats to 'change gears' in order to boost the round, because 'the credibility lies in the capacity to produce results, not statements'. See WTO, 'Lamy Reports to General Council on Doha Round and Urges Negotiators to "Change Gears"', News Items (Geneva, 25 July 2012) www.wto.org/english/news_e/news12_e/gc_rpt_25jul12_e.htm.
[160] WTO, 'Lists of All RTAs', http://rtais.wto.org/UI/PublicAllRTAList.aspx.

demonstrates that the United States had FTAs with only four countries in 2001, and in April 2011 it concluded FTAs with 17 countries.[161] It recently signed the Trans Pacific Partnership (TPP) Agreement with Pacific-rim countries and currently negotiating the Transatlantic Trade and Investment Partnership (TTIP) with the European Union. This phenomenon is not only experienced by the United States but also by other countries throughout the world. Bhagwati, in his article 'US Trade Policy: The Infatuation with Free Trade Agreements', refers to this phenomenon as a 'spaghetti bowl'.[162]

Porges classifies dispute settlement mechanisms in RTAs into three broad categories: RTAs with diplomatic dispute settlement, standing tribunals (judicial) and ad hoc arbitral panels (quasi-judicial).[163] According to Porges, RTAs with political/diplomatic dispute settlement rely on settlement by agreement; a failure to comply with an agreement resolving a dispute means the start of another negotiation.[164] The China and Hong Kong Closer Economic Partnership Agreement (CEPA) is an example for diplomatic dispute settlements.[165] Article 19.5 of the Mainland–Hong Kong CEPA, for instance, provides that 'two sides should resolve any problem arising from the interpretation or implementation of the "CEPA" through consultation in the spirit of friendship and cooperation'.[166] The ECJ, a court comprised of permanent judges, is an example of an RTA standing tribunal.[167] The ECJ, for example, recently ordered the annulment of a 2012 trade agreement between the European Union and Morocco since it includes the territory of Western Sahara.[168]

An ad hoc panel dispute settlement is the most prevalent model of dispute settlement in many recent RTAs.[169] It is similar to the WTO dispute settlement model. The North American Free Trade Agreement (NAFTA) chapter 20, the Association of Southeast Asian Nations (ASEAN) Enhanced

[161] J Meltzer, 'The Challenges to the World Trade Organization: It's All about Legitimacy' (2011) Global Economy and Development at Brookings Policy Paper 2011-04.

[162] J Bhagwati, 'Trade Policy: The Infatuation with Free Trade Agreements' in J Bhagwati and AO Krueger (eds), *The Dangerous Drift to Preferential Trade Agreements* (Washington DC, AEI Press, 1995).

[163] A Porges, 'Dispute Settlement' in J-P Chauffour and J-C Maur (eds), *Preferential Trade Agreement Policies for Development: A Handbook* (Washington DC, World Bank publications, 2011) 470.

[164] ibid 490.

[165] ibid 470.

[166] Mainland and Hong Kong Closer Economic Partnership, signed in Hong Kong on 29 June 2003, www.tid.gov.hk/english/cepa/files/main_e.pdf.

[167] Porges (n 163) 471.

[168] Case T-512/12 *Front Polisario v Council* [2015] http://curia.europa.eu/juris/document/document.jsf?text=&docid=172870&pageIndex=0&doclang=FR&mode=lst&dir=&occ=first&part=1&cid=164110.

[169] Porges (n 163) 473. According to Mavroidis, until 2012 two-thirds of RTAs notified to the WTO belonged to the category of quasi-judicial. See PC Mavroidis, 'Dispute Settlement in the WTO (Mind Over Matter)' (2015) EUI Working Paper RSCAS 2015/34, 21.

Dispute Settlement Mechanism, the Singapore–Australia FTA and the China–New Zealand FTA are examples of RTAs using the ad hoc panel model. These RTAs are but a few examples of many RTAs that indicate compliance with the tribunal's findings in the case of violation found to be the preferred outcome. Nearly all RTAs that follow the WTO model also provide temporary remedies for pending implementation such as compensation and suspension of concessions, available in the case of non-implementation.

Additionally, since 2001 the RTAs to which the United States is a party provide a third remedy where the defendant may agree to pay annual monetary assessment to the complainant, and in return the concessions will not be suspended.[170] This third remedy is discussed in the next chapter.

As regards suspension of concessions, many RTAs that follow the WTO model do not provide a body equivalent to the WTO DSB to authorise retaliation.[171] ASEAN, however, has the Senior Officials Meeting (SEOM), a body which has similar functions to the DSB. For example, the 2004 ASEAN Protocol on Enhanced Dispute Settlement Mechanism states that parties to a dispute may request an authorisation to retaliate from the SEOM.[172]

Generally, the retaliation stage can be taken upon the expiration of the time period allowed for negotiations with a view to reaching compensation. The complaining party may initiate the use of retaliation by notifying its intention[173] or in some instances directly requesting the original arbitral tribunal to determine the appropriate level of retaliation.[174] Donaldson and Lester note that nearly all RTAs provide the substantive rules regarding the level of retaliation; and while they might not be in the same language/terms, they normally require the 'equivalent' standard to the nullification or impairment caused by inconsistent measures.[175] For example, the China–New Zealand FTA refers to the phrase 'equivalent effect to'[176] and the Korea–Singapore FTA provides 'benefits of equivalent effect'.[177] Interestingly, the Singapore–Australia FTA does not explicitly employ the 'equivalent' standard but refers to 'appropriate level of any suspension of benefits'.[178]

While the number of RTAs has been growing sharply, this proliferation is not accompanied by increased utilisation of the RTAs dispute settlement

[170] AUSTA, Art 21.11; US–Chile FTA, Art 22.15; CAFTA–DR–US, Art 20.17; US–Singapore FTA, Art 20.8; and US–Morocco FTA, Art 20.11.

[171] V Donaldson and S Lester, 'Dispute Settlement' in S Lester and B Mercurio (eds), *Bilateral and Regional Trade Agreements: Commentary and Analysis* (New York, Cambridge University Press, 2009) 408.

[172] The 2004 Protocol on the Enhanced Dispute Settlement Mechanism, Art 16.2.

[173] China–New Zealand FTA, Art 198.1.

[174] Singapore–Australia FTA, Art 10.2.

[175] Donaldson and Lester (n 171) 409.

[176] China–New Zealand FTA, Art 198.2.

[177] Korea–Singapore FTA, Art 20.14.

[178] Singapore–Australia FTA, Art 10.2.

system. Compared with WTO dispute settlement, the state-to-state dispute settlement mechanism under RTAs appears to be used much less frequently. ASEAN, for example, has comprehensive rules and procedures governing dispute settlement, however the mechanism, such as the establishment of a panel, has never been tested in practice and it is unclear if ASEAN Members will have recourse to it in the future. Thus, it is not surprising that cases involving state-to-state retaliation in the RTAs are very rare.

There is a trade retaliation case between Mexico and the United States under Chapter 20 of NAFTA. By way of overview, NAFTA provides several dispute settlement mechanisms. Chapter 20 provides for a general dispute settlement mechanism applicable to all disputes. Chapter 19 establishes a system that offers an alternative judicial review to domestic courts' final determinations in anti-dumping and countervailing duty cases. Chapter 11 provides a settlement of investment disputes mechanism between a NAFTA party and an investor of another party. Chapters 11 and 19 are not a state-to-state system.

The US–Mexico cross-border trucking dispute is so far the only retaliation dispute under Chapter 20 of NAFTA. Under NAFTA, the United States and Mexico agreed to remove the restrictions on cross-border passenger and cargo services.[179] However, the United States suspended the implementation on the ground that Mexican trucks were unsafe for the US highways. Mexico brought a formal complaint under NAFTA in 1998 and the panel found the United States to be inconsistent with its NAFTA obligations in 2001.[180] In 2007 Mexico agreed with a joint demonstration programme as a step towards full NAFTA implementation, allowing limited Mexican truck firms to serve the US market.[181] But the truck pilot programme funding was stopped in 2009 by the Obama administration. As a result, Mexico, consistent with its NAFTA obligations, imposed retaliatory tariffs against the United States for the cancellation of the trucking pilot project in March 2009. The Mexican government targeted politically important products from US exports, ranging from agricultural goods to jewellry.[182]

In July 2011 Mexico and the United States signed an agreement allowing Mexican trucks to operate in the United States as a part of a pilot programme; in return, Mexico agreed to suspend its retaliatory measures.[183] In

[179] International Trade Administration, 'Foreign Retaliations' (25 August 2015) www.trade.gov/mas/ian/tradedisputes-enforcement/retaliations/tg_ian_002094.asp.

[180] *Cross-Border Trucking Services*, NAFTA Panel Report (6 February 2001) USA-MEX-98-2008-01.

[181] International Trade Administration (n 179).

[182] International Trade Administration, 'Mexico Retaliation List Summary' (2011) www.trade.gov/mas/ian/build/groups/public/@tg_ian/documents/webcontent/tg_ian_002692.pdf.

[183] US Department of Transportation, 'US–Mexico Agreement Will Lift Tariffs and Put Safety First', Briefing Room (6 July 2011) www.transportation.gov/briefing-room/united-states-and-mexico-announce-safe-secure-cross-border-trucking-program.

sum, retaliatory measures imposed by Mexican government were deemed effective to induce the United States to comply with its NAFTA obligations.

SUMMARY

This chapter elaborated on temporary remedies in the event of non-compliance in the WTO dispute settlement system. Since retaliation is the main topic in this book, the major part of this chapter was dedicated to discussing the concept of retaliation in the multilateral trading system. However, a discussion about compensation both in the GATT and WTO dispute settlement was also included in this chapter.

This chapter examined the basic features, nature and substantive rules of GATT/WTO retaliation. It carried out an assessment of three principles of retaliation and the method of calculation employed by the arbitrators in determining the level of retaliation. Since this chapter aims to provide a robust understanding of WTO retaliation in the DSU and SCM Agreement, the assessment of the rules of countermeasures provided in the SCM Agreement is significant and relevant. Finally, to provide a fuller picture, retaliation in several bilateral and regional RTAs was also evaluated in this chapter.

The next chapter examines the shortcomings of retaliation and associated problems. Due to these shortcomings and problems, retaliation has often been claimed harmful and ineffective by several observers and WTO Members.

3

Shortcomings of WTO Retaliation and Reform Proposals

> These and other practical problems [of retaliation] lead some to favor an overhaul of the WTO compliance system. But many proposals have various flaws also.[1]

OVERVIEW

RETALIATION IS A controversial feature of the WTO dispute settlement system. Retaliation, and in particular the threat of it, have successfully induced compliance in a number of cases. For example, the threat of retaliation by Canada in the *Australia—Salmon* dispute was likely to have influenced Australia to bring its measures into compliance by reaching a mutually agreed solution.[2] However, this 'inducing-compliance-effect' experience did not occur in other cases such as the *EC—Hormones* and *US—Gambling* disputes. Thus, there are some concerns regarding retaliation, which are as follows: (1) it takes a form of suspension of concession which is contrary to the spirit of trade liberalisation;[3] (2) it has failed to induce compliance;[4] (3) it is ineffective for, and harmful to, the respective

[1] JH Jackson, Sovereignty, the WTO, and Changing Fundamentals of International Law (Cambridge, Cambridge University Press, 2006) 198.

[2] Australian DFAT, 'Australia—Measure Affecting Importation of Salmon (WT/DS18)' http://dfat.gov.au/international-relations/international-organisations/wto/wto-dispute-settlement/pages/australia-measures-affecting-importation-of-salmon-wt-ds18.aspx.

[3] S Charnovitz, 'Should the Teeth be Pulled?: An Analysis of WTO Sanctions' in DLM Kennedy and JD Southwick (eds), *Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 622.

[4] BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 152–53; NJ Udombana, 'A Question of Justice: the WTO, Africa, and Countermeasures for Breaches of International Trade Obligations' (2005) 38 *John Marshall Law Review* 1153, 1187–88; GL Slater, 'The Suspension of Intellectual Property Obligations under TRIPS: A Proposal for Retaliating against Technology-Exporting Countries in the World Trade Organization' (2009) 97 *Georgetown Law Journal* 1365, 1371; LEFA Spadano, 'Cross-agreement Retaliation in the WTO Dispute Settlement System: An Important Enforcement Mechanism for Developing Countries?' (2008) 7 *World Trade Review* 511, 512.

countries, particularly small developing countries.[5] Due to its flaws, retaliation is often deemed to be an ineffective instrument for obtaining compliance. A number of reform proposals have been proposed by WTO Members and academics and the discussions are still taking place.

The first part of this chapter analyses the problems inherent in the WTO's retaliation scheme demonstrated in practice and from the academic viewpoint. In doing so, it looks at a considerable number of academic writings and retaliation disputes under Article 22.6 of the DSU, which elaborate on the shortcomings and problems encountered by the complainant and respondent states with regard to retaliation. The second part of this chapter discusses the suggested reform proposals to address the problems embedded in WTO retaliation.

I. THE SHORTCOMINGS AND PROBLEMS INHERENT IN WTO RETALIATION

As mentioned previously, the 'suspension of concessions' form of retaliation implies trade restrictions and seems to go against the basic trade liberalising principle of the WTO. One might question why the WTO, an international organisation with the aim of promoting trade liberalisation, provides trade restrictions as the remedy in its dispute settlement system. Trade concessions in the multilateral trading system are based on reciprocal exchange between Members. Consequently, if one breaks its promise, another Member is entitled to withdraw its promise too. Nonetheless, imposing a trade restriction with the intention to redress the injury suffered because of another trade restriction is just adding one problem to another problem. Retaliation measures are trade destructive; thus, by their very nature, they produce harm and have negative effects on the retaliating state.

The effectiveness of retaliation has been challenged since GATT dispute settlement. Dam writes that the scheme of retaliation (the withdrawal of concessions or other obligations) creates paradoxical consequences in

[5] B Mercurio, 'Improving Dispute Settlement in the World Trade Organization: The Dispute Settlement Understanding Review—Making It Work?' (2004) 38 *Journal of World Trade* 795, 840. Similarly, the arbitrators in the *US—Gambling* dispute stated that 'the thrust of the "effectiveness" criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance'. Put differently, if the impact of the suspension (cross-retaliation) is not strong and does not induce compliance, in the view of arbitrators, the suspension does not meet the 'effectiveness' criterion. See *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Gambling (Article 22.6—US)'), Decision by the Arbitrator (21 December 2007) WT/DS285/ARB* [4.84].

regard to one of the basic principles of GATT: the reciprocity principle.[6] The concept of reciprocity underlies the notion of exchanging the obligations of each government that is party to the agreement, which involves a balance of benefits and costs.[7] Dam points out that fortuitous protection can be provided by retaliation towards industries that do not deserve such protection, while the injured industries and domestic customers may not gain any benefit from the remedy.[8] Thus, Dam argues that Article XXIII gives a remedy without a right.[9] Hudec affirms Dam's view by stating that the balancing rationale for retaliation is a fiction in economic terms because the injured state does not gain anything by raising tariff barriers; instead its customers are afflicted by such barriers.[10]

The debate as to the shortcomings of retaliation continues under the WTO dispute settlement system. Bronckers and van den Broek write that the threat of retaliation has proven effective in placing pressure on a violator government to comply with its WTO obligations; however, in their view the WTO remedies system also suffers from several significant flaws.[11]

These problems or shortcomings will be discussed in more detail below.

A. 'Shooting [Oneself] in the Foot'

'Shooting [oneself] in the foot' is a phrase utilised by some observers in describing the self-defeating consequences of retaliation.[12] This phrase explains that by imposing retaliation, the retaliating state could hurt its own economy; this is because retaliation normally takes the form of increasing the tariff barriers (namely 100 per cent duties) on the violator state's products. For example the United States retaliated against the European Communities ban on hormone-treated beef in the form of a 100 per cent duty on certain European Communities products, ranging from Italian scarves, Dijon mustard to French Roquefort cheese.[13]

[6] KW Dam, *The GATT: Law and International Economic Organization* (Chicago, IL, University of Chicago Press, 1970) 357.

[7] RE Hudec, 'Broadening the Scope of Remedies in WTO Dispute Settlement' in F Weiss (ed), *Improving WTO Dispute Settlement Procedures: Issues and Lesson from the Practice of Other International Courts and Tribunals* (London, Cameron May, 2000) 387.

[8] Dam (n 6) 357.

[9] ibid 358.

[10] Hudec, 'Broadening the Scope of Remedies' (n 7) 388.

[11] M Bronckers and N van den Broek, 'Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement' (2005) 8 *Journal of International Economic Law* 101, 103.

[12] ibid 104; Spadano (n 4) 533; S Bermann, '*EC-Hormones* and the Case for an Express WTO Postretaliation Procedure' (2007) 107 *Columbia Law Review* 131, 148.

[13] J Pauwelyn, 'Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?' in CP Bown and J Pauwelyn (eds), *The Law, Economics and*

In today's globalised world, trade barriers and restrictions can distort the market and result in a loss of welfare for the consumers and industries of the retaliating state which are closely connected with the businesses in the respondent states.[14] Consumers in the retaliating state have to pay a higher price when the tariff on selected products is increased, and industries that need those imported products for their production process will face commercial difficulties.[15] In short, consumers and industries in the retaliating state who prefer cheaper products would face the risk of rising costs and reduced imports of immediate or capital goods.

The cost of retaliation also makes it counterproductive, particularly for developing and least-developed country Members. Similarly, they may have to eliminate their access to foreign products or make those products more expensive for their domestic customers. Alavi argues that it is difficult for African countries to retaliate against bigger trading states because such retaliatory measures would impede their trade and losses would exceed any possible gains.[16] The fear of 'shooting [oneself] in the foot', therefore, makes retaliation unappealing in the eyes of developing and least-developed countries.

B. Contrary to the Basic Principle of the WTO

Why does the WTO centralise its retaliation measures on the suspension of concessions or other obligations? Tietje suggests that the rationale can be derived from the notion of a concession based on a mercantilism view, and that the GATT was established on this mercantilism thought: exchanging concessions, such as market access, reciprocally.[17] Mercantilism always attempts to maximise exports and minimise imports. Accordingly, those exchanging concessions have been concerned with the exporters' interests, and retaliation reverses this exporter-oriented view by closing its market to another party that has failed to perform its obligation to open its market.[18] However, a retaliatory measure in the form of additional customs duties appears to be contrary to the basic principle of WTO trade liberalisation.

Politics of Retaliation in WTO Dispute Settlement (Cambridge, Cambridge University Press, 2010) 36.

[14] Jackson Sovereignty, the WTO (n 1) 198.

[15] McGivern (n 4) 153.

[16] A Alavi, 'African Countries and the WTO's Dispute Settlement Mechanism' (2007) 25 *Development Policy Review* 25, 34.

[17] C Tietje, 'The WTO Sanctions Regime and International Constitutional Political Economy: A Comment on the Case Against Reforming the WTO Sanctions Regime' (2008) 1 *University of Illinois Law Review* 383, 384–85.

[18] ibid 385.

WTO law is not only about exchanging concessions and is no longer merely concerned with the exporters' interests. Thus, many question the notion of 'protectionism against protectionism'.

The Report of the Meltzer Commission raised a similar concern, noting that 'retaliation is contrary to the spirit of the WTO'.[19] Pauwelyn highlights this paradox by stating that it is an irony that the world body preaching trade liberalisation depicts trade protectionism (retaliation) as offering some kind of benefit that could neutralise the effect of illegal trade restrictions.[20] As Charnovitz also put it, 'the World Health Organization does not authorize one party to spread viruses to another. The World Intellectual Property Organization does not fight piracy with piracy'.[21]

C. Imposing an Inappropriate Burden on Innocent Industries

Retaliation is perceived as unfair by affected private parties or industries of the responding state. These parties or industries are not involved at all in the trade dispute, yet will suffer and have to carry an inappropriate burden as a result of trade retaliation.[22] For example, retaliatory measures are imposed on a sector, say agriculture goods such as oranges, apples and pears that actually stand aloof from the sector involved in the dispute, say the steel industry. Bronckers and van den Broek point out that the objective of this scheme is to encourage innocent bystanders to put more pressure on their non-complying governments.[23]

Despite this objective, retaliation itself is perceived as an unfair remedy. First, it provides fortuitous protection to industries that do not deserve such protection while leaving industries that have suffered from illegal measures uncompensated. Secondly, it affects parties or industries that are not involved in the particular trade dispute or breach. Thirdly, it does nothing to industries in the responding country that benefit from the WTO-inconsistent measures.[24]

[19] International Financial Institution Advisory Commission, *The Report of the International Financial Institution Advisory Commission* (The Meltzer Commission) (Washington DC, March 2000) 108. The International Financial Institution Advisory Commission, chaired by Allan H Melzer, was a commission established by the US Senate to make recommendations on future US policies towards several international organisations, including the WTO. See also McGivern (n 4) 152.

[20] J Pauwelyn, 'Enforcement and Countermeasures in the WTO: Rules are Rules—Toward a More Collective Approach' (2000) 94 *American Journal of International Law* 335, 343.

[21] Charnovitz (n 3) 622.

[22] Bronckers and van den Broek (n 11) 103; R Malacrida, 'Toward Sounder and Fairer WTO Retaliation: Suggestions for Possible Additional Procedural Rules Governing Members' Preparation and Adoption of Retaliation Measures' (2008) 42 *Journal of World Trade* 3, 11.

[23] Bronckers and van den Broek (n 11) 102–03.

[24] JA Conti, *Between Law and Diplomacy: The Social Contexts of Disputing at the World Trade Organization* (Stanford, CA, Stanford University Press, 2011) 128.

D. Lack of Inducement Power for the Measures that Have Strong Domestic Political Support

This problem occurred, for instance, in the *US—Byrd Amendment* case. The Continued Dumping and Subsidy Offset Act of 2000 (CDSOA), also known as the Byrd Amendment, named after Senator Robert Byrd of West Virginia who sponsored it, was enacted as a part of the Agricultural, Rural Development, Food and Drug Administration, and Related Agencies Appropriation Act.[25] The CDSOA mandates the distribution of collected anti-dumping and countervailing duties to the US companies that brought and supported petitions for anti-dumping/countervailing investigations against foreign producers. The panel, in a decision which was upheld by the Appellate Body, found that the Byrd Amendment was inconsistent with the GATT, the Anti-Dumping Agreement and the SCM Agreement. Following the expiry of a reasonable period of time, the complainants proceeded to request authorisation for retaliation, even though eventually only the European Communities, Japan, Mexico and Canada imposed the retaliatory measures against the United States.

Although the Clinton administration requested that Congress revisit and repeal the CDSOA, Congress passed the legislation to neutralise actionable subsidies in order to preserve jobs that might otherwise be destroyed.[26] Thus, despite the controversy surrounding it, this legislation is popular in the US Senate and among domestic producers, especially the US steel industry, which has obtained benefits from it. It is unsurprising that it took many years for the United Stated to comply fully with the ruling.

The imposition of retaliatory measures by the retaliating states appeared to do little in inducing the United States to cease its inconsistent measures promptly. The US Congress passed the Deficit Reduction Act of 2005 which repealed the Byrd Amendment in February 2006. However, the Act allowed for a two-year transition. The complainant states denied the US claim about compliance and asserted that the transitional provisions in the Act still permit distribution of anti-dumping and countervailing duties collected on goods that are imported into the United States before 1 October 2007 to eligible US companies.[27]

[25] US Public Law 106-387, 19 CFR § 159.61 (2000) [US Public Law 106-387].

[26] S Hartmann-Tröger, 'Antidumping and Countervailing Duties: The Byrd Amendment' (2008) 11 *International Trade and Business Law Review* 287, 289.

[27] S Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* (The Hague, Kluwer Law International, 2009) 139.

Regardless of the sanctions imposed by the complaining Members and the fact that the US administration strongly urged that the Byrd Amendment be repealed, the strong support which the Byrd Amendment enjoyed in the Senate as well as the domestic support which it received from the companies which benefited from it, had made the repeal process difficult. Consequently, a long delay in the United States implementing the WTO ruling was inevitable.

E. Continued Sanctions

Another retaliation problem that occurs in practice is that parties to the dispute continue to disagree as to what constitutes compliance, and as a result retaliatory measures remain in place longer than necessary. This happened in the *EC—Hormones* case. The European Communities, by adopting a new directive, claimed that it had complied with the DSB recommendations and rulings, because the prohibition of certain hormones under the new directive was based on a comprehensive scientific assessment, which was required by the SPS Agreement.[28] However, the United States and Canada did not agree that the new directive was based on a scientific assessment and argued that it was still inconsistent with the European Communities obligations under the SPS Agreement. Therefore, both states insisted on maintaining their retaliatory measures.[29] The European Communities, infuriated with the continuance of the sanctions, initiated another dispute settlement proceeding against Canada and the United States, seeking their removal.[30]

The *EC—Hormones* case demonstrates post-retaliation problems, particularly the disagreement on whether implementation has occurred, and when retaliatory measures should be terminated. This implementation disagreement and continued sanctions definitely prolonged the dispute, and in the end might undermine the purpose of 'security and predictability' of the WTO dispute settlement system.[31]

[28] *European Communities—Measures concerning meat and meat products (Hormones)—Communication from the European Communities*, WT/DS26/22, WT/DS48/20, 28 October 2003.

[29] DSB, *Minutes of Meeting held on 7 November 2003*, WT/DSB/M/157, 18 December 2003, paras 30–31.

[30] *United States—Continued Suspension of Obligations in the EC—Hormones Dispute ('US—Continued Suspension'* (AB)), Appellate Body Report (adopted 14 November 2008) WT/DS320/AB/R; *Canada—Continued Suspension of Obligations in the EC—Hormones Dispute ('Canada—Continued Suspension'* (AB)), Appellate Body Report (adopted 14 November 2008) WT/DS321/AB/R.

[31] The DSU reform proposals also cover the 'post-retaliation' issue. The European Communities and Japan submitted a joint paper on a specific post-retaliation remedy.

F. Lack of Retaliating Capacity for Small Developing Countries and Least-Developed Countries

Power asymmetries exist in reality. A group of developing countries expressed this concern, stating that 'tremendous imbalance in the trade relations between developed and developing countries places severe constraints on the ability of developing countries to exercise their rights under Article 22 [rights of retaliation]'.[32]

Commentators have identified *power* constraints as one of the major factors that affect small developing countries' participation in WTO dispute settlement.[33] The term *power constraints* includes a lack of confidence by developing states in their ability to force developed countries to comply with rulings, the fear of losing development aid or preferential trade treatment, the lack of capacity to retaliate, and the fear of being retaliated against.[34] Power constraints derive from the asymmetries in political and economic capabilities between large developed states and small developing states. This asymmetry creates uncertainty for small developing and least-developed countries as to whether the responding developed country will comply with the DSB recommendations and rulings within a reasonable period of time, and whether they consider that they can retaliate against the recalcitrant developed state in the event of non-compliance. The fear of losing aid or preferential treatment may also constrain small developing and least-developed countries from initiating disputes against developed countries, since such aid or treatment is non-reciprocal and can be withdrawn at any time.[35] The United States was considering withdrawing the Generalised

[32] DSB Special Session, Negotiations on the Dispute Settlement Understanding—Special Differential Treatment for Developing Countries Proposals on DSU by Cuba, Honduras, India, Indonesia, Malaysia, Pakistan, Sri Lanka, Tanzania and Zimbabwe, TN/DS/W/19, 9 October 2002, 1.

[33] ibid; AT Guzman and BA Simmons, 'Power Plays and Capacity Constraints: The Selection of Defendants in World Trade Organization Disputes' (2005) 34 *Journal of Legal Studies*, 557; G Shaffer, 'The Challenges of WTO Law: Strategies for Developing Country Adaptation' (2006) 5 *World Trade Review* 177; H Nottage, 'Developing Countries in the WTO Dispute Settlement System' (2009) GEG Working Paper 2009/47, www.globaleconomicgovernance.org/geg-wp-200947-developing-countries-wto-dispute-settlement-system; V Mosoti, 'Africa in the First Decade of WTO Dispute Settlement' (2006) 9 *Journal of International Economic Law* 427, 429.

[34] M Shahin, 'WTO Dispute Settlement for a Middle-Income Developing Country: The Situation of Egypt' in GC Shaffer and R Meléndez-Ortiz (eds), *Dispute Settlement at the WTO: The Developing Country Experience* (New York, Cambridge University Press, 2010) 276.

[35] E Kessie and K Addo, 'African Countries and the WTO Negotiations on the Dispute Settlement Understanding' (International Centre for Trade and Sustainable Development, 2007) http://ictsd.org/downloads/2008/05/african-countries-and-the-wto-negotiations-on-the-dispute-settlement-understanding.pdf, 4.

System of Preferences (GSP)[36] benefits on products from Bangladesh in the wake of a garment factory fire that killed more than 100 people in November 2012.[37]

The issue of the ability of small developing countries to impose retaliatory measures emerged in *EC—Bananas III (Ecuador)* for the first time. The dispute stems from the European Communities banana regime, which provided for duty-free importing of bananas originating from the European Communities former colonies in Africa, the Caribbean and the Pacific (ACP) regions.[38] The WTO panel and Appellate Body concluded that the European Communities bananas regime was inconsistent with obligations under the GATT, GATS, and the Agreement on Import Licensing Procedures. The European Communities subsequently attempted to revise its regime;[39] however, both the United States and Ecuador claimed that the revised regulation continued to violate WTO obligations.

The United States directly requested the suspension of concessions under Article 22.2 of the DSU.[40] Ecuador requested a compliance panel under Article 21.5 of the DSU.[41] In the end, both the United States and Ecuador obtained authorisation to retaliate; in fact, only the United States enforced the retaliatory measures. Ecuador, considering the harm of retaliation under the same sector or agreement, requested and obtained authorisation to suspend TRIPS obligations (cross-retaliation).[42] Nevertheless Ecuador did not implement this authorised retaliatory measure. The arbitration panel itself provided a lengthy note on the political, practical and legal problems that can emerge with regard to the imposition of cross-retaliation.[43]

[36] The legal basis for GSP is found in the 'Decision on Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries' (often referred to as the Enabling Clause).

[37] Office of the United States Trade Representative, 'Possible Withdrawal, Suspension, or Limitation of Generalized System of Preferences Benefits: Bangladesh', www.ustr.gov/federal-register-notices/possible-withdrawal-suspension-or-limitation-generalized-system-preferences; SZ Al-Mahmood, 'US Mulls Ending Bangladesh Duty-Free Access' *The Wall Street Journal* (Dhaka, 21 January 2013) http://online.wsj.com/article/SB10001424127887324624404578254941577156834.html.

[38] Regulation 404/93 of 13 February 1993 on the common organisation of the market in bananas [1993] OJ L047.

[39] For example by introducing Regulation 1637/98 of 20 July 1998 amending Regulation 404/93 on the common organisation of the market in bananas [1998] OJ L210.

[40] *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Recourse by the United States to Article 22.2 of the DSU*, WT/DS27/43, 14 January 1999.

[41] *European Communities—Regime for the Importation, Sale and Distribution of Bananas (Recourse to Article 21.5 of the DSU by Ecuador) ('EC—Bananas III (Article 21.5—Ecuador II)')*, Panel Report (adopted 6 May 1999) WT/DS27/RW/ECU.

[42] The complainant may request an authorisation to retaliate under other sectors or agreements (cross-retaliation) if the complainant finds that retaliation in the same sector is impracticable or ineffective. Article 22.3 of the DSU provides the procedures and principles regarding cross-retaliation. The principles of cross-retaliation are explained in Chapter 2.

[43] *EC—Bananas III (Article 21.5—Ecuador II)* (n 41) [130]–[165].

Retaliation is considered to be counterproductive for small developing and least-developed country Members because it is by its nature trade destructive and it is hard for those countries to afford the cost of retaliation. Thus, for small developing-country and least-developed country Members, imposing retaliatory measures is often not the best option. Due to their small economies and amounts of trade, imposing retaliation under the same sectors also would not produce harm or a significant impact on the developed-country Members.[44] To increase their bargaining leverage, less economically powerful Members requested an authorisation for cross-retaliation. The authorisation to cross-retaliate has arisen in three disputes: *EC—Bananas III*, *US—Gambling* and *US—Upland Cotton*.

Antigua, for instance, requested an authorisation to cross-retaliate at first under GATS and the TRIPS Agreement; however, in the end, it limited its request to the TRIPS Agreement only. At the time of writing, Antigua had not yet imposed any retaliation against the United States. It has chosen to pursue a negotiated solution with the United States.[45] In contrast, in the *US—Upland Cotton* case, Brazil's threat to impose cross-retaliation under the TRIPS Agreement has successfully led to the temporary agreement between Brazil and the United States. Thus one may conclude that the credible threat of retaliatory measures depends on the economy, trade relations and the market size of the retaliating state as well as its substantial interest in intellectual property rights (IPRs).

II. PROPOSALS TO ENHANCE WTO RETALIATION AND THE CRITICISMS

To date, the DSB has authorised retaliation in 10 disputes.[46] Three among the nine are disputes in which retaliation under different sectors or agreements (cross-retaliation) has been requested and authorised.[47] Retaliatory measures have several problematic aspects which are evident in practice and the previous part of this chapter described these shortcomings. The harm caused by retaliation and its inability to induce compliance are, among other things, considered to be the major shortcomings of WTO retaliation.

[44] Antigua highlighted its small economic capacity and tourism-dependent economy, and because of that, the imposition of retaliation under the GATS would have 'a disproportionate adverse impact' on Antigua while it would have 'virtually no impact' on the United States. See *US—Gambling (Article 22.6—US)* (n 5) [4.87].

[45] See DSB, *Minutes of Meeting Held in the Centre William Rappard on 29 August 2014*, WT/DSB/M/349, 23 October 2014, para 6.3.

[46] *EC—Bananas III*, *EC—Hormones*, *Brazil—Aircraft*, *US—FSC*, *US—1916 Act*, *Canada—Aircraft Credits and Guarantees*, *US—Byrd Amendment*, *US—Gambling*, *US—Cotton and US—COOL*.

[47] *EC—Bananas III*, *US—Gambling* and *US—Upland Cotton*.

Some commentators offer options to enhance and improve WTO temporary remedies.

For instance, Bronckers and van den Broek, and Fukunaga suggest financial or monetary compensation as an option.[48] Fukunaga argues that one of the advantages of monetary compensation is that it allows for the provision of non-MFN compensation, since monetary compensation, unrelated to particular import or export transactions, neither distorts trade nor increases the transaction cost.[49] Other commentators, such as Rafiqul Islam and Udombana, suggest multilateral collaborative efforts. Through a collective process, weaker injured Members can have access to remedial justice; and the application itself is the last resort to bring international pressure on the recalcitrant Member to comply.[50] Choi proposes rotating retaliation combined with an increasing level of retaliation over time. This approach should be subject to the proportionality standard and should not have a punitive nature. Moreover, Choi also proposes such multilateral remedies as: (a) restricting a non-complying Member's voting rights; (b) obliging a non-complying party to pay legal costs incurred by the complaining party; and (c) requiring a non-complying party to make a financial contribution to certain neutral institutions such as the Advisory Centre on WTO Law (ACWL).[51]

Charnovitz proposes a 'transparency and sunshine' method. All of the DSU bodies should hold most of their sessions in public. Whenever a government fails to comply, the DSB should convene a public hearing where a government would be asked to explain its delays, and other governments and concerned private economic and social actors could respond.[52] Van den Broek also provides some additional ideas, such as changes in the methods for calculations of the level of suspension or compensation; regular review of compliance with the Secretariat's dispute settlement reports; specific suggestions for compliance with dispute settlement reports; and damages in the case of *mala fide* non-compliance at the end of the compliance period.[53]

[48] Bronckers and van den Broek (n 11); Y Fukunaga, 'Securing Compliance through the WTO Dispute Settlement System: Implementation of DSB Recommendations' (2006) 9 *Journal of International Economic Law* 383, 415.

[49] Fukunaga (n 48) 415.

[50] M Rafiqul Islam, 'Recent EU Trade Sanctions on the US to Induce Compliance with the WTO Ruling in the Foreign Sales Corporation Case: Its Policy Contradiction Revisited' (2004) 38 *Journal of World Trade* 471, 486–87; see also Udombana (n 4) 1198–99, the author suggests collective countermeasures through the African Union.

[51] W-M Choi, 'To Comply or Not to Comply?—Non-implementation Problems in the WTO Dispute Settlement System' (2007) 41 *Journal of World Trade* 1043, 1068.

[52] S Charnovitz, 'The WTO's Problematic "Last Resort" against Noncompliance' (2002) 57 *Aussenwirtschaft* 409, 431–32.

[53] N Van den Broek, 'Power Paradoxes in Enforcement and Implementation of World Trade Organization Dispute Settlement Reports: Interdisciplinary Approaches and New Proposals' (2003) 37 *Journal of World Trade* 127, 157–60.

Other scholars suggest enhancing cross-retaliation as a mechanism to induce compliance for a developing-country complainant Member.[54]

Several reform proposals have been made by WTO Members to improve the performance of retaliation. Their proposals, among others, include: collective retaliation,[55] increasing the capacity of trade compensation,[56] earlier determination of level of nullification or impairment,[57] introduction of the right to request or to take preventive measures in exceptional situations,[58] enhancing cross-retaliation,[59] and tradable retaliation.[60]

The following part explains several major proposals in more detail, including criticisms of these proposals.

A. Collective Retaliation

A number of observers support a collective retaliation proposal in light of the inability of smaller countries to engage effectively at the dispute settlement and enforcement level against bigger countries.[61] Basically, the idea of collective retaliation is to allow states which are not directly injured to impose retaliation collectively on a recalcitrant state in order to force it to cease its illegal measures. The proposal for collective retaliation was first submitted by developing states, Brazil and Uruguay, in 1965.[62] They argued that bilateral retaliation only works more effectively if it is used by

[54] Spadano (n 12) 531. See also A Subramanian and J Watal, 'Can TRIPS Serve as an Enforcement Device for Developing Countries in the WTO?' (2000) 3 *Journal of International Economic Law* 403.

[55] Mostly supported by least-developed countries and the Africa group.

[56] Ecuador (TN/DS/W/9), for example, realised the short period of time (20 days) in negotiating compensation, and therefore it proposed the possibility of negotiating compensation at all stages of the sequence in which compliance is at risk.

[57] Ecuador proposed to determine the level of nullification when determining the reasonable period of time under Article 21.3(a) or when it is mutually agreed by parties under Article 21.3. Mexico (TN/DS/W/40) went even further by proposing retroactive determination and application of nullification or impairment (date imposing the measure or the date of the request for consultation or the date of establishment of panel).

[58] Mexico proposed that such right be activated when, for example, the challenged measure is causing damage that would be difficult to repair.

[59] The proposal (TN/DS/W/47) is to ensure that cross-retaliation is the exception rather than the rule, so the developing-country complaining Member could cross-retaliate whenever it sees fit to do so.

[60] Mexico proposed that Members should be allowed to 'negotiate' the right to suspend or transfer the right to suspend to another Member.

[61] For instance, Udombana suggests collective countermeasures for African countries through the African Union. See Udombana (n 4) 1198–99.

[62] Ad Hoc Group on Legal Amendments to the General Agreement *Proposals for Amendments to the General Agreement—Note by the Secretariat*, COM.TD/F/W/1, 27 April 1965, 18. See also RE Hudec, 'The Adequacy of WTO Dispute Settlement Remedies: A Developing Countries Perspective' in BM Hoekman, A Mattoo and P English (eds), *Development, Trade, and the WTO: A Handbook* (Washington DC, World Bank Publications, 2002) 84.

developed countries.[63] During the WTO era, the African Group proposed collective retaliation against a developed country, notwithstanding the 'equivalent' requirement.[64] The Least Developed Countries (LDC) Group suggested collective retaliation be available automatically when developing or least-developed countries become a successful complainant, as a matter of special and differential treatment.[65]

In their proposal, the LDC Group proposed a solution to the lack of an effective enforcement of retaliatory measures by adopting a '"principle of collective responsibility" akin to its equivalent under the *United Nations Charter*'.[66] Shadikhodjaev states that the LDC Group appears to make reference to collective security and enforcement actions under Chapter VII of the UN Charter, which deals with the breaches of norms of *jus cogens* and that are not covered by the ILC Draft Articles.[67]

According to Article 53 of the VCLT, *jus cogens* is a norm that is accepted and recognised by the international community as a whole and as a norm from which no derogation is permitted and which can be modified by a subsequent norm having the same character. The norms of *jus cogens* give rise to obligations *erga omnes*.[68] The International Court in the *Barcelona Traction case* referred to the words 'the importance of the rights involved' in order to decide what constitutes a valid *erga omnes* obligation.[69] The obligations obtain or retain their status as *erga omnes* obligations depending on the importance of specific obligations and/or their non-reciprocal structure.[70] Put in different words, an obligation becomes valid *erga omnes* depending on the intrinsic value of the obligation itself.

In *US—FSC (Article 22.6—US)*, the arbitrators referred to the prohibition of export subsidies as an *erga omnes* obligation owed to each or every

[63] COM.TD/F/W/1 (n 62) 15; DP Steger, *Peace through Trade: Building the World Trade Organization* (London, Cameron May, 2004) 248.

[64] DSB Special Session, Negotiations on the Dispute Settlement Understanding—Proposal by African Group, TN/DS/W/15, 25 September 2002; and DSB Special Session, Text for the African Group Proposals on Dispute Settlement Understanding Negotiations—Communication from Kenya, TN/DS/W/42, 24 January 2003.

[65] DSB Special Session, *Negotiations on the Dispute Settlement Understanding—Proposal by the LDC Group*, TN/DS/W/17, 9 October 2002, para 15.

[66] ibid.

[67] Shadikhodjaev (n 27) 171.

[68] All norms of *jus cogens* are enforceable *erga omnes* but not all *erga omnes* obligations are *jus cogens*. See R Nieto-Navia, 'International Preemptory Norms (Jus Cogens) and International Humanitarian Law' in LC Vohrah, F Pocar, Y Featherstone, O Fourmy, C Graham, J Hocking and N Robson, *Man's Inhumanity to Man: Essays on International Law in Honour of Antonio Cassese* (The Hague, Kluwer Law International, 2003) 619.

[69] *Barcelona Traction, Light and Power Company Limited (Belgium v Spain) (Second Phase)* [1970] ICJ Rep 1970, 32, 33 [*Barcelona Traction case*].

[70] CJ Tams, *Enforcing Obligations Erga Omnes in International Law* (New York, Cambridge University Press, 2005) 125.

Member. Thus, the arbitrators provided that 'the United States had breached its obligation to the European Communities in respect of all the money that it has expended, because such expenditure in breach … is the very essence of the wrongful act'.[71] In other words, the arbitrators took into account the harm to the entire membership (under the concept of obligation *erga omnes*) in calculating the level of appropriate countermeasures.

The concept of obligation *erga omnes* applied by the arbitrators in *US—FSC (Article 22.6—US)* is somehow controversial. Howse and Neven argue that 'what the panel had in mind, most likely, was the concept of an *erga omnes partes* obligation'.[72] The terms *erga omnes* and *erga omnes partes*, although quite similar, indicate independent concepts. Obligations *erga omnes* are derived from general international law, whereas obligations *erga omnes partes* are derived from a multilateral treaty.[73] An *erga omnes partes* obligation is an obligation owed not only to each Member individually, but collectively to the entire membership.[74] Nonetheless, Howse and Neven also reject those obligations considered as *erga omnes partes*, by arguing that the primary interest at stake in dispute settlement is individual Members, notwithstanding the fact that there is community interest in compliance. Dispute settlement rulings are binding between parties to disputes, and not legally binding on the Members as a whole.[75]

So, on the premise that WTO obligations do not qualify as *jus cogens* and *erga omnes*, the collective retaliation proposal in the WTO may be at odds with general international law.

Moreover, although this proposal seems to add more power to developing and least-developed countries at the enforcement level, some observers express doubt that the proposal would be successful. Fukunaga, for instance, argues that this proposal is legally unsound and politically unrealistic because the nature of WTO obligations is reciprocal; so the participation of other non-party Members would induce disruption and increase tension rather than achieve implementation.[76] Malacrida also notes a number of

[71] *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement ('US—FSC (Article 22.6—US)')* Decision by the Arbitrator (30 August 2002) WT/DS108/ARB [6.10].

[72] R Howse and DJ Neven, 'United States—Tax Treatment for "Foreign Sales Corporations" Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS108/ARB): A Comment' (2005) 4 *World Trade Review* 101, 116.

[73] L-A Sicilianos, 'The Classification of Obligations and the Multilateral Dimension of the Relations of International Responsibility' (2002) 13 *European Journal of International Law* 1127, 1136.

[74] Howse and Neven (n 72).

[75] ibid 118.

[76] Fukunaga (n 48) 425. She suggests that it is possible for collective retaliation to be implemented when the obligation is owed to the international community as a whole or when it is established to protect the collective interest of the group of states.

difficulties in implementing collective retaliation, such as the problem a developing-country Member would face in convincing non-party Members to participate in collective action due to the high cost of retaliation.[77]

B. Transferrable Retaliatory Rights

During the negotiations of the DSU, Mexico proposed a concept that allows the right to suspend to be transferred to third parties.[78] According to Diego-Fernandez, there are two benefits of transferrable retaliatory rights. First, they create a market because they open up the possibility to auction the right to retaliate to the rest of the Members, and in exchange for its right to retaliate, the injured Member would receive compensation.[79] Secondly, they bring benefits in terms of inducing compliance; developing countries that are unable to utilise or impose retaliation might transfer the right to countries that are interested in exercising the right against the Member concerned.[80] Bagwell, Mavroidis and Staiger suggest a third potential benefit, namely that a small developing country can use the auction revenue to finance private legal support for WTO legal actions that it cannot otherwise afford to initiate.[81]

However, other observers raise the question of why a country would buy the right to retaliate due to the fact that retaliation itself is harmful or problematic. Yenkong states it is hard to imagine that a country would want to buy trouble; it would be like shooting oneself in the foot.[82] Malacrida suggests that the most probable reason for a Member to buy the right to retaliate is to provide temporary protection to its domestic interest groups against competition from the respondent state. However, since retaliation is only a temporary measure, the issue of lack of predictability emerges.[83]

[77] Malacrida (n 22) 22.

[78] DSB Special Session, *Amendment to the Understanding on Rules and Procedures Governing the Settlement of Disputes Proposed by Mexico*, TN/DS/W/40, 27 January 2003.

[79] M Diego-Fernández, 'Compensation and Retaliation: A Developing Country's Perspective' in GA Bermann and PC Mavroidis (eds), *WTO Law and Developing Countries* (New York, Cambridge University Press, 2007) 241.

[80] ibid.

[81] K Bagwell, PC Mavroidis and RW Staiger, 'The Case for Auctioning Countermeasures in the WTO' (2003) National Bureau of Economic Research Working Paper No 9920, 4 www.nber.org/papers/w9920.pdf.

[82] NH Yenkong, 'World Trade Organization Dispute Settlement Retaliatory Regime at the Tenth Anniversary of the Organization: Reshaping the "Last Resort" Against Non-Compliance' (2006) 40 *Journal of World Trade* 365, 380– 81.

[83] Malacrida (n 22) 23.

C. Financial/Monetary Compensation

The idea of having monetary or financial compensation as one of the dispute settlement remedies has emerged since the GATT dispute settlement system. In 1965, alongside the collective retaliation proposal, Brazil and Uruguay submitted the monetary compensation proposal.[84] According to Hudec, the reason behind this proposal was that developing countries perceived that illegal measures not only caused serious harm, but also hampered their development process, and thus the forward-looking remedies would not be sufficient to cover all the damage.[85] Therefore, developing countries claimed that they were entitled to be awarded retroactive monetary compensation that would be paid to the government economic development programme rather than to private interests.[86]

Numerous observers also suggest the application of financial or monetary compensation in the WTO dispute settlement remedies. Bronckers and van den Broek, for instance, strongly advocate several advantages of monetary compensation, such as the fact that it is not trade restrictive, it helps to redress the injury of the country and/or private interests, it does not put a disproportionate burden on innocent bystanders, and it is a better device to induce compliance.[87] Fukunaga also asserts as one of the advantages of financial compensation that it is permitted to be non-MFN compensation because its existence is not related to either import or export transactions or market access.[88] At the time of writing, there were two cases where a deal related to financial matters was agreed upon by the parties to the dispute. Those cases are *US—Copyright Act* and *US—Upland Cotton*.

Beyond the WTO, a number of FTAs, particularly those to which the United States is a party, provide monetary assessment as an additional remedy.[89] The violating party may agree to pay annual monetary assessment to the injured party, and if they cannot agree on the amount of the assessment, the amount should be set at a level equal to 50 per cent of the level of nullification or impairment determined by the arbitrator or the complaining

[84] GATT, *Proposal Submitted by the Brazilian and Uruguayan Delegations—Draft Decision on Article XXIII*, COM.TD/F/W/4, 11 October 1965 www.wto.org/gatt_docs/English/SULPDF/90560081.pdf; see also GATT, *Report of the Ad Hoc Group on Legal Amendments to the General Agreement*, COM.TD/F/4, 4 March 1966.

[85] Hudec (n 7) 383. However, the monetary compensation proposal was not adopted.

[86] ibid.

[87] Bronckers and van den Broek (n 11) 110–11.

[88] Fukunaga (n 48) 415.

[89] AUSTA, Art 21.11; US–Chile FTA, Art 22.15; CAFTA–DR–US FTA, Art 20.17; US–Singapore FTA, Art 20.8; and US–Morocco FTA, Art 20.11.

parties.[90] Monetary assessment is also offered in violations of certain rules, namely labour and environmental laws.[91]

Additionally, other tribunals such as International Court of Justice (ICJ/inter-state tribunal) and Investor–State dispute settlement of the NAFTA make available the payment of monetary damages as a final award.[92]

There is no specific provision for financial compensation in the DSU; however, there is also nothing in the DSU that precludes compensation from being pecuniary. Thus, monetary compensation to an injured party is possible as long as it does not lead to another violation of WTO law, or become another inconsistent measure that nullifies or impairs other states' benefit. The two cases (*US—Copyright Act* and *US—Upland Cotton*) where the United States provides a compensatory arrangement in the form of a financial settlement are an example in this regard. While both cases relate to a temporary settlement in a monetary form, the nature of the monetary arrangements in these cases is different. The lump-sum payment made by the United States 'to a fund to be set up by performing rights societies in the European Communities' in *US—Copyright Act* resembles financial compensation.[93] The payment was made to compensate the royalty loss suffered by the European Communities IPRs holders because of the application of section 110(5) of the US Copyright Act.[94] In contrast, the funds or payments scheme made by the United States in *US—Upland Cotton* may constitute subsidy. It is a direct transfer of funds from the US government to Brazilian cotton industries.[95] In this situation it seems that the United States is subsidising Brazil cotton farmers in order to allow itself to maintain its subsidy to the US domestic cotton farmers. Such a payment scheme could be challenged by other cotton-exporting Members.

Not all observers are strong supporters of financial compensation. Mercurio, for example, argues that financial compensation is unpersuasive because only rich and developed countries can afford it, while poor countries are left in a helpless position. He also claims that it does not redress the injury of the aggrieved industry and it allows the continuance of a non-complying measure.[96]

[90] For example, see US–Singapore FTA, Art 20.6.5.

[91] CAFTA–DR–US FTA, Art 20.17; US–Singapore FTA, Art 20.7.

[92] *Corfu Channel Case (United Kingdom of Great Britain and Northern Ireland v Albania)*, Judgment of 15 December 1949: ICJ Reports 1949, 244; NAFTA, Art 1135.

[93] *United States—Section 110(5) of the US Copyright Act—Notification of a Mutually Satisfactory Temporary Arrangement*, WT/DS160/23, 26 June 2003.

[94] B Mercurio, 'Retaliatory Trade Measures in the WTO Dispute Settlement Understanding: Are There Really Alternatives?' in JC Hartigan (ed), *Trade Disputes and the Dispute Settlement Understanding of the WTO: An Interdisciplinary Assessment* (Bradford, Emerald, 2009) 397, 414–15.

[95] R Schnepf, 'Brazil's WTO Case against the US Cotton Program' (2011) Congressional Research Service 7-5700 RL32571, 28, www.fas.org/sgp/crs/row/RL32571.pdf.

[96] B Mercurio, 'Why Compensation Cannot Replace Trade Retaliation in the WTO Dispute Settlement' (2009) 8 *World Trade Review* 315, 329–35.

D. Compulsory Compensation

Since imposing retaliation may cause harm to retaliating states' economy and trade, the LCD group proposed compulsory compensation to an injured state instead of authorising retaliation.[97] Trade compensation, by its nature, opens up the market. Thus, it would be beneficial for developing and least-developed countries if trade compensation were made mandatory prior to the option of using retaliation. Ecuador and Mexico also circulated proposals suggesting the inclusion of a temporary MFN waiver to developing countries in terms of compensation granted.[98]

Fukunaga demonstrates her disagreement with compulsory compensation by stating that it is not a realistic option because compensation always depends on voluntary payment by the respondent Member concerned.[99] According to Fukunaga, Members most likely find it difficult to obtain approval from domestic producers to reduce tariffs on certain sectors since affected domestic producers would likely oppose such tariff reduction.[100]

E. Automatic Application of Cross-Retaliation

Historically, the inclusion of 'cross-retaliation' provisions into the DSU was initiated by developed-country Members who felt that they would not be able to retaliate effectively in the case of non-compliance by developing-country Members in the IPRs area.[101] Developing countries requested the limitation on Article 22.3 to prevent the risk of cross-retaliation by developed countries in the enforcement of their IPRs and GATS obligations.[102]

However, it appears now that it is developing-country Members who find 'cross-retaliation' to be a useful instrument. Thus, a group of developing countries proposed that in the case of a developing-country Member being the complainant against a developed-country Member, the developing-country Member should be permitted to seek retaliation in the sector of its choice (any or all sectors).[103] Mexico, for example, proposed the elimination

[97] TN/DS/W/17 (n 65) para 13.

[98] DSB Special Session, *Contribution of Ecuador to the Improvement of the Dispute Settlement Understanding of the WTO—Communication from Ecuador, TN/DS/W/9*, 8 July 2002; DSB Special Session, *Negotiations on Improvement and Clarifications of the Dispute Settlement Understanding—Proposal by Mexico*, TN/DS/W/23, 4 November 2002.

[99] Fukunaga (n 48) 412.

[100] ibid.

[101] TN/DS/W/19 (n 32).

[102] Mercurio (n 94) 428.

[103] TN/DS/W/19 (n 32); DSB Special Session, *Dispute Settlement Understanding Proposals: Legal Text—Communication from India on Behalf of Cuba, Dominican Republic, Egypt, Honduras, Jamaica and Malaysia*, TN/DS/W/47, 11 February 2003.

of Article 22.3 of the DSU so that a complainant party would not have to justify the impracticability of retaliating in the same sector or agreement.[104] Put differently, the Mexican proposal would make it possible for a complainant party to retaliate in any sector or under a different agreement automatically.[105] India also proposed that a cross-retaliation application should only be available to developing-country Members.[106]

Malacrida comments that the proposal put forward by developing-country Members in the DSU reform would minimise the cost of retaliation and make retaliation a more practical enforcement device for developing-country Members.[107] While direct application of cross-retaliation would streamline procedures and reduce the cost of retaliation, there are a number of negative aspects that need to be considered, according to Mercurio.[108] For example, he argues that in the case of retaliation in the TRIPS area, the real coercive threat would only be produced by economically significant Members, since any retaliatory measures taken against the responding Members would be limited to the territory of the complaining Member.[109] He also adds that a private business that wishes to take a potential gain from the suspension of IPRs faces the risk of uncertainty due to the temporary nature of retaliation.[110]

F. Retroactive Remedies

The WTO remedies under the current DSU are prospective in nature. In other words, the amount of retaliation does not cover the entire period the inconsistent measure has been applied. Even though there were a number of disputes, particularly the safeguard and anti-dumping disputes, in which panels have granted retroactive remedies, it is an uncommon practice in the WTO dispute settlement system.

Several Members, particularly developing countries and least-developed countries, support the inclusion of retroactive remedies in the dispute settlement system.[111] Mexico, for example, proposed that the level of nullification

[104] TN/DS/W/40 (n 78) 5.
[105] Mercurio (n 94) 427.
[106] TN/DS/W/47 (n 103).
[107] Malacrida (n 22) 20–21.
[108] Mercurio (n 94) 429–30. See also Subramanian and Watal (n 54); van den Broek (n 53) 154–55.
[109] ibid 429.
[110] ibid 430.
[111] DSB Special Session, *Text for LDC Proposal on Dispute Settlement Understanding Negotiations—Communication from Haiti*, TN/DS/W/37, 22 January 2003, VII; TN/DS/W/42 (n 64), VIII.

or impairment be calculated from the date of the imposition of the measure, or request for consultation, or establishment of panels.[112] Canada, in contrast, strongly opposed such a proposal on 'retroactive determination and application of nullification and impairment'.[113]

Observers have brought forward various arguments concerning retroactive remedies. Plasai suggests the introduction of an interim relief measure; this measure can be deemed to be a de facto retroactive remedy.[114] Plasai adds that even without interim relief, retroactive remedies are significant in restoring the complaining party to the situation that existed before the violation.[115] Grané, however, suggests that for the time being, WTO remedies should be prospective in nature. He argues that although retroactive remedies may more often provide incentive to comply, they may also encroach too much on the sovereignty of a state, and if a state feels the 'system has gone too far' and is no longer protecting their interests, a reason to opt out from the system is created.[116] Choi also notes that retroactive remedies tend to be punitive, thus they would undermine the objective of WTO dispute settlement.[117]

SUMMARY

Numerous studies have demonstrated the counterproductive features of retaliation. It poses the risk of increased protectionism. It imposes inappropriate burdens on innocent consumers and industries. Put differently, the studies have claimed that it would end up with the complaining country 'shooting itself in the foot'. The problems inherent in the retaliation system have been noted in practice. Retaliation has failed to induce compliance in a number of Article 22.6 cases. The system is also deemed unfair for small developing and least-developed countries. Small developing and least-developed countries lack the capacity to retaliate against larger and economically powerful countries. This deficiency is derived from the asymmetries in political and economic capabilities between large developed states and small developing states.

[112] TN/DS/W/40 (n 78) 5.

[113] DSB, Special Session, *Minutes of Meeting—Held in the Centre William Rappard on 13–15 November 2002*, TN/DS/M/6, 31 March 2003, 39.

[114] V Plasai, 'Compliance and Remedies against Non-Compliance under the WTO System: Towards a More Balanced Regime for All Members' (2007) International Centre for Trade and Sustainable Development, 20.

[115] ibid 20.

[116] P Grané, 'Remedies under WTO Law' (2001) *Journal of International Economic Law* 755, 769–70.

[117] Choi (n 51) 1064.

A range of reform proposals such as collective retaliation, transferable retaliatory rights, mandatory compensation, monetary compensation, automatic option to cross-retaliate and so forth have been put forward to reduce the high cost of retaliation and to enhance its capacity as an effective enforcement tool. However, these proposals are also not free from criticisms and disapproval. These reform proposals were discussed in the second part of this chapter.

The next chapter aims to evaluate the nexus between 'effectiveness' and 'purpose' and assess the importance of purpose-based analysis in assessing the effectiveness of retaliation.

4

Purposed-based Approach in Evaluating Effectiveness

> Determining whether a trade sanction is effective requires specification of its objectives.[1]

OVERVIEW

THE WTO ACKNOWLEDGES the importance of dispute settlement in the multilateral trading system, stating that without a means of settling disputes, the rules-based system would be less effective and meaningful since the rules could not be enforced.[2]

While most observers agree that WTO dispute settlement is a success, they view the work of retaliation as disappointing and claim that it is ineffective because it does little or nothing to induce compliance.[3] The effectiveness of retaliation is often associated with its ability to induce 'compliance'. It is frequently assumed that low levels of compliance indicate low level of effectiveness, and vice versa. This is not surprising since law and compliance are conceptually linked.[4]

[1] S Charnovitz, 'Rethinking WTO Trade Sanctions' (2001) 95 *American Journal of International Law* 792, 808.

[2] WTO, *Understanding the WTO*, 5th edn (Geneva, WTO Information and External Relations Division, 2015) 55.

[3] For example, BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 152–53; NJ Udombana, 'A Question of Justice: the WTO, Africa, and Countermeasures for Breaches of International Trade Obligations' (2005) 38 *John Marshall Law Review* 1153, 1187–88. Similarly, the arbitrators in the *US—Gambling* dispute stated that 'the thrust of the "effectiveness" criterion empowers the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance'. Put differently, if the impact of the suspension (cross-retaliation) is not strong and does not induce compliance, in arbitrators' view, the suspension does not meet the 'effectiveness' criterion. See *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse to Arbitration by the United States under Article 22.6 of the DSU* ('*US—Gambling (Article 22.6—US)*'), Decision by the Arbitrator (21 December 2007) WT/DS285/ARB [4.84].

[4] K Raustiala and A-M Slaughter, 'International Law, International Relations and Compliance' in W Carlnaes, T Risse and BA Simmons (eds), *Handbook of International Relations* (London, Sage Publications, 2002) 538.

The central point of this chapter lies in the question of effectiveness and the purpose(s) of retaliation. What does 'effective' mean? Does effective have a similar meaning to compliance? When can an instrument be considered an effective device? Answering these questions is the first task in this chapter. The second task concerns the question of what the purpose(s) of retaliation is. Identifying the purpose or purposes of retaliation is not a simple task. The second part of this chapter discusses the debates and uncertainty in relation to the purpose or purposes of WTO retaliation.

I. COMPLIANCE, IMPLEMENTATION, EFFECTIVENESS AND PURPOSE-BASED APPROACH

Why and when compliance occurs has long puzzled international relations and international legal theorists. They have not found the most satisfactory theory to answer why and when states comply with international law.[5] In contrast, the understanding of compliance is quite straightforward.[6] Compliance generally refers to a state of conformity between the subject's or actor's behaviour and stated requirements or commitments.[7] This common definition, according to Simmons, distinguishes compliance from implementation and effectiveness.[8]

People are sometimes confused by the terms compliance, implementation and effectiveness and it is therefore important to distinguish between these three terms at the outset.

A. The Distinction Between Implementation, Compliance and Effectiveness

According to the *Cambridge Advanced Learner's Dictionary*, 'effective' means 'successful or achieving the result that you want'. Likewise, the definition of effectiveness in the *Oxford English Dictionary* is 'successful in producing a desired and intended result'. Thus, according to dictionary

[5] AT Guzman, 'A Compliance-Based Theory of International Law' (2002) 90 *California Law Review* 1823, 1826.

[6] Kingsbury, however, offers a different perspective, stating that compliance is not a free-standing concept thus different theories lead to different concepts of what compliance is. See B Kingsbury, 'The Concept of Compliance as a Function of Competing Conceptions of International Law' (1998) 19 *Michigan Journal of International Law* 345, 346.

[7] OR Young, *Compliance and Public Authority: A Theory with International Applications* (Baltimore, MD, Johns Hopkins University Press, 1979) 4; K Raustiala, 'Compliance and Effectiveness in International Regulatory Cooperation' (2000) 32 *Case Western Reserve Journal of International Law* 387, 391.

[8] BA Simmons, 'Compliance with International Agreements' (1998) 1 *Annual Reviews of Political Science* 75, 77–78.

definitions, something is effective if it is adequate to accomplish its purpose or objective.

Effectiveness is germane to the implementation and compliance discussion. In his foreword to a symposium on 'implementation, compliance and effectiveness', Alvarez refers to the work of Jacobson and Brown-Weiss, which states that these three are related but distinct phenomena.[9] Jacobson and Brown-Weiss provide the definitions of the three. Implementation refers to a method or measures by which states transform international accords into acceptable rules within their domestic law. The authors explain that some accords are self-executing, but most accords need domestic legislation to become operative. Compliance goes beyond implementation. It refers to whether states abide by procedural and substantive international obligations, regardless of what their domestic legislation provides. Effectiveness is related, but not identical to compliance. It goes beyond implementation and compliance to determine whether an international norm achieves its policy objective.[10]

Let us discuss further the distinctions between 'effectiveness' and 'compliance'. It appears to be a common perception that a high level of compliance indicates the effectiveness of the rule, and vice versa. Put differently, people often assume that compliance can be equated with effectiveness. However, if we delve deeper, both concepts, though related, are distinct.

An international law and international relations scholar, Raustiala, provides a credible analysis relating to the complex relationship between them. He argues that a high level of compliance is not necessarily an indication of high effectiveness, and vice versa: both compliance and effectiveness must be distinguished from each other.[11] When the rule or standard matches with the current practice in a given state, compliance is automatic, but it does not mean that the rule or standard is effective. Raustiala employs speed limits as an example. He explains that people could easily comply with, for example, a 65-miles-per-hour speed limit, but if this speed limit did not reduce accidents, it cannot be claimed that it is effective. In contrast, although speed limits are very seldom complied with strictly, if it has sufficient influence on driving behaviour and reduces traffic accidents to a certain degree, it is an effective device.[12] Raustiala concludes that it is the 'effectiveness' that provides causal linkage between a legal rule and behaviour.[13] Compliance

[9] JE Alvarez, 'Foreword: Why Nations Behave' (1998) 19 *Michigan Journal of International Law* 303, 304.

[10] HK Jacobson and E Brown-Weiss, 'A Framework for Analysis' in E Brown-Weiss and HK Jacobson (eds), *Engaging Countries: Strengthening Compliance with International Environmental Accords* (Cambridge, MA, MIT Press, 2000) 1, 4–5. See also Alvarez (n 9).

[11] Raustiala (n 7) 388; PM Gerhart, 'Reflection: Beyond Compliance Theory—TRIPS as a Substantive Issue' (2000) 32 *Case Western Reserve Journal of International Law* 352, 363.

[12] Raustiala (n 7) 395–96.

[13] ibid 398.

is agnostic about causality; it merely identifies the conformity between the rule and the behaviour.[14]

B. A Purpose-based Approach to Effectiveness

According to several international relations and international law studies, there are a number of approaches or models of effectiveness, ranging from something similar to compliance, to problem-solving, to economic efficiency, to achieving its inherent policy objectives.[15] Shany, a leading expert in international law and organisational effectiveness studies, notes that among these approaches, the most dominant definition of effectiveness in the social science literature appears to be a 'goal-based' approach, which 'offers a rather straightforward formulation: "an action is effective if it accomplishes its specific objective aim"'.[16] As Mitchell put it: '[t]he question "is this regime effective?" is often simply a shorthand for "Did this regime accomplish certain goals?"'.[17] Thus, as suggested by Gerhart, it is necessary to specify the goal or goals the rule or standard is intending to achieve in order to assess its effectiveness.[18]

Sebastian expressed doubt that identifying the purpose would have a substantial implication in helping to resolve the issues faced by the arbitrators. He notes that the actual calculation method employed by the arbitrators does not rely on the purpose of retaliation, and that even identifying the purpose would not lighten the task of arbitrators as they would still encounter the practical difficulties of setting up the level of retaliation in accordance with the identified purpose.[19] For instance, if retaliation has the purpose of inducing compliance, the arbitrators need information about the magnitude of the retaliatory measures that would be sufficient to force violator

[14] Raustiala and Slaughter (n 4) 539.

[15] OR Young and MA Levy, 'The Effectiveness of International Environmental Regimes' in OR Young (ed), *The Effectiveness of International Environmental Regimes: Causal Connections and Behavioral Mechanisms* (Cambridge, MA, MIT Press, 1999) 1, 4–6; RB Mitchell, 'Institutional Aspects of Implementation, Compliance, and Effectiveness' in U Luterbacher and DF Sprinz (eds), *International Relations and Global Climate Change* (Cambridge, MA, MIT Press, 2001) 221.

[16] Y Shany, 'A Goal-Based Approach to Effectiveness Analysis' in Y Shany (ed), *Assessing The Effectiveness of International Courts* (Oxford, Oxford University Press, 2014) 13–14.

[17] Mitchell (n 15) 222. While admitting the 'purposed-based' approach is the most common definition of effectiveness, Mitchell prefers to adopt 'problem-solving' of effectiveness in assessing the issues.

[18] Gerhart (n 11) 373.

[19] T Sebastian, 'The Law of Permissible WTO Retaliation' in C Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (New York, Cambridge University Press, 2010) 124–25.

Members to comply, but this information is unattainable. Likewise, in order to rebalance, the arbitrators need information about particular bilateral exchanges of promises between the violator and the retaliating state, and this information is not available, simply because trade negotiations are not carried out in that type of bilateral bargain.[20]

While the doubt raised by Sebastian is reasonable, a different perspective is pursued in this book. First, identifying the purpose of WTO retaliation is not to evaluate the arbitral awards or to determine the level of retaliation.[21] Secondly, identifying the purpose is useful in assessing the degree of effectiveness of retaliation. Thirdly, being 'effective' does not necessarily mean being able to eliminate all underlying problems. Articles written by Young and Levy, Raustiala and Gerhart are helpful in elucidating the latter stand point. They note that the most common-sense notion of effectiveness—'solving the underlying problem'—presents a severe practical difficulty[22] because 'the factors that may influence the solution to a complex international problem are myriad, and in many cases disentangling them is impossible'.[23]

Two additional approaches, process-oriented and political approaches, are also referred to in this book. The similarity of these approaches is that both focus on changes in the behaviour of actors, actors' interests or policies and performance of institutions in a way to refine or further the purposes or goals attainment.[24] As Shany put it: 'the goal-based approach looks not only at organizational outcomes, but also at organizational process'.[25] Accordingly, effectiveness can be understood as the degree to which a rule induces changes in behaviour that further the goals or purposes of the rule.[26]

In sum, unless stated otherwise, the term 'effectiveness' in this book refers to the instrument's degree of success in attaining its purposes, taking into account the process and political circumstances that refine the instrument's purposes.

[20] ibid 125.

[21] As the arbitrators in *US—Upland Cotton (Article 22.6—US)* put it: '[t]he fact that countermeasures under Article 4.10 of the SCM Agreement serve to induce compliance does not in and of itself provide specific indications as to the level of countermeasures that may be permissible under this provision'. See *United States—Subsidies on Upland Cotton—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*US—Upland Cotton (Article 22.6—US)*'), Decision by the Arbitrator (31 August 2009) WT/DS267/ARB/1 [4.112].

[22] Raustiala (n 7) 393–94.

[23] ibid 394; Young and Levy (n 15) 4. Thus, Raustiala in his article employs a more 'modest' term of effectiveness: desired changes in behaviour.

[24] Shany (n 16) 16; Young and Levy (n 15) 5.

[25] ibid.

[26] Raustiala (n 7) 388; Gerhart (n 11) 363.

C. The Importance of Identifying the Purpose of Retaliation and the Uncertainty on the Purpose(s) of WTO Retaliation

Arbitrators in *US—Byrd Amendment* observed that the conceptual debate relating to retaliation could have been avoided if the object and purpose of WTO retaliation had been identified.[27] The arbitrators' statement highlights their awareness of the significance of identifying the purpose of retaliation. To have a better picture in this regard, let us look at a speed limit as an analogy, as provided by Raustiala and Gerhart. Gerhart, for instance, specifies that one would not know whether, for example, a 65-mile-per-hour speed limit was effective without knowing what its goal was. The answer would be different if the purpose of introducing this speed limit was to reduce speeding of 70 miles per hour, or for the purpose of reducing accidents or deaths, or to broaden the police's source of revenue.[28]

To recap, identifying the purpose of a rule or standard is significant and helpful in determining the effectiveness of the rule or standard.[29] Effectiveness is the degree to which a rule or standard achieves its policy objective. With this in mind, articulating the purpose of retaliation first is important so that effectiveness can be measured objectively.

So, what is the purpose of WTO retaliation? The DSU does not state explicitly the purpose(s) of retaliation.[30] Article 22 of the DSU, in particular, simply sets forth general principles and procedure that should be followed in order to perform retaliation.

The doubt over the purposes of retaliation has been reflected in practice. This is demonstrated by the changes of the US view and arbitrators' statement regarding the purpose of retaliation. The United States, at first in the *EC—Bananas III* dispute, strongly supported the purpose of inducing compliance by stating:

> The suspension of concessions under Article 22 was an essential element of an important objective of the DSU, namely compliance with the WTO rules. The arbitrators had recognised this and had agreed that the purpose of countermeasures was to induce compliance.[31]

However, afterwards in the *US—Byrd Amendment* dispute, the United States appeared to reverse its stand point by stating that '[t]he United States

[27] *United States—Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil—Recourse to Arbitration by the United States under Article 22.6 of the DSU* ('*US—Byrd Amendment (Article 22.6—US)*'), Decision by the Arbitrator (31 August 2004) WT/DS217/ARB/BRA [6.4].

[28] Gerhart (n 11) 373.

[29] Jacobson and Brown-Weiss (n 10) 4–5; Gerhart (n 11) 373.

[30] See *US—Byrd Amendment (Article 22.6—US)* (n 27) [6.2].

[31] DSB, *Minutes of Meeting—Held in the Centre William Rappard on 19 April 1999*, WT/DSB/M/59 (statement by the United States), 3 June 1999, 1–2.

also welcomed the Arbitrators' rejection of the argument that the "ultimate goal" of the suspension of concessions or other obligations was to "induce compliance"'.[32] The uncertainty also appears in arbitrators' statements. Though at first in *EC—Bananas III (US) (Article 22.6—EC)* they stated that the purpose of countermeasures is to induce compliance, in *US—Byrd Amendment (Article 22.6—US)*, they showed uncertainty regarding their previous position by giving these two statements. First, they were not persuaded that the object and purpose of the DSU would be exclusively to induce compliance, and second they stated that it is not completely clear what role is to be played by the suspension of obligations in the DSU.[33]

The problem of goal ambiguity, according to Shany, can be as a result of several circumstances such as the vagueness of treaty language, the abstract nature of goals and the plurality and hierarchy/priority of goals.[34] At the international law level, it is common for the treaty drafters sometimes to opt for constructive ambiguity due to political difficulties.[35]

The uncertainty on the purpose(s) of retaliation sparks debate among observers. As explained briefly in Chapter 1, there are at least four arguable purposes of WTO retaliation. These four purposes can be categorised into two major schools of thought: inducing compliance and rebalancing.

The battle between these schools of thought has a strong correlation with the previous debate between Judith Bello and John Jackson. In 1996 Bello wrote an article in the *American Journal of International Law*[36] which stated that

> [l]ike the GATT rules … the WTO rules are simply not 'binding' in the traditional sense … there is no prospect of incarceration, injunctive relief, damages for harm inflicted or police enforcement. The WTO has no jailhouse, no bail bondsmen, no blue helmets, no truncheons or tear gas. Rather, the WTO … relies upon voluntary compliance.[37]

She also suggested that compliance with the WTO remains optional; a Member has three choices when its measures are challenged. First, it may comply with the ruling. Second, it may maintain inconsistent measures but provide a compensatory benefit to restore the balance of negotiated concessions. Third, it may choose to maintain the inconsistent measure and suffer retaliation for the purpose of rebalancing. Thus, she concludes that the only

[32] DSB, *Minutes of Meeting—Held in the Centre William Rappard on 24–26 November 2004* (statement by the United States), WT/DSB/M/178, 17 January 2005, 73.
[33] *US—Byrd Amendment (Article 22.6—US)* (n 27) [3.73], [6.4].
[34] Shany (n 16) 20.
[35] ibid.
[36] J Bello, 'The WTO Dispute Settlement Understanding: Less is More' (1996) 90 *American Journal of International Law* 416.
[37] ibid 416–17.

truly binding WTO obligation is to maintain the balance of concessions negotiated among Members.[38]

Jackson subsequently inserted a rebuttal in the same journal and argued that

> an adopted dispute settlement report establishes an international law obligation upon the member in question to change its practice to make it consistent with the rules of the WTO Agreement and its annexes … Thus, the DSU clearly establishes a preference for an obligation to perform … Certainly they [WTO rules] are binding in the traditional *international law* sense. (emphasis added)[39]

Even though many legal scholars and commentators support Jackson's view on compliance,[40] others, particularly economists, seem to disagree with a purpose of strict compliance and support Bello's arguments on a purpose of rebalancing.[41]

The next part discusses the debates and arguments presented by these two schools of thought in more detail.

II. DEBATES REGARDING THE PURPOSE OF RETALIATION

The study of international trade has engaged the purpose of retaliation extensively. Most writings, however, promote a single purpose of retaliation: either inducing compliance or rebalancing. Many scholars of international trade approach this issue from a law and economics stand point. For example, Jackson, a leading expert in international law and international trade law, is a strong proponent of the purpose of inducing compliance, while Sykes, a leading expert on the application of economics to legal problems, advocates the purpose of rebalancing.

[38] ibid 418.

[39] JH Jackson, 'The WTO Dispute Settlement Understanding—Misunderstandings on the Nature of Legal Obligations (responding to Bello's article)' (1997) 91 *American Journal of International Law* 60, 63.

[40] For example, Mitchell states that the suspension of concessions is indeed to induce compliance. See AD Mitchell, 'Proportionality and Remedies in WTO Disputes' (2006) 17 *European Journal of International Law* 985, 999; S Charnovitz, 'Should the Teeth be Pulled?: An Analysis of WTO Sanctions' in DLM Kennedy and JD Southwick (eds), *Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 603; J Pauwelyn, 'Enforcement and Countermeasures in the WTO: Rules are Rules—Toward a More Collective Approach' (2000) 94 *American Journal of International Law* 335, 343.

[41] RZ Lawrence, *Crimes and Punishments? Retaliation under the WTO* (Washington DC, Institute for International Economics, 2003) 47; WF Schwartz and AO Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization' (2002) 31 *Journal of Legal Studies* S179; K Bagwell, 'Remedies in the WTO: An Economic Perspective' (2007) Columbia University Department of Economics Discussion Paper No 0607-09, 7–11.

This part assesses two major schools of thought about WTO retaliation purpose, first, inducing compliance and second, rebalancing.

A. The Purpose of Retaliation: Inducing Compliance vs Rebalancing

Jackson and Sykes have different opinions as to whether WTO Members are legally obligated to bring their measure into conformity with the recommendations made by WTO panels or the Appellate Body, or whether they have an option to remain in violation and pay 'damages'. Jackson argues that the DSU text clearly establishes a preference for the obligation to perform, and thus such an opting-out solution is not supported by the text of the DSU. He also disagrees that rebalancing and the efficient breach policy are central to, or even operative in, the normal dispute settlement process. Thus, he strongly disagrees with the view of some commentators that retaliation is intended as a tool to 'buy out' of obligations.[42]

In contrast, Sykes refers to the WTO Agreement as an incomplete contract in economic parlance, because of the difficulties of anticipating all future contingencies and the complexity of relations between the Members. Therefore efficient breach is possible and the damages option facilitates it. Sykes does not dispute that there is a 'preference' for compliance implicitly stated in the system, but he argues that 'its existence by no means excludes the possibility that Members have the legal right to opt for paying damages'.[43]

Below, the main points of arguments from each camp are discussed.

i. Inducing Compliance

Not only have the arbitrators in numerous Article 22.2 arbitral proceedings recognised inducing compliance to be the purpose of WTO retaliation, but many observers also support this proposition in their writings. While the arbitrators in their rulings never explain in detail the reason why they selected inducing compliance,[44] the observers provide the arguments as to

[42] JH Jackson, 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"' (2004) 98 *American Journal of International Law* 109, 115–22.

[43] AO Sykes, 'The Remedy for Breach of Obligations under the WTO Dispute Settlement Understanding: Damages or Specific Performance?' in M Bronckers and R Quick (eds), *New Directions in International Economic Law: Essays in Honour of John H. Jackson* (The Hague, Kluwer Law International, 2000) 347, 350.

[44] The arbitrators referred to the US argument that the temporary nature of retaliation demonstrates that the purpose of retaliation is inducing compliance, see *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* ('*EC—Bananas III (US) (Article 22.6—EC)*'), Decision by the Arbitrators (9 April 1999) WT/DS27/ARB [6.3].

why inducing compliance should be the purpose of WTO retaliation. The general arguments presented by the proponents of the purpose of inducing compliance are as follows.

a. It Is in Line With the DSU Textual Context and WTO Rules as International Law Obligations

Jackson was the first leading expert who provided an analysis on this matter. In his rebuttal of Bello's argument, he identifies several clauses of the DSU that demonstrate the preference for an obligation to perform the recommendation.[45] Arguably, among others, the legal clauses that are deemed to indicate a strong preference for inducing compliance are: securing the withdrawal under Article 3.7, bringing the measure into conformity and promptly complying with the recommendation or ruling under Article 19.1, and the temporary nature of compensation or suspension of concession under Article 22.8 of the DSU.[46] Jackson's arguments are cited and supported subsequently by other international trade law scholars.[47]

Furthermore, proponents of a purpose of inducing compliance view WTO rules as binding international legal obligations. Therefore, they believe that when the DSB finds a breach of WTO rules, the Member in question should be deemed to be breaching its obligations under international law, and accordingly should be required to bring its inconsistent measure into compliance.[48]

b. The 'Equivalent' Requirement Does Not Mean that Retaliation Cannot Induce Compliance

The 'equivalent to the level of nullification or impairment' requirement is often considered to be contrary to the purpose of inducing compliance because the equivalence requirement seems to make the effect of retaliation more compensatory or rebalancing, rather than giving retaliation the effect of inducing compliance. Therefore, rebalancing proponents often employ the 'equivalent' requirement as the key counter-argument to the 'inducing compliance' proponents.

[45] Jackson (n 39) 63.
[46] ibid.
[47] S Cho, 'The Nature of Remedies in International Trade Law' (2004) 65 *University of Pittsburgh Law Review* 763, 770; BP McGivern, 'Seeking Compliance with WTO Rulings: Theory, Practice and Alternative' (2002) 36 *The International Lawyer* 141, 144; S Charnovitz, 'The WTO's Problematic "Last Resort" against Noncompliance' (2002) 57 *Aussenwirtschaft* 409, 423.
[48] Jackson (n 39) 60; Pauwelyn (n 40) 341.

Spamann, however, argues that due to the method of calculation employed by the arbitrators, there is no 'equivalence' or 'rebalancing' in the level of suspension and nullification.[49] By using an economic approach, Spamann notes that the arbitrators were comparing incommensurate values (lost trade and affected trade) in their level-of-nullification or impairment calculations.[50] The loss of trade is often less than affected trade; consequently, the level of suspension reached by the arbitrators is lower than the level of nullification or impairment suffered by the injured state.[51]

Retaliation itself is destructive to trade and contrary to the principle of liberalising trade, therefore a limitation needs to be set on it. This does not mean that the limitation would necessarily undermine the purpose of inducing compliance. Pauwelyn argues that even though an equivalent suspension does not seem strong enough to induce compliance, this formal remedy is actually backed up by informal remedies such as the cost to a state's reputation. The formal cost of suspension combined with informal remedies explains the high compliance rate in WTO dispute settlement.[52]

c. Complainant Demanding Compliance Not Rebalancing

From a complainant state's point of view, the paramount purpose for entering into dispute settlement is to ensure the withdrawal of the inconsistent measure. This aim can be seen from the strategy of complainants when they impose the sanction of retaliation. Shaffer and Ganin, after assessing the implementation of retaliatory measures in *EC—Bananas III*, *EC—Hormones* and *US—FSC*, conclude that the complainant governments, in imposing retaliatory measures, 'selectively targeted politically-significant exporters in the non-complying Member with little or no regard to reciprocal rebalancing in terms of the affected sectors'.[53] Shaffer and Ganin argue that this selective retaliation on highly political sectors or products is obviously aimed at putting maximum pressure on scofflaw governments to comply with rulings.[54]

[49] H Spamann, 'The Myth of "Rebalancing" Retaliation in WTO Dispute Settlement Practice' (2006) 9 *Journal of International Economic Law* 31.

[50] ibid 45–47.

[51] ibid 46.

[52] J Pauwelyn, 'Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge, Cambridge University Press, 2010) 10–11.

[53] G Shaffer and D Ganin, 'Extrapolating Purpose from Practice: Rebalancing or Inducing Compliance' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (New York, Cambridge University Press, 2010) 81.

[54] ibid 82. However, the complainants also tried to select the sectors or products that have minimum impact or harm to complainants' domestic constituencies.

ii. Rebalancing

Bello was the pioneer of this school of thought. She argues that a state is not required to comply with a WTO ruling but instead that the only binding WTO obligation is to maintain a balance of concessions among Members. Therefore a Member can choose to comply, or pay compensation, or suffer retaliation in order to balance concessions.[55]

Although 'inducing compliance' proponents strongly oppose this purpose, a number of well-known experts in international economic law such as Sykes, Palmeter, Schwartz and Davey are strong proponents of the 'rebalancing' purpose. The general arguments provided by the 'rebalancing' proponents are as follows.

a. No Obligation to Comply With the Ruling

Bello argues that the WTO depends on voluntary compliance, or, in other words, nothing can force a Member to comply with a ruling. Members can deviate from their obligations as long as they are willing to pay compensation or suffer retaliation. Sykes, analysing the matter from an economic perspective, supports Bello's point of view and states that her view is analogous to 'the duty to perform or to pay damages' from the private contract law theory introduced by Oliver Wendell Holmes.[56]

Moreover, Sykes examines several clauses in the DSU that were argued by Jackson as being 'inducing compliance' clauses in a different way. For instance, he points out that the adjective 'usually' in Article 3.7 of the DSU implies that 'to secure the withdrawal' is not always the objective, so in his view this clause opens up the possibility of the application of other objectives.[57] Overall, Sykes argues that nothing in the DSU states that a Member which chooses compensation or retaliation rather than compliance is in violation of the WTO rules.[58]

b. Equivalent Level Requirement Favours Rebalancing Purpose

'Rebalancing' proponents employ the 'equivalent level' requirement under Article 22.4 of the DSU as their stand point. The logic for them is that if the aim of retaliation is inducing compliance, the WTO should not have 'equivalent to the harm done' as the ceiling level for the suspension. Therefore,

[55] Bello (n 36) 418.
[56] Sykes (n 43) 348; see also OW Holmes, 'The Path of the Law' (1897) 10 *Harvard Law Review* 457.
[57] ibid 349.
[58] ibid 349–50.

Palmeter and Alexandrov state that the purpose of inducing compliance is not consistent with the equivalence requirement.[59]

Moreover, Sykes argues that 'equivalent to the harm done' resembles the expectation remedy under private contract law, and by excluding more coercive sanctions, he argues that retaliation serves the duty of paying damages.[60] Palmeter argues in a similar way, stating that considering the various economies and power sizes of the Members, and the fact that the WTO encourages the Members to make more concessions, the purpose of rebalancing should be deemed to be the purpose of retaliation.[61]

c. 'Rebalancing' Purpose is Necessary to Secure Future Commitments

'Inducing compliance' proponents strongly criticise the notion that the 'rebalancing' purpose allows deviation as long as the violator is willing to pay the damages. However, 'rebalancing' proponents argue that this is significant in keeping the system running. Dam states that a system that does not allow any deviation (withdrawal) would tend to discourage the making of concessions in the first place.[62] This is why, from the perspective of 'rebalancing' proponents, the DSU introduced the 'equivalent' requirement so that retaliation would not become too coercive or punitive, and threaten the future commitments of the Members. Palmeter notes that punishing non-compliance severely will risk upsetting the balance that governments have already reached. He recalls Chayes' words: 'treaties with teeth are will-o'-the-wisp'.[63]

Sykes also points out that, even though compliance seems preferable, the system has carefully designed a non-compliance option coupled with a sanction similar to expectation damages.[64] This efficient adjustment will bring a benefit to Members that cannot perform because the cost of performance is too high, by providing them room to restore political balance through compensation or retaliation.[65]

[59] D Palmeter and S Alexandrov, '"Inducing Compliance" in WTO Dispute Settlement' in DLM Kennedy and JD Southwick (eds), *The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 651.

[60] Sykes (n 43) 351–52.

[61] D Palmeter, 'The WTO Dispute Settlement Mechanism: Compliance with WTO Rulings and Other Procedural Problems' (2001) 4 *Journal of World Intellectual Property* 291, 294.

[62] KW Dam, *The GATT: Law and International Economic Organization* (Chicago, IL, University of Chicago Press, 1970) 80.

[63] Palmeter (n 61) 294.

[64] Sykes (n 43) 357. See also Schwartz and Sykes (n 41) S181.

[65] Sykes (n 43) 356–57.

SUMMARY

What does 'effective' mean? Does effective have a similar meaning to compliance? Does retaliation aim solely at forcing the recalcitrant state to comply? These were a number of questions outlined in this chapter as the starting point. To better understand the concept of effectiveness, it has been argued in this chapter that 'effectiveness', 'compliance' and 'implementation', though related, are distinct. Effectiveness was referred to as the degree to which a rule or standard achieves its objective or purpose. Put differently, this book employs a purpose-based approach to effectiveness. This also means that to determine the effectiveness of retaliation, it is important first to identify the purposes of retaliation. The DSU, however, does not stipulate explicitly the purpose or purposes of WTO retaliation. Consequently, the uncertainty and debates regarding the purposes of retaliation emerged. Among many theories, there are two major schools of thought: 'inducing compliance' and 'rebalancing'.

5

Legal Quests in Searching for the Purposes of Retaliation

> In other words, it is not completely clear what role is to be played by the suspension of obligations in the DSU and a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear 'object and purpose' were identified.[1]

OVERVIEW

THE UNCERTAINTY ON the purpose of WTO retaliation, as elaborated on in the previous chapter, has sparked controversy. The purpose behind evoking countermeasures in public international law is, in contrast, more straightforward—that is to induce a wrongdoing state to comply with its obligations.[2]

The question is where the place of international legal order in WTO law is? One may view the WTO as a 'self-contained regime' because, as a global trade system, it consists of substantive, procedural and institutional rules. However, the 'self-contained regime' view has proved to be unpopular. In his speech addressed to the European Society of International Law, Lamy, the former Director-General of the WTO, highlighted the important relationship between WTO law and public international law. Lamy noted that international trade law is treaty based, and treaties are one of the sources of public international law.[3] He also pointed out that WTO law respects a number of public international law concepts such as the sovereign equality

[1] *United States—Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Byrd Amendment (Article 22.6—US)')*, Decision by the Arbitrator (31 August 2004) WT/DS217/ARB/BRA [6.4].

[2] ILC Draft Articles, Art 49.1.

[3] P Lamy, 'The Place and Role of the WTO (WTO Law) in the International Legal Order', Speech (The European Society of International Law, Paris, 19 May 2006) www.wto.org/english/news_e/sppl_e/sppl26_e.htm.

of states, good faith, international cooperation, settling disputes by peaceful means and the application of the customary rules of treaty interpretation.[4] Lamy cited the statement of Professor Abi-Saab, a former member of the Appellate Body, stating that 'in using general principles of public international law in its interpretation of the WTO provisions, the Appellate Body confirmed that the WTO is operating within the compound of international legal order'.[5]

The fact that the WTO law interacts and takes into account other rules of international law, means that WTO law is not a 'self-contained' regime either in the strict sense of existing outside international law, or in the broader sense of being a sub-system of international law that has blocked itself off from other branches of international law.[6] Pauwelyn also argues that 'states can "contract out" of one or more (other than *jus cogens*) rules of international law, but they cannot contract out of the system of international law'.[7]

It is not the purpose of this book to explore further the relationship between WTO law and public international law. The primary message of this introductory section is that we should not overlook the importance of the customary rules of treaty interpretation of public international law and other relevant norms of public international law in clarifying WTO provisions.

Thus, the quests to discover the purpose or purposes of WTO retaliation conducted in this chapter are namely through evaluating Article 22.6 arbitrators' references to remedies under public international law analysing WTO remedies rules in the perspective of law and economics, examining Article 22.6 arbitrators' statements regarding the purpose of retaliation and interpreting Article 22 of the DSU in accordance with the customary rules of treaty interpretation. Finally, this chapter concludes that multiple purposes coexist, including the purpose of inducing a mutually agreeable solution.

I. FIRST QUEST: REFERENCE TO REMEDIES UNDER THE ILC DRAFT ARTICLES ON STATE RESPONSIBILITY

The WTO takes into account public international law. This also means that absolute isolation of WTO law from public international law is unlikely.

[4] P Lamy, 'The Place of the WTO and its Law in the International Legal Order' (2007) 17 *European Journal of International Law* 969, 972.

[5] ibid 981.

[6] PFJ Macrory, AE Appleton and MG Plummer *The World Trade Organization: Legal, Economic and Political Analysis* (New York, Springer, 2005) 1409; J Pauwelyn, *Conflict of Norms in Public International Law: How WTO Law Relates to Other Rules of International Law* (New York, Cambridge University Press, 2003) 37.

[7] Pauwelyn (n 6).

WTO panels, for example, apply general principles of international law on burden of proof, rules on standing or representation before panels.

As regards the purpose of countermeasures, the arbitrators in *Brazil—Aircraft* referred to the ILC Draft Articles and stated that it is, inter alia, to induce compliance.[8] The question is whether the arbitrators' statement regarding the purpose, by referring to the term 'countermeasures' under the ILC Draft Articles, is reasonable. This section attempts to evaluate the arbitrators' reference to the purpose of countermeasures under public international law in determining the purpose of WTO retaliation. Accordingly, this section first elaborates on the remedies under the ILC Draft Articles. Second, it looks at the relationship between WTO remedies and remedies under the ILC Draft Articles and whether the arbitrators made an appropriate reference with regard to the purpose of countermeasures.

A. Remedies Under the ILC Draft Articles

The basic rules and general principles of international law in the field of state responsibility are codified by the ILC under the ILC Draft Articles. Under the ILC Draft Articles, every internationally wrongful act (action or omission) conducted by a state entails international responsibility. Besides the basic rules and principles, the ILC Draft Articles also regulate the legal consequences of an internationally wrongful act, generally known as remedies under international law. This section explains the remedies under the ILC Draft Articles and whether those remedies also exist in WTO law.

i. Cessation and Non-Repetition

Article 30 of the ILC Draft Articles provides that the foremost legal consequence of an internationally wrongful act is the cessation of the wrongful act and an assurance and guarantee of non-repetition. This means that the violator state must immediately terminate its illegal act, and that it is prospective in nature. Cessation aims to put an end to the violation of international law and to safeguard the validity and effectiveness of the primary rule.[9] The arbitration tribunal in *Rainbow Warrior* noted two conditional requirements for cessation to arise. First, the wrongful act must have a continuing character and secondly the obligation breached must still be in force at the time at which the order is issued.[10] The latter requirement is related

[8] *Brazil—Export Financing Programme for Aircraft—Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*Brazil—Aircraft (Article 22.6—Brazil)*'), Decision by the Arbitrators (28 August 2000) WT/DS46/ARB [3.44].

[9] ILC Draft Articles, commentary (5) Art 30.

[10] *Rainbow Warrior (New Zealand v France)* (1990) 20 RIAA 215, 113; See also ILC Draft Articles, commentary (3) Art 30.

to the law of treaties, for instance the legal consequence of the breach is the termination of the treaty because of its material breach.[11]

Cessation also exists in WTO remedies. It is referred to as 'the withdrawal' of the inconsistent measure in violation cases.[12] There is no obligation of withdrawal in cases of non-violation. The recommendation of withdrawal is only made in cases of violation. In most cases, the withdrawal has a prospective effect. Withdrawal may also apply to the application of the measure or regulation. For instance, the Appellate Body in *US—Shrimp* applied the 'application-oriented chapeau test' and noted that it is the application of the regulation that constitutes arbitrary or unjustifiable discrimination.[13]

Recommendation of non-repetition is an uncommon practice in WTO dispute settlement, but nothing in the DSU precludes the complainant party from seeking an assurance of non-repetition. The Philippines in the *Brazil—Coconut* dispute, for example, asked about assurance and non-repetition.[14] In *Norway—Trondheim*, due to the facts that the act of non-compliance had taken place in the past, the benefits accruing were in respect of the event (the opportunity to bid), and the toll ring system was already in place by the time the decision was issued, the panel believed that a guarantee of non-repetition from the respondent state would be significant for the complainant party.[15]

ii. Reparation

The second legal obligation or consequence of an internationally wrongful act is reparation to the injured party. The Permanent Court of International Law (PCIJ) in *Chorzów Factory* stated that 'reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed'.[16]

[11] S Shadikhodjaev and N Park, 'Cessation and Reparation in the GATT/WTO Legal System: A View from the Law of State Responsibility' (2007) 41 *Journal of World Trade* 1237, 1240.

[12] DSU, Art 19.1.

[13] *United States—Import Prohibition of Certain Shrimp and Shrimp Products* ('*US—Shrimp* (AB)'), Appellate Body Report (adopted 6 November 1998) WT/DS58/AB/R [115]; see also S Cho, 'The Nature of Remedies in International Trade Law' (2004) 65 *University of Pittsburgh Law Review* 763–774.

[14] *Brazil—Measures Affecting Desiccated Coconut*, Panel Report (adopted 20 March 1997) WT/DS22/R (1996) 101.

[15] *Norway—Procurement of Toll Collection Equipment for the City of Trondheim, GATT Panel Report (adopted 13 May 1992) GPR.DS2/R* [4.17], [4.22] and [4.24]; PC Mavroidis, 'Remedies in the WTO Legal System: Between a Rock and a Hard Place' (2000) 11 *European Journal of International Law* 763, 776.

[16] *Factory at Chorzów (Germany v Poland) (Indemnity)* [1928] PCIJ (Series A No 17) 47; see also the ILC Draft Articles, commentary (2) Art 31.

The ILC Draft Articles provide three forms of reparation: restitution, compensation and satisfaction; they are offered either singly or in combination.[17]

iii. Restitution

Restitution is the first form of reparation available to the injured state.[18] The ILC Draft Articles employ a narrow definition of restitution which states that it is intended to re-establish the status quo ante, the situation that existed prior to the occurrence of the wrongful act.[19] Therefore, restitution is a retroactive form of reparation.

There are very few cases in GATT and WTO dispute settlement where panels have provided the remedy of restitution.[20] As explained in a previous chapter, retroactive remedies are not common practice in GATT/WTO dispute settlement. Cho asserts that they are regarded as the exception rather than the rule because both GATT and WTO give priority to the withdrawal of inconsistent measures, which is prospective in nature.[21]

iv. Compensation

Together with restitution, compensation is one of the main forms of reparation. In the commentary of the ILC Draft Articles, the ILC noted that even though restitution is the primary form of reparation, it is often unavailable or inadequate. Therefore, compensation has a role in filling the gaps and ensuring full reparation for damage suffered.[22] In other words, compensation is feasible when restitution to the injured party is inadequate. It covers any financially assessable damage including the loss of profit; compensation is generally a pecuniary matter.[23]

The elements of the compensation provisions provided under the DSU are mainly tariff or trade compensation. Nonetheless, this does not mean that WTO dispute settlement precludes the application of financial compensation. *US—Copyright Act* and *US—Cotton* are two disputes where financial compensation was offered and agreed to. So, although WTO compensation in theory is not a pecuniary matter, in practice parties to the dispute may agree on some sort of monetary compensation as a temporary settlement.

[17] ILC Draft Articles, Art 34.
[18] ibid commentary (1) Art 35.
[19] ibid commentary (2) Art 35.
[20] See Chapter 2.
[21] Cho (n 13) 777.
[22] ILC Draft Articles, commentary (3) Art 36.
[23] ibid commentary (4) Art 36.

Moreover, the injured state or complainant cannot directly opt for a compensation remedy; it is non-compliance with the DSB recommendations that gives rise to the option of compensation. In contrast, the law of state responsibility provides that an injured state is entitled to compensation for a wrongful act of state for the damage caused. In the case of non-violation complaints, compensation 'may be part of a mutually satisfactory adjustment as final settlement of the dispute'.[24] In regard to violation cases, compensation is a temporary remedy. Other important elements of WTO compensation are that it is a 'voluntary offer', 'mutually acceptable' and 'consistent with the covered agreements', including the basic principle of the most favoured nation (MFN). All these elements distinguish WTO compensation from compensation under the law of state responsibility.

v. Satisfaction

Satisfaction is usually referred to as the additional form of reparation. This means that satisfaction may be required when the two other forms (restitution and compensation) do not provide full reparation.[25] Article 37.2 of the ILC Draft Articles states that satisfaction may be in the form of an 'acknowledgement of the breach, an expression of regret, a formal apology, or another appropriate modality'. In contrast to compensation, satisfaction is not capable of financial assessment.[26]

According to Shadikhodjaev, satisfaction in GATT/WTO dispute settlement can come in two forms: assurance of non-repetition and acknowledgement by a violator state.[27] Satisfaction is not regulated explicitly in the DSU; however, like assurance of non-repetition, nothing prohibits the complainant state from seeking satisfaction and nothing precludes the respondent or violator state from voluntarily acknowledging its violation action and providing satisfaction.

vi. Countermeasures

The ILC Draft Articles explain that the term 'countermeasures' is quite similar to the traditional term 'reprisals'. Both are a self-help response to a breach. However, while the term 'reprisals' has been limited to the action taken in international armed conflict, 'countermeasures' cover a type of reprisal outside the context of armed conflict.[28] The right to countermeasures

[24] DSU, Art 26.1(d).
[25] ILC Draft Articles, commentary (1) Art 37.
[26] ibid commentary (3) Art 37.
[27] S Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* (The Hague, Kluwer Law International, 2009) 26.
[28] ILC Draft Articles, chapter II countermeasures commentary (3).

emerges when the violator state refuses to negotiate and settle the dispute amicably.[29]

Article 51 of the ILC Draft Articles states that the 'countermeasures must be commensurate to the injury suffered, taking into account the gravity of the international wrongful act and the rights in question'. In short, they must be proportional to the damage suffered and to the gravity of the illegal act. The ILC Draft Articles also provide limitations on the objectives of countermeasures by stating that countermeasures are not intended to be a form of punishment but are supposed to induce compliance.[30]

Unlike the DSU, the SCM Agreement adopted the term 'countermeasures' for retaliation. Although both the DSU and the SCM Agreement have terminological differences, the arbitrators noted that the term 'countermeasures' in Article 4 of the SCM Agreement may include suspension of concessions or other obligations.[31] While the arbitrators in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* also recognised that 'there is no restriction on the types of countermeasure',[32] in practice the form of countermeasures in all Article 4.11 arbitration cases is the suspension of concessions or other obligations. Moreover, the ILC Draft Articles set up a proportional requirement, while Article 4.11 of the SCM Agreement requires appropriateness and the DSU has an equivalence requirement. By providing such standards, the WTO countermeasures are not meant to be punitive.

Countermeasures/retaliation in the WTO is a self-help instrument. It is, however, subject to surveillance and approval by the DSB. Therefore, it is not a unilateral reprisal. Neither the SCM Agreement nor the DSU states explicitly the objective of countermeasures/retaliation. Table 5.1 provides a general comparison between remedies under public international law and under WTO law.

B. Contracting Out of Remedies Under State Responsibility

To identify whether WTO law is contracting out of remedies under state responsibility, it is significant to look at the extent to which the WTO remedies can exclude the application of remedies under state responsibility. Put

[29] Mavroidis (n 15) 772.
[30] ILC Draft Articles, commentary (1) Art 49.
[31] *Brazil—Aircraft (Article 22.6—Brazil)* (n 8) [3.29].
[32] *Canada—Export Credits and Loan Guarantees for Regional Aircraft—Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)*') Decision by the Arbitrator (17 February 2003) WT/DS222/ARB, footnote 82.

Table 5.1: Comparison between remedies under public international law and WTO law

Remedies under public international law (the ILC Draft Articles)	**Remedies under the WTO (the DSU/SCM Agreement)**
1. Cessation of illegal act ✓ prospective 1.1. Assurance of non-repetition	1. The withdrawal of inconsistent measure ✓ prospective in nature 1.1. Not common practice but injured state may seek assurance of non-repetition
2. Reparation: • Restitution ✓ retroactive in nature • Compensation ✓ feasible when restitution is inadequate ✓ generally in monetary form • Satisfaction ✓ additional form of reparation ✓ acknowledgement of the breach, an expression of regret, a formal of apology and so forth ✓ not capable of financial assessment	2. Reparation/restitution remedy is not a common practice in the WTO. Only a few numbers of cases where panels recommended restitution. • Compensation ✓ cannot opt directly for compensation ✓ temporary in nature and prospective ✓ not a pecuniary concept ✓ voluntary offer in terms of additional trade concessions or market access • Satisfaction ✓ not stated explicitly in legal text but nothing in the DSU precludes the complainant state from requesting or seeking a satisfaction remedy ✓ can be in the form of assurance of non-repetition and acknowledgement by a violator state
3. Countermeasures ✓ emerge when the violator state refuses to negotiate and settle the dispute amicably ✓ proportional to the damage suffered and to the gravity of the illegal act ✓ not intended to be a form of punishment ✓ objective is to induce compliance	3. Countermeasures/Retaliation ✓ emerge when non-compliance is taking place ✓ appropriate/equivalent to level of nullification or impairment ✓ non-punitive sanction ✓ not stipulated explicitly in the legal text

differently, it must be determined whether WTO remedies are *lex specialis* in relation to the remedies under state responsibility.

The phrase *lex specialis* comes from the Latin maxim *lex specialis derogate lex generali*, which means that a specific rule prevails over a general rule. Article 55 of the ILC Draft Articles elaborates on the concept of *lex specialis* as follows:

> These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.[33]

In other words, the ILC Draft Articles provide that the specific rules of a treaty can modify the content or implementation or effects of the international rules of state responsibility, and that the specific rules will apply to the extent of this modification as provided by the specific rules. Consequently, where specific rules do not modify or deviate, general international law still applies.

Under Article 19.1 of the DSU, a panel or the Appellate Body, having found a violation, shall recommend the violator Member to bring the measure into conformity with the covered agreements. Accordingly, the DSU confirms the general international law of cessation as a WTO remedy. However, compensation and retaliation remedies available under Article 22 of the DSU are different in form and scope from those stipulated in the ILC Draft Articles.

Commentary (3) Article 55 of the ILC Draft Articles concerning *lex specialis* provides the DSU as a specific example of a rule that has contracted out of general international law in terms of remedies (compensation and countermeasures/retaliation). In the footnote, the ILC Draft Articles state that 'for WTO purposes, "compensation" refers to the future conduct, not past conduct, and involves a form of countermeasure'.[34] It also states that the WTO dispute settlement focuses on 'cessation rather than reparation'.[35]

WTO rules are *lex specialis* in several aspects of general international law on remedies such as the timing, multilateral surveillance and authorisation, nature and permissible level of countermeasures, and three levels of retaliation.[36] Thus, it can be concluded that WTO law has contracted out of remedies under general international law.

[33] ILC Draft Articles, Art 55.
[34] ILC Draft Articles, footnote 818.
[35] ibid footnote 431.
[36] Pauwelyn (n 6) 233; Shadikhodjaev (n 27) 45.

C. Reference to the ILC Draft Articles in Determining the Purpose of WTO Retaliation in *Brazil—Aircraft*: Sound or Unsound Approach?

In *Brazil—Aircraft (Article 22.6—Brazil)* the arbitrators pointed out that inducing compliance was the purpose of countermeasures.[37] There are two points to be considered regarding the arbitrators' statement in this regard. First, the arbitrators draw a parallel between the term 'countermeasures' used in the SCM Agreement and those employed in the work of the ILC on state responsibility. Secondly, they refer to the purpose of countermeasures in Article 47 of the Draft Articles in deciding that the purpose of countermeasures under the SCM Agreement is to induce compliance.

However, the arbitrators ignored an important fact in determining the purpose of countermeasures: WTO law has contracted out of the rules of international law in terms of remedies. By merely making reference to the ILC Draft Articles without further explanation as to why this was relevant, the arbitrators indirectly applied the concept of something that WTO law has contracted out of.

This is an unsound approach. The arbitrators made reference to the ILC Draft Articles merely because both the SCM Agreement and the ILC Draft Articles provide the same term 'countermeasures' but they did not consider whether both refer to the same concept. Moreover, after making reference to, and employing the purpose of, countermeasures under the ILC Draft Articles, the arbitrators ignored the benchmark of proportionality provided under public international law. The arbitrators decided that 'when dealing with a prohibited export subsidy, an amount of countermeasures which corresponds to the total amount of the subsidy is "appropriate"'.[38] The arbitrators provided that 'the total amount of subsidy' benchmark is set at this level in order to cause the countermeasures to have an inducing effect.[39] In contrast, Article 51 of the ILC Draft Articles provides the 'proportionality to the injury suffered' benchmark.[40] As a result, the arbitrators did not support their finding on the proper benchmark.

Article 51 states that a countermeasure is proportional when it is commensurate with the injury that is suffered. This is recognised in state practice and doctrine, and confirmed in the *Naulilaa* and *Air Service Agreement* arbitration cases.[41] Thus, as argued by Palmeter and Alexandrov, neither

[37] *Brazil—Aircraft (Article 22.6—Brazil)* (n 18) [3.44].

[38] ibid [3.60].

[39] ibid [3.58]. The arbitrators stated that the equivalent to the level-of-nullification requirement would limit the efficacy of countermeasures in the case of prohibited subsidies.

[40] Article 51 of the ILC Draft Articles states that 'countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and its harmful effects on the injured party'.

[41] ILC Draft Articles, Commentary Art 51.

general international law nor the ILC Draft Articles support the conclusion of the *Brazil—Aircraft* arbitrators when they relied only on the sole stated purpose of inducing compliance and ignored the proportionality principle by determining a level of countermeasure that is unrelated to the harm suffered.[42] Additionally, Green and Trebilcock assert that there is no necessary connection between the level of subsidy and the harm caused to other Members; the level of subsidy may be much lower than the harm or higher than the harm.[43]

So in short, why is this approach unsound? First, the arbitrators referred to and indirectly applied the purpose of countermeasures provided under the ILC Draft Articles on the ground that both the SCM Agreement and the ILC Draft Articles have the same term 'countermeasures' without considering the fact that WTO law has contracted out of the remedies under public international law. Secondly, after referring to the purpose of countermeasures in the ILC Draft Articles, they employed a different benchmark from the one provided therein. These two views do not mean to argue that inducing compliance is not the purpose of WTO retaliation. They are primarily intended to demonstrate the arbitrators' unsound reference in determining the purpose of inducing compliance in the *Brazil—Aircraft* dispute. The arbitrators in making reference to the purpose of remedies under public international law should have provided strong reasons why such reference is relevant given the fact that the WTO has contracted out of general international law on remedies.

II. SECOND QUEST: REFERENCE TO CONTRACT REMEDIES FROM LAW AND ECONOMICS PERSPECTIVE

The WTO is an organisation born out of negotiations and based upon an international contract among sovereign states and custom territories.[44] The Appellate Body in *Japan—Alcoholic Beverages* affirmed the 'contract' character of the WTO by stating that 'the WTO Agreement is a treaty—the international equivalent of a contract'.[45]

[42] D Palmeter and S Alexandrov, '"Inducing Compliance" in WTO Dispute Settlement' in DLM Kennedy and JD Southwick (eds), *The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec* (New York, Cambridge University Press, 2002) 658.

[43] A Green and M Trebilcock, 'Enforcing WTO Obligations: What Can We Learn from Export Subsidies?' (2007) 10 *Journal of International Economic Law* 653, 674–75.

[44] M Matshushita, TJ Schoenbaum, PC Mavroidis and M Hahn, *The World Trade Organization: Law, Practice, and Policy*, 3rd edn (New York, Oxford University Press, 2015) 47.

[45] *Japan—Taxes on Alcoholic Beverages* ('*Japan—Alcohol Beverages II* (AB)'), Appellate Body Report (adopted 1 November 1996) WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R [15].

One of the common features of WTO agreements and private contracts is that they establish rights and obligations of the parties. According to Schropp, it is in the contract design stage that the parties determine what their substantive goals are and how these goals are to be achieved in the most effective way.[46] Thus, conducting the search by looking at the WTO treaty design might be useful in articulating the goals of retaliation.

Many studies of remedies in international trade law refer to American contract law remedies as a comparative due to conceptual similarities.[47] In American contract remedies literature, many seminal studies on the relationship between remedial rules and economic efficiency were propounded in an article by Calabresi and Melamed concerning the rules for protecting legal entitlements.[48]

The discussion in this section first looks at the remedy rules model developed by Harvard professors Calabresi and Melamed—property and liability rules—in 1972.[49] Each of these rules has a different approach to the question of whether or not parties to an agreement can deviate from their obligations as long as they are willing to 'pay'.

A. Property or Liability Rules and Their Relevance in WTO Law

Although Calabresi and Melamed's protection rules model was developed in connection with domestic law,[50] various observers in the field of WTO law or international law have made reference to this framework in their discussions.[51] Pauwelyn asserts that one of the main attractions of this model is that it uses 'the law and economics criteria of welfare maximization and rational action'; and by making several assumptions, the model can

[46] SAB Schropp, *Trade Policy Flexibility and Enforcement in the WTO: A Law and Economics Analysis* (Cambridge, Cambridge University Press, 2009) 43.

[47] D Collins, 'Efficient Breach, Reliance and Contract Remedies at the WTO' (2009) 43 *Journal of World Trade* 225.

[48] E Yorio and S Thel, *Contract Enforcement: Specific Performance and Injunctions*, 2nd edn (New York, Wolters Kluwer, 2015) 22.

[49] G Calebresi and AD Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 *Harvard Law Review* 1089.

[50] However, in applying their analysis to remedies, Calabresi and Melamed refer to examples drawn from the law of crimes, tort or real property rather than breach of contract. See Yorio and Thel (n 48) 1–24.

[51] For instance, WF Schwartz and AO Sykes, 'The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization' (2002) 31 *Journal of Legal Studies* S179; JP Trachtman, 'The WTO Cathedral' (2007) 43 *Stanford Journal of International Law* 127, 149; J Pauwelyn, *Optimal Protection of International Law: Navigating between European Absolutism and American Voluntarism* (Cambridge, Cambridge University Press, 2008).

offer useful insights into international law.[52] Furthermore, Trachtman provides that an economic analysis of law, by focusing on incentives and consequences, is helpful in enhancing understanding of not only contract and tort, but also other areas of law.[53] Trachtman compares the WTO Agreement to a contract and Calabresi and Melamed's protection rules model is useful in understanding the incentives provided by remedies for breach of the contract and possible consequences.[54]

Calabresi and Melamed distinguish between property and liability rules for the entitlements protection. Under a property rule protection, the entitlement can be transferred but with the consent of the entitlement's holder. Meanwhile, under a liability rule protection, the entitlement can be taken without consent as long as compensation is provided to the entitlement's holder. The liability rule is often referred to as the theory of efficient breach.[55] However, it is important to note that the nomenclature of 'efficient breach' in this context is somewhat misleading. The term 'breach' suggests the violation or breach of rules (extra-treaty commitments/violation), but there is no breach here because it is permissible under the rule or the contract to deviate from the obligation if the taker is paying compensation (intra-treaty behaviour). Only if the taker fails to pay the compensation will the extra-contractual violation emerge.[56]

Property and liability rules will now be considered briefly.

i. Property Rules

The entitlement is protected by a property rule when no one can take the entitlement unless the holder sells it willingly/voluntarily. Put differently, the holder has an absolute right to his entitlement. Under property rules, parties are under a 'specific performance duty', that is a strict obligation to respect the initial commitment. A failure to perform or to respect the initial commitment is punished severely; he would never prefer violating his obligation. However, a taker can buy off the holder's entitlement through 'renegotiations'. The obligation to perform can be avoided by securing permission from the holder, usually by paying for it. Whenever the parties come to an agreement, the holder cedes his entitlement and sells it to the taker—the transfer is thus bilateral.[57]

[52] Several assumptions are as follows: the actor is state; the term of welfare maximisation is not limited on monetary welfare; the preference of states is assumed to be political welfare. See Pauwelyn (n 51) 27–30.

[53] Trachtman (n 51) 145.

[54] ibid.

[55] For instance Schwartz and Sykes (n 51) S180.

[56] Pauwelyn (n 51) 14.

[57] SAB Schropp, 'Revisiting the "Compliance -vs.- Rebalancing" Debate in WTO Scholarship: Towards a Unified Research Agenda' (2007) HEI Working Paper No 29, 28–29.

ii. Liability Rules

The holder of the entitlement that is protected by a liability rule cannot object to the action of the transfer of the entitlement but must receive payment of damages. In order to operate, liability rules require the availability of a court to determine the value of the damages.[58] There are three reasons to replace a property rule with a liability rule: (i) hold-outs; (ii) free-loaders or free-riders; and (iii) transaction costs.[59]

First, liability rules resolve a hold-out problem, that is where the sale of entitlements is efficient (the buyer values the entitlement higher than the seller), certain sellers or holders of the entitlement may refuse to sell at their 'normal' price in the hope of capturing more of the premium that the buyer is willing to pay. Calabresi and Melamed provide the example where the owners of land may hold out with the purpose of getting a higher price from the town authority wanting to build a park. Although the park is Pareto desirable (that is, the town's citizens value a park more than the land owners value their land), with enough hold-outs, the park will not be built. Under liability rules, the town can simply take the land and compensate its owners at an objectively determined value.[60]

Secondly, liability rules solve the free-rider problem, which occurs on the buyer side. For example, although the town's citizens may each value the land at a price that makes the sale Pareto desirable, some citizens may try to free-ride. That is, they may claim that the park has less value, although the true value is higher. For instance, they claim that the park is only worth $50 to them or even nothing at all, when in fact the real value of the park is $100. They would do so in the hope that other citizens will admit to a higher desire and buy the land with their money, even though, subsequently, everyone would benefit from the park. With enough free-riders unwilling to pay, the park may not materialise, even though it is Pareto desirable. As with the hold-out problem, liability protection may then offer a way out: 'if society can value collectively each individual citizen's desire to have a park and charge him a "benefits" tax based upon it, the freeloader problem is gone'. In other words, where the entitlement of citizens to their money is protected by liability rules, the town can simply take the citizens' money (that is, impose a tax) and compensate them with the creation of a park.[61]

[58] Trachtman (n 51) 147.
[59] Calabresi and Melamed (n 49) 1006–10.
[60] ibid 1106; Pauwelyn (n 51) 43.
[61] Calabresi and Melamed (n 49) 1107; Pauwelyn (n 51) 45.

Thirdly, liability rules can resolve the problem of high transaction costs. A transaction cost is a cost connected with a process of transaction, such as the cost of information gathering, cost of bargaining, post-contractual litigation, enforcement and so forth. Calabresi and Melamed note that

> perhaps the most common [reason], for employing a liability rule rather than a property rule to protect an entitlement is that market valuation of the entitlement is deemed inefficient, that is, it is either unavailable or too expensive compared to a collective valuation.[62]

Hence, instead of forcing risk takers to negotiate *ex ante* a deal with all potential victims (for example accidental injury), in domestic law, the risk taker can simply take the entitlement (cause an accident) but will have to compensate the victim.[63]

By referring to Calabresi and Melamed's protection rules model, the next part attempts to evaluate how WTO Members' rights and obligations are protected under WTO law. The protection rules model can be a useful reference in articulating the purpose of WTO retaliation.

For instance, if the WTO contractual commitments can only be taken or changed by renegotiation, Members have a duty to perform, consequently there is a stricter sanction in case of violation. Thus, the purpose of inducing compliance is the primary purpose of retaliation. In contrast, if they can be taken unilaterally as long as compensation is provided, then Members do not have a duty to perform but to compensate in case of violation. In short, the outcome of a property rule is the issuance of the injunction or a demand for specific performance, while the outcome of a liability rule is an award of damages.

B. Evaluating WTO Entitlements from the Perspective of Protection Rules

The assignment of entitlements in the WTO is based on the concessions exchanged among its Members. Due to the fact that most of the rights and obligations under the WTO are related to trade opportunities and interests, it can be remarked that generally the main entitlements of the WTO are market access plus the standards of protection that are stipulated under covered agreements.

So, how are such entitlements protected? Are they protected under property or liability rules?

[62] Calabresi and Melamed (n 49).
[63] Pauwelyn (n 51) 47.

i. The Debate over Protection Rules of WTO Entitlements: Property or Liability Rules

By providing textual analysis of the WTO Charter and the DSU, Jackson argues that WTO law clearly establishes a preference for an obligation to perform the recommendations of the DSB. Compensation shall be resorted to only if the immediate withdrawal of the measure is impracticable. He also adds that several scholars' suggestion that the DSU text gives Members an option to comply with and conform to the ruling or to 'buy out' of their obligations to conform (opting-out solution), is not supported by the text of the DSU.[64] Jackson's arguments demonstrate that entitlements under WTO law are protected by a property rule. His view is supported by other commentators, such as Nzelibe[65] and, to some extent, Trachtman.[66]

Trachtman agrees with the legal text analyses provided by Jackson; that is, WTO law is mandatory law and states are not permitted to violate it even if they agree to suffer retaliation. However, he also suggests that it is important to distinguish between the law as legislated and the law in action; accordingly, he states that 'as a matter of fact and practice, if not as a matter of legal doctrine, the WTO legal system is best characterized as employing a liability rule, rather than a property rule'.[67]

Schwartz and Sykes strongly argue that renegotiation and modification of concessions in the WTO are protected by a liability rule.[68] Article XXVIII:3 of GATT states that Members may withdraw concessions unilaterally where the MFN compensatory adjustment negotiation fails. Moreover, Article XXI of GATS provides that WTO Members may renegotiate the schedules by reaching an MFN compensatory adjustment agreement, and in the event that no agreement can be achieved, the WTO Member requesting the change can enact it unilaterally but subject to a 'compensatory adjustment' set by arbitration or the suspension of 'substantially equivalent' concessions or benefits by other Members. Other provisions for 'escape' in specific areas are the safeguards provisions of Article XIX of GATT and the compulsory licences provision of Article 31 of the TRIPS Agreement.[69]

[64] JH Jackson, 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"' (2004) 98 *American Journal of International Law* 109, 115–16. See JH Jackson, 'The WTO Dispute Settlement Understanding—Misunderstandings on the Nature of Legal Obligations (responding to Bello's article)' (1997) 91 *American Journal of International Law* 60, 63.

[65] J Nzelibe, 'The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization's Dispute Resolution Mechanism' (2005) 6 *Theoretical Inquiries in Law* 215.

[66] Trachtman (n 51).

[67] ibid 146, 149.

[68] Schwartz and Sykes (n 51) S183–88.

[69] Trachtman (n 51) 148; Pauwelyn (n 51) 135.

Schwartz and Sykes argue that under the MFN principle, trade concessions must extend to all WTO Members, therefore a Member would encounter a hold-out problem as well as high transaction costs under a property rule, because it would require negotiations with each WTO Member.[70] The liability rule approach prevents this problem. Schwartz and Sykes also argue that the rules of the DSU are protected by a liability rule because the provisions allow violations to continue as long as the violator is willing to pay the price.[71]

ii. WTO Law Accommodates Some Amount of Intra-Contractual Flexibility, Yet WTO Entitlements are Protected by a Property Rule

Various commentators have suggested that international trade agreements are incomplete in the sense that they do not stipulate all possible contingencies in advance.[72] The incompleteness is a result of the uncertain conditions that the drafters encountered.[73] Accordingly, the drafters may be expected to have included provisions that allowed them to adjust the bargain when it becomes mutually disadvantageous.[74]

In the WTO, the provisions for modifying tariff schedules in Article XXVIII of the GATT and for modifying scheduled services commitments in Article XXI of the GATS provide such intra-contractual flexibility. In other words, these provisions offer WTO Members a certain amount of flexibility to adjust the bargain without amounting to a breach of obligation.[75] For that reason, WTO entitlements under the rules of unilateral concessions adjustment, as well as the rules on safeguards, are protected by a liability rule. Other than these specified rules, WTO entitlements are protected by a property rule, and such protection is provided under the dispute settlement system.[76] WTO law has a strong preference for compliance and mutually agreed solutions, whereas compensation and retaliation are intended as temporary measures.

The fact that some entitlements in the WTO are protected by a liability rule demonstrates the presence of a certain amount of (intra-contractual)

[70] Schwartz and Sykes (n 51) S187. See also Trachtman (n 51) 149.

[71] Schwartz and Sykes S188–89.

[72] For instance, H Horn, G Maggi and RW Staiger, *The GATT/WTO as an Incomplete Contract* (Mimeo, 2006); RZ Lawrence, *Crimes and Punishments? Retaliation under the WTO* (Washington DC, Institute for International Economics, 2003).

[73] Pauwelyn, for instance, notes that it is difficult or impossible for the drafters to predict and foresee all future economic and political developments both domestically and internationally. See Pauwelyn (n 51) 137.

[74] Schwartz and Sykes (n 51) S184.

[75] CD Zimmermann, 'Toleration of Temporary Non-Compliance: The Systemic Safety Valve of WTO Dispute Settlement Revisited' (2011) 3 *Trade Law and Development* 382, 384.

[76] Pauwelyn (n 51) 139.

flexibility in the WTO. Zimmermann describes how such flexibility plays an important role in ensuring that WTO Members remain willing to make generous concessions in future rounds, therefore serving the long-term interests of the international trading system.[77]

iii. WTO Enforcement in the Context of Property Rules Protection

The rules of the DSU indicate a strong preference for a mutually agreed solution (MAS) and compliance. Such preference is demonstrated in Article 3.7 of the DSU stating that a mutually agreed solution to the dispute is clearly preferred and the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures in the event that violation is found.[78] Moreover, Article 22.8 of the DSU provides that retaliation is terminated either by achieving compliance or MAS.

These provisions appear to tell us that the WTO provides a remedy that closely resembles a property rule where a violating state has an obligation to perform, and in order for a violator state to be released from performing obligation it should negotiate mutual solutions to the nullification or impairment. Amicable settlements (interim or final settlements) reached after the threat or imposition of retaliation are discussed in more detail in the next chapter.

Recalling the protection rules model, if the rules are protected by a property rule, they should be supported by strict sanctions. Thus, it is reasonable that a high level of protection requires strong back-up enforcement. Property rules require specific performance and failure to do so is punished severely. Interestingly, the suspension of concessions under the DSU and the countermeasures under the SCM Agreement are non-punitive measures. Thus, one may argue that retaliation seems to resemble measures under liability rules in the sense that it is not punitive and the violator party can voluntarily opt for suffering retaliation (efficient breach).

The WTO dispute settlement system, however, is not designed to accommodate efficient breach under liability rules. The DSU clearly states that the central objective of the WTO dispute settlement is to provide security and predictability to the multilateral trading system. Facilitating the theory of efficient breach in WTO dispute settlement would threaten the DSU's stated objective.[79] Moreover, WTO remedies do not accommodate expectation

[77] Zimmermann (n 75) 397–98.

[78] An obligation to comply is also reflected in Article 19.1 of the DSU, which provides: 'where a Panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity', and Article 21.1 of the DSU, which stipulates that prompt compliance with the DSB's recommendations and rulings is essential.

[79] Collins (n 47) 231.

damages, which are needed to facilitate efficient breach. As pointed out by Collins and Zimmermann, due to the absence of retroactive damages under the DSU and the inexactness of damages calculations which do not represent the accurate cost of violation (under-compensation), it is very likely that some breaches are not efficient at all.[80] Finally, 'equivalent' and 'appropriate' standards in WTO dispute settlement are not intended to promote or facilitate efficient breach but to prevent an excessive amount of retaliation.

Pauwelyn eloquently argues that mere compensation and proportional countermeasures (seemingly weak back-up enforcement) are sufficient as back-up enforcement for a property rule. These formal sanctions, together with informal sanctions such as reputation and community costs, will provide sufficient incentive to comply with dispute settlement reports.[81] Zimmermann also rightly points out that the seemingly weak back-up enforcement, with its de facto toleration of temporary non-compliance, serves as a valuable systemic safety valve.[82] The de facto toleration of temporary non-compliance demonstrates an extra-contractual flexibility and constitutes an important systematic safety valve for scenarios where WTO Members find it impossible to comply with the DSB's recommendations or rulings within the reasonable period of time.[83]

Members still have to deal with various complexities in enforcing WTO rulings, especially when the matter ruled on by the panel or the Appellate Body leads to high domestic political tension. In a situation where there is a high level of domestic political tension, a high level of enforcement (punitive sanction) would escalate the risk of a Member opting out of the system. Therefore, the DSU designs the enforcement level in such a way as to keep Members within the WTO dispute settlement system. Hudec argues that WTO Members are repeat players in the game, as they may have roles both as complainants and respondents.[84] Therefore, Hudec is of the view that:

> The optimum legal system is not simply the strongest legal system. It is the legal system that will be most helpful in enforcing one's trade agreement rights as complainant, while at the same time preserving the desired degree of freedom to deal with adverse legal rulings against one's own behaviour.[85]

In sum, WTO remedies closely resemble the remedial character of property rules, where a violating state has an obligation to perform. Parties are allowed to negotiate interim and final solutions to the nullification and

[80] ibid 229–38; Zimmermann (n 75) 397–98. WTO remedies do not accommodate expectation damages, which are needed to facilitate efficient breach.
[81] Pauwelyn (n 51) 150–57.
[82] Zimmermann (n 75) 402–05.
[83] ibid 404.
[84] RE Hudec, 'Broadening the Scope of Remedies in WTO Dispute Settlement' in F Weiss (ed), *Improving WTO Dispute Settlement Procedures: Issues and Lesson from the Practice of Other International Courts and Tribunals* (London, Cameron May, 2000) 377.
[85] ibid.

impairment, and particularly for final solution the negotiation is intended to replace the obligation to perform.

III. THIRD QUEST: ARTICLE 22.6 ARBITRATORS' STATEMENTS WITH REGARD TO THE PURPOSE OF RETALIATION

In most Article 22.6 arbitral proceedings, the arbitrators try to point out the purpose of retaliation. Their findings overall appear to be gradually changing and opening the door to other purposes that retaliation can pursue besides the purpose of inducing compliance. Pauwelyn explains that as with the historical evolution from GATT to the WTO, there has been an evolution in WTO case law on the purpose of retaliation where the arbitrators' statements in the reports have also been less clear and made reference to multiple purposes.[86] At first in *EC—Bananas III (US) (Article 22.6—EC)*, the arbitrators stated that inducing compliance based on the 'equivalent' standard is the purpose of WTO suspensions.[87] Later in *US—FSC (Article 22.6—US)* and *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)*,[88] the arbitrators provided rulings which amounted to punitive sanctions. Afterwards in *US—Byrd Amendment (Article 22.6—US)*, the arbitrators ruled that the purpose of retaliation is not clear and might be to achieve some form of temporary compensation.[89] In the most recent Article 22.6 dispute, *US—COOL (Article 22.6—US)*, the arbitrators said nothing about the purpose of retaliation. This part examines the purpose stated in the Article 22.6 arbitrators' reports and shows these gradual changes in their decisions with respect to the purpose of retaliation.

A. The Purpose of 'Inducing Compliance' with 'Equivalent' Level Requirement

EC—Bananas III (Article 22.6—EC) was the first WTO Article 22.6 arbitration proceeding on suspension. It was the very first dispute in which the arbitrators made the statement regarding the purpose of retaliation.

[86] J Pauwelyn, 'Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge, Cambridge University Press, 2010) 49–50.

[87] *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* ('*EC—Bananas III (US) (Article 22.6—EC)*'), Decision by the Arbitrators (9 April 1999) WT/DS27/ARB [6.3].

[88] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (n 32) [3.121]; *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*US—FSC (Article 22.6—US)*') Decision by the Arbitrator (30 August 2002) WT/DS108/ARB [5.52]–[5.57], [6.2].

[89] *US—Byrd Amendment (Article 22.6—US)* (n 1) [3.73]–[3.74].

The arbitrators in *EC—Bananas III (US) (Article 22.6—EC)* confirmed that retaliation is a temporary measure pending full compliance by a defaulting Member concerned.[90] They further agreed with the United States that 'this temporary nature indicates that it is the purpose of countermeasures to induce compliance'.[91] However, in the subsequent statement, the arbitrators set a limitation on the intended purpose by stating that it (the purpose of inducing compliance) does not mean that the DSB should grant the authorisation to suspend beyond what is equivalent.[92] The arbitrators held the view that 'there is nothing in Article 21.1 of the DSU, let alone in paragraphs 4 and 7 of Article 22, that could be read as a justification for countermeasures of a punitive nature'.[93]

The arbitrators in *EC—Bananas III (Ecuador) (Article 22.6—EC)* similarly stated that 'the object and purpose of Article 22 … is to induce compliance'.[94] The purpose of inducing compliance was also confirmed subsequently in *EC—Hormones (Article 22.6—EC)* and later in *US—Gambling (Article 22.6—US)*.[95]

There are several interesting points raised in *EC—Bananas III (Article 22.6—EC)*. First, the statement of the arbitrators regarding the purpose was an assertion; the arbitrators did not provide any further explanation or reference to the text of the WTO agreements.[96] The arbitrators merely stated that they agreed with the United States that the temporary nature indicates that the purpose of countermeasures is to induce compliance.[97]

Secondly, the arbitrators set up a rather ambitious purpose yet provided limited support (equivalent rather than appropriate standard).[98] The arbitrators put a limitation on the retaliation instrument by stating that

[90] *EC—Bananas III (US) (Article 22.6—EC)* (n 87) [6.3].
[91] ibid.
[92] ibid.
[93] ibid.
[94] *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* ('*EC—Bananas III (Ecuador) (Article 22.6—EC)*'), Decision by the Arbitrators (24 March 2000) WT/DS27/ARB/ECU [76].
[95] *European Communities—Measures Concerning Meat and Meat Products (Hormones), Original Complaint by the United States—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* ('*EC—Hormones (US) (Article 22.6—EC)*'), Decision by the Arbitrators (12 July 1999) WT/DS26/ARB [40]; *European Communities—Measures Concerning Meat and Meat Products (Hormones), Original Complaint by Canada—Recourse to Arbitration by the European Communities under Article 22.6 of the DSU* ('*EC—Hormones (Canada) (Article 22.6—EC)*'), Decision by the Arbitrators (12 July 1999) WT/DS48/ARB [39]; *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse to Arbitration by the United States under Article 22.6 of the DSU* ('*US—Gambling (Article 22.6—US)*'), Decision by the Arbitrator (21 December 2007) WT/DS285/ARB [2.7].
[96] Palmeter and Alexandrov (n 42) 651.
[97] *EC—Bananas III (US) (Article 22.6—EC)* (n 87) [6.3].
[98] Pauwelyn (n 86) 50.

suspension cannot go beyond what is equivalent. Consequently, the stated purpose of the instrument seems to be limited by its own standard, and vice versa; the limited standard seems to not support the intended purpose of the instrument.

B. The Purpose of 'Inducing Compliance' with 'Appropriate' Level Requirement

The arbitrators provided the standard of 'appropriate' countermeasures in the retaliation disputes related to prohibited subsidies under the SCM Agreement. *Brazil—Aircraft (Article 22.6—Brazil)* is the first retaliation dispute under the DSU and the SCM Agreement. In this dispute, the arbitrators concluded that 'a countermeasure is "appropriate" *inter alia* if it effectively induces compliance'.[99] The arbitrators went further by stating that the concept of nullification or impairment is absent from Articles 3 and 4 of the SCM Agreement and that an 'equivalent' requirement would limit the efficacy of the countermeasures.[100] Therefore, the arbitrators decided that 'an amount of countermeasures which corresponds to the total amount of the subsidy is "appropriate"',[101] even though such an amount goes beyond the 'equivalent' trade effects caused by the violation.

The arbitrators in *US—FSC (Article 22.6—US)* also confirmed that the purpose of countermeasures is to induce compliance. However, the arbitrators adopted a different approach to the arbitrators in *Brazil—Aircraft* in determining the appropriateness and the level of countermeasures. The arbitrators in *US—FSC* went further by taking into consideration the gravity of the breach. The arbitrators considered that 'in assessing the "appropriateness" of such countermeasures—in light of the gravity of the breach –, a margin of appreciation is to be granted, due to the severity of the breach'.[102] So in carrying out the 'appropriateness' test, the arbitrators considered not only the trade effects but also the gravity of the breach (the violation).

The arbitrators in *US—Upland Cotton (Article 22.6—US)* appeared to adopt the arbitrators' approach in *US—FSC (Article 22.6—US)* by taking into account the unlawful character of export subsidies in assessing the 'proportionality' and lack of 'disproportion' in the proposed countermeasures.[103] The arbitrators concluded that 'it is permissible that the assessment of the

[99] *Brazil—Aircraft (Article 22.6—Brazil)* (n 8) [3.44].
[100] ibid [3.57]–[3.58].
[101] ibid [3.60].
[102] *US—FSC (Article 22.6—US)* (n 88) [5.62].
[103] *United States—Subsidies on Upland Cotton—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*US—Upland Cotton (Article 22.6—US)*'), Decision by the Arbitrator (31 August 2009) WT/DS267/ARB/1 [4.91].

overall trade impact on the complaining Member not be precise nor that the countermeasure should be directly equivalent to that impact'.[104]

In *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)*, the arbitrators also recognised the purpose of inducing compliance. Moreover, due to Canada's statement that it did not intend to withdraw its inconsistent measures, the arbitrators considered that it was appropriate to add another 20 per cent of the amount of the subsidy to the total amount of the subsidy to force Canada to comply.[105]

Accordingly, while the arbitrators argued that their approach in assessing the appropriateness does not make the countermeasures punitive,[106] we can observe that the arbitrators have provided tougher sanctions in the prohibited subsidies disputes, and in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* the additional 20 per cent constitutes, or has the character of, a punitive sanction.

C. Inducing Compliance is 'Not the Only Purpose' Pursued by Retaliation

The arbitrators started to acknowledge that retaliation may have other purposes in *US—1916 Act (Article 22.6—US)*.[107] Nonetheless, the arbitrators did not clarify or list these purposes, but confirmed the previous arbitrators' statements that inducing compliance is the key purpose of retaliation.[108]

It was the arbitrators in *US—Byrd Amendment (Article 22.6—US)* who questioned the exclusivity of inducing compliance as the purpose of retaliation. The arbitrators stated that:

> Having regard to Articles 3.7 and 22.1 and 22.2 of the DSU as part of the context of Articles 22.4 and 22.7, we cannot exclude that inducing compliance is part of the objectives behind suspension of concessions or other obligations, but at most it can be only one of a number of purposes in authorizing the suspension of concessions or other obligations. By relying on 'inducing compliance' as the benchmark for the selection of the most appropriate approach we also run the risk of losing sight of the requirement of Article 22.4 that the level of suspension be *equivalent* to the level of nullification or impairment.[109]

[104] ibid [4.94].

[105] *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (n 32) [3.107], [3.121].

[106] *Brazil—Aircraft (Article 22.6—Brazil)* (n 8) [3.55]; *US—FSC (Article 22.6—US)* (n 88) [5.56].

[107] *United States—Anti-Dumping Act of 1916, Original Complaint by the European Communities—Recourse to Arbitration by the United States under Article 22.6 of the DSU* ('*US—1916 Act (Article 22.6—US)*'), Decision by the Arbitrators (24 February 2004) WT/DS136/ARB [5.5].

[108] ibid [5.4], [5.8].

[109] *US—Byrd Amendment (Article 22.6—US)* (n 1) [3.74].

The arbitrators also explained the reason why the DSU does not explicitly state the purpose of retaliation. In their view, it is because 'what may induce compliance is likely to vary in each case'.[110] The arbitrators argued that 'in some cases, even a very high amount of countermeasures may not achieve compliance, whereas in some others a limited amount may'.[111] The arbitrators noted that there are two implied purposes: first, suspension is intended to 'induce compliance', and secondly, it is only 'a means of obtaining some form of temporary compensation'.[112] So even though the arbitrators in this case were not convinced that inducing compliance is the only purpose of retaliation, the arbitrators left this problem unanswered by merely stating that the purpose of WTO retaliation is 'not clear' and that 'a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear "object and purpose" were identified'.[113]

Figure 5.1 demonstrates the arbitrators' statements with respect to the purpose of retaliation.

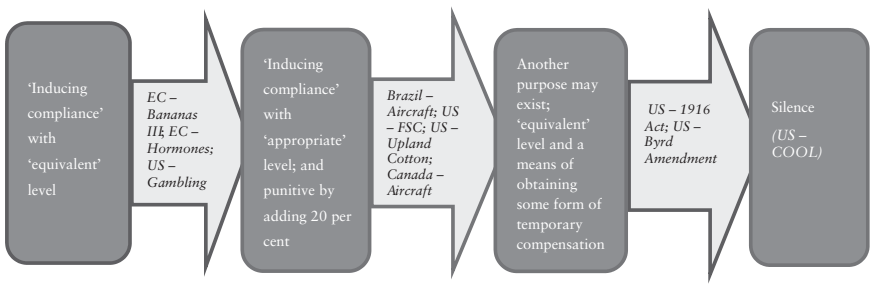

Figure 5.1: Article 22.6 arbitrators' statements with regard to the purpose of retaliation

IV. FOURTH QUEST: INTERPRETATION OF ARTICLE 22 OF THE DSU IN ACCORDANCE WITH THE CUSTOMARY RULES OF INTERPRETATION TO CLARIFY THE PURPOSES OF WTO RETALIATION

Legal provisions in international agreements often lack clarity because the negotiators in a negotiation process try to produce a text that can reconcile their divergent positions at the international level and satisfy the demands of

[110] ibid [6.2].
[111] ibid footnote 131.
[112] ibid [6.2]–[6.3].
[113] ibid [6.4].

their various domestic constituents at the national level.[114] The negotiators of international agreements also could not have foreseen all political and economic changes, as well as possible disputes that might arise in the future. As a result, they may have deliberately used broad and ambiguous language in drafting the provisions.[115] The rules of interpretation in accordance with the customary rules of international law play a significant role in clarifying ambiguities and filling the gaps in the WTO legal provisions.

A. The Customary Rules of Interpretation

In *EC—Chicken Cuts (Thailand)*, the panel noted that:

> The primary purpose of treaty interpretation is to identify the common intention of the parties and that the rule contained in Articles 31 and 32 of the Vienna Convention have been developed to help assessing, in objective terms, what was or what could have been the common intention of the parties to a treaty.[116]

The customary rules of interpretation are mainly codified under Articles 31 and 32 of the VCLT, but these two articles do not exhaust the customary rules of interpretation of international law.[117]

Article 31(1) of the VCLT provides that:

> A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

While Article 31 sets up the primary rules of interpretation, Article 32 provides the supplementary means of interpretation such as the preparatory work of the treaty and the circumstances of treaty conclusion.

i. Good Faith

The good faith principle flows from the principle of *pacta sunt servanda*, which provides that every treaty must be performed in good faith.[118] It also correlates with the principle of 'effective treaty interpretation'.[119]

[114] WTO, *A Handbook on the WTO Dispute Settlement System: A WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellate Body* (Cambridge, Cambridge University Press, 2004) 3.

[115] AD Mitchell, *Legal Principles in WTO Disputes* (Cambridge, Cambridge University Press, 2008) 15.

[116] *European Communities—Custom Classification of Frozen Boneless Chicken Cut (Complaint by Thailand)*, Panel Report (adopted 27 September 2005) WT/DS286/R [7.94].

[117] Mitchell (n 115) 76.

[118] ibid 77; see also VCLT, Art 26.

[119] *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services* ('*US—Gambling*'), Panel Report (adopted 20 April 2005) WT/DS285/R [6.49].

The principle of 'effective treaty interpretation' entails 'the duty … to read all applicable provisions of a treaty in a way that gives meaning to all of them, harmoniously'.[120] Therefore, the good faith principle requires interpreters to read a treaty or its particular sections as a whole and in such a way that would not 'result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility'.[121] The interpretation should also not lead to an outcome that is deliberately absurd or unreasonable. Accordingly, it should be conducted in a reasonable, honest and fair way.[122]

The WTO panels and the Appellate Body have applied, confirmed and made reference to the principle of good faith.[123] For instance, the panel in *US—Gambling* considered good faith to be 'a core principle of interpretation of the WTO Agreement'.[124]

ii. Ordinary Meaning

Article 31 of the VCLT requires the interpretation to be carried out in accordance with the ordinary meaning that is given to the terms of the treaty. The ordinary meaning is the normal or true meaning of the terms 'taking into account all the consequences which normally and reasonably flow from the text'.[125] It is a textual approach to interpretation.[126] If the parties do not intend such terms to have their ordinary meaning, Article 31(4) of the VCLT provides that special meanings shall be given to the term.

While an interpretation in accordance with the ordinary meaning can be established in various ways, it has mainly led to reference to dictionary definitions.[127] But, when having recourse to dictionary definitions, the context of the term is also significant because the dictionary may provide more than one meaning, which may displace or distract from the real meaning of a particular term.[128] The Appellate Body in *US—Gambling*, for instance, stated

[120] *European Communities—Export Subsidies on Sugar, Complaint by Brazil* (*EC—Export Subsidies on Sugar (Brazil)*'), Panel Report (adopted 19 May 2005) WT/DS266/R [7.152]. See also AH Qureshi, *Interpreting WTO Agreements: Problems and Perspectives* (Cambridge, Cambridge University Press, 2006) 13.

[121] *EC—Export Subsidies on Sugar (Brazil)* (n 120) [7.151]; *Korea—Definitive Safeguard Measure on Imports of Certain Dairy Product* ('*Korea—Dairy* (AB)'), Appellate Body Report (adopted 12 January 2000) WT/DS98/AB/R [81]; *United States—Standard for Reformulated and Conventional Gasoline* ('*US—Gasoline*'), Panel Report (adopted 20 May 1996) WT/DS2/R [12].

[122] *US—Gambling* (n 119) [6.49]; see also IM Sinclair, *Vienna Convention on the Law of Treaties* (Manchester, Manchester University Press, 1984) 120.

[123] *United States—Tax Treatment for 'Foreign Sales Corporations'*, Appellate Body Report (adopted 20 March 2000) WT/DS108/AB/R [166].

[124] *US—Gambling* (n 119) [6.50].

[125] Sinclair (n 122) 121.

[126] Mitchell (n 115) 78.

[127] ibid.

[128] Qureshi (n 120) 17.

that 'dictionaries, alone, are not necessarily capable of resolving complex questions of interpretation, as they typically aim to catalogue all meanings of words—be those meanings common or rare, universal or specialized'.[129] Thus, the reference to a dictionary meaning should also have regard to the context, and the object and purpose of a treaty.

iii. The Context, and the Object and Purpose of a Treaty

Article 31(2) of the VCLT states that the context comprises: (1) the text, preamble and annexes; (2) any agreement and instrument made in connection with the conclusion of the treaty. Any subsequent agreement and practice regarding the interpretation of the treaty and relevant rules of international law should also be taken into account together with the context.[130] The context requires the text of the treaty to be read as a whole, and not that paragraphs, articles, sections, chapters or parts be read separately.[131]

Article 31(1) of the VCLT also asserts that interpretation should be in accordance with the object and purpose of a treaty. Identifying the object and purpose is not a simple task. Sinclair argues that 'most treaties have no single, undiluted object and purpose but a variety of differing and possibly conflicting objects and purposes'.[132] The preamble is often utilised to solve this matter, because it normally stipulates the scope, background, object and purpose of a treaty. Thus, the preamble may contain both the context and the object and purpose of a treaty. The WTO panels and Appellate Body often refer to the preamble of various WTO agreements in the course of their interpretation.[133]

iv. Relevant Rules of International Law

Article 31(3)(c) of the VCLT provides that 'any relevant rules of international law applicable in relations between the parties' shall also be taken into consideration in interpreting a treaty. This means that the customary international law of treaty rules of interpretation requires the interpreters to also take into account any relevant rules of international law.[134]

[129] *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services* (*US—Gambling* (AB)), Appellate Body Report (adopted 20 April 2005) WT/DS285/AB/R [164].

[130] VCLT, Art 31(3).

[131] Sinclair (n 122) 127.

[132] ibid 130.

[133] Mitchell (n 115) 81.

[134] The panel in *EC—Approval and Marketing of Biotech Products* stated that 'Article 31(3)(c) mandates a treaty interpreter to take into account other rules of international law', see *European Communities—Measures Affecting the Approval and Marketing of Biotech Products*

The Appellate Body in *US—Anti-Dumping and Countervailing Duties (China)* noted that Article 31(3)(c) contains three elements. First, it refers to 'rules of international law'; second, the rules must be relevant; and third, such rules must be 'applicable in the relations between the parties'.[135]

According to the Appellate Body, the first element corresponds to the sources of international law in Article 38(1) of the Statue of the International Court of Justice including customary rules of international law and general principles of law.[136] The panel in *EC—Approval and Marketing of Biotech Products* took a slightly different view with regard to the general principles of law. They stated that 'it may not appear self-evident that they can be considered as "rules of international law" within the meaning of Article 31(3)(c)', however in their view, they are applicable because the Appellate Body in *US—Shrimp* made it clear that general principles of law should be taken into account in the interpretation of WTO provisions.[137] The Appellate Body in *US—Shrimp*, for instance, in interpreting the chapeau of Article XX, made a reference to the principle of good faith and the doctrine of *abus de droit* as general principles of international law.[138]

As regards the second element, the Appellate Body in *US—Anti-Dumping and Countervailing Duties (China)* stated that such rules, in order to be relevant, must concern the same subject matter as the treaty term being interpreted.[139] With regard to the third element, the Appellate Body observed that certain provisions in the ILC Draft Articles are not binding by virtue of being part of an international treaty, but they are applicable insofar as they reflect customary international law or general principles of law.[140]

Additionally, the Appellate Body in *EC and certain member states—Larger Civil Aircraft* admitted that the term 'the parties' in Article 31(3)(c) has been the subject of academic debate in recent years and that there has not yet been a statement by the Appellate Body as to whether the term 'the parties' refers to all WTO Members or the parties to the dispute.[141] However, the Appellate Body noted that 'an interpretation of "the parties" should be guided by the Appellate Body's statement that "the purpose of treaty interpretation is

('*EC—Approval and Marketing of Biotech Products*'), Panel Report (adopted 21 November 2006) WT/DS291/R; WT/DS291/R; WT/DS293/R [7.49].

[135] *United States—Definitive Anti-Dumping and Countervailing Duties on Certain Products from China* ('*US—Anti-Dumping and Countervailing Duties (China)* (AB)'), Appellate Body Report (adopted 25 March 2011) WT/DS379/AB/R [307].

[136] ibid [308].

[137] *EC—Approval and Marketing of Biotech Products* (n 134) [7.67].

[138] *US—Shrimp* (AB) (n 13) [158].

[139] *US—Anti-Dumping and Countervailing Duties (China)* (AB) (n 135) [308].

[140] ibid.

[141] *European Communities and Certain Member States—Measures Affecting Trade in Large Civil Aircraft* ('*EC and certain member states—Larger Civil Aircraft* (AB)'), Appellate Body Report (adopted 1 June 2011) WT/DS316/AB/R [844].

to establish the *common* intention of the parties to the treaty"', which means that caution must be exercised when making a reference to an international agreement to which not all WTO Members are a party.[142]

v. Supplementary Means of Interpretation

Article 32 of the VCLT states that recourse to supplementary means of interpretation is permitted either 'to confirm the meaning resulting from the application of Article 31' or when the interpretation under Article 31 'leaves the meaning ambiguous or obscure' or 'leads to a result which is manifestly absurd or unreasonable'. Accordingly, recourse to supplementary means of interpretation is not mandatory.[143] Even though Article 32 stipulates that supplementary means includes the preparatory work of the treaty and the circumstances of its conclusion, it does not define those supplementary materials exhaustively.[144] In a number of cases, panels and the Appellate Body have utilised several documents from various negotiating rounds to confirm the meaning from the application of Article 31.[145]

B. Interpretation of Article 22 of the DSU in Accordance with the Customary Rules of Interpretation

It has been recognised that the WTO respects and takes into account general international law.[146] The Appellate Body in *US—Gasoline* acknowledged that the WTO Agreement 'is not to be read in clinical isolation from public international law'.[147] Thus, the rules of the multilateral trading system should be read in harmony with the principles of international law.[148] Article 3.2 of the DSU in particular confirms the applicability of the customary rules of treaty interpretation of public international law. The panel in *Korea—Procurement* highlighted the importance of treaty interpretation rules

[142] ibid [845].
[143] Qureshi (n 120) 24.
[144] The Appellate Body in *EC—Computer Equipment* included the historical background examination with regard to the circumstances of the conclusion of a treaty. See *European Communities—Customs Classification of Certain Computer Equipment* ('*EC—Computer Equipment* (AB)'), Appellate Body Report (adopted 22 June 1998) WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R [86]; Qureshi (n 120) 24.
[145] For instance, the Appellate Body in *US—Gambling* noted recourse to preparatory work as supplementary means of interpretation. See *US—Gambling* (AB) (n 129) [236]; Mitchell (n 115) 85.
[146] Lamy (n 4) 973.
[147] *United States—Standards for Reformulated and Conventional Gasoline* ('*US—Gasoline* (AB)'), Appellate Body Report (adopted 20 May 1996) WT/DS2/AB/R, 17.
[148] Lamy (n 4) 972.

regulated by customary international law as an interpretative tool to clarify the meaning of WTO treaty provisions provided that WTO treaty agreements do not 'contract out' from it.[149]

i. Contracted In: The Customary Rules of Interpretation

Although not all WTO Members signed and ratified the VCLT,[150] the rules of interpretation apply for two reasons. First, the rules of interpretation provided in Articles 31 and 32 of the VCLT retain the status of customary international law, and secondly, Article 3.2 of the DSU confirms the reference to the customary rules of interpretation of international law to clarify the existing provisions of WTO agreements.

Panels and the Appellate Body in a number of cases have confirmed the customary status of treaty interpretation stipulated in Articles 31 and 32 of the VCLT. For instance, the Appellate Body in *US—Gasoline* provided that Article 31(1) 'had attained the status of a rule of customary or general international law'.[151] The Appellate Body in *Japan—Alcoholic Beverages II* confirmed that Article 32 'has also attained the same status'.[152] Panels and the Appellate Body have also deliberately engaged with how to apply these rules of interpretation in the appropriate way.[153] For instance, the Appellate Body in *India—Patents (US)* stated that the principles of treaty interpretation 'neither require nor condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that were not intended'.[154] Therefore, interpretation is not about creating new rules but merely about providing meaning to rules of law. Consequently, interpretations *contra legem* are not permitted.[155]

ii. The Multiple Purposes Identified from the Text of Article 22 of the DSU

Article 31(1) of the VCLT requires the interpretation to be carried out in accordance with the ordinary meaning. The ordinary meaning is the normal

[149] *Korea—Measures Affecting Government Procurement ('Korea—Procurement')*, *Panel Report* (adopted 19 June 2000) WT/DS163/R [7.96].

[150] For example, to date the United States has not ratified the Convention although it signed it on 24 April 1970. Indonesia has neither signed nor ratified the Convention. See: United Nations Treaty Collection, 'Chapter XXIII—Law of Treaties', https://treaties.un.org/pages/ViewDetailsIII.aspx?src=TREATY&mtdsg_no=XXIII-1&chapter=23&Temp=mtdsg3&lang=en.

[151] *US—Gasoline* (AB) (n 147) 17.

[152] *Japan—Alcoholic Beverages II* (AB) (n 45) 10.

[153] A Lindroos and M Mehling, 'Dispelling the Chimera of "Self-Contained Regimes": International Law and the WTO' (2006) 16 *European Journal of International Law* 857, 868.

[154] *India—Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Appellate Body Report (adopted 16 January 1998) WT/DS50/AB/R [45].

[155] J Pauwelyn, 'The Role of Public International Law in the WTO' (2001) 95 *American Journal of International Law* 535, 554, 573.

or true meaning of the terms 'taking into account all the consequences which normally and reasonably flow from the text'.[156] It is a textual approach to interpretation and can be established by the reference to dictionary definitions.[157]

As observed by the panel in *Japan—Alcoholic Beverages II*, the wording of the treaty is the starting point for an interpretation of an international treaty.[158] There are several portions of the wording of Article 22 that may indicate the purpose of retaliation. They are 'temporary', 'equivalent to' and 'a mutually satisfactory solution'.

The *Concise Oxford English Dictionary* suggests the meaning of the following words respectively as:[159]

— temporary—lasting for only a limited period;
— equivalent to—having the same or a similar effect as;[160]
— mutual—experienced or done by each of two or more parties towards the other or others;
— satisfactory—fulfilling expectations or needs or acceptable; and
— solution—a means of solving a problem.

The reference to a dictionary meaning is simply inadequate. As Ortino put it: 'the "raw text" is only *one* piece of the puzzle'.[161] The meaning should also have regard to the context, and the object and purpose of a treaty.

iii. Multiple Purposes Carried Out in the Context of Article 22 of the DSU

The panel in *Japan—Alcoholic Beverages II* stated that the wording should be interpreted in its context and in the light of the object and the purpose of the treaty as a whole.[162] Thus, this part attempts to interpret the pieces of wording 'temporary', 'equivalent to' and 'a mutually satisfactory solution' in the context of Article 22 of the DSU.

[156] Sinclair (n 122) 121.
[157] Mitchell (n 115) 78.
[158] *Japan—Taxes on Alcoholic Beverages* ('*Japan—Alcoholic Beverages II*'), Panel Report (adopted 1 November 1996) WT/DS8/R, WT/DS10/R, WT/DS11/R [6.9].
[159] See A Stevenson and M Waite, *Concise Oxford English Dictionary* (Oxford, Oxford University Press, 2011) 1484, 483, 945, 1278, 1375.
[160] Similarly, when the arbitrators in *EC—Bananas III (US) (Article 22.6—EC)* looked at the ordinary meanings of the word 'equivalence', they found that they are as follows: 'equal in value, significant or meaning', 'having the same effect', 'having the same relative position or function', 'corresponding to', 'something equal in value or worth', also 'something tantamount or virtually identical'. See *EC—Bananas III (US) (Article 22.6—EC)* (n 87) [4.1].
[161] F Ortino, 'Treaty Interpretation and the WTO Appellate Body Report in *US—Gambling*: A Critique' (2006) 9 *Journal of International Economic Law* 117, 123.
[162] *Japan—Alcoholic Beverages II* (n 158) [6.9].

a. The Suspension Shall Be 'Temporary' Under Articles 22.1 and 22.8 of the DSU

There are two paragraphs under Article 22 of the DSU that refer to the temporary nature of retaliation. First, paragraph 1 as the general provision provides that both compensation and the suspension of concessions or other obligations (retaliation) are temporary measures. Secondly, paragraph 8 particularly states that the suspension of concessions shall be temporary.

The United States in *EC—Bananas III (US) (Article 22.6—EC)* stated that the temporary nature indicates that the purpose of retaliation/countermeasures is to induce compliance. The US statement was confirmed subsequently by the arbitrators.[163] Article 22.1 adds another sentence that also specifies the temporary nature of retaliation: 'neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation'.[164] This sentence clearly establishes a connection between the temporary nature of retaliation and pending compliance.[165] As demonstrated by Jackson, the temporary nature of suspension of concessions indicates that the DSU has a strong preference for compliance and that retaliation is an alternative measure applied until compliance occurs.[166]

b. The Level of the Suspension Shall Be 'Equivalent to' the Level of the Nullification or Impairment Under Article 22.4 of the DSU

When non-compliance occurs, the goal of inducing compliance may lead to a call for equipping WTO retaliation with a tougher sanction. However, the arbitrators in *EC—Bananas III (US) (Article 22.6—EU)* and *US—1916 Act (Article 22.6—US)* emphasised that the concept 'equivalent to' embodied in Article 22.4 of the DSU means that retaliation cannot be imposed in a punitive manner.[167]

The arbitrators in *US—Byrd Amendment (Article 22.6—US)* expressed a concern that by merely relying on 'inducing compliance' as the benchmark for the selection of the most appropriate approach, they could run the risk of losing sight of the 'equivalent to' requirement under Article 22.4.[168] A non-punitive standard derived from the wording 'equivalent to' under

[163] *EC—Bananas III (US) (Article 22.6—EC)* (n 87) [6.3].

[164] DSU, Art 22.1.

[165] The arbitrators in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* provided that 'Article 22.1 of the DSU is particularly clear as to the temporary nature of suspensions of concessions or other obligations, pending compliance'. See *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* (n 32) [3.105].

[166] Jackson, 'Obligation to Comply or to Buy Out' (n 64) 115.

[167] *EC—Bananas III (US) (Article 22.6—EC)* (n 87) [6.3]. See also *US—1916 Act (Article 22.6—US)* (n 107) [5.8].

[168] *US—Byrd Amendment (Article 22.6—US)* (n 1) [3.74].

Article 22.4 indicates retaliation has more of a compensatory than a punitive nature.[169] Being merely compensatory in nature, Article 22.4 acknowledges another competing purpose of retaliation, that is to restore the balance of concessions resulting from the continuation of a non-compliance measure, or, in short, the purpose of rebalancing.

1. 'Equivalent to' Standard in Relation to the 'Appropriate' Standard Under the SCM Agreement

The terms 'equivalent to' and 'appropriate' should not be treated as excessively distinctive. The word 'equivalent to' refers to the basic character of trade concessions that is reciprocal. The term 'appropriate' refers to the character of export subsidies and it also differentiates between prohibited and actionable subsidies. Export subsidies are prohibited regardless of the adverse effects described in Article 5 of the SCM Agreement, whereas domestic subsidies require the existence of the adverse effects to be actionable. Since domestic subsidies are only illegal to the extent they cause those stated adverse effects, the adverse effect should be regarded as the upper limit on countermeasures.[170] Thus, the countermeasures should be commensurate with the degree and nature of the adverse effects.[171] In contrast, prohibited subsidies are illegal regardless of the existence of the adverse effects. In the absence of adverse effects as a ceiling, the countermeasures should be appropriate.

Most of the arbitrators in Article 22.6 disputes took into account footnote 9 in the context of interpreting the term 'appropriate' countermeasures in Article 4.10 of the SCM Agreement.[172] The Arbitrators in *US—FSC (Article 22.6—US)*, for example, noted that 'these two elements are part of a single assessment and that the meaning of the expression "appropriate countermeasures" should result from a combined examination of these terms of the text in light of its footnote'.[173] The arbitrators pointed out that footnote 9 confirms that such a flexibility provided by the notion of 'appropriate countermeasures' is not unbounded.[174] The arbitrators in *US—Upland*

[169] ibid [6.3]. See also Schwartz and Sykes (n 51) S189.

[170] R Howse and DJ Neven, 'United States—Tax Treatment for "Foreign Sales Corporations" Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS108/ARB): A Comment' (2005) 4 *World Trade Review* 101, 111.

[171] SCM Agreement, Art 7.9.

[172] WTO, 'Analytical Index: Subsidies and Countervailing Measures—Agreement on Subsidies and Countervailing Duties', www.wto.org/english/res_e/booksp_e/analytic_index_e/subsidies_02_e.htm#article4. Footnotes 9 and 10 of the SCM Agreement provide that they are 'not meant to allow countermeasures that are disproportionate'.

[173] *US—FSC (Article 22.6—US)* (n 88) [5.8].

[174] ibid [5.19].

Cotton (Article 22.6—US) were of the view that the formulation of footnote 9 serves to guard against an interpretation of the words 'appropriate countermeasures' that would allow measures that are disproportionate. So in their view the proportionality requirement is intended to be a protection against excessive countermeasures.[175] Additionally, the terms 'appropriate countermeasures' as contained in Article 4.10 of the SCM Agreement are understood to have a similar meaning in Article 4.11 of the SCM Agreement.[176]

The ILC Draft Articles also provide the benchmark of proportionality. Article 51 of the ILC Draft Articles states that 'Countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and its harmful effects on the injured party'. The commentary to Article 51 further explains that:

> [A] clearly disproportionate measure may well be judged not to have been necessary to induce the responsible State to comply with its obligations but to have had a punitive aim and to fall outside the purpose of countermeasures enunciated in article 49.[177]

This means that countermeasures are not proportional if they are aimed to be punitive. So, the 'appropriate' countermeasures might fall within the 'equivalent' level or go beyond that.[178] Nonetheless, 'appropriateness' has the upper ceiling that is the non-punitive level (non-excessive countermeasures).

c. The Suspension Shall Only Be Applied Until … the Violator Member Provides a Solution to the Nullification or 'a Mutually Satisfactory Solution' Is Reached Under Article 22.8 of the DSU

Article 22.8 provides three situations in which retaliatory measures have to be terminated. They are: the removal of the inconsistent measure, a solution to the nullification or impairment provided, or a mutually satisfactory solution reached. Article 22.8 demonstrates not only when retaliatory measures have to be terminated, but also what retaliation can achieve in the end. Put differently, Article 22.8 also reflects the goal that retaliation intends to pursue. The article also shows the connection between the temporary nature of retaliation and the goal of achieving an amicable settlement either by providing a solution to the nullification or by reaching a mutually agreed solution.

The removal of the inconsistent measure clearly supports the purpose of inducing compliance. Nonetheless, Article 22.8 provides not only the

[175] *US—Upland Cotton (Article 22.6—US)* (n 103) [4.85].
[176] ibid footnote 118.
[177] ILC Draft Articles, commentary (7) Art 51.
[178] The arbitrators in *Brazil—Aircraft (Article 22.6—Brazil)* noted that the term appropriate may allow for more leeway than the word 'equivalent'. See *Brazil—Aircraft (Article 22.6—Brazil)* (n 8) footnote 51.

wording 'removal of inconsistent measure', but also stipulates other goals that retaliation can achieve that are an amicable solution or settlement to a dispute. An amicable solution is a form of settlement provided for in the DSU[179] and therefore it is an integral part of the WTO dispute settlement system.

In sum, the wording and the context indicate a number of purposes that retaliation can serve. The arbitrators in *US—Byrd Amendment (Article 22.6—US)* reached a similar conclusion when they questioned whether inducing compliance was the only objective pursued by the DSU. The arbitrators stated that 'we are not persuaded that the object purpose of suspension of concessions or other obligations pursuant to Article 22 would be exclusively to induce compliance'.

iv. Multiple Purposes in the Light of the Object and Purpose of WTO Dispute Settlement

The Appellate Body in *EC—Chicken Cuts* stated that the term 'its object and purpose' in Article 31(1) of the VCLT demonstrates that 'the starting point for ascertaining "object and purpose" is the treaty itself, in its entirety'.[180] However, the Appellate Body also believed that Article 31(1) does not exclude consideration of the 'object and purpose of particular treaty terms, if doing so assists the interpreter in determining the treaty's object and purpose on the whole'.[181] To identify the object and purpose is not a simple task. Sinclair notes that 'most treaties have no single, undiluted object and purpose but a variety of differing and possibly conflicting objects and purposes'.[182] Thus, the preamble is often utilised to discern this matter, because it normally stipulates the scope, background, object and purpose of a treaty.[183]

The third recital of the preamble to the WTO Agreement highlights the phrase 'reciprocal and mutually advantageous arrangements'. The Appellate Body in *EC—Computer Equipment* emphasised that 'The security and predictability of "the reciprocal and mutually advantageous arrangements …" is an object and purpose of the WTO Agreement, generally, as well as of the GATT 1994'.[184] Moreover, the Appellate Body in *Japan—Alcoholic*

[179] DSU, Art 3.7.

[180] *European Communities—Customs Classification of Frozen Boneless Chicken Cuts*, Appellate Body Report (adopted 27 September 2005) WT/DS269/AB/R, WT/DS286/AB/R [238].

[181] ibid. See also Mitchell (n 115) 80.

[182] Sinclair (n 122) 130.

[183] Mitchell (n 115) 80–81.

[184] *EC—Computer Equipment* (AB) (n 144) [82]. See also WTO, 'Analytical Index: Marrakesh Agreement—Marrakesh Agreement Establishing the World Trade Organization', www.wto.org/english/res_e/booksp_e/analytic_index_e/wto_agree_01_e.htm#fnt8.

Beverages II provided that the 'security and predictability' sought in the multilateral trading system by the Members will be achieved through the establishment of the dispute settlement system.[185]

In light of the above, one can conclude that providing security and predictability to the multilateral trading system is the object and purpose of the WTO Agreement as well as the central objective of WTO dispute settlement.[186] Moreover, in protecting 'security and predictability' first the object and purpose of the dispute settlement is to settle disputes through multilateral processes.[187] Secondly, the aim of the dispute settlement mechanism is to secure a positive solution to a dispute.[188] According to Shlomo-Agon and Shany, they are intermediate goals to sustain the central goal of dispute settlement: providing security and predictability.[189]

a. Security and Predictability: Settlement of Disputes Through Multilateral Procedures and Not Through Unilateral Action

The panel in *US—Section 301 Trade Act* held that Article 23.1 of the DSU prescribes 'a general duty of a dual nature'.[190] It imposes a duty on all Members to use the multilateral process set out in the DSU when they seek to redress a WTO inconsistency, and because of that, recourse to any other system, in particular a system of unilateral enforcement, is excluded.[191] Having recourse to the DSU also requires Members to 'abide by' rules and procedures set out in the DSU.[192]

The prohibition on taking unilateral action is also applied to the imposition of retaliatory measures.[193] Although, the suspension of concessions under Article 22 is a Member-to-Member action, a WTO Member is prohibited from imposing retaliation without a relevant DSB authorisation.[194]

Thus, regardless of their intended purpose(s), retaliatory measures should not be imposed contrary to the object and purpose of the WTO dispute settlement system. An injured state cannot retaliate unilaterally even though its retaliatory measures are intended to force the violator state to bring its

[185] *Japan—Alcoholic Beverages II* (AB) (n 45) 31.
[186] See DSU, Art 3.
[187] ibid Art 23.
[188] ibid Art 3.7. See also P Van den Bossche and W Zdouc, *The Law and Policy of the World Trade Organization*, 3rd edn (New York, Cambridge University Press, 2013) 179–83.
[189] S Shlomo-Agon and Y Shany, 'The WTO Dispute Settlement System' in Y Shany, *Assessing the Effectiveness of International Courts* (Oxford, Oxford University Press, 2014) 191–93.
[190] *United States—Sections 301–310 of the Trade Act of 1974*, Panel Report (adopted 27 January 2000) WT/DS152/R [7.43].
[191] ibid.
[192] ibid.
[193] DSU, Art 23.2(c).
[194] ibid Arts 22.6 and 23.2(c).

inconsistent measures into conformity. Put differently, whatever purposes WTO retaliation intends to achieve, such purposes should not transform retaliation into an arbitrary measure.

b. Security and Predictability: Peaceful Means of Dispute Settlement

Articles 3.2, 3.3 and 3.7 of the DSU tell us that the WTO dispute settlement system serves at least three functions to protect security and predictability. First is an adjudication function, which is 'to preserve the rights and obligations of Members under the covered agreements' and 'to clarify the existing provisions'. Second is a rebalancing function to maintain the proper balance between the rights and obligations of Members. Third is a settlement function to 'secure a positive solution to a dispute'.

The multiple functions of WTO dispute settlement provide retaliation with the possibility to pursue more than one goal. This also explains why Article 22.8 provides several situations in which retaliation could be terminated. Article 22.8 sustains the adjudication and settlement functions of WTO dispute settlement. The wording of 'measure found to be inconsistent with a covered agreement has been removed' maintains the adjudication function whereas 'a solution to the nullification' and 'a mutually satisfactory solution' support the settlement function.

The rebalancing function reflects the basic framework of the WTO as a reciprocity-based system. Thus, one of the goals of dispute settlement is to maintain the balance of concessions and benefits and to restore it when a Member upsets it. Retaliation as an integral part of the dispute settlement system upholds this goal, as reflected in Article 22.4 of the DSU.

Above all, the three functions embedded in the WTO dispute settlement system reflect the intention of Members to resolve their disputes through peaceful means.

v. The Assessment of Remedies Provisions Under the ITO Charter, the GATT 1947 and the Uruguay Round Draft Texts as Supplementary Means of Interpretation

Supplementary means of interpretation under Article 32 of the VCLT have been employed in fewer WTO cases than Article 31. The panels and Appellate Body in several cases referred to negotiating history, custom classification practice, and working documents of the GATT Secretariat as supplementary means of interpretation.[195] Article 32 of the VCLT states that recourse to

[195] *United States—Measures Treating Exports Restraints as Subsidies*, Panel Report (adopted 23 August 2001) WT/DS194/R, [8.64]; *EC—Computer Equipment* (n 144) [92]; *Mexico—Measures Affecting Telecommunications Services*, Panel Report (adopted 1 June 2004) WT/DS204/R [7.44].

supplementary means of interpretation is permitted either 'to confirm the meaning resulting from the application of Article 31' or when the interpretation under Article 31 'leaves the meaning ambiguous or obscure' or 'leads to a result which is manifestly absurd or unreasonable'. Accordingly, recourse to supplementary means of interpretation is not mandatory.[196] It is not the intention of this book to enter into the debate about the importance of resorting to supplementary means of interpretation. The assessment of the remedies provisions under the International Trade Organization (ITO) Charter, the GATT 1947 and the Uruguay Round Draft Texts aims to confirm the meaning of interpretation of Article 22 of the DSU in accordance with Article 31 of the VCLT (text, context, object and purpose), which have been discussed earlier.

a. 'Appropriate and Compensatory' Remedy Provision Under the ITO Charter

The significant work on the ITO remedy provisions was started in the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Development (UNCTAD).[197] As regards the suspension of obligations, the drafting subcommittee on Chapter VIII dealt with the issue on whether suspension was to serve as a sanction or compensation for the injury suffered.[198] While in the subcommittee's ninth meeting some delegations suggested that both sanction and compensation for nullification or impairment of the benefit be included,[199] the Report submitted by the Working Party concerning Articles 89 and 90 of Chapter VIII provided the text 'to the extent and upon such conditions as it considers appropriate and compensatory, having regard to the benefit which has been nullified or impaired'.[200] Interpretative notes of the text proposed by the Working Party explained that 'appropriate' should be read to provide a relief within the limits of compensation.[201] Subsequently in the Reports of the Havana

[196] Qureshi (n 120) 24.

[197] *Report of the Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment (adopted by the Preparatory Committee 22 August 1947)*, E/PC/T/186, 10 September 1947, Art 90 (the 1947 Geneva Preparatory Conference Report). RE Hudec, 'The GATT Legal System: A Diplomat's Jurisprudence' (1970) 4 *Journal of World Trade Law* 615, 625. The provision concerning the settlement of disputes in the Report of the First Session did not govern any remedy issue. See *Report of the First Session of the Preparatory Committee of the United Nations Conference on Trade and Employment*, E/PC/T/33, November 1946, Art 86 (the London Draft).

[198] Hudec (n 197) 625.

[199] Sub-Committee on chapter VIII (Settlement of differences-interpretation), *Notes on the Ninth Meeting*, E/Conf.2/C.6/W.66, 22 January 1948.

[200] Sixth Committee, *Report of Working Party 3 of Sub-Committee G*, E/Conf.2/C.6/W.80, 30 January 1948, 2.

[201] Sub-Committee on chapter VIII (Settlement of differences-interpretation), *Notes of the Seventeenth Meeting*, E/Conf. 2/C.6/W.102, 16 February 1948.

Conference, the Committee described more clearly the nature of suspension of obligations by stating that 'the text provides that the nature of the relief to be granted is compensatory and not punitive'.[202]

In his assessment of the ITO preparatory work, Hudec makes an interesting point that although the Working Party agreed that the remedy should be 'appropriate and compensatory', these words were not included in the Charter itself. Nevertheless, the Working Party preferred to state it in the form of an ambiguous text plus interpretative note.[203] In Hudec's view, the reason behind this drafting decision was to strike a balance between two issues: 'a duty to adhere to the rules' and 'a duty to pay for damage done' (limitation to the sanction).[204] Hudec notes that the draftsmen encountered the difficult problem that on the one hand they wanted the ITO legal obligations to be treated and enforced effectively, but on the other hand they were unwilling to endorse punitive sanction remedies due to the fact that governments would not accept the notion of being punished by an international authority.[205]

b. 'Appropriate' Remedy Provision Under the General Agreement

The ITO Charter contained detailed rules for third-party adjudication of international trade disputes, including the possibility of appeal to the Plenary Conference and a right to seek an advisory opinion from the ICJ.[206] The ITO was stillborn because it failed to win the approval of the US Congress. As an agreement that was intended to apply provisionally, the GATT only incorporated two provisions from the Charter: 'consultations' under Article XXII and 'nullification or impairment' under Article XXIII. As regards the suspension-of-concessions provision, the ITO Charter provided suspension of concessions or other obligations should be 'appropriate and compensatory' to the benefit which has been nullified or

[202] Havana Conference *Reports of the Committee and Principal Sub-Committees*, UN Doc ICITO1/8 (September 1948) 155.

[203] Hudec (n 197) 626. Hudec writes that 'the interpretative note was relegated to a relatively inconspicuous document. Although the ITO Charter contained a formal "Annex" for the interpretative notes, it was decided that this bit of clarification belonged in the subcommittee's "report", a wholly separate document not signed by governments nor even voted on by the plenary drafting body'.

[204] ibid 626–27.

[205] ibid 626. For example, in the *US—Upland Cotton* dispute, the spokeswoman for the USTR Ron Kirk stated that while they are disappointed at the outcome of the dispute, they were pleased that the arbitrators awarded Brazil an amount of countermeasures far below what it had asked for. See: ICTSD, 'WTO Panel Allows Brazil to Cross-Retaliate on IP, Services in Cotton Row', 13 BRIDGES, 9 September 2009.

[206] E-U Petersmann, 'The Establishment of a GATT Office of Legal Affairs and the Limits of "Public Reason" in the GATT/WTO Dispute Settlement System' in G Marceau (ed), *A History of Law and Lawyers in the GATT/WTO: The Development of the Rule of Law in the Multilateral Trading System* (Cambridge, Cambridge University Press, 2015) 190.

impaired, while the General Agreement only specified the term 'appropriate'.[207] Neither the GATT nor the ITO Charter provided the terms 'retaliation' or 'sanction'.[208] What does 'appropriate' mean? The *US—Suspension of Obligations* dispute was only one case in the GATT dispute settlement where the 'appropriate' standard was observed. The Working Party in this case was instructed by contracting parties to investigate the appropriateness of the measure which the Netherlands government proposed to take. It provided that the level of suspension was determined 'having regard to its equivalence to the impairment suffered by the Netherlands as a result of the United States restrictions'.[209]

c. From 'Appropriate' to 'Equivalent': The Uruguay Round Negotiations Draft Texts

During the dispute settlement negotiations in the Uruguay Round, the negotiating parties discussed a number of proposals to improve and strengthen the GATT dispute settlement rules and procedures. These proposals included the standard of retaliation and the political commitment to restraint use of unilateral measures.

There were three pieces of wording concerning the standards of retaliation proposed in the 1990 Draft text on Dispute Settlement. They were 'commensurate to the damage suffered', 'substantially equivalent' and 'appropriate in the circumstances'.[210] Neither the 1990 Draft Text nor the Brussels Draft Text[211] stipulated the wording 'equivalent to the level of the nullification or impairment'. The 'equivalent to' standard was proposed later on in the Dunkel Draft Text.[212] Interestingly, the negotiators agreed to the 'equivalent to' standard instead of the standards proposed in the 1990 Draft Text.[213] The choice of 'equivalent to' standard may be viewed as a compromise between divergent positions, since the Dunkel Draft Text

[207] GATT 1947, Art XXIII:2; S Charnovitz, 'Rethinking WTO Trade Sanctions' (2001) 95 *American Journal of International Law* 792, 801.

[208] Charnovitz (n 207).

[209] *Netherlands Action under Article XXIII:2 to Suspend Obligations to the United States* ('*US—Suspension of Obligations*'), GATT Working Party Report (adopted 8 November 1952) L/61, 2.

[210] Negotiating Group on Dispute Settlement, *Draft Text on Dispute Settlement*, MTN.GNG/NG13/W/45, 21 September 1995) 5–7.

[211] *Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, MTN.TNC/W/35/Rev.1, 3 December 1990. The Brussels Draft Text contained a draft agreement on dispute settlement procedures entitled 'Understanding on the Interpretation and Application of Article XXII and XXIII of the General Agreement on Tariffs and Trade'.

[212] Shadikhodjaev (n 27) 43.

[213] *Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, MTN.TNC/W/FA, 20 December 1991. The Dunkel Draft was issued by Arthur Dunkel, the Director-General of the GATT. The Draft contained the suggested results of negotiations in nearly all the negotiating groups and provided arbitrated solutions to issues on which

also proposed a binding dispute settlement system, an automatic authorisation to retaliate and cross-retaliation. As noted by Sebastian, parties that were not content with particular obligations may have sought to limit the enforceability of these obligations.[214]

During the Uruguay Round negotiations, the negotiating parties also proposed a commitment to refrain from unilateral measures. For instance, a number of delegations during the Negotiating Group meeting in September 1989 highlighted that with regard to the issue of retaliatory measures, 'no contracting party should have the right to use unilateral measures to preserve what it believe to be its rights under the General Agreement'.[215] This concern was primarily addressed to the United States and its Section 301.[216] The commitment to refrain from unilateral action was eventually reflected in Article 23 of the DSU.

After all, it can be concluded that none of the provisions in the ITO Charter, the GATT 1947 and the Uruguay Round Draft Texts provide a punitive punishment for non-compliance. Non-punitive sanctions demonstrate that the aim of retaliation either in the ITO or the GATT or the WTO is by no means to punish the violator Member. The notions of settlement of disputes through a positive settlement and non-punitive sanctions appear to suggest another goal of WTO retaliation: the inducement of an amicable settlement.

SUMMARY

This chapter has conducted legal quests to search the purpose of retaliation. The first two quests were performed by looking at the remedy rules in the disciplines outside WTO law, namely international law and private contract

parties had been unable to reach agreement. The Dunkel Draft was accepted by the Uruguay Round Negotiators and became the foundation of the WTO Agreements, including the current DSU. See TP Stewart (ed), *The GATT Uruguay Round: A Negotiating History (1986–1992) Volume IIb: Commentary* (The Hague, Kluwer Law and Taxation Publishers, 1995) 2793; T Sebastian, 'World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness' (2007) 48 *Harvard International Law Journal* 337, 347.

[214] Sebastian (n 214) 347–48.

[215] Negotiating Group on Dispute Settlement, *Meeting of 28 September 1999*, MTN.GNG/NG13/16, 13 September 1989, 14.

[216] Section 301 of the Trade Act of 1974 gives the President authority to retaliate against unreasonable, unjustifiable or discriminatory foreign government practices that restrict US commerce. In the middle of the 1980s, Congress amended section 301 and passed into law the Omnibus Trade and Competitiveness Act of 1988 (the '1988 Trade Act'), which extended and added section 301 with Special 301 and Super 301. Super 301 requires the US Trade Representative (USTR) to identify annually US 'trade liberalization priorities' including the list of countries that engage in trade barrier and distorting practice. Additionally, Special 301 requires the USTR to prepare an annual catalogue of countries that have inadequate protection of US intellectual property.

law. The last two quests were conducted by evaluating the DSU and WTO arbitrators' decisions.

First, the quest was focused on the reference to the remedies of public international law made by the arbitrators in *Brazil—Aircraft*. It provided that by merely referring to the purpose of countermeasures under public international law, only because both the SCM Agreement and the ILC Draft Articles provide the same term 'countermeasures', without further explanation as to whether or not this is relevant, the arbitrators indirectly applied the concept of something that the WTO has contracted out. Secondly, the search was done by looking at contract remedies from a law and economics perspective. It found that WTO remedies are similar to the remedial character of property rules. Parties have an obligation to perform but are allowed to negotiate mutual solutions to the nullification. The negotiation is intended to replace the obligation to perform.

Thirdly, the search was done by conducting an assessment of Article 22.6 arbitrators' statements concerning the purpose of retaliation. The evaluation found that the arbitrators' statements in Article 22.6 arbitral proceedings were changed gradually and seemed to offer a space for multiple purposes. Finally, the quest was conducted by interpreting Article 22 of the DSU in accordance with the general rules of interpretation. The interpretation of Article 22 undertaken in this chapter demonstrates that there are several parts of the wording of Article 22 of the DSU that indicate the purposes of retaliation. Put differently, Article 22 indicates multiple purposes that retaliation can pursue, and they are: inducing compliance, rebalancing, and reaching a mutually satisfactory solution. To sum up, this chapter's key conclusion is: retaliation can have more than one purpose.

6

Retaliation to Induce an Amicable Settlement as Another Competing Purpose and the Effectiveness of WTO Retaliation

The aim of the dispute settlement mechanism is to secure a positive solution to a dispute.[1]

OVERVIEW

WTO DISPUTE SETTLEMENT is the central pillar of the multilateral trading system in providing security and predictability.[2] The system offers a numbers of ways to settle a dispute once a complaint has been submitted: (i) parties to a dispute can find a mutual solution during the stage of bilateral consultations; (ii) during adjudication, the parties can cease their dispute or implement panel/AB reports;[3] (iii) at non-implementation stage, parties to a dispute can reach an amicable solution or settlement.[4]

An amicable settlement is a common instrument in WTO dispute settlement used by parties to a dispute to resolve their problem. It offers a number of significant benefits to the disputing parties. It provides privacy and confidentiality for the parties when they negotiate their settlement. It develops an amicable environment where parties can negotiate more smoothly, efficiently and in a corporative manner. It also provides flexibility, which is often needed to resolve problematic and high-political-cost disputes. Thus,

[1] DSU, Art 3.7.

[2] WTO, *Understanding the WTO*, 5th edn (Geneva, WTO Information and External Relations Division, 2015).

[3] WTO, *A Handbook on the WTO Dispute Settlement System: A WTO Secretariat Publication prepared for publication by the Legal Affairs Division and the Appellate Body* (Cambridge, Cambridge University Press, 2004) 43.

[4] DSU, Arts 3.6, 3.7 and 22.8.

when compliance seems not to be feasible at the non-implementation level, the imposition of retaliation can be intended to achieve the purpose of inducing a mutually agreed solution.

Retaliatory measures imposed by the United States in *EC—Hormones*, for example, would be terminated not because the European Communities removed its inconsistent measure (ban on hormone-treated beef), but because both states reached and agreed upon a mutually satisfactory settlement. In other words, retaliation imposed by the United States has not induced the withdrawal of the inconsistent measure (compliance) but a mutually agreeable solution (MAS).

The practical issue is that the contents of settlements reached by parties to the dispute at the non-implementation level such as in *EC—Hormones*, *US—Upland Cotton* and *US—Clove Cigarettes* are often considered disturbing.[5] The settlements reached in *Hormones*, *Upland Cotton* and *Clove Cigarettes* allow the defaulting parties (the United States and European Union) to maintain their offending practices and buy out their WTO compliance obligations by offering monetary or other forms of settlement.

This chapter first evaluates the amicable solution in the framework of WTO dispute settlement, including the purpose of inducing an amicable settlement as another competing purpose of retaliation, and subsequently it discusses the effectiveness of retaliation in light of its purposes and the way forward.

I. AMICABLE SETTLEMENTS IN THE MULTILATERAL TRADING SYSTEM

Article 3.7 of the DSU recognises that a 'solution mutually acceptable to the parties to a dispute and consistent with the covered agreements is clearly to be preferred'. The preference is materialised in practice. As at March 2015, around 24 per cent of all WTO complaints have been mutually agreed and notified to the DSB pursuant to Article 3.6 of the DSU.[6] But, if we also take into account the disputes that have been resolved bilaterally but where the outcomes have not yet been notified, the percentage of amicable settlements in WTO dispute settlement is higher.[7]

[5] W Watson, 'As Expected, WTO Clove Cigarettes Case Goes Nowhere', Cato Institute, 8 October 2014, www.cato.org/blog/expected-wto-clove-cigarette-case-goes-nowhere.

[6] WTO, 'Chronological List of Disputes Cases', www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm.

[7] For example, at the end of 2009, of 402 disputes brought before the WTO, 84 seemed to be solved bilaterally (no outcomes notified to the WTO) and 95 were resolved bilaterally (outcomes notified to the WTO). See WTO, *Annual Report 2010*, www.wto.org/english/res_e/booksp_e/anrep_e/anrep10_e.pdf, 82.

Before discussing the DSU provisions regarding amicable settlement, the rules and practice of amicable settlements in the GATT will be considered.

A. A Brief Historical Context of Amicable Settlements in the GATT Practice

The GATT dispute settlement system was based on Articles XXII and XXIII. Article XXII in particular provides a rule requesting contracting parties to seek a satisfactory solution through consultation. There were a number of GATT disputes that were terminated with MAS. For example, the United States and Japan settled their dispute with MAS in *Japanese Measures on Imports of Leather*.[8]

During the Tokyo Round negotiations, the contracting parties adopted the 1979 GATT Understanding Regarding Notification, Consultation, Dispute Settlement and Surveillance as part of the codification of GATT's dispute settlement practice.[9] Annex 4 of the Document states that 'The aim of the CONTRACTING PARTIES has been always been to secure a positive solution to a dispute. A solution mutually acceptable to the parties to a dispute is clearly to be preferred'. The DSU's Article 3.7, undeniably, has reflected this passage. Annex 4 of the 1979 GATT Understanding, however, does not include the term 'consistent with the covered agreements'. It was during the Uruguay Round that the elements to balance contractual freedom of parties to a dispute and protection of collective interests were put in place. The 1989 Improvements to the GATT Dispute Settlement Rules and Procedures introduced two paragraphs requiring 'conformity with the GATT' and mandatory 'notification'.[10] These two requirements appeared subsequently in Articles 1.7 and 1.6 of the DSU Draft.[11]

B. Amicable Settlement in WTO Dispute Settlement

Several provisions of the DSU explicitly make reference to amicable settlements. Article 1.1 of the DSU clearly states that the DSU applies to consultations and the settlement of disputes between Members. Articles 3.5 of

[8] *Japanese Measures on Imports of Leather*, GATT Panel Report (adopted 6 November 1979) L/4789—26S/320.

[9] GATT, *Understanding regarding Notification, Consultation, Dispute Settlement and Surveillance*, L/4907, 28 November 1979.

[10] The Decision of 12 April of 1989 on Improvements to the GATT Dispute Settlement Rules and Procedures, BISD36S/61, 12 April 1989, Paragraphs A and B.

[11] Trade Negotiations Committee, *Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, MTN.TNC/W/FA, 20 December 1991, S.2–3.

the DSU provides that all solutions must be consistent with WTO covered agreements and must not nullify or impair benefits accruing to any Member under the WTO agreements. Despite these references, there is no definition of MAS in the DSU. In practice, the notion 'mutually agreed' is often understood as 'consensual' outcomes reached by the parties to a dispute;[12] and 'solution' amounts to a 'final settlement/agreement'. In *EC—Bananas III (Article 21.5—Ecuador II)*, the panel and the Appellate Body viewed solutions in the Bananas Understanding as 'a series of steps which were intended as a precursor to the possible conclusion of a final settlement agreement'.[13] Thus, they considered that the Bananas Understanding was not MAS.

The DSU is silent on the legal status of MAS and their enforcement in subsequent dispute proceedings.[14] This was an issue encountered by the panel in *India—Autos* when assessing the legal effects of MAS. The panel stated that 'the status of mutually agreed solutions under the DSU and their impact in subsequent dispute settlement proceedings is not expressly indicated in the DSU and has not been previously addressed in WTO dispute settlement proceedings'.[15] In this case, India argued that a MAS concluded with the European Communities to settle their dispute over India's quantitative restrictions barred the European Communities from bringing this dispute to the panel.[16] The panel took the view that:

> Without clear guidance in the DSU, this question raised an important systemic issue. On the one hand … the right for any WTO Member to bring a dispute to the DSB is one of the fundamental tenets of the DSU… On the other hand … it could not be lightly assumed that those drafters intended mutually agreed solutions, expressly promoted by the DSU, to have no meaningful legal effect in subsequent proceedings.[17]

The panel subsequently noted that this issue should be assessed on a case-by-case basis as there may be significant differences between provisions of MAS from case to case.[18] The panel did not find that the terms of MAS concluded

[12] W Alschner, 'Amicable Settlements of WTO Disputes: Bilateral Solutions in a Multilateral System' (2014) 13 *World Trade Review* 66, 68.

[13] *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Second Recourse to Article 21.5 of the DSU by Ecuador* ('*EC—Bananas III (Article 21.5—Ecuador II)* (AB)'), Appellate Body Report (adopted 11 December 2008) WT/DS27/AB/RW2/ECU [214].

[14] A Alvarez-Jiménez, 'Mutually Agreed Solutions under the WTO Dispute Settlement Understanding: An Analytical Framework after the *Softwood Lumber* Arbitration' (2011) 10 *World Trade Review* 343, 348.

[15] *India—Measures Affecting the Automotive Sector*, Panel Report (adopted 5 April 2002) WT/DS146/R, WT/DS175/R, [7.113].

[16] ibid [7.05].

[17] ibid [7.115].

[18] ibid. See also, *India—Quantitative Restriction on Imports of Agricultural, Textile and Industrial Products—Notification of Mutually Agreed Solution*, WT/DS90/2/Add.1; WT/

in the earlier dispute covered the issues or measures brought in the newer dispute,[19] and concluded that the terms of MAS do not preclude them from examining the matter brought to them, but this finding is without prejudice to 'the legal question as to whether a notified mutually agreed solution can ever operate as a bar to a panel's express mandate from the DSB'.[20]

Moreover, while the DSU does not define MAS, it highlights 'multilateral' procedural and substantive obligations for a solution to be qualified as MAS. They are notification and conformity with WTO law, which are stipulated in Articles 3.6 and 3.7 of the DSU.

i. Notification Obligation of MAS

Article 3.6 of the DSU regulates the obligation for parties to a dispute to notify the DSB and any relevant Councils or Committees when a mutually agreed solution has been reached. Alschner points out that such an obligation gives the opportunity to the third party or other Members who are not involved in the dispute to raise any point or inquire about the MAS.[21] Put differently, the notification obligation sustains one of the basic pillars of the WTO: transparency.

In practice, a number of disputes have been settled through a MAS but the MAS was never notified pursuant to Article 3.6 of the DSU.[22] The question is that whether notification is a prerequisite for the legally binding characteristic of MAS or whether failure to notify will make the existence of a MAS invalid.

The disagreement on MAS was one of the issues in *EC—Bananas III (Article 21.5—Ecuador II)*. The European Communities notified the 2001 Bananas Understanding to the DSB as MAS to its bananas dispute with the United States and Ecuador.[23] However, shortly after the United States and Ecuador claimed that the Bananas Understanding was not MAS under Article 3.6 of the DSU.[24] The panel highlighted the indispensable character of the notification requirement as a multilateral element of MAS, however the panel did not see the Bananas Understanding as a MAS (due to the

DS91/2/Add.1; WT/DS92/2/Add.1; WT/DS93/2/Add.1; WT/DS94/2/Add.1; WT/DS96/2/Add.1, 14 January 1999.

[19] ibid [7.113].
[20] ibid [7.134].
[21] DSU, Art 3.6.
[22] WTO, 'Chronological List of Disputes Cases' (n 6).
[23] *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Notification of Mutually Agreed Solution*, WT/DS27/58, 2 July 2001.
[24] *European Communities—Regime for the Importation, Sale and Distribution of Bananas*, Communication from the United States, WT/DS27/59, 2 July 2001; *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Understanding on Bananas between Ecuador and the EC*, WT/DS27/60, G/C/W/274, 9 July 2001.

disagreement between parties regarding the Understanding), irrespective of its proper notification under Article 3.6.[25] The Appellate Body upheld the panel's decision that the Bananas Understanding was not MAS, but the Appellate Body were of the view that the panel must look at the text of the Understanding rather than the conflicting notifications or *ex post* communications of the parties at the meeting of the DSB.[26]

The Appellate Body's finding tells us that what mattered was the text of the agreement/solution where the rights and obligations are laid down.[27] Neither the conflicting statements of the parties nor the failure to notify would alter the binding character of such agreement/solution. As Alschner put it: 'non-notification of a MAS [procedural violation] may result in a violation of DSU Article 3.6, but it does not invalidate the existence of a settlement in the first place'.[28]

ii. Consistent with Covered Agreement

As mentioned above, MAS offers a greater degree of flexibility to the parties in settling their dispute.[29] Article 3.6 merely lays down procedural obligations for MAS. Articles 3.5 and 3.7 of the DSU place substantive obligation on the MAS by mandating that the MAS should be consistent with WTO covered agreements. Article 3.5 in particular provides that 'all solutions' which include MAS and any outcomes must be 'consistent with those agreements and shall not nullify or impair benefits accruing to any Member under those agreements, nor impede the attainment of any objective of those agreements'.

The text of MAS can create rights and obligations. For example, a party to MAS can agree to relinquish its right to bring action under the DSU, as is evidenced in the final settlement of *US—Clove Cigarettes* where the United States agreed to not bring any future action against Indonesia's export ban/restriction on certain minerals.[30] The Appellate Body in *EC—Bananas III (Article 21.5—Ecuador II)* recognised this type of agreement by stating that

[25] *European Communities—Regime for the Importation, Sale and Distribution of Bananas—Second Recourse to Article 21.5 of the DSU by Ecuador* ('*EC—Bananas III (Article 21.5—Ecuador II)*'), Panel Report (adopted 11 December 2008) WT/DS27/RW2/ECU, [7.106]–[7.107].

[26] *EC—Bananas III (Article 21.5—Ecuador II)* (AB) (n 13) [222].

[27] Alvarez-Jiménez (n 14) 351.

[28] Alschner (n 12) 81.

[29] In comparison with MAS, the DSU provides a stricter requirement for the WTO adjudicators' recommendations and rulings that they cannot add or diminish the rights and obligations provided in the covered agreements. See DSU, Arts 3.2 and 19.2.

[30] *Memorandum of Understanding Between the Government of the United States of America and the Government of the Republic of Indonesia*, done on 3 October 2014, Section A ('the MOU on Clove Cigarettes Dispute').

MAS may encompass an agreement to forgo the right to initiate proceedings as long as it is clearly specified.[31] A party can also agree with additional commitments or obligations, for example the recognition of the State of Santa Catarina as free of foot-and-mouth disease by the United States is one of the interim settlement terms in the *US—Upland Cotton* dispute.[32] So, how do we know that the text of MAS is WTO consistent?

When evaluating the reference in the introductory clause of Paragraph 5.1 of China's Accession Protocol to the phrase 'in a manner consistent with the WTO Agreement', the Appellate Body in *China—Publications and Audiovisuals Products* noted that 'WTO Members' regulatory requirements may be WTO consistent in one of two ways. First, they may simply not contravene any WTO obligation. Secondly, even if they contravene a WTO obligation, they may be justified under an applicable exception'.[33] According to Alschner, in the context of MAS, this means that MAS must conform to all WTO obligations to be qualified as WTO-consistent settlements.[34] In other words, disputants cannot use MAS to reduce their WTO obligations but they can agree to waive their WTO rights or accept additional obligations.

C. Amicable Settlements at Non-Implementation Level Induced by Retaliation

The preference for MAS provided by the DSU has made the instrument available to the disputants at any stage of the dispute settlement mechanism, including at the stage of non-implementation.[35] For instance, the very first dispute brought to WTO dispute settlement between Singapore and Malaysia was settled amicably prior to the establishment of a panel.[36] Moreover, in *EC—Scallops* the parties to the dispute reached a MAS after the issuance of an interim report but before the issuance of final reports.[37] In other cases,

[31] *EC—Bananas III (Article 21.5—Ecuador II)* (AB) (n 13) [212].

[32] Office of the United States Trade Representative, 'US, Brazil Agree on Framework Regarding WTO Cotton Dispute', Press Release (Washington DC, June 2010) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2010/june/us-brazil-agree-framework-regarding-wto-cotton-disput.

[33] *China—Measures Affecting Trading Rights and Distribution Services for Certain Publications and Audiovisual Entertainment Products*, Appellate Body Report (adopted 19 January 2010) WT/DS363/AB/R [223].

[34] Alschner (n 12) 94.

[35] DSU, Arts 4.3, 11, 12.7, 15 and 22.8. See also: WTO, *A Handbook on the WTO Dispute Settlement System* (n 3) 93.

[36] DSB, *Minutes of the DSB Meeting Held in the Centre William Rappard on 19 July 1995*, WT/DSB/M/6, 28 August 1995.

[37] *European Communities—Trade Descriptions of Scallop—Notification of Mutually Agreed Solution*, WT/DS12/12, WT/DS14/11, G/L/94, G/TBT/D/9, 19 July 1996.

EC—Butter, the parties reached the solution after the issuance of the final report but before the circulation of the report to all Members.[38] In *US—DRAMS*, the disputants reached a MAS prior to the issuance of the interim report of the compliance panel.[39] In *Japan—Apples*, the parties to the dispute reached a MAS after the issuance of the Article 21.5 panel report.[40] MAS were also reached in the *US—Upland Cotton* and *US—Clove Cigarettes* disputes prior to the imposition of retaliation.[41] In *EC—Hormones*, a MAS has been reached after the imposition of retaliation.[42]

The next section focuses on an amicable solution reached at the non-implementation stage (prior to or after the imposition of retaliatory measures) in the *EC—Hormones*, *US—Upland Cotton* and *US—Clove Cigarettes* disputes.

i. 'Greater Market Access' Reached in EC—Hormones

The *EC—Hormones* dispute is a two decade-long dispute related to the health policies of the European Communities. The European Communities enacted a Directive that prohibited the importation and sale of hormone-treated beef and beef by-products. The United States (and Canada) challenged this directive in WTO dispute settlement.[43]

The United States argued that its beef is from cattle that are treated with approved growth hormones and therefore does not cause any risk to public health.[44] In contrast, the European Communities claimed that there are potential risks to human health associated with hormone-treated beef and beef products.[45] However, the European Communities' claim lacked an objective scientific risk assessment as required by the SPS Agreement.[46] The

[38] *Measures Affecting Butter Products—Notification of Mutually Agreed Solution, European Communities*, WT/DS72/7, G/L/157/Add.1, G/TBT/D/12/Add.1, G/LIC/D/4Add.1, 18 November 1999.

[39] *United States—Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea—Recourse to Article 21.5 of the DSU by Korea*, Panel Report (adopted 7 November 2000), WT/DS99/RW.

[40] *Japan Measures Affecting the Importation of Apples—Notification of Mutually Agreed Solution*, WT/DS245/21 G/L/520/Add.1 G/SPS/GEN/299/Add.1 G/AG/GEN/50/Add.1, 2 September 2005.

[41] *Memorandum of Understanding Related to the Cotton Dispute (WT/DS267)* ('the 2014 MOU on Cotton Dispute') https://ustr.gov/sites/default/files/20141001201606893.pdf; the MOU between the US and Indonesia (n 30).

[42] *Joint Communication from the European Union and the United States, European Communities—Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/29, 17 April 2014.

[43] For efficiency reasons, this chapter focuses on the beef hormone dispute between the United States and the European Communities.

[44] *EC Measures Concerning Meat and Meat Products (Hormones), Complaint by the United States*, Panel Report (adopted 13 February 1998) WT/DS26/R/USA, 51.

[45] ibid 52.

[46] ibid 49–50.

ban was mostly derived from subjective domestic consumer fear and bad experiences in the past.[47] The fear and experiences of the past (including the mad cow disease outbreak) have established a social-cultural perspective. The European Communities producers and consumers have a preference for naturally produced foods. The US producers and consumers generally accept technological interference with food. The panel, in a decision which was upheld by the Appellate Body, concluded that the European Communities measure was not based on a risk assessment as required by the SPS Agreement.[48]

While the European Communities always affirmed its intention to comply with the report adopted by the DSB, it appeared that it never intended to withdraw its ban on hormone-treated beef.[49] The European Communities' effort to comply was demonstrated from the actions pursued by the Commission. After the decision of the DSB, the Commission immediately initiated a complementary risk assessment and funded several scientific studies and research projects on the six hormones involved in the dispute.[50] The risk assessment conducted by the Scientific Committee on Veterinary Measures relating to Public Health (SCVPH) concluded that all six hormones have potentially adverse effects on human health, particularly for prepubertal children. However, the evidence is not equally conclusive for all hormones.[51] In May 2001 the Commission proposed new legislation amending Council Directive 96/22/EC, which suggests the complete ban of the use of oestradiol 17β.[52] With regard to the other five hormones, although admitting that the current state of knowledge does not make it possible to give

[47] ibid 8–9. In the history of events, the panel report described the illegal use of dethylstilboestrol (known as DES) in 1970 in veal production in France, and incidents in Italy where adolescents reportedly suffered from hormonal irregularity and the veal had been suspected as a possible cause.

[48] *EC Measures Concerning Meat and Meat Products (Hormones)*, Appellate Body Report (adopted 13 February 1998) WT/DS26/AB/R, WT/DS48/AB/R.

[49] NC Lloyd, 'Beef Hormones Foster Animosity and Not Growth: An Analysis of the World Trade Organization Solving the United States' and European Communities' Beef Hormone Dispute' (2006) 25 *Penn State International Law Review* 557, 798. See also: *European Communities—Measures Concerning Meat and Meat Products (Hormones)—Status Report by the European Communities*, WT/DS26/17/Add.4, WT/DS48/15/Add.4, 11 May 1999.

[50] *Proposal for a Directive of the European Parliament and of the Council Amending Council Directive 96/22/EC concerning the Prohibition on the Use in Stockfarming of certain Substances Having a Hormonal or Thyrostatic Action and of Beta-agonists* [2000] COM (2000)0320, 2.

[51] *Report on the Proposal for a European Parliament and Council Directive Amending Council Directive 96/22/EC concerning the Prohibition on the Use in Stockfarming of certain Substances Having a Hormonal or Thyrostatic Action and of Beta-agonists* [2001] EUR PARL DOC A5-0002/2001, 14.

[52] COM (2000)0320 (n 50) 6.

a quantitative estimate of the risk to consumers, the Commission proposed to continue to provisionally prohibit these hormones in accordance with Article 5.7 of the SPS Agreement.

Despite any risk assessment conducted by the European Communities, the United States and Canada viewed that the withdrawal of the inconsistent measures (the ban) was the only way to implement the DSB recommendations or rulings. The United States went even further; infuriated by the European Communities' non-compliance, it adopted 'carousel retaliation' in 2000.[53] After a conflict over compliance which lasted many years, in May 2009 the European Union[54] and the United States signed an MOU implementing an agreement that promises to end this long-standing dispute.

The memorandum provides for three phases in which at phases 1 (August 2009–August 2012) and 2 (August 2012–August 2013) the European Union agreed to expand its market access for US high-quality beef (HQB), and the United States agreed to reduce its retaliatory duties levied on certain EU exports. Phase 3 provides for the possibility of a definitive solution.[55]

In phase 1 the European Union agreed to open up a tariff quota for 20,000 metric tons imports of HQB,[56] and the US beef products under this scheme must originate from the cattle that have never been treated with growth hormones. In return, the United States agreed to not implement its January 2009 revised carousel retaliatory sanctions on selected EU products to the United States.[57] But trade retaliation remained in place for certain EU products ('reduced' list) until the final phase of the agreement.[58] In phase 2, the European Union adopted regulations increasing the quota of HQB to 48,200 metric tons and laying down rules for the quota management system.[59]

[53] Trade and Development Act Pub L No 106-200, § 407 114 Stat 251.

[54] The European Union was established when the Maastricht Treaty entered into force on 1 November 1993. The European Communities are one of the three pillars of the European Union. This chapter use both terms (the European Union and European Communities) interchangeably.

[55] If both the United States and the European Union agree that the arrangement is working to their mutual satisfaction, it could lead to a final solution under phase 3, in which the European Union would make permanent the 45,000 tons import quota for HQB and the United States would remove the retaliatory duties. *See* ICTSD, 'Truce Declared in Beef Hormone Dispute', 13 BRIDGES, 11 June 2009. See also *European Communities—Measures concerning Meat and Meat Products (Hormones)—Joint Communication from the European Communities and the United States*, WT/DS26/28, 30 September 2009.

[56] Council Regulation No 617/2009 of 13 July 2009 'Opening an Autonomous Tariff Quota for Imports of High-Quality Beef' OJ L182/1, 15 July 2009.

[57] *Implementation of the US-EC Beef Hormones Memorandum of Understanding—A Notice by the Trade Representative, Office of the United States*, 74 Federal Register 48808, 24 September 2009.

[58] R Johnson, 'The US-EU Beef Hormone Dispute', Congressional Research Service Report 7-5700, 14 January 2015.

[59] Regulation (EU) No 464/2012 of the European Parliament and of the Council of 22 May 2012, 'Amending Council Regulation (EU) No 617/2009 Opening an Autonomous Tariff

On 14 April 2014 the European Union and the United States notified the DSB of a revised MOU dated 21 October 2013 where both parties agreed to extend phase 2 for two extra years without a change of tariff-rate quota (TQR) and to enter into a negotiation for a definite solution to the dispute by August 2015.[60]

ii. 'Cash Payments' in US—Upland Cotton

US—Upland Cotton is a decade-long dispute between the United States and Brazil regarding the issue of unfair subsidies on cotton. In 2002 Brazil brought a claim in WTO dispute settlement complaining that certain US legislation and regulations provided subsidies (including export credits), grants and assistances to US producers and exporters of upland cotton.[61] Such subsidies arguably increased US upland cotton production, increased US exports and suppressed the cotton prices in the world. In 2002 and again in 2008 the WTO panels and Appellate Body found certain features of the US agricultural programme (domestic support to cotton under the marketing loan and countercyclical payment programmes, and export credit guarantees under the GSM-102 programme) inconsistent with WTO law.

The United States took some steps they deemed necessary to comply with the rulings. They abandoned some export credit schemes and the Step 2 cotton programme, which was authorised by the 2002 Farm Bill.[62] Brazil disagreed with the US claim that they had complied with the DSB rulings which led to the establishment of the compliance panel in 2006. Brazil argued that the US changes to the programmes were insufficient and it had not taken any specific measures to scrap its programme on marketing loans and countercyclical payments.[63] The WTO compliance panel determined that the United States had failed to bring its cotton subsidy programmes into compliance with the earlier rulings.[64] The United States appealed. The

Quota for Imports of High-Quality Beef', OJ L149/1, 8 June 2012; Commission Implementing Regulation (EU) No 481/2012 of 7 June 2012, 'Laying Down Rules for the Management of a Tariff Quota for High Quality Beef', OJ L148/9, 8 June 2012.

[60] See the Revised MOU on EC—Hormones, Art V, http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:22014A0130%2801%29.

[61] WTO, 'Dispute DS 267: United States—Subsidies on Upland Cotton' www.wto.org/english/tratop_e/dispu_e/cases_e/ds267_e.htm.

[62] R Schnepf, 'Brazil's WTO Case against the US Cotton Program' (2011) Congressional Research Service 7-5700 RL32571, 15–16.

[63] ICTSD, 'WTO Panel: US has Failed to Comply with Cotton Ruling in Dispute with Brazil', 11 BRIDGES, 17 October 2007.

[64] *United States—Subsidies on Upland Cotton—Recourse to Article 21.5 of the DSU by Brazil* ('*US—Upland Cotton (Article 21.5—Brazil)*'), Panel Report (adopted 20 June 2008) WT/DS267/RW.

Appellate Body also ruled in favour of Brazil.[65] Their reports gave a way for Brazil to request from the DSB an authorisation to retaliate—including, possibly, cross-retaliation in services and intellectual property rights.[66]

In June 2010 the United States and Brazil agreed on an interim settlement (the 2010 MOU) to avert the imposition of countermeasures by Brazil that would have affected approximately US$800 million of US trade at that time, including the threat of retaliation outside the agricultural sector.[67] In the 2010 MOU, the United States agreed to provide a monthly payment to the Brazil Cotton Institute (IBA) for a technical assistance fund and capacity-building activities related to the cotton sector in Brazil. In return, Brazil would suspend temporarily the imposition of the countermeasures.[68] The 2010 MOU was considered as a series of steps to help make progress for a mutually agreed solution, thus it was not MAS.

In October 2014 the two disputants agreed on a final settlement which terminates the *Upland Cotton* case. The United States agreed to make a one-off and final payment of US$300 million to the IBA. The MOU allows Brazil to spend the moneys according to the list of activities provided in Section II of the MOU but it also requires Brazil to be transparent in utilising such payment. Brazil, in return, agreed to relinquish its right to retaliate and to not bring any new complaints against the US domestic cotton support programmes and the GSM-102 programme.[69]

iii. 'GSP Facilitation' Reached in US—Clove Cigarettes

The *Clove Cigarettes* dispute was one of the high-profile disputes in the WTO as it involved a complex issue of how to achieve public policy objectives such as public health protection without creating unnecessary burden and obstacles to international trade.

The dispute started when Indonesia brought a complaint against the United States before the WTO dispute settlement system. Indonesia claimed that a piece of US legislation (the Family Smoking Prevention and Tobacco

[65] *United States—Subsidies Upland Cotton—Recourse to Article 21.5 of the DSU by Brazil*, Appellate Body Report (adopted 20 June 2008) WT/DS267/AB/RW.

[66] ICTSD, 'WTO Panel Allow Brazil to Cross-Retaliate on IP, Services in US Cotton Row', BRIDGES 13(30), 9 September 2009.

[67] Office of the United States Trade Representative, 'United States and Brazil Reach Agreement to End WTO Cotton Dispute', Press Release (Washington DC, October 2014) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2014/October/United-States-and-Brazil-Reach-Agreement-to-End-WTO-Cotton-Dispute.

[68] *Memorandum of Understanding between the Government of the United States of America and the Government of the Federative Republic of Brazil Regarding a Fund for Technical Assistance and Capacity Building with respect to the Cotton Dispute (WT/DS267) in the World Trade Organization* ('the 2010 MOU on Cotton Dispute') www.state.gov/documents/organization/143669.pdf.

[69] The 2014 MOU on Cotton Dispute (n 41).

Control Act, which amended the Federal Food, Drug, and Cosmetic Act, section 907(a)(1)(A)) is inconsistent with the WTO principle of non-discrimination by banning clove cigarettes, the majority of which are imported from Indonesia, while exempting menthol cigarettes, most of which are produced domestically.[70] Indonesia also claimed that the legislation is more trade restrictive than is necessary to protect human health because it does little to prevent young people from smoking, which is the objective pursued by the legislation.[71] The WTO Panel, in a decision which was upheld by the Appellate Body, found in Indonesia's favour that the disputed piece of US legislation was indeed discriminatory.[72]

At the DSB meeting on 24 May 2013, the United States made a statement that:

> US authorities … had worked to implement the recommendations and rulings of the DSB in a manner that is appropriate from the perspective of public health … the challenged US measure reflects the overwhelming view of the scientific community that banning clove and other flavoured cigarettes benefited the public health by reducing the likelihood that the youth would enter into a lifetime of cigarette addiction … The health risks posed by using tobacco were well-documented, and the public health challenges posed by menthol cigarettes in particular were significant … Raising awareness and educating about the health risks of tobacco could be an important means to discourage its use. In light of the significant public health challenges posed by menthol cigarettes, these actions by US health authorities brought the United States into compliance with the DSB's recommendations and rulings.[73]

The US statement clearly demonstrates that the United States has no intention of lifting the ban on clove cigarettes, nor have they the intention to impose a ban on menthol cigarettes.

In August 2013 Indonesia lodged a request to the DSB to authorise retaliation against the US failure to comply with WTO rulings.[74] The United States disputed Indonesia's claim that it did not need to refer this dispute to the compliance panel, and the European Union, the third party in this case, challenged Indonesia's decision to request authorisation to retaliate without

[70] *United States—Measures Affecting the Production and Sale of Clove Cigarettes—Request for Consultations by Indonesia*, WT/DS406/1, G/L/917, G/SPS/GEN/1015, G/TBT/D/38, 14 April 2010.

[71] ibid.

[72] *United States—Measures Affecting the Production and Sale of Clove Cigarettes* ('*US—Clove Cigarettes* (AB)'), Appellate Body Report (adopted 24 April 2012) WT/DS406/AB/R [298].

[73] DSB, *Minutes of Meeting—Held in the Centre William Rappard on 23 August 2013*, WT/DSB/M/335, 4 October 2013, para 1.9.

[74] *United States—Measures Affecting the Production and Sale of Clove Cigarettes—Recourse to Article 22.2 of the DSU by Indonesia*, WT/DS406/12, 13 August 2013.

resorting first to a compliance panel.[75] In October 2014 the Indonesian government announced that both Indonesia and the United States had reached an amicable settlement to resolve their dispute.[76] Subsequently, the European Union withdrew its request for consultations in the procedural dispute against Indonesia's decision to retaliate in *Clove Cigarettes*.[77]

The MOU between Indonesia and the United States, according to the Indonesian government, will end the Clove Cigarettes dispute, 'by way of settlement accommodating to the interests of both parties involved'.[78] The United States will able to maintain its ban on flavour cigarettes except menthol, but at the same time it will not impede the market access of Indonesian-made cigars and cigarillos in the US market until the new regulation, that are non-arbitrary and non-discriminative are in place.[79] The United States has also agreed to grant an additional Generalised System Preference (GSP)—a programme to help developing and least-developed countries—beyond certain value limitations for the next five years and to refrain itself from filing a complaint against Indonesia's current restrictions on the export of certain mineral and mining products.[80]

D. The Purpose of Inducing a Mutually Agreeable Solution (Final Settlement)

The reforms of dispute settlement system agreed in the Uruguay Round have introduced a number of innovative features which have driven WTO

[75] *Indonesia—Recourse to Article 22.2 of the DSU in the US—Clove Cigarettes Dispute—Request for Consultations by the European Union*, WT/DS481/1, G/L/1072, 19 June 2014. See also World Trade Online, 'US, Indonesia Clove Cigarette Fight Raises Key DSU Issues in the WTO', 6 September 2013, http://insidetrade.com/inside-us-trade/us-indonesia-clove-cigarette-fight-raises-key-dsu-issues-wto. A similar situation arose in the *US—Tuna II (Mexico)* dispute. The United States claimed that by extending two requirements to the fishing vessels outside the Eastern Tropical Pacific Ocean (ETP) that previously applied to the vessels within that ocean, where most Mexican fleets operate, it had complied with the WTO rulings. Mexico argued that the new rule was not relevant to their request for retaliation due to the United States not having made any reference to the new rule in its communication objecting to Mexico' retaliation request and therefore Mexico will proceed with retaliation when the arbitration is concluded. See World Trade Online, 'Despite New Tuna Rule, Mexico Says It will Impose Retaliation As Soon As Possible', *Daily News* (Washington DC, 23 March 2016) http://insidetrade.com/daily-news/despite-new-tuna-rule-mexico-says-it-will-impose-retaliation-soon-possible.

[76] Indonesian Ministry of Trade, 'Indonesia and the United States Agree to Stop Clove Cigarettes Case', Press Release (Jakarta, 7 October 2014) www.kemendag.go.id/files/pdf/2014/10/07/indonesia-as-sepakat-hentikan-kasus-rokok-kretek-en0-1412676149.pdf.

[77] *Indonesia—Recourse to Article 22.2 of the DSU in the US—Clove Cigarettes Dispute—Notification of a Mutually Agreed Solution and a Withdrawal of a Request for Consultations*, WT/DS481/5, G/L/1072/Add.1, 11 May 2015.

[78] Indonesian Ministry of Trade, 'Indonesia and the United States Agree to Stop Clove Cigarettes Case' (n 76).

[79] The MOU on Clove Cigarettes Dispute.

[80] ibid.

dispute settlement towards a quasi-judicial system. Regardless of such evolution, the DSU preserves the diplomatic elements of dispute settlement. Thus, the DSU establishes a system that combines diplomatic and adjudicatory components. A MAS resembles the 'diplomatic' feature of WTO dispute settlement. At the non-implementation stage, these mixed elements of dispute resolution can be seen in Article 22.8, which allows retaliation to be terminated by either withdrawal/compliance or MAS. Three disputes elaborated on previously are examples of the imposition of retaliation or its threat leading to the disputants' agreement on an amicable solution.

Achieving compliance or MAS is the eventual goal of retaliation. As with compliance, MAS is a factor that brings to an end the retaliatory measures imposed by the retaliating state. However, both are two distinct goals. The withdrawal of the inconsistent measures is often considered to be the course of action to secure compliance. MAS provides final solutions to the nullification and impairments that will replace the withdrawal of the inconsistent measures.

One might argue that the amicable settlement reached in *EC—Hormones* reflects the purpose of rebalancing. Such a view is rational. As argued by Pauwelyn, there are multiple, and sometimes overlapping purposes of retaliation.[81] In practice, the arbitrators in *US—FSC (Article 22.6—US)* acknowledged that the act of withdrawing the inconsistent measures (prohibited subsidies) restores the balance of rights and obligations.[82] Shadikhodjaev notes that the inducement of compliance serves as a means of rebalancing trade concessions or benefits whereas the rebalancing effect is a result of the compliance inducement.[83] The inducement of a MAS similarly has an element of rebalancing the mutual benefits under WTO agreements. By providing a final solution to the nullification or impairment, MAS restores the balance of concessions and benefits where the respondent has violated. It is, however, clear that suffering retaliation for the purpose of (temporary) rebalancing or reaching an interim settlement is the provisional or immediate aim of retaliation.[84] It does not provide the parties with finality. The interim settlements reached in *EC—Hormones* (the 2009 MOU) and

[81] J Pauwelyn, 'Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?' in CP Bown and J Pauwelyn (eds), *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (Cambridge, Cambridge University Press, 2010) 36.

[82] *United States—Tax Treatment for 'Foreign Sales Corporations'—Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*US—FSC (Article 22.6—US)*') Decision by the Arbitrator (30 August 2002) WT/DS108/ARB [5.56].

[83] ibid.

[84] R Malacrida, 'Toward Sounder and Fairer WTO Retaliation: Suggestions for Possible Additional Procedural Rules Governing Members' Preparation and Adoption of Retaliation Measures' (2008) 42 *Journal of World Trade* 3, 5.

US—Upland Cotton (the 2010 MOU) are examples of disputes where the imposition of retaliation serves the purpose of rebalancing in light of its provisional aim.

i. Retaliation Inducing a Mutually Agreeable Solution: A Defeat for the Winning Party?

The DSU provides mechanisms that give a degree of flexibility to the disputants to solve their dispute. This is demonstrated from the mechanisms that make the negotiations or bilateral consultations available at any stage of dispute settlement.

While reaching MAS at the beginning of the dispute or prior to the issuance of the WTO adjudicative bodies' report is preferred and presumably creates a win-win situation for the disputants, concluding MAS after the imposition of the retaliation measures may raise a question regarding the justice aspect from the complainant side. One may argue that the winning party does not obtain what it is supposed to gain when winning the dispute. Such concern is understandable when we focus on compliance or the withdrawal of inconsistent measures as the only solution to the nullification or impairment in WTO dispute settlement.

However, as pointed out by Trachtman, in high-profile cases involving politically sensitive matters, 'the nirvana of perfect compliance is a chimera'.[85] Zimmermann also states that compliance is essential, but not at all costs.[86] The purpose of inducing a MAS provides the disputants with a degree of flexibility that they want in settling their disputes. When the purpose of inducing compliance is not attainable, final solutions to the nullification or impairment through MAS is important to restore the balance of rights and obligations between parties to the dispute. Retaliation inducing MAS would help the disputants to find a tailored solution to their dispute. Thus, the concern of retaliation inducing MAS may not be so much whether it is reached at the expense of the complaining party, but the contentious issue is more on systemic implications and their consequences for the third parties' interests and the legality of the settlements.

ii. Retaliation Inducing a Mutually Agreeable Solution: Systemic Implications and Third Parties' Interests

Never-ending disputes will undermine the credibility of the WTO dispute settlement system. Terminating retaliatory measures and solving a decade-long

[85] JP Trachtman, 'Bananas, Direct Effect and Compliance' (1999) 10 *European Journal of International Law* 655, 678.

[86] CD Zimmermann, 'Toleration of Temporary Non-Compliance: The Systemic Safety Valve of WTO Dispute Settlement Revisited' (2011) 3 *Trade Law and Development* 382, 402.

dispute through MAS, on the one hand, appears to bring a positive result for the disputants and from the point of view of settlement of disputes. On the other hand, they might be questionable from the aspect of third parties' interests. Such bilateral solutions may be reached at the cost of third parties or may be at odds with the collective interests within the WTO. This section takes a look at the settlements reached in the *Hormones*, *Clove Cigarettes* and *Upland Cotton* disputes to evaluate the implications that they might have.

The MOU between the European Union and the United States established three phases that would lead to the final settlement of the *Hormones* dispute. The EU–US interim settlement received mixed domestic reactions. A US Senator hailed the provisional agreement as satisfactory from the perspective of greater market access to the European Union's market but also labelled it as disappointing from the point of view of evasion of hormones issues.[87] The agreement itself received a more positive response from the US meat exporters. The United States Meat Exporter Federation, for instance, stated that the meat export activity under the new quota had been increasing very encouragingly and had had a positive impact on demand for high-quality US beef.[88] In contrast, a major EU farm organisation, Copa and Cogeca, was unhappy with the Agreement, stating that the interim deal would hurt the European Union farmers who were already struggling in a market hit by economic crisis.[89] They also took the view that the deal was unfair since the European Union granted a greater market access from year one but the United States would maintain its retaliatory measures on certain products from the European Union for another three years.[90] The local beef producers' criticism of the beef deal is the standard/common economic argument, since increased market access for foreign products means increased competition faced by local products.

The EU–US provisional deal appears to carry potential trade implications for third parties' interests. During the DSB meeting, most of the beef-exporting Members such as Australia, Argentina and Uruguay expressed their concerns about the deal related to the quota allocation system and the definition of 'high-quality' beef, which might provide unequal market access to other

[87] ICTSD, 'EU, US Strike Provisional Deal to End 13-Year-Old Beef Dispute' 13 BRIDGES, 13 May 2009, www.ictsd.org/bridges-news/bridges/news/eu-us-strike-provisional-deal-to-end-13-year-old-beef-dispute.

[88] US Meat Export Federation, 'International Market Development Activities for US Beef', Fourth Quarter FY09, 1 July–30 September 2009, 7.

[89] Copa-Cogeca, 'EU-US Hormones Deal: Another Blow for Struggling Beef Farmers', EurActiv Press Release (Brussels, 8 May 2009) http://pr.euractiv.com/pr/eu-us-hormones-deal-another-blow-struggling-beef-farmers-88897.

[90] ibid.

beef-exporting Members and, therefore, could trigger another potential dispute under MFN treatment.[91] The European Union, in responding to this concern, provided that the new quota would be 'non-discriminatory' and 'origin neutral'.[92] However, at the meeting of the WTO Committee on Technical Barriers to Trade in June 2013, Argentina raised a concern regarding EU Regulation No 481/2012 as regards the validity certificates of authenticity for HQB. Argentina argued that the HQB quota, although it is origin neutral, is administered in a way that is tantamount to a 'de facto' discrimination inconsistent with the MFN principle.[93] It is reported that Argentina secured access to the EU HQB quota on 26 September 2014, although it is not clear when they would be able to start exporting to the European Union since Argentina beef exports have been decreased due to domestic supply and export restrictions issues since 2012.[94] Apart from the United States and Argentina, currently other beef exporter countries such as Australia, Canada, New Zealand and Uruguay have access to the quota. At the time of writing, no WTO Members have brought a formal complaint to WTO dispute settlement with regard to the arrangement to settle the hormone-treated beef dispute.

MAS reached in the *Clove Cigarettes* dispute seem to produce rather minor systemic and trade effects to third parties compared with those in the *Hormones* and *Upland Cotton* disputes. Indonesia is the world's largest producer of kretek/clove cigarettes. While virtually all clove cigarettes imported into the United States in the three years prior to the ban, and the vast majority of clove cigarettes consumed in the United States, come from Indonesia,[95] the US market is not profitable for Indonesia. The smoking rate in the United States has declined steadily in the past few years,[96] and Indonesia's exports of clove cigarettes to the United States were minuscule. In 2007, imports of clove cigarettes totalled US$398.8 million (out of US$360 billion of the total US market for cigarettes) or approximately one-tenth of 1 per cent of the total US market.[97] Meanwhile, more than 94 per cent of all

[91] DSB, *Minutes Meeting 19 June 2009—Held in Centre William Rappard on 19 June 2009*, WT/DSB/M/270, 28 August 2009, 66–69.

[92] ibid 76.

[93] See WTO, 'Members Continue to Discuss "Good Practices" for Technical Regulations', News Items (Geneva, 17 and 20 June 2013) www.wto.org/english/news_e/news13_e/tbt_17jun13_e.htm; FratiniVergano, 'Argentina Raises a Specific Trade Concerns at the WTO Regarding the EU's "High-Quality Beef" Quota', 13 *Trade Perspectives*, 28 June 2013.

[94] Y Polet, 'EU HQB Quota Reaches Quota Fill Ceiling as Argentina Secures Access', USDA GAIN Report Number E14051, 10 January 2014. http://gain.fas.usda.gov/Recent%20GAIN%20Publications/EU%20HQB%20Quota%20Reaches%20Quota%20Fill%20Ceiling%20as%20Argentina%20Secures%20Access_Brussels%20USEU_EU-28_10-1-2014.pdf.

[95] *US—Clove Cigarettes* (AB) (n 72) [222].

[96] Centers for Disease Control and Prevention, 'Current Smoking among Adults in the United States', www.cdc.gov/tobacco/data_statistics/fact_sheets/adult_data/cig_smoking/.

[97] WTO, *Executive Summary of the First Written Submission of Indonesia*, WT/DS406/R. Indonesian exports of clove cigarettes and cigars in 2008 totalled US$357.8 million.

cigarettes sold in the United States were produced domestically, and menthol accounted for around 26 per cent of the total US cigarettes market.[98]

Consequently, based on the equivalent standard, the level of authorised retaliation would arguably be insignificant for Indonesia. As an Indonesian senior trade official put it, 'what we gain by settling outside the WTO is more significant than what we would gain by taking retaliatory measures valued at USD 55 million out of Indonesia's total imports from the United States'.[99]

MAS to resolve the *Upland Cotton* dispute arguably had the most significant systemic implications compared with the ones reached in the *Hormones* and *Clove Cigarettes* disputes. By providing cash payment to a Brazil Cotton Fund, the United States subsidises not only its local cotton farmers but also Brazilian farmers. The US cotton subsidies have long been recognised as 'trade distorting'. According to the Environmental Working Group, cotton subsidies in the United States totalled US$32.9 billion from 1995 to 2012.[100] The programmes provided rewards to farmers for increasing production. The over-supply consequently dampened the world price of cotton, which also depleted the revenue of other cotton producer countries, particularly from Africa.[101] Cotton farmers in the West African region have relatively few options other than growing cotton. Geographical conditions limit the types of crops that can be grown. As a result, the economies of cotton producer countries in Africa rely to a great extent on cotton exports.[102]

The 2014 Cotton deal allows the United States to continue propping up its domestic farmers (by paying Brazilian farmers) at the expense of poor developing countries, as well as US taxpayers. While one may argue that subsidies from China and India in agriculture have increased in recent years and China is now considered the largest subsidiser of cotton, subsidies provided by the United States to its cotton farmers are still significant in creating an

[98] *US—Clove Cigarettes* (AB) (n 72) [223].

[99] Indonesian Ministry of Trade, 'Indonesia and the United States Agree to Stop Clove Cigarettes Case' (n 76). Although based on an interview conducted with another Indonesian senior trade official, the settlements reached in *Clove Cigarettes* are disappointing from his personal point of view. According to him, the GSP facilitation offered to certain Indonesian products is not comparable with the US violation of the WTO's non-discrimination principle. The United States' assurance that they would not bring any legal claims against Indonesia's export restrictions on certain minerals did not shield Indonesia from similar complaints brought by other countries against Indonesia to WTO dispute settlement.

[100] Environmental Working Group, 'EWG's Farm Subsidy Database', http://farm.ewg.org/progdetail.php?fips=00000&progcode=cotton.

[101] WTO, 'African Producers Call for Curbs on Subsidies as Cotton Prices Fall', News Items (Geneva, 28 November 2014) www.wto.org/english/news_e/news14_e/cdac_28nov14_e.htm.

[102] WTO, 'African Producers Call for Curb on Subsidies and Open Markets for Cotton', News Items (Geneva 26 and 27 November 2015) www.wto.org/english/news_e/news15_e/cdac_26dec15_e.htm.

artificially low world cotton price.[103] In responding to a question before the Senate Finance Committee, the chief of the United States Trade Representative (USTR) admitted that 'if you are a poor subsistence farmer in Africa, it does not matter whether the subsidy's coming from the United States or China, it matters that the subsidy exists'.[104] A study conducted by the United Nations Industrial Development Organization (UNIDO) demonstrates that trade-distorting polices on tariffs and subsidies imposed by developed and developing countries alike continue to hamper small developing states' and least-developed countries' trade and economies.[105] Valentine Rugwabiza, the former Deputy Director-General of the WTO, highlighted that 'the road to realizing Africa's potential lies in removing trade barriers'.[106]

Challenging the US–Brazil MAS and unfair cotton subsidies in WTO dispute settlement is a way for African countries to protect their trade interests. However, it is known that African countries have been largely absent in WTO dispute settlement due to *capacity* and *power* constraints.[107] So it seems unlikely that African countries will challenge a powerful developed country such as the United States and big developing countries such as Brazil, China and India. Put differently, they appear to be caught between a rock and a hard place for now.[108]

iii. Solutions Allowing the Continuity of Inconsistent Measures: Legal or Illegal?

Settlements reached in the *Hormones*, *Clove Cigarettes* and *Upland Cotton* disputes have at least one similarity: the losing parties are able to keep maintaining their WTO-inconsistent measures. Discrimination, ban and unfair subsidies are still in place. Meanwhile, the DSU clearly mandates that 'all solutions' must be 'consistent with' the covered agreements. This raises a concern about the legality of these settlements.

[103] KW Watson, 'Will China Help End US Farm Subsidies?', Blog (Cato Institute, 27 January 2015) www.cato.org/blog/will-china-help-end-us-farm-subsidies accessed.

[104] C-Span 'trade policy', video, www.c-span.org/video/?323992-1/hearing-trade-policy; Watson (n 103).

[105] UNIDO, 'Supply Side Constraints on the Trade Performance of African Countries' (2006) 1 Background Paper, 2.

[106] V Rugwabiza, 'The Road to Realising African's Potential Lies in Removing Trade Barriers', Speech (UBS African Forum 2012, 1 October 2012) www.wto.org/english/news_e/news12_e/ddg_01oct12_e.htm.

[107] M Limenta, 'African Countries, The Unpolished Diamonds' in L Boulle, ET Laryea and F Sucker (eds), *International Economic Law and African Development* (Cape Town, Siber Ink, 2014).

[108] However, it has been argued that African countries' involvement should not be discouraged by power and capacity constraints. Other developing countries such as Costa Rica, Thailand, Viet Nam and Pakistan encountered similar constraints as African countries; however, they have been largely able to overcome them through increased experience in utilising WTO dispute settlement. See ibid.

So, is this kind of settlement permissible? Technically yes. It is mentioned in previous section that settlements reached between the disputants cannot be used to diminish their WTO obligations but the disputants can agree to waive their WTO rights.[109] Appellate Body in *EC—Bananas III* and later on reinstated in *EC—Poultry* noted that as regards concessions, a Member could yield rights but could not diminish its obligation.[110] This is exactly what the disputants in these three disputes have agreed on. Brazil, Indonesia and most likely the United States at phase 3 of the settlement have agreed to relinquish their rights to demand compliance from the respondents in the respective cases. They have agreed to withdraw their complaints and to terminate retaliatory measures and the disputes. The Appellate Body in *EC—Bananas III (Article 21.5—Ecuador II)* recognised this flexibility by stating that as long as it is indicated explicitly, a MAS may encompass an agreement to forego the right to initiate compliance proceedings.[111] If the disputants are satisfied with the deal outcomes and decide to drop the case, the dispute is resolved and little can be done unless the third party, particularly when the stakes for them are high, takes up the deal in a new dispute. As the Appellate Body in *US—Wool Shirts and Blouses* put it: 'if any Member should consider that its benefits are nullified or impaired as result of circumstances set out in Article XXIII, then dispute settlement is available'.[112]

II. THE QUESTION ABOUT THE EFFECTIVENESS OF WTO RETALIATION

According to the purpose-based approach, an effective instrument is the one that achieves or meets its intended purposes. Accordingly, in order to be effective, retaliation as one of the WTO dispute settlement instruments is expected to fulfil its purposes.

Inducing compliance is often considered to be the sole aim of WTO retaliation and the primary factor in assessing the effectiveness of WTO retaliation. This perspective may not only limit the role that can be played by retaliation, but also may trap the arbitrators in a situation where they award a 'punitive' amount which they deemed reasonably meaningful to induce compliance.[113]

[109] See also Alschner (n 12) 93–96.

[110] *European Communities—Measures Affecting Importation of Certain Poultry Products*, Appellate Body Report (adopted 23 July 1998) WT/DS69/AB/R [98]; *European Communities—Regime for the Importation, Sale and Distribution of Bananas* ('*EC—Bananas III* (AB)'), Appellate Body Report (adopted 25 September 1997) WT/DS27/AB/R [154].

[111] *EC—Bananas III (Article 21.5—Ecuador II)* (AB) (n 13) [212].

[112] *United States—Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Appellate Body Report (adopted 23 May 1997) WT/DS33/AB/R [13].

[113] As a result, the arbitrators may go beyond their mandate. The arbitrators, under Art 22.6 of the DSU and Art 4.11 of the SCM Agreement, are mandated to determine a level of

The inducement for compliance does not depend much on the level of retaliation. The arbitrators in *US—Byrd Amendment (Article 22.6—US)* acknowledged this complexity by stating that 'Inn some cases, even a very high amount of countermeasures may not achieve compliance, whereas in some others a limited amount may'.[114] The selection of the concessions or other obligations to be suspended can have a greater effect on inducing the recalcitrant state to comply or bringing the parties to the dispute back to the negotiation table. Informal remedies such as reputation also add considerable power to the non-punitive retaliation. This explains why the non-punitive level of retaliation can still operate effectively in inducing compliance or settlement.

The analysis provided in this book is in favour of the multiple purposes of WTO retaliation. The DSU has a strong preference for compliance; at the same time, it tolerates temporary non-compliance and allows a MAS to be reached at the non-implementation level.[115] In practice, a complaining Member utilises retaliation and its formal threats in inducing compliance, reaching temporary arrangements or achieving partial or complete solution. In other words, WTO retaliation contributes to changing the behaviour of the disputants, particularly the respondent, to promote the goals of retaliation.

For example, the threat of retaliation by the European Union in *US—Safeguards* was successful in inducing the United States to repeal the US steel safeguards in 2003.[116] Similarly in the *COOL* dispute, a few days after the DSB granted Canada and Mexico the authorisation to retaliate, the United States informed the DSB meeting that the COOL regulation had been repealed by the US Congress.[117] The domestic poultry and farmers' associations strongly support US compliance with WTO law due to the fear

retaliation that is equivalent or appropriate so that the amount of retaliation will not become punitive.

[114] *United States—Continued Dumping and Subsidy Offset Act of 2000, Original Complaint by Brazil—Recourse to Arbitration by the United States under Article 22.6 of the DSU ('US—Byrd Amendment (Article 22.6—US)')*, Decision by the Arbitrator (31 August 2004) WT/DS217/ARB/BRA footnote 131.

[115] If the rules were too rigid or strict, Members would lose their interest in complying with the rules, or they would even ignore the rules. Some flexibility is important to keep Members in the system and to attract other non-Members to join the system. The DSU reflects the dual nature of dispute settlement, and for the system that retains 'some of the ambivalence about law versus diplomacy', it works reasonably well. See also AE Lowenfeld, *International Economic Law*, 2nd edn (New York, Oxford University Press, 2003) 172.

[116] B Mercurio, 'Why Compensation Cannot Replace Trade Retaliation in the WTO Dispute Settlement' (2009) 8 *World Trade Review* 315, 318.

[117] WTO, 'DSB Grants Authorization to Canada and Mexico for Retaliation against the US in the COOL Dispute', News Items (Geneva, 21 December 2015) www.wto.org/english/news_e/news15_e/dsb_18dec15_e.htm.

of retaliation imposed by Canada and Mexico.[118] In the *Byrd—Amendment* dispute, the United States repealed the Byrd Amendment as a response to the retaliatory measures imposed by the European Communities, Japan, Canada and Mexico.[119]

In the *EC—Hormones* dispute, the European Union and the United States agreed on a provisional agreement as a series of steps designed to end the retaliatory measures and the long-standing dispute between them.[120] Similarly in the *EC—Bananas* dispute, the European Union, the United States and Latin American banana supplier countries signed agreements designed to provide for final settlement of all disputes over the EU import regime on bananas.[121] In the *US—Upland Cotton* dispute, Brazil and the United States have reached a final settlement in 2014 to resolve their cotton subsidy dispute. The agreement involves one-time US payment to Brazil Cotton Institute in return for Brazil not pursuing any WTO claims in five years time while the 2014 Farm Bill is in effect.[122] The amount of countermeasures awarded to Brazil in *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* was close to the amount awarded to Canada in *Brazil—Aircraft (Article 22.6—Brazil)*. In their decision, the arbitrators in the *Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)* arbitration proceeding stated that they understood that both parties had conducted consultations, thus awarding almost a similar amount of countermeasures was aimed to accommodate the parties to dispute to achieve a MAS.[123] Canada and Brazil finally reached a settlement in these two disputes over aircraft subsidies.

The presence of results such as temporary arrangements, final settlement or compliance as a response to retaliation actions demonstrates that WTO retaliation is reasonably effective in the light of its purposes.

[118] B Olejnik, 'WTO Approves Retaliatory Tariff over US COOL Rule', *Poultry Times*, 31 December 2015, www.poultrytimes.com/poultry_today/article_72d65698-a5c2-11e5-8cdc-f7ebf66d83b3.html.

[119] International Trade Administration, 'Foreign Retaliations' (25 August 2015) www.trade.gov/mas/ian/tradedisputes-enforcement/retaliations/tg_ian_002094.asp.

[120] WT/DS26/28 (n 55).

[121] Office of the United States Trade Representatives, 'US, EU Sign Agreement Designed to Settle Bananas Dispute' Press Release (Washington DC, 26 June 2010) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2010/june/us-eu-sign-agreement-designed-settle-bananas-dispute.

[122] The 2014 MOU on Cotton Dispute (n 41).

[123] *Canada—Export Credits and Loan Guarantees for Regional Aircraft—Recourse to Arbitration by Canada under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement* ('*Canada—Aircraft Credits and Guarantees (Article 22.6—Canada)*') Decision by the Arbitrator (17 February 2003) WT/DS222/ARB [4.4].

III. A WAY FORWARD

Evaluating the effectiveness of WTO retaliation is not uncontroversial, and disagreement may arise as to how to measure or evaluate effectiveness. As explained in the previous chapter, there are several approaches that can be taken to measure effectiveness. Regardless of such approaches, it is hard to imagine that there is an instrument that can perform perfectly without any issues or flaws.

Retaliation in the form of increasing tariff is obviously not a perfect instrument for small developing and least-developed country Members with small markets. Cross-retaliation under the TRIPS Agreement arguably is more effective and useful for them.[124] Antigua, for example, obtained an authorisation from the DSB to cross-retaliate against the United States on the subject of intellectual property rights.[125] The threat of cross-retaliation has brought the disputants back to the negotiating table in the hope of reaching a MAS.[126]

Many have criticised WTO retaliation. Churchill's famous adage should also be recalled: democracy is the worst form of government except for all the alternatives. Similarly, WTO retaliation is the worst form of trade remedy except for the alternatives that are provided outside the system (unilateral trade sanctions). As flawed as it can be, retaliation in the multilateral trading system provides a rule-based system that gives WTO Members equal opportunity, standards and platform that they may not have otherwise outside the WTO. As a delegation from the United States, Claire Wilcox, put it during the negotiations of the ITO Charter:[127]

> We have sought to tame [unilateral] retaliation, to discipline it, to keep it within bounds. By subjecting it to the restraints of international control, we have

[124] S Frankel, 'The TRIPS Agreement and Cross-Retaliation' in S Frankel and M Lewis (eds), *Trade Agreements at the Crossroads* (New York, Routledge, 2014) 208, 210.

[125] DSB, *Minutes Meeting held in the Centre William Rappard on 28 January 2013*, WT/DSB/M/328, 22 March 2013.

[126] The Antigua government is seeking to retaliate by hosting a website that will sell copyright-infringing content without paying the American right holders. See *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse by Antigua and Barbuda to Article 22.2 of the DSU*, WT/DS285/22, 22 June 2007; *United States—Measures Affecting the Cross-Border Supply of Gambling and Betting Services—Recourse by Antigua and Barbuda to Article 22.7 of the DSU*, WT/DS285/25, 13 December 2012; M Palmedo, 'Background on WTO Rules Allowing Antigua to Partially Suspend TRIPS as Cross Retaliation in a Trade Dispute', Infojustice, 28 January 2013, http://infojustice.org/archives/28373. However, obtaining the authorisation does not necessarily mean that the Antigua government will resort to the suspension immediately. The Antigua government still hopes to reach a mutually satisfactory solution with the United States.

[127] UNECOSOC, 'Second Session of the Preparatory Committee of the United Nations Conference on Trade and Employment', E/PC/T/A/PV/6, 2 June 1947, 4.

> endeavoured to check its spread and growth, to convert it from a weapon of economic welfare into an instrument of international order.

There is always room for improvement. There are various reform proposals on the table to improve WTO retaliation. However, replacing WTO retaliation with the alternatives that are equally controversial and problematic, as discussed in the previous chapter, is not the best solution and would not preclude continuing criticism. Retaliation and its threat is an effective instrument to achieve the compliance objective if the case is not a politically sensitive one. In the coming years, we might find more politically difficult cases resolved at the non-implementation level by reaching MAS. Jackson once stated that 'In some instances it is more important that international disputes be settled quietly and peacefully than that they conform to all correct economic policy goals, although the long-term impact of a "settlement" in the rule structure must also be considered'.[128] Thus, it is important to also focus the DSU reform on amicable settlements. A number of Members have put forward proposals to strengthen notification requirements for MAS/final settlement under Article 3.6 of the DSU.[129] Japan called for the inclusion of a notification time frame and detailed terms of such solution in the MAS notification.[130] The European Communities proposed to insert a new Article 22*bis* that would make a notified MAS subject to compliance review.[131] However, future improvement also needs to cover the area of provisional settlement due to the increasing number of retaliations inducing a temporary settlement in recent years, as evidenced in the *Hormones* and *Upland Cotton* disputes. In particular, the DSU reform should take into account the procedural/transparency aspect of temporary settlements as they may be reached at the expense of other Members. For greater transparency, a mandatory detailed notification, regular reporting to a WTO Committee/DSB (monitoring and surveillance mechanism) and an authorisation/adoption by the DSB requirement related to temporary/provisional settlements should be considered in the reform, and this may be a fruitful area of study for another day.

[128] JH Jackson, *The World Trading System: Law and Policy of International Economic Relations*, 2nd edn (Cambridge, MA, MIT Press, 2002) 340.

[129] TA Zimmermann, 'The DSU Review (1998–2004): Negotiations, Problems and Perspectives' in D Georgiev and K Van der Borght (eds), *Reform and Development of the WTO Dispute Settlement System* (London, Cameron May, 2006) 456.

[130] DSB Special Session, *Amendment of the Understanding on Rules and Procedures Governing the Settlement of Disputes—Proposal by Japan*, TN/DS/W/32, attachment, para 16.

[131] DSB Special Session, *Contribution of the European Communities and Its Member States to the Improvement of the WTO Dispute Settlement Understanding—Communication from the European Communities*, TN/DS/W/1, 13 March 2002.

SUMMARY

This chapter introduced another purpose of retaliation: inducing a MAS. In evaluating this purpose, first the chapter assessed amicable settlements within the framework of the DSU. In general, the DSU provisions require substantive (consistent with covered agreement) and procedural (notification) obligations for MAS. Nothing under the DSU prevents a MAS from being reached at any stage of the dispute settlement, including at the stage of non-implementation. In this regard, this chapter assessed the purpose of inducing a MAS and looked at the final settlements reached in the *Clove Cigarettes* and *Upland Cotton* disputes and the provisional settlement agreed in the *Hormones* dispute. This chapter also addressed the concerns raised in these settlements such as the legality of the settlements and their implications for third parties' interests. As regards the question of the effectiveness of retaliation, it is concluded in this chapter that WTO retaliation performs reasonably well in the light of its purposes. Finally, it is suggested in this chapter that the number of retaliation cases in which the retaliatory measures may be terminated because an amicable settlement is reached might increase in the future. Thus, the DSU reform is needed, in particular regarding strengthened transparency and notification requirements for final and provisional settlements, as they may be concluded at the expenses of third parties.

7

Concluding Remarks

C*onclūdō*: to make an end; conclude.[1]

IRRESPECTIVE OF HOW innovative an international agreement is, it is worthless if its rights and obligations cannot be enforced. Thus, an effective dispute resolution system is necessary to add value to the agreement. Every dispute settlement system requires effective enforcement instruments and mechanisms. This view goes well with the maxim *Ubi jus ibi remedium*, which demonstrates the importance of having legal remedies in every legal system.

While the WTO dispute settlement system has been lauded as effective, as Members have regularly had recourse to the system, the WTO dispute settlement's instrument at the non-implementation level—so-called retaliation—is deemed 'harmful' and 'ineffective'.

I. SUMMARY OF THE BOOK

This book began with an introductory chapter where concerns over WTO retaliation, as a flaw in a successful system, and the question as to the purpose of retaliation were raised. It was followed by Chapter 2, discussing temporary remedies in the multilateral trading system, particularly retaliation in more detail. In order to provide a fuller picture, a brief discussion regarding retaliation in the context of bilateral and plurilateral free trade agreements was provided in Chapter 2.

Chapter 3 elaborated on the discontent of various observers and WTO Members over WTO retaliation. For example they are of the view that imposing retaliation is like 'shooting [oneself] in the foot' and it does little or nothing to induce compliance. Therefore, they consider WTO retaliation to be an ineffective instrument to induce compliance. This chapter also looked at the reform proposals by WTO Members and observers; however, it has been argued that such proposals are equally problematic.

[1] PGW Glare (ed), *Oxford Latin Dictionary* (Oxford, Oxford University Press, 1982) 389–90.

It is often assumed that a high level of compliance indicates the effectiveness of the rule/instrument. However, it can be discovered in Chapter 4 that compliance and effectiveness, although related, are distinct. To evaluate the effectiveness of retaliation, this book referred to a purposed-based approach where a rule is considered effective if it can achieve its purposes or objectives. Put differently, a stand point pursued in this book is that the effectiveness of WTO retaliation is assessed in the light of its purposes. There is a fairly extensive literature discussing the purposes of retaliation whose two main schools of thought are: the purpose of inducing compliance, and the purpose of rebalancing. Those who support the purpose of rebalancing have written that when the cost of political performance exceeds the benefit of performance (political cost), the DSU allows a violator to continue a violation as long as the violator compensates or is willing to suffer retaliation. This thought is refuted by the proponents of inducing compliance.

In search of the purposes of retaliation, an evaluation looking at remedies in the context of public international law and law and economics was conducted in Chapter 5. WTO remedies have conceptual similarities to those under public international law and law and economics. However, it has been suggested in this book that by referring to the purpose of countermeasures under public international law merely based on the same terminology of 'countermeasures' found in the SCM Agreement and the ILC Draft Articles, the arbitrators indirectly adopted the concept of something that the WTO has contracted out of. Additionally, the remedies within the framework of the WTO dispute settlement system are not intended to facilitate expectation damages, which are needed to accommodate efficient breach, a concept where a party is allowed to breach a contract and pay damages if doing so would be economically efficient rather than performing the contract.

Besides these two disciplines, the search for the purposes of WTO retaliation in Chapter 5 was focused on two areas of study: Article 22.6 arbitrators' statements and interpretation of Article 22 of the DSU. As regards Article 22.6 arbitrators' statements, the arbitrators generally referred to inducing compliance as the purpose of retaliation, even though they employed different standards in calculating the level of retaliation for the prohibited subsidies disputes. There were two disputes in which the arbitrators questioned the exclusivity of the purpose of inducing compliance. Finally, an interpretation of Article 22 of the DSU in accordance with the rules of treaty interpretation was considered as the best way to illuminate what the purposes of retaliation are. It has also been established in this book that the proper method of interpretation is the VCLT rules of treaty interpretation. This is consistent with Article 3.2 of the DSU, which provides that the WTO Agreements are to be interpreted in accordance with customary rules of interpretation of public international law. The customary rules

of interpretation are widely regarded as being codified in Articles 31 and 32 of the VCLT.

The interpretation of Article 22 has two results: first, retaliation should not turn into an arbitrary measure in pursuing its objectives; secondly, retaliation can be used to pursue more than one purpose in the light of the object and purpose of WTO dispute settlement.

The penultimate chapter of this book evaluated the purpose of inducing a mutually agreed solution and the effectiveness of retaliation in the light of its purposes. The chapter assessed final settlements reached in the *Clove Cigarettes* and *Upland Cotton* disputes and the provisional settlement agreed in the *Hormones* dispute. It pointed out and addressed several concerns raised about the indicated settlements such as their legality and implications for third parties' interests. As regards the question of the effectiveness of retaliation, it was established in Chapter 6 that WTO retaliation contributes to changing the behaviour of the disputants, particularly the respondent, to promote the goals of retaliation; thus it was concluded that WTO retaliation performs reasonably well in the light of its purposes.

II. FINAL OBSERVATIONS

This book employs the purpose-based approach to effectiveness. Identifying the purpose(s) of retaliation is not a simple task. Uncertainty and debate concerning the purpose of WTO retaliation exist since the DSU does not stipulate the purpose of retaliation explicitly. The DSU, however, demonstrates a strong preference for compliance and MAS, and at the same time indicates a lack of preference for punitive sanction. In other words, the DSU rules are not excessively rigid or so inflexible as not to leave room for temporary arrangements or other forms of solution or settlement. A mutually agreeable solution, for example, can be reached after the imposition of retaliation, and such a solution will terminate retaliation measures imposed by a retaliating state. Retaliation in the multilateral trading system is not intended to be punitive as the purpose of WTO dispute settlement is never to facilitate punishment, but to constrain it. Thus, arguably the function of Article 22.6 arbitrators is not to determine whether or not the amount of suspension of concessions, let us say, is sufficient to induce compliance. Instead, the role of Article 22.6 arbitrators is to establish a non-punitive (equivalent or appropriate) level of suspension of concessions. This is in accordance with the (limited) mandate of the Arbitrators pursuant to Articles 22.6 and 22.7 of the DSU. These two articles empower arbitrators to determine whether the level of retaliation requested is equivalent to the level of nullification and whether the principles or procedures concerning retaliation pursuant to Article 22.3 of the DSU have been followed. It is the retaliatory state that

should decide the nature of its authorised retaliatory measures and its design as a means to induce compliance or to achieve a MAS.

By focusing on the notion of a single purpose, one may overlook the coexistence of the multiple purposes of retaliation. Prompt compliance with a rule is important; and WTO dispute settlement has a reasonably good record of it. However, where there is an impracticable situation for a Member to comply with the adverse rulings, a system that offers a certain amount of flexibility in settling the dispute is required to keep the Members in the system. This book is in favour of the multiple purposes of retaliation, including inducing a MAS. The wording and the context of Article 22 and the object and purpose of WTO dispute settlement maintain this premise. While suffering retaliation for the purpose of rebalancing is often regarded as the provisional aim, the ultimate aim of retaliation is achieving either compliance or a MAS.

Ultimately, retaliation may not induce compliance in all disputes; it may nevertheless be used to achieve other results as is evidenced by the parties seeking and pursuing other goals than retaliation such as a positive settlement through a MAS. It is therefore concluded that WTO retaliation is effective in the light of its purposes.

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Index