

HOW BINDING ARE WTO RULES?
A TRANSATLANTIC ANALYSIS OF INTERNATIONAL LAW

Joost Pauwelyn
(Duke University School of Law)

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*** *PRELIMINARY DRAFT – NOT FOR QUOTATION* ***

INTRODUCTION

Few if any will question today that WTO agreements set out legally binding rules part of public international law (PIL). The WTO is *not* some economic bargain between governmental trade elites without normative value. It is a legally binding treaty squarely within the wider corpus of international law. As compared to the original GATT, the WTO has, indeed, been “legalized” and, like the proverbial lost son, been re-introduced into the broader family of PIL. During this process the system had a lot to learn from PIL. Moreover, important questions as to the WTO’s place in PIL remain to be answered.

Yet, on many levels, the ‘lost son’ is fast outclassing his established family. As much as the WTO can learn from PIL, PIL can also learn from the WTO. This cross-fertilization is perhaps best illustrated in the area of remedies.

While it is clear by now that WTO rules are binding as international law, the next question that arises is: what happens, or ought to happen, in case this law is breached or violated? Put differently, we must distinguish the *legally binding nature* of WTO rules, from the *consequences* entailed by breaching those rules. Indeed, whilst PIL is quite content to have an abstract rule *imposing* cessation of all breaches and the Statute of the International Court of Justice (ICJ) felt satisfied stating that its rulings *must* be

implemented (with little or no follow-up) the WTO, with its unique dispute settlement system and detailed implementation procedures, can *and must* afford the luxury of asking how far and strictly compliance ought to be pushed for.

This transforms the WTO, probably the most legalized treaty regime out there, into a laboratory for further sophistication of international law. In this respect, it is the WTO that can impact PIL and push it to the next level of sophistication and development rather than the other way around.

One's view on the remedies that international law ought to provide – e.g., must its rules always be complied with or should there be room for bilateral settlement, re-negotiation or even unilateral breaches as long as compensation is paid for – is ultimately determined by how one perceives international law more generally: what is its normative value and role and what goals can it achieve.

This is how the rather technical question of WTO remedies eventually leads one to fundamental questions about international law and, in my view, the widening gap in this respect between the two sides of the Atlantic.

Though grossly generalized and probably overstated for dramatic effect, my claim is that the American approach to international law is radically different from that of Europe and that this difference, in turn, affects how one evaluates WTO remedies. I elaborate this claim in Section I.

Section II sets out how remedies and more broadly the goals of the judicial function are perceived *and* pursued in PIL, the original GATT and now the WTO. It tries to explain why these differences are present and draws lessons from them. My core claim in Section II is that the WTO system is in flux (from a 'liability rule' to a 'property rule' regime) and that, as a result, confusion reigns as to the goals of WTO dispute settlement, including the function and impact of its core remedy, suspension of concessions.

Section III offers some of the highlights of WTO case law on suspension of concessions. It does so to illustrate the ongoing disarray in the field of WTO remedies. Based on this case law, my claim is that (though softened in the last two cases) in the first 10 years of the WTO the normative aspirations and rule-oriented approach of the WTO have been overdone. Given the instruments available (essentially “equivalent suspensions”), the benchmark objective of the DSU has been set too high.

Finally, Section IV offers suggestions for a way forward. In summary version, it tries to answer the following questions: why should WTO rules not always be complied with; or, in contrast, why should we not permit or even stimulate so-called efficient breaches; should the level of suspensions be increased or rather lowered; what are the prospects for compensation and how should economic and other differences between countries be addressed?

I. CONTRASTING VIEWS: EUROPE AND THE UNITED STATES ON INTERNATIONAL LAW AND WTO REMEDIES

Europe and the United States have fundamentally different views on international law, what it is and what it can achieve. Whilst European countries are locking themselves into a new EU Constitution, Presidential candidates in the United States gain their biggest applause when pledging not to be constrained by the UN or any other “global test”.¹

International legal scholarship is equally divided across the Atlantic. With limited exceptions, European legal scholars approach and analyze international law largely the way they analyze domestic law. They take its independent normative value and constraints for granted and often make abstraction of politics and power. In Europe, the need for cooperation and international governance is a given, the question is only how best to legitimize it. In this exercise many Europeans see the need to “constitutionalize”

¹ For a representative sample, see Robert Kagan, *Paradise and Power, America and Europe in the New World Order* (2003) and Jeremy Rifkin, *The European Dream, How Europe's Vision of the Future is Quietly Eclipsing the American Dream* (2004).

international law in pursuit of the Kantian ideal of cosmopolitan law separated from politics as far as possible.

In the United States, in contrast, the academic picture is quite different. With limited exceptions, the debate of whether international law is really law remains as hot as ever. Most regard international law as merely a pattern of behavior that is driven by self-interested, rational actors and *reflected in* law, not *constrained by* law. For many American scholars, international law can, at best, be *explained* as a patchwork of contract-type, cost-benefit analyses aimed at enhancing economic welfare or political support at home. In this exercise, international cooperation, if feasible and needed in the first place, must be legitimized by national sovereignty, preferably through the interface of domestic, democratic politics.

Of all WTO affairs, this divide between the European normative approach and the American transactional approach to international law is felt most acutely in the discussion over WTO remedies.

Not surprisingly, the EC (as well as most other WTO members, in particular developing countries) have strongly defended the WTO as a legally binding regime and taken the view that compliance with WTO rules has a self-standing normative value and is, therefore, *required*. The United States, in contrast, though a strong supporter of a rules-based system in the sense that redress *must* be sought, and *can* automatically be obtained, through the multilateral dispute settlement system, frequently portrays the WTO as a balance of trade concessions, backed-up by the threat of reciprocal withdrawals of concessions. In this spirit, the United States seems to accept the possibility to settle, re-negotiate, compensate or suffer suspensions as an alternative, though not preferred, solution to trade disputes.

In a similar vein, in WTO arbitrations where the right and level of trade suspensions was set, the EC has consistently argued that the objective of suspensions is *to induce compliance with WTO rules*, not to compensate or re-balance the scales of trade

concessions. Discounting the cases where it was the *target* of retaliation, the EC has also been the strongest supporter of broad retaliation rights and an expansive view on the level of suspensions permitted (see *FSC, 1916* and *Byrd* arbitrations). Confirming its general stance in favor of further legalization and tougher remedies for non-compliance, in the ongoing review of the Dispute Settlement Understanding (DSU), the EC introduced proposals to strengthen WTO remedies, in particular, the remedy of compensation, be it trade or monetary compensation.

The United States, in contrast, though ready to accept that inducing compliance is possibly *one* of the objectives of WTO suspensions, has taken the view that “retaliation” also serves other objectives, in particular compensation or re-balancing of the scales of trade concessions (see *Byrd* arbitration). In addition, convinced that retaliation ought to be strictly limited to harm caused in the bilateral trade relations between the disputing parties, the United States has balked at arbitration reports that broadly defined the right or level of suspensions.² This aversion for stricter WTO remedies came to light also in the DSU review process where none of the US proposals had to do with remedies and the United States did not make a single comment in the long winded discussions, triggered by countries such as Mexico and the African Group, on how to strengthen WTO remedies. It is hard not to read this diplomatic silence as a rejection of such proposals. Quite tellingly, when a panel found that Australia was obliged to reclaim export subsidies that it had granted to one of its leather producers *in the past*, thereby awarding the United States a uniquely strong retrospective remedy, the United States reaction at the DSB was one of disappointment:

The Panel's remedy went beyond that sought by the United States. Nevertheless, because this case had gone on for far too long ... the United States believed that it was time to bring this dispute to a close by adopting the Panel Report.³

² In particular, the *FSC* report where the EC was authorized to suspend up to the full amount of US export subsidies including those for exports going to third countries and the *Export Credits* report where the arbitrators rather dryly added 20% to the amount of suspensions Brazil could take in response to the admission by Canada that it would not withdraw the subsidy for contracted, but non-delivered aircraft.

³ WT/DSB/M75, p. 5.

In the legal academy, this EU-US contrast -- more *versus* less legalization, stricter *versus* weaker retaliation rights – is arguably even more outspoken. With the exception of John Jackson and Gary Horlick, most American commentators stress the re-negotiation or rebalancing the scales nature of WTO dispute settlement, warning against too much legalization or tougher retaliation that would prevent so-called efficient breaches of WTO rules.⁴ In this class of no-need-for-stronger-remedies advocates, one could also add commentators who have argued for a less coercive and more managerial approach to WTO compliance.⁵

In contrast, most European legal scholars -- in unison with developing country governments and commentators⁶ -- have raised serious doubts as to the equity and efficiency of current WTO remedies. They point out that developing countries, given their relatively weak economies and strong dependency on investment and consumer imports, are severely disadvantaged in a system based on economic “sanctions”.⁷ They stress the need to go beyond equivalent suspensions or to add compensation or reparation if the DSU is to truly induce compliance with WTO rules in the interest of private economic operators.⁸ To limit governmental discretion and ensure rule-predictability for private traders, a number of European scholars advocate giving direct effect to WTO rules before domestic European courts.⁹

As I try to illustrate below both the European normative approach and the American transactional approach to international law have their advantages. However, both, especially when driven to the extreme, also present serious flaws: in summary, the normative approach for trying to be “more catholic than the pope”, failing to make distinctions between types of rules and disregarding concerns of economic efficiency,

⁴ See Judith Bello, Alan Sykes & Warren Schwartz, David Palmeter, Downs & Rocke, Robert Lawrence.

⁵ Such as Steve Charnovitz, calling for the WTO’s teeth to be pulled, or Chi Charnody, as well as a number of non-American *economists* writing on WTO retaliation (see Hauser & Roitinger), which should come as no surprise since the “rebalancing” view of the US legal academy is engrained in notions of law and economics.

⁶ Such as Edwini Kessie, Victor Mosoti and Rafiqul Islam.

⁷ Horn & Mavroidis, Mary Footer, Naboth van den Broek.

⁸ Mavroidis, Marco Bronckers, Andreas Ziegler, Bernard O’Connor.

⁹ Cottier, Petersmann.

political reality and domestic politics; the transactional approach, in turn, for its denial of international law as true law and its failure to transcend the domestic interest and accept international law as a constraining factor to the benefit of all countries, not just the most powerful ones, and at the service not just of unitary states or governments but private individuals and economic actors behind the state veil.

II. THE GOALS AND INSTRUMENTS OF THE JUDICIAL FUNCTION IN PUBLIC INTERNATIONAL LAW, GATT AND THE WTO

The judicial branch of most legal systems has a combination of, at least, the following functions or goals:

- (1) **Settlement:** exchange information/arguments and provide incentives for parties to come to a mutually agreed settlement;
- (2) **Rebalancing:** if one party violates, another should not be obliged to continue to perform its obligation v-a-v the wrongdoer; this results from an idea of fairness or reciprocity;
- (3) **Compensation:** repair damage caused by the breach to victims of the breach
- (4) **Compliance:** bring about conformity with the rules
- (5) **Clarification:** clarify the rules to facilitate compliance or settlement in the specific case, as well as to guide future conduct
- (6) **Deterrence/Punishment:** deter future violations of the law

The way these functions are pursued in public international law, the original GATT and now the WTO is summarized in Table 1. Only the *legal* instruments available to fulfill any or all of these goals are listed. Crucially, especially for the GATT/WTO regimes, the following elements that may induce compliance and/or affect deterrence, should be added:

- Reputation costs (in particular the risk that future commitments lose credibility)
- A desire to maintain the stability and legitimacy of the institution itself

- Independent belief in the ideas/benefits behind the rules
- Domestic costs linked to breach (such as higher consumers prices and losses for importers or limits imposed by national law)

TABLE 1: DISPUTE SETTLEMENT FUNCTIONS IN PUBLIC INTERNATIONAL LAW, GATT 1947 AND THE WTO

	Settlement	Rebalancing	Compensation	Compliance	Clarification	Deterrence
PIL	* Treaty can be <u>re-negotiated</u> Arts. 39-41 VC * Victim can <u>consent</u> to breach Art. 20 ASR * Victim can <u>waive rights</u> Art. 45	Unilateral <u>Suspension</u> of treaty in response to material breach Art. 60 VC (<i>Exceptio inadimpleti contractus</i>)	Obligation to make full <u>reparation</u> for the injury caused by the breach Art. 31 ASR	*Obligation to <u>cease the breach</u> Art. 30 ASR *Unilateral <u>Countermeasures</u> to induce compliance Art. 49 ASR	No compulsory dispute settlement mechanism	*Treaty suspension “in whole or in part” *Full reparation *Unilateral Countermeasures must be <u>proportional</u> (not punitive) Art. 51 ASR
GATT	* First objective is “ <u>satisfactory adjustment</u> ” Art. XXIII:2 But: <i>Not harm 1/3 parties (MFN)</i> * Can <u>re-negotiate</u> tariff Art. XXVIII * Can obtain <u>waiver</u>	Authorized <u>Suspension</u> if circumstances are serious enough Art. XXIII:2	* No reparation *Suspension offers some compensation (but only restores situation <i>ex ante</i> ; does not offer benefits of performance)	*No explicit obligation of cessation *No countermeasures on top of suspension	Specific dispute settlement mechanism but can be blocked	Suspension “ <u>appropriate</u> in the circumstances” (but not punitive)
WTO	<i>Idem GATT</i> DSU Art. 3.7: Settlement is “ <u>clearly preferred</u> ”	*Voluntary <u>compensation</u> to offset continued breach *If no compensation: <u>Automatic suspension</u> in all cases	<i>Idem GATT</i>	*Implied obligation of <u>cessation</u> *No countermeasures on top of suspension	Automatic dispute settlement	Suspension “ <u>equivalent</u> ” to nullification (not punitive)

VC: Vienna Convention on the Law of Treaties

ASR: Articles on State Responsibility of the International Law Commission

A number of points can be drawn from Table 1:

- **Compliance with the rules at all cost is not the objective of any of the three systems:** even if there is an obligation to cease the breach (as in PIL and implicitly in the WTO), **the breach can also be stopped by dis-applying or changing the rule in the first place** (through re-negotiation, bilateral settlement or waiver)¹⁰; such ‘settlement’ in the broad sense may not, however, affect the rights of third parties (in the GATT/WTO in particular their MFN rights) nor alter rules of *jus cogens* (such as the prohibition on genocide or slavery).

The direction in DSU Art. 3.5 that all solutions to matters formally raised under the DSU “shall be consistent with [WTO] agreements” is there to protect third parties. It does not prevent the two disputing parties from changing, adapting or dis-applying a particular rule as it applies to the dispute at hand *for as long as third party rights remain unaffected*. Under the VC (Article 30), such settlement prevails over the WTO rule as the norm later in time; under the ASR, the settlement amounts to consent precluding wrongfulness (under Art. 20) or, at the least, a waiver of dispute settlement rights (under Art. 45).

The fact that rules (other than those of *jus cogens*) are, therefore, not written in stone and can be changed by agreement should not come as a surprise nor should it reflect badly on international law. In domestic law as well, parties are at liberty to re-negotiate their contracts (only in special areas such as criminal law are wrongdoer and victim precluded from settlement). Unlike human rights or international criminal law where compliance with the original rule leaves little scope for manoeuvring, trade law is riddled with exceptions, differential

¹⁰ WTO examples of such “settlements” in deviation from the original rule, though without affecting third party rights, can be seen in procedural agreements on how to pursue DSU implementation provisions and sequencing (in deviation of Art. 22 of the DSU but routinely enforced by WTO panels); almost all bilateral settlements ending a dispute (where some delay in compliance or minor deviations from the rules are tolerated, albeit at time conditioned on the payment of compensation elsewhere; or, such as in the *Helms-Burton* case where the measure remained intact but was simply dis-applied in a number of cases and the EC was convinced not to push the case further if only to avoid the breakdown of the DSU); and the waiver granted for the EC’s banana regime (since still inconsistent with WTO rules).

treatment, deviations and possibilities for re-negotiation. Without it the system would not have been erected in the first place, nor would it be as effective in offering practical solutions to real-world trade problems. This should temper too normative (or too ‘European’) an approach to international and GATT/WTO law.

- **Whilst PIL has separate instruments to achieve each of the different goals, the GATT/WTO has essentially only one instrument** to achieve a variety of goals, namely suspension of concessions.

This lack of further legal remedies, in particular reparation, is explained by the fact that at its origin GATT was a political bargain struck in a club-like atmosphere, not a legal construct based on the rule of law and reparation or punishment for ‘illegal’ conduct (what remains actionable today is not so much a violation of WTO rules but rather nullification or impairment of benefits, irrespective of whether there is breach).

Given the vagueness and incompleteness of much of the GATT contract (future events as well as future support for trade liberalization are unclear), countries were simply not ready to commit themselves to reparation (nor did they feel much need for it given that the GATT bargain was thought of as self-enforcing based on the principle of reciprocity).¹¹ Moreover, as one WTO arbitrator noted: “In WTO dispute settlement cases, it is probably true that most defending parties argue in good faith that they believed the measures at issue were in conformity with the relevant provisions of the WTO Agreement”¹² (this stands in contrast to realist, or law and economics, authors which regard breach as a calculated decision based on national gains or cost-benefit calculations). To give large damages awards in such ‘good faith situations’ (knowing, in particular, that most trade disputes are

¹¹ In addition, in many WTO cases, a finding that the measure is inconsistent with the rules at the time of a panel ruling does not necessarily mean that it has been inconsistent from the day it was enacted. Balance of payments measures are a prime example.

¹² *Canada – Export Credits*, para. 399.

about laws or regulations that may have been in place for years) may have been regarded as too drastic a remedy.

In respect of the remaining remedy of suspension, from the very creation of GATT in 1947 confusion existed as to its function. It was clearly thought of as achieving more than passively suspending compliance in return for breach (in the Art. 60 VC sense of *inadimpleti non est adimplendum*). During GATT negotiations the goal of compensation, even that of deterrence and punishment were also referred to. In the drafting history there was, for example, much discussion on whether suspension was to be “merely” compensatory or also amount to a sanction so as to induce compliance.¹³

Unlike other treaty suspensions, suspending a trade concession may, indeed, have some compensatory elements (beyond a mere technical re-balancing) in that re-introducing a higher tariff can possibly improve the country’s terms of trade (if the country is large enough) and renewed protection can bring along political support from domestic industries (even though, like a true countermeasure, such as a military strike, trade suspensions can also be costly to the one imposing them, in terms of losses to importers and higher consumer prices). In addition, the

¹³ Although some delegations wanted to provide for punitive sanctions so as to ensure compliance with the rules rather than simply re-balance the scales (ROBERT HUDEC, *THE GATT LEGAL SYSTEM AND WORLD TRADE DIPLOMACY* (2nd edition, 1990) at 31; JOHN JACKSON, *WORLD TRADE AND THE LAW OF GATT* (1969), at 169, note 21), a Working Group examining the question in the context of the Havana Charter recommended that, even in the case of legal violation, the remedy should be compensatory suspension of concessions and no more (E/Conf.2/C.6/W.80, Working party report, January 30, 1948, the proposals were adopted without debate, *ibid.*, W.102, February 16, 1948). As a result, in the final Havana Charter, the provision corresponding to GATT Article XXIII:2 referred to suspensions that are “appropriate *and compensatory*”. To clear all doubt, an interpretative paragraph stated that “the nature of the relief to be granted is compensatory and not punitive” and that the word “appropriate” should not be read to provide relief “beyond compensation” (*Reports of Committees and Principal Subcommittees*, note 16, p. 155). These Havana Charter clarifications occurred, however, *after* the GATT itself was concluded and were subsequently not incorporated into the GATT. Article XXIII of GATT was taken from the earlier Geneva draft of the ITO Charter, as Hudec noted, “a stop-action photograph of a provision still very much in flux” (Hudec, *supra*, at 52). The legal value of those later Havana Charter clarifications is questionable. One could say that they confirm the GATT contracting parties’ philosophy of regarding GATT as a balance of concessions (compensatory suspensions, not punitive economic sanctions). One could also argue *a contrario* and focus on the fact that the clarifications were *not* subsequently incorporated into the GATT. In support of the latter position, John Jackson adds that the Havana Charter dealt with a broader range of obligations than GATT and that this difference may explain why the ITO mechanism was made softer, i.e., compensatory only (Jackson, *supra* at 169).

suspension of trade concessions may also have a more active, coercive effect than other (purely technical or passive) treaty suspensions in that closing off export markets causes both economic and political harm to the country kept out.

Hence, from day one suspension was set up as a mixed instrument in the hope of achieving multiple goals without clearly defining those goals nor tailor-making suspension as a instrument to actually achieve those goals.

- **Whilst the WTO has set more ambitious goals than the GATT** (by adding an at least implicit obligation of cessation, i.e., an obligation to conform to DSB rulings), **the one GATT/WTO instrument to achieve those goals has been weakened** (from ‘appropriate’ to ‘equivalent’ suspensions¹⁴, a level that is weaker also than ‘proportional’ countermeasures under PIL¹⁵).

Though somewhat of a paradox this move can be explained: (i) WTO members agreed to a compulsory and automatic dispute system; this meant that they would likely face rulings with which they strongly disagree or that they cannot implement (at least not immediately); as a result, as a precondition for their

¹⁴ Nothing in GATT Art. XXIII:2, referring to suspensions “as appropriate”, explicitly restricted suspension to a level reciprocal or equivalent to the original nullification. The requirement that the suspension be “appropriate” can include equivalence to the original harm caused but depending on the circumstances may also go below or above that level. In support, see a 1988 statement by the GATT Legal Adviser: After noting that suspension under Article XIX (safeguards) and Article XXVIII (tariff renegotiations) was limited to “equivalent” concessions, he added: “In the case of Article XXIII, the wording was wider, referring to measures determined to be appropriate in the circumstances, which meant that there was a wider leeway in calculating the retaliatory measures under Article XXIII than under Articles XIX or XXVIII” (GATT doc. C/M/220, at 36, quoted in WTO, 2 Analytical Index: Guide to GATT Law and Practice 698 (1995); as confirmed by the then Deputy Director-General, GATT doc. C/M/224, at 19, quoted in WTO, ANALYTICAL INDEX: GUIDE TO GATT LAW AND PRACTICE (1995) 699. Yet, in the one case where suspensions under GATT 1947 were authorized, 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” (*Netherlands Action Under Article XXIII:2 to Suspend Obligations to the United States*, BISD 1S/62 (1/61), para. 2, see also para. 3).

¹⁵ Suspension *equivalent* to nullification or impairment in DSU terms is also more limited than *proportional* countermeasures under PIL (Art. 51 ASR) where “[c]ountermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question”. The gravity of the act and the rights in question can drive countermeasures above the harm caused or at least provide flexibility to over-estimate such harm. For an example see the *Case Concerning the Air Services Agreement of 27 March 1946 (United States of America v. France)* (1978) International Law Reports, Vol. 54 (1979), p. 304.

acceptance of the DSU, remedies had to be kept weak and suspension capped at “equivalence”;

(ii) the basic deal underlying the DSU was automatic dispute settlement (so that US requests for panels would no longer be blocked) in exchange for stopping US unilateralism in the enforcement of trade obligations (Section 301). In this context, for many WTO members (in particular the weaker ones) capping US sanctions to “equivalence” was a major objective and achievement;

(iii) it is common place in the evolution of any legal system to start out with a regime of unregulated retaliation (i.e., unfettered countermeasures at a multiplier of the original harm caused, much like in the pre-PIL world and, for some areas of international law, as remains the case today even under PIL); the next step is usually formalized retaliation, capped 1:1 with the original breach (such as the *lex talionis* or the Exodus’ “eye for eye, tooth for tooth”).¹⁶ This 1:1 move occurs to limit the societal costs of crime and punishment and to stabilize relations by making reactions and the cost of crime more predictable.

In this sense, the reduction and cap on WTO countermeasures is *a step forward* (though only made possible because dispute settlement, including authorization to take countermeasures, became automatic; otherwise the US would never have abandoned Section 301; equally, without multilateral control over breach and equivalence of suspension, weaker countries would not have agreed to making countermeasures automatic).

Notwithstanding these explanations, the fact remains that too much is now expected from “suspension of concessions”; it is seen as an instrument to rebalance, to compensate, to induce compliance/settlement *and* to deter future violations. Given the nature of trade sanctions (costly for the one imposing

¹⁶ Note, however, that the *lex talionis* (as implied by its origin in the word *talio*, equal in kind) sets a *qualitative* equivalence (i.e., your eye for my eye). The DSU’s equivalence is a purely *quantitative* one (in terms of nullification and impairment caused by the breach and the countermeasure).

them), their 1:1 cap (unlikely to make breach more costly than compliance) and the purely prospective nature of WTO remedies (the first 2-3 years of any breach are “for free”), in most cases, it is simply impossible for suspension alone to meet *any*, let alone *all*, of those objectives. Moreover, as economists have long pointed out, a single economic instrument cannot achieve more than one distinct purpose.¹⁷

- The fact that, nonetheless, the compliance record with WTO rules and rulings is impressive indicates that **it is not so much legal remedies (such as suspensions) that induce compliance with WTO rules but rather political/normative factors**, such as the *threat* of suspensions, reputation costs, peer pressure, example setting (all of which are amplified given that WTO dispute settlement is a repeat play), a broader stake in the institution as a whole, shared beliefs in the its rules and domestic pressure to comply (be it because of legal incorporation of WTO principles into national law or domestic constituencies pushing for compliance).

The influence of these largely non-economic factors (difficult to grasp under US-style realist or law and economics approaches to international law) is well illustrated by WTO suspension practice. Winning complainants push hard for the right to suspend concessions, and spent valuable resources on obtaining as high a level as possible in long-winded WTO arbitrations, only to afterwards not actually use the authorization to suspend concessions (only 4 out of the current 16 authorizations have so far been used, one of which (*FSC*) not even to the full amount).¹⁸ It shows that the mere right to suspend (preferably as high as possible) is seen as a valuable asset in and of itself, even if it is not actually exercised, because of the reputation and other institutional/normative effects that are linked to it.

¹⁷ See J. Tinbergen, *On the Theory of Economic Policy* 39-41 (1963).

¹⁸ The EC, for example, was fighting tooth and nail in the *1916 Act* and *Byrd Amendment* arbitrations trying to obtain as high a level as possible, while at the same time it cannot even utilize to the full the suspension rights it already has against the US as a result of *FSC* (instead of the usual 100% duties, in *FSC*, the EC has only added 5% , to be increased monthly by 1%).

- **PIL grants a so-called “property right” to right holders**, that is, the right holder has, at least in theory, a right to compliance with the rules; without his approval, compensation or suspension *in lieu* of compliance is *not* accepted. Put differently, the obligation of cessation is strictly imposed (and can only be taken away *by agreement*, e.g., through settlement, discussed in point 1 above): the wrongdoer cannot “buy his way out”, that is, *unilaterally* decide to pay compensation instead of performing on the ground, for example, that the cost of compliance exceeds the cost of compensation. In this sense, PIL does not permit, let alone induce, so-called “efficient breaches”. **PIL is a property rule regime, not a liability rule regime.**

As a result, and again somewhat paradoxically, the legal regime that probably has the hardest time inducing compliance with its rules – i.e., international law, given its lack of coercion over states -- sets for itself the *highest* benchmark of compliance: cessation or specific performance in every case. In most domestic legal systems a difference is made, however, between, on the one hand, obligations requiring specific performance or criminal sanctions even if the victim were happy with compensation and, on the other hand, obligations where the obligation-holder can unilaterally pay compensation *in lieu* of performance (as under most contracts). In international law, in contrast, all laws and obligations are put on equal footing (with the exception of *jus cogens*) and all require cessation in the event of breach (compensation does not suffice).

The idea that imposing specific performance (say, forcing a person to comply with a labor contract and work for a particular company) may go against the physical integrity or individual freedom of individuals, has not been transposed to the inter-state level. Nor has the law and economics theory that certain breaches, if fully compensated for, may actually be desirable if on the whole they lead to more welfare without making anyone worse off (the theory of so-called “efficient breach”). Again, this is somewhat surprising given that each state considers itself

to be sovereign (and ought therefore be quite hesitant to commit itself to specific performance in each case) and international law is often portrayed as a game of rational actors seeking welfare maximization (and might therefore be inclined to engage in efficient breaches).

One explanation for this attempt by international law to be stricter and more rule-oriented than domestic law itself -- if you wish, to be “more catholic than the pope” -- is that the system fully realizes that cessation and specific performance are far from ensured in a system that lacks centralization and coercion and that therefore it may be better to at least have the strict obligation of cessation on the books, in the hope that it will induce compliance with the most egregious breaches (though well aware that it may not stop states to engage in smaller or so-called efficient breaches).¹⁹

This consideration loses, of course, much of its force in the WTO context with compulsory and automatic dispute settlement. It transforms the WTO, probably the most legalized treaty regime out there, into a laboratory for further sophistication of international law. As noted earlier, whilst PIL is quite content to have an abstract rule *imposing* cessation and the Statute of the International Court of Justice felt satisfied stating that its rulings *must* be implemented (with little or no follow-up) the WTO, with its unique dispute settlement system and detailed implementation procedures, can afford the luxury of asking how far and strictly compliance ought to be pushed for (see below).

- **In contrast, the original GATT was a liability rule regime:** it lacked an obligation of cessation and was focused rather on rebalancing; in other words, wrongdoers could, *without the agreement of the opposing party*, “pay their way

¹⁹ This thinking was expressed by at least one of the Rapporteurs on State Responsibility preparing the ASR. He observed that cessation assumes greater importance in international, as opposed to domestic, law because international law lacks a coercive mechanism. Where states cannot be compelled to take positive measures, they should at least be obliged to observe the bare rule of law. Cessation therefore stresses “not only the interest of the injured State but also the interests of the international community in the preservation of, and reliance upon, the rule of law” (Yearbook of the International Law Commission 1993, Vol. II (Part Two), p. 55).

out” by offering compensatory trade concessions or suffering a reciprocal withdrawal of concessions. This was reflected not only in GATT Art. XXIII, but also (and more explicitly) in escape clauses and re-negotiation provisions such as Art. XIX on safeguards and Art. XXVIII on tariff re-negotiations where, in the absence of agreement between the parties, a country can unilateral re-impose protection for as long as it pays for it by suffering reciprocal withdrawals of concessions.

- **The move from GATT to WTO is a gradual evolution from a liability rule regime to a property rule regime:** the WTO has an implicit obligation of cessation: compensation or suspension are only temporary and can no longer replace compliance; wrongdoers do not have the unilateral right to “buy their way out”. As one recent arbitrator put it, “we do not read anything in the DSU or in the [Subsidies] Agreement which would create a right not to comply with DSB recommendations and rulings”.²⁰ In practice, however, they can still do so “temporarily” (by paying compensation as in the *EC-US Copyright* case or by suffering suspensions as in the *Hormones* or *FSC* disputes).

At the same time, the WTO did maintain aspects of the GATT’s liability rule regime, namely the safeguards mechanism, the tariff re-negotiation provision as well as other regimes (such as Art. XXIV:6 on customs unions or Art. XII on balance of payments measures) where protectionist barriers can be re-erected *unilaterally* for as long as one pays for it, without the agreement of other parties. In addition, of course, the WTO also maintained the possibility – now expressed even as a “clear preference” -- for settlement, including, “buying your way out” *with the agreement* of the opposing party as long as the rights of third parties remain unaffected.

In this context, the ongoing discussion on whether WTO members have a strict legal obligation to conform to WTO rulings is somewhat artificial and must be

²⁰ *Canada – Export Credits*, para. 3.104.

transcended.²¹ I do agree with John Jackson that an obligation to comply can be implied from DSU provisions (as importantly: not a single WTO member, not even the US, has ever argued in any WTO dispute nor during any of the DSU review sessions, that compensation or suspension can fully replace compliance as an equally available option the way proponents of “efficient breach” suggest²²). At the same time, the DSU does permit *temporary* compensation or suspension of concessions *in lieu* of compliance. Since “temporary” is not defined, in practice, compliance can therefore be seriously delayed. As importantly, the WTO has maintained, even extended, a number of alternative ways to avoid strict compliance with WTO rules, be it (i) the liability rules in Arts. XIX (safeguards), XXIV:6 (custom unions), XXVIII (tariff re-negotiations, copied also for GATS concessions in GATS Art. XXI), etc. or (ii) through settlement or re-negotiation by mutual agreement (point 1 above) or by waiver. In sum, **the WTO is a mixed system combining an implicit property rule (in the DSU) with explicit liability rules (in specific GATT/GATS provisions).**

In sum, while PIL and its insistence on cessation in each and every case reflects the European, normative approach to international law, the traditional GATT system, with its mercantillistic, reciprocity-driven foundation and political flexibility far removed from the strictures of law as we know it domestically, corresponds rather to an American, transactional approach to international law. The current WTO system, in contrast, falls somewhere in between the two.

The gradual shift from a (GATT) “liability rule” regime to a (WTO) “property rule” regime has left the WTO’s judicial branch confused as to the goals of WTO dispute settlement. In particular, the case law on suspension of concessions is in disarray (see Section III below). The inclusion of an implicit “property rule” in the DSU (a legal obligation to conform to WTO rulings), combined with the more general rule-orientation of the new WTO (away from blocking panel reports and *a la carte* agreements), created

²¹ See for the latest on this issue: John H. Jackson, *International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to “Buy Out”?*, 98 AJIL (January 2004).

²² See Sykes & Schwartz, Lawrence etc.

extremely high normative expectations. Those expectations were only fuelled by the WTO's gradual re-instatement into the broader corpus of public international law (in its very first report the Appellate Body stated that the WTO treaty cannot be read "in clinical isolation" from public international law). This re-instatement meant that for the interpretation of WTO remedies as well, guidance was sought in the fall-back remedies of PIL. And as noted earlier, for a variety of reasons, those PIL remedies (a "property rule" regime) are harsher than those at the WTO.

Considering the early WTO case law, my claim is, therefore, that the normative aspirations and rule-oriented approach of the new WTO have been overdone. The effort to legalize the world trade system has in a way been too successful or created too high an expectation. Countries, panels and commentators have lost sight of the DSU's "clear preference" for settlements and the WTO's flexibility that, much like PIL, permits re-negotiation, escape clauses and settlements (point 1 above). This over-eagerness for normative stability (which may please the lawyer's ear but can in effect hamper the practical and efficient resolution of trade problems) is best illustrated in the early case law of WTO arbitrators deciding on equivalent levels of suspension.

III. HIGHLIGHTS OF WTO CASE LAW ON SUSPENSION OF CONCESSIONS

The WTO's initial eagerness for what could be seen as over-legalization (too normative or 'European' an approach) is reflected in the following case law highlights. These highlights demonstrate the disarray and confusion that currently prevails in the field of WTO remedies and the related question of the goal(s) of WTO dispute settlement. In particular, the confusion over what suspensions of concessions are, how to define and measure them and what they are aimed at, is complete.

In this light, the need for the Appellate Body to step in is acute. Under current rules arbitration reports on suspension cannot be appealed (much to the delight of arbitrators, who have often not fully explained their rulings and calculations or made creative legal interpretations that other panels would not have made in the shadow of an appeal). This rule ought to be changed and WTO members must be granted a right to challenge the legal (not the factual) conclusions of arbitrators.²³ The question of WTO remedies and the goals of WTO dispute settlement are too important to be left outside of the purview of the WTO's highest judicial organ.

²³ Mexico's proposal for DSU review makes Art. 22.6 arbitrations subject to appeal. In the alternative, the Appellate Body could pronounce its views in complaints brought against suspensions under normal DSU proceedings (as it did in *US – Certain Products*, but only as regards the timing of suspensions) or in implementation procedures under DSU Art. 21.5 (where appeal is now accepted, though nowhere explicitly confirmed in the DSU itself).

TABLE 2: WTO SUSPENSIONS 1995-2004

	Amount requested	Opposing party's estimate	Suspensions authorized	Actual suspensions
US in Bananas	\$520 m	0	\$191.4 m	April 1999- July 2001
US in Hormones	\$202 m	\$53,301,675	\$116.8 m	July 1999 – ...
Canada in Hormones	CAN\$75 m	CAN\$ 3,537,769	CAN\$ 11.3 m	August 1999 - ...
Ecuador in Bananas	\$450 m		\$201.6 m	Not imposed
Canada in Aircraft	CAN\$700 m		CAN\$344.2m	Not imposed
EC in FSC	\$4.043 billion	\$1.110 billion	\$4.043 billion	Additional duty of 5% as of March 2004 (monthly increase by 1% until 17%)
Brazil in Aircraft	\$3.36 billion		\$247,797,000	Not imposed
EC in 1916 Act	Mirror legislation	0	Amounts of final judgments and disclosed settlements against EC	No nullification so far
Brazil, Canada, Chile, EC, India, Japan, Korea, Mexico in Byrd	Offset disbursements related to country's own exports plus share of balance (except for Chile)	Limit suspension to disbursements on own exports	72% of total disbursements related to country's own exports only <u>For 2003:</u> Brazil: \$ 1 m Canada: \$ 3.1m Chile: \$576,000 EC: \$ 18 India: \$ 1.44 m Japan: \$ 76 Korea: \$ 9 Mexico: \$ 2.9 <u>Total: \$112 m</u>	Not (yet) imposed

* Total number of 16 authorizations in 7 different disputes (2 against EC; 3 against US; one dispute pending: *US-Japan Apples*, US request for \$143.4 m)

* Total amount of 1.144 billion plus 4.043 billion in FSC = \$ 5.187 billion

* Also \$ 1,219,800 paid annually by US to EC in *Copyright case*

* Threat of EC sanctions in *US Steel case* (US safeguard withdrawn in time)

(i) Are suspensions of trade concessions mere treaty suspensions rebalancing the scales (a la Art. 60 VC), or a compensatory device; or rather must they be seen as countermeasures (in line with Art. 49 of the ASR) or even sanctions (as prohibited even under PIL)?

- Up to the last two cases (*1916 Act* and *Byrd*), arbitrators found unabashedly that suspensions are there “to induce compliance”. They **equated WTO suspensions with countermeasures under PIL**. As a result, they found support for the objective of “inducing compliance” in the ASR and PIL cases on countermeasures. However, driven by a normative/European/property rule approach to the WTO, they never really examined whether WTO suspensions can genuinely be said to be countermeasures, both in name and in terms of their level and function.
- At the same time, arbitrators were faced with the **restriction that suspensions could not go beyond a level “equivalent” to the nullification** caused by the original breach. As noted earlier, this is below the GATT standard of “appropriate” suspensions²⁴ (even though, quite paradoxically, GATT did *not* have the DSU’s implied obligation of cessation) as well as below the PIL standard of “proportional” countermeasures.
- Frustrated with the ceiling of “equivalence”, arbitrators took the first opportunity to go beyond it so as to make their awards somewhat more credible in light of the self-professed objective of “inducing compliance”. In **all three export subsidy cases** so far – where, pursuant to the Art. 4.10 of the Subsidies Agreement, “appropriate countermeasures” can be taken instead of “equivalent suspensions” – arbitrators happily exploited the broader meaning of “appropriate” (as opposed to “equivalent”) and granted **awards tailored not to the nullification caused, but to the value of the violation itself, that is, the total amount of the subsidy** (*irrespective of the impact it had on the complainant in question, i.e., had Malawi*

²⁴ Confirmed in US/EC Bananas arbitration, paras. 6.4-6.5.

requested suspension instead of the EC, they would also be given 4.033 billion).²⁵
A great number of WTO Members remain strongly opposed to this approach.²⁶

This was done notwithstanding the fact that a footnote to the term “appropriate countermeasures” states that “[t]his expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited”. Rather than construing this footnote as *tempering* the level of suspensions, arbitrators took it as proof that given the “prohibited nature” of export subsidies, suspensions in response to export subsidies ought to be of a *higher* level than those in “normal” WTO violations.²⁷

This, of course, overlooks the more general move (not limited to the Subsidies Agreement) from a GATT “liability rule” regime to a WTO “property rule” regime and the WTO’s re-introduction as legally binding international law. Indeed, both export subsidies and all other breaches of WTO rules (other than mere actionable subsidies and non-violation complaints which are backed up by a liability rule, not a property rule²⁸) constitute “illegal conduct” and must hence,

²⁵ The *FSC* arbitrators noted, indeed, (at para. 6.28) that “[t]he reasoning we have followed above could be construed – in a purely abstract manner – to be as inherently applicable to any other Member as to the complainant in this case viz. the European Communities”. Hence, had Malawi brought the complaint, Malawi as well would have been authorized to suspend concessions worth 4.033 billion !

²⁶ In DSB meetings, for example: Philippines, Brazil, Canada, United States. When *FSC* was adopted, the US offered a blistering critique, which did not draw any opposing response (DSB Minutes, p. 3): “to the extent that the *Canada – Aircraft* decision was devoid of standards, it was because it was modelled on the *FSC* decision, which was itself devoid of any standard. The *FSC* arbitration decision was a seriously flawed document ... The minutes of the Uruguay Round Negotiating Group on Subsidies revealed that this was the position of every delegation that had spoken on this issue. Not a single delegation had expressed the view that countermeasures should be based on anything other than trade effects”.

²⁷ The *FSC* arbitrator went as far as stating that this aggravating factor *must be* taken into account (para. 5.30): “we have found not only that ... there is an entitlement to take account of the unlawful nature of the initial act which gives rise to the countermeasures, but also that this is the perspective for assessment specifically required under the *SCM Agreement*.”

²⁸ Actionable subsidies must not necessarily be removed. It suffices to “take appropriate steps to remove the adverse effects” (Art. 7.8 Subsidies Agreement). The same applies to successful non-violation cases where there is “no obligation to withdraw the measure”, “a mutually satisfactory adjustment” suffices and “compensation may be part of a mutually satisfactory adjustment as final settlement of the dispute” (DSU Art. 26.1(b) and (d)). In other words, actionable subsidies and non-violation claims are backed-up by a liability rule, not a property rule. Moreover, while no suspensions back up non-violation claims, actionable

under the DSU's implicit obligation of cessation, be withdrawn or brought into conformity with WTO rules. To give but one example, is it really so that export subsidies under the Subsidies Agreement (where the term "appropriate countermeasures" is found) are *more* prohibited or a *more serious* violation than export subsidies inconsistent with, and hence prohibited under, the Agreement on Agriculture?

- Notwithstanding what is now a huge discrepancy between export subsidy violations (at least those under the Subsidies Agreement) and all other WTO violations, arbitrators in all cases so far confirmed that **suspensions cannot be "punitive"**. Quite surprisingly, they continue to say so even in export subsidy awards where they grant suspensions not based on the harm caused, but inflated on the ground of the importance of the rules violated, i.e., the fact that export subsidies are "prohibited". Depending, of course, on how one defines "punitive", to the extent export subsidy awards have gone beyond damage caused to the complainant, punitive suspensions have, in my view, been authorized.²⁹

This was particularly so in *Export Credits* where Canada openly stated that it would not comply in respect of contracted but not yet delivered aircraft. On that ground, the arbitrators decided to adjust the level upwards with 20%, i.e. "by an amount which we deem reasonably meaningful to cause Canada to reconsider its current position to maintain the subsidy at issue in breach of its obligations" (para. 3.121). If this is not punitive, it is hard to imagine what is.

- Although (in non-Subsidy agreement cases) one might expect that arbitrators would broadly interpret "equivalence" in the light of the stated objective that suspensions must "induce compliance", the opposite has happened. Arbitrators

subsidies can justify "countermeasures, commensurate with the degree and nature of the adverse effects determined to exist" (Art. 7.9 Subsidies Agreement).

²⁹ The *1916 Act* arbitrators would agree. In their view, "any suspension of obligations in excess of the level of nullification or impairment would be punitive" (para. 5.22).

have been **very hesitant not to over-estimate nullification and refused to factor in harm that was not direct, absolutely clear and fully proven.**

In *US/Bananas* arbitrators refused to count US fertilizer and machinery exports to Latin America as well as US capital, management and packaging services offered in respect of Latin American banana exports (arguing that it was for those Latin American countries to claim these harms).

In *Hormones*, the arbitrators noted: “we need to guard against claims of lost opportunities where the causal link with the inconsistent hormone ban is less than apparent” (para. 41) and rejected harm with “too remote” or “too speculative” a causal link (para. 77).

In *1916 Act* the arbitrators insisted on “credible, factual, and verifiable information” (para. 5.54) and stressed that “this prudent approach ... is appropriate” (para. 5.57). As a result, they rejected to count any settlement under the 1916 Act that was not disclosed (para. 5.63). Since under US law most (if not all) settlements are bound by confidentiality rules, no settlements are currently covered. The same arbitrators refused to count the “chilling effect” of merely having legislation in place (even if it is not actually applied) for being “too speculative, and too remote” (para. 5.69), noting dryly that “a quantification of the chilling effect is not possible (para. 5.72). While accepting final damages amounts and fines in judgments under the 1916 Act, they refused to count litigation costs (para. 5.76).

Under this line of case law, the question must be asked why the benefit of the doubt is given to the wrongdoer? Given that it is the wrongdoer who breached WTO rules in the first place *and* the stated objective of suspensions is “inducing compliance”, **ought the benefit of the doubt not be given to the victim?** After all, arbitrators have confirmed that it is for the wrongdoer to prove why the level

proposed by the victim is *not* equivalent to nullification (the burden of proof does not rest on the victim).

- In the *1916 Act* and especially the *Byrd* arbitration, **a question mark has finally been raised as to the objective of “inducing compliance”**. Already in *FSC* the United States referred to “the objective of maintaining a proper balance between the rights and obligations of Members, as foreseen in Article 3.3 of the DSU” (para. 5.29). In response to a similar US argument, the *1916* arbitrators found:

“in our view, a key objective of the suspension of concessions or obligations whatever other purposes may exist – is to seek to induce compliance by the other WTO Member with its WTO obligations” (para. 5.5).

In *Byrd*, however, the arbitrators went a step further (para. 6.2 and 3.74):

“the DSU does not expressly explain the purpose behind the authorization of the suspension ... we are not persuaded that ... the purpose of suspension ... would be exclusively to induce compliance ... we cannot exclude that inducing compliance is part of the objectives behind suspension ... but at most it can be only one of a number of purposes in authorizing the suspension ... By relying on “inducing compliance” as the benchmark ... we also run the risk of losing sight of the requirement of Article 22.4 that the level of suspension be *equivalent*”.

The *Byrd* arbitrators referred to the compensatory function of suspension, noting (at para. 6.3) that the requirement of equivalence

“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.”

In the end the arbitrators admitted their confusion as follows (para. 6.4):

“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.”

(ii) Must suspensions offset the full value of the original violation (e.g., the total sum of the subsidy), compensate all economic harm caused by the breach or be limited to bilateral trade damage?

- In most cases, “equivalence to nullification and impairment” was interpreted as referring only to the **trade effects** of the original breach. In other words, US/Canadian beef exports kept out of the EC market because of the hormone-beef ban. The level of suspensions was then set at the *total trade value of exports annually kept out* (the same happened in *Byrd* and the two *Bananas* arbitrations, including the Ecuador/EC one where the value of a TRIPS suspension was measured not with reference to lost royalties but with reference to the total trade value of, for example, CDs that would be kept out of Ecuador due to the suspension of IP rights).
- In the *1916 Act* and *Copyright* arbitrations, however, (under the same “equivalence” standard) reference was made not to trade effects but to the more general formula of **economic effects** (in *1916*, the money lost by EC firms in US court judgments and final settlements; in *Copyright*, the licensing royalties that EC copyright holders were foregoing under US copyright legislation).

On the one hand, this benchmark can lead to higher levels of suspension (since harm other than direct trade harm can be factored in), on the other hand in pure welfare terms this could also lower the level of suspensions (since the economic

harm caused by having to shift export markets or domestic industries altogether is generally estimated at only a couple of percentages of the full value of diverted trade).

- Using the benchmark of economic effects also raises the question of whether it is the **economic harm to the exporting country as a whole** that counts, **or rather the economic harm to individual operators** (in particular exporting firms).³⁰

In 1916, for example, the arbitrators refused to discount moneys recovered by EC firms under internal EC 'blocking' legislation pursuant to which EC firms can reclaim any amounts they had to pay under the 1916 Act against the US firms that initiated the claim. If it is truly the economic harm caused to EC firms that counts, such recovered sums ought, however, to be factored in. The same argument could be made in respect of prison terms pronounced under the 1916 Act (pursuant to which certain exporters dumping on the US market can be forced to pay treble damages, fines and even be put in prison). Spending time in prison surely harms, including economically. Should WTO arbitrators put a money value on this and add it for purposes of the level of suspensions? If economic effects is the standard I would think so. However, the arbitrators in 1916 failed to even mention this element. Crucially, if all economic effects must be calculated they should include litigation costs and "chilling effects" related to the mere enactment of a measure, i.e., the effect it has on exporters changing their behavior and thereby losing money to avoid application of the law; even the mere risk of seeing the law applied has an economic effect. The arbitrators rejected all of these costs.

- Finally, using economic harm rather than trade harm raises the question of whether **only harm caused after the reasonable period of time** for implementing a WTO ruling can be covered, **or also harm caused before that**.

³⁰ In US/Bananas, para. 7.1, the arbitrators explicitly rejected the idea of using as a reference "US firms' costs and profits, as used in the US submission". What counted was US exports.

In 1916, reference was made to “any” judgments and final settlement awards. Does this mean that also those before the end of the reasonable period of time count? If so, this would be quite different from the standard trade effects test where the calculation is based on the question of what trade would have been added if the wrongdoer had brought his regime in line with WTO rules (e.g., lifted the hormone-beef ban) *the day of the lapse of the reasonable period of time?*

(iii) *How have developing countries been able to use the instrument of suspension?*

The “suspension” experience so far of developing country complainants is not very promising. Although there is no evidence that developing countries have been less able to induce compliance with WTO rules and rulings (though more because of reputational costs for the rich countries than based on the threat of retaliation by the poor), when they did resort to countermeasures the limits of the instrument for weaker players became readily apparent.

- Although six developing countries obtained authorization to suspend concessions (Ecuador in *Bananas*; Brazil in *Export Credits*; and Brazil, Chile, India and Mexico in *Byrd*), **so far none of these have actually been exercised.**
- In *Bananas*, the **arbitrators openly acknowledged the difficulty** of a small, developing country inducing compliance through suspension against a big trading nation like the EC (para. 73):

“One may ask whether this objective [of inducing compliance] may ever be achieved in a situation where a great imbalance in terms of trade volume and economic power exists between the complaining party seeking suspension and the other party which has failed to bring WTO-inconsistent measures into compliance with WTO law. In such a case, and in situations where the complaining party is highly dependent on imports from the other party, it may happen that the suspension ... entails more

harmful effects for the party seeking suspension than for the other party”.³¹

Developing countries are, indeed, twice disadvantaged under the WTO’s retaliation mechanism. Firstly, the harm they suffer from a violation, even if small in absolute terms, can be huge for them in relative terms. Yet, the suspension authorized in return only offsets the harm in absolute terms and if it does so against a big trading nation this absolute figure will have a much smaller impact, in relative terms, on the wrongdoing big nation than the original breach has on the small victim. In relative terms, suspension is therefore never equivalent to harm. Secondly, suspension itself is unlikely to bring any benefit to developing countries nor to harm big country wrongdoers. Since most developing countries are not “large countries”, protection is unlikely to improve their terms of trade. Moreover, when US steel producers are kept out of the Malawi market in retaliation, US steel producers will make little noise with the US government. Hence, unlike retaliation by the EC, the US government will feel far less pressure to comply when retaliation comes from a small player than when it comes from a big trading partner. These factors plead in favor of spreading the cost of countermeasures away from developing country complainants, that is, to make countermeasures more collective for developing country complaints (in the UN Security Council, for example, trade sanctions are an obligation on all UN members).

- **Factors other than the absolute amount of the trade impact** have been referred to in Ecuador’s request for cross-retaliation in *Bananas*. Cross-retaliation was granted in that case (at least partly, under GATS and TRIPS) taking into account

³¹ For an idea of the asymmetry (para. 125): “Ecuador’s population is 12 million, while the EC’s population is 375 million. Ecuador’s share of world merchandise trade is below 0.1 per cent, whereas the EC’s world merchandise trade share is in the area of 20 per cent. In terms of world trade in services, the EC’s share is 25 per cent, while no data are available for Ecuador because its share would be so small. The GDP at market prices in 1998 was US\$20 billion for Ecuador and US\$7,996 billion for the 15 EC member States. In 1998, the EC’s GDP per capita is US\$22,500, whereas per capita income is US\$1,600 in the case of Ecuador”.

- (i) “the importance of [bananas] trade to” Ecuador³²; and
- (ii) “the broader economic elements related to the nullification” and “the broader economic consequences of the suspension”.³³

Crucially, however, this *relative* trade factor (how important are bananas *for Ecuador*) and broader economic factors have only played out only in deciding whether cross-retaliation is permitted, not in setting the level of suspensions. Nonetheless, in cases where developing countries are forced to take countermeasures, a strong argument can be made that such factors should count also in setting the level itself. DSU Art. 22.7 provides:

“If the case is one brought by a developing country Member, in considering what appropriate action might be taken, the DSB shall take into account not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned”.³⁴

- In *Export Credits* the relatively small size of the Brazilian market actually worked against it. It was used as an argument to *lower* Brazil’s rights to suspension. The arbitrators looked at the overall level of trade between Canada and Brazil (Canada’s export to Brazil are, according to Canada, US\$591 m, according to Brazil, US\$927 m) and found as follows (para. 3.42):

³² DSU Art. 22.3(d)(i). Ecuador/EC Bananas Arbitration, para. 129: “Nearly 11 per cent of Ecuador’s population is totally dependent on this sector. Banana exports (in goods only) represent 25.45 per cent of Ecuador’s total merchandise exports. Banana production represents nearly 5.2 per cent of the GDP. In Ecuador’s view, the banana industry is of greater importance to its economy than the whole agricultural sector in most developed countries”.

³³ DSU Art. 22.3(d)(ii). Ecuador referred in this respect to the fact that it was experiencing “the worst economic crisis in Ecuador’s history” (para. 132).

³⁴ This provision follows DSU Art. 22.7: “If the matter is one which has been raised by a developing country Member, the DSB shall consider what further action it might take which could be appropriate to the circumstances”. DSU Art. 21.2 adds: “Particular attention should be paid to matters affecting the interests of developing country Members with respect to measures which have been subject to WTO dispute settlement”.

“This disparity between the level of the proposed countermeasures and the total value of Brazil's imports of goods from Canada is so large that, in our view, it is not fitting by way of response to the case at hand.”

Hence, instead of feeling pity for Brazil (and its low levels of imports from Canada), the arbitrators used this factor against Brazil. This is like saying that since the victim of a crime is poor or does not have the strength to retaliate, we must reduce the penalty on the wrongdoer.

In summary, WTO case law on suspension of concessions is in disarray. There is great confusion as to what the objective(s) are of suspension and even in those cases where it was taken to be “inducement of compliance”, varying benchmarks have been adopted (export subsidy cases vs. other cases; trade effect vs. economic effect, etc.). Moreover, whilst in the early cases a clear normative stance of “inducing compliance” was taken (reaching a “punitive peak” in the *Canada – Exports Credit* case), the latest tendency demonstrates the realization that suspension may not induce compliance and has other objectives as well. The early “inducing compliance” tendency reflects a normative/European view of international law that sees a need for WTO rules to be complied with in all cases, at all times. The more recent tendency is probably a swing back to a more American/transactional approach to international law. If correct, this evolution portrays the WTO as a fledgling institution that needed to establish itself, assert its authority and confirm its rules as serious and legally binding. Doing so it started off with permitting *little* flexibility. However, once the legitimacy of the system established, and the system taken seriously, it can now permit itself some wiggling room. This approach sees the WTO evolving from a strict, legalized system accepting only full compliance with its rules (at least officially and on the books), to a more flexible system where alternative settlements are tolerated as long as certain conditions are met. This trend stands in contrast to the traditional view of the GATT/WTO, that is, one that sees a uni-directional move toward ever more legalization, with increasingly less room for

flexibility and where the GATT's exceptions, escape clauses and re-negotiation potential are seen as birth defects that need to be eradicated as soon as possible.

At the same time, WTO case law on suspensions highlights the limits of the American/transactional approach, in particular its realist and law & economics incarnations. Suspension is a tool at the hands mainly of big trading nations. Although it can be effective as an instrument to induce compliance, it does not operate in a neutral way. Both the realist and law & economics school can explain why big trading nations use the instrument and why it may work for them, they fail, however, to take account of, let alone contain, the imbalances *between* WTO members. In addition, both schools largely consider WTO members as unitary actors and fail to pierce the state veil so as to protect individual economic operators. Although in realist terms a WTO member may be content with offsetting compensation or suspensions, its economic operators harmed by the original breach remain uncompensated (both the lower tariffs abroad, i.e., compensation, and the higher tariffs at home, i.e. retaliation, are in another sector than the original breach). Moreover, even if in purely political terms, compensation or reciprocal suspensions may be "efficient" in that the wrongdoing state or politician is still better off breaching than complying, the individual companies harmed by either the original breach or the countermeasure remain in the cold.

IV. IN CONCLUSION: SUGGESTIONS FOR FUTURE DIRECTIONS

1. *The "European" extreme: Why not demand compliance with WTO rules in all cases?*

This normative/European approach driven to the extreme must be tempered. WTO rules are not like human rights or criminal law rules. They permit flexibility (safeguards, re-negotiations, bilateral settlements, temporary compensation or suspension, etc.) and do so for good reasons: (i) otherwise trade agreements would not have been concluded in the first place; (ii) the flexibility offered is a welcome democratic safety-valve *ex post*.

The drive for ever more legalization has its limits: (i) legalization alone does not guarantee compliance (in the end, what matters is the political and broader societal will to comply); (ii) ever more legalization or closure of “Exit” from WTO rules in the WTO’s legal/normative regime calls for ever more “Voice” or participation in the WTO’s political regime. Hence, the current balance between low Exit (a strong DSU) and high Voice (consensus decision-making) is a natural equilibrium (not, as most claim, an unhealthy imbalance). At the same time, to further reduce Exit (e.g. by strengthening the obligation of cessation or imposing punitive suspensions) risks destroying the current equilibrium: it will lead to even more demands for Voice or participation and too high a demand for Voice, if not met, puts pressure on the Exit option so that eventually too normative a regime may lead to the collapse of the system altogether (e.g., members openly disregarding the rules, even leaving the organization).

The risks related to suspensions that are *too high* are real: (i) the system may be over-deterrent (in law and economics terms: deter even breaches that are efficient)³⁵; too high a suspension level may make a bilateral settlement impossible; it may be impossible for the wrongdoer to “buy off” the retaliation; overall breach plus retaliation may then do more harm than good; (ii) if suspensions are too high, victims may be unable/unwilling to implement them, as is already the case today (only 4 of the 16 authorizations have so far been utilized): if so, the threat of retaliation loses credibility and the instrument of suspension loses its incentive toward compliance; in that case, the right to retaliate also loses its value and may prevent meaningful settlements: if the threat of retaliation is not real, who would want to pay for it? Incidentally, this is a good reason for WTO members to apply retaliation, once authorized, as much as they can. Under US Section 301, retaliation *must* be imposed. In most other countries, including the EU, this remains an option. An obligation to retaliate makes the instrument more forceful and credible.

³⁵ An obvious example of over-deterrence is anti-dumping. Unlike the DSU or any other trade remedies, the countermeasure permitted against dumping is not linked to the injury caused. Rather, it can go up to the full amount of the dumping margin. This is all the more paradoxical since dumping is not even prohibited under WTO law !

Note, finally, that the current 1:1, equivalence benchmark for WTO suspension can be more forceful than it looks at first sight. The level of suspension must not be equivalent to the *benefit derived by the wrongdoer from breach*, but rather equivalent to *the harm caused to the victim*. Since harm to victim often exceeds benefit to wrongdoer (say, the EC suffers more from the FSC export subsidy than the US gains from it), *and* a trade breach always incurs some harm also to the wrongdoer himself, breach may be more costly than compliance. In other words, the cost of FSCs to the US – both that of tax revenues foregone by the US and a 4 billion loss in exports to the EC – is likely to exceed the benefits (economic and, especially political) that the US derives from FSCs. In this sense, even with less than 100% probability of detection and the possibility of other enforcement errors, a 1:1 *lex talionis* type countermeasure can approximate optimal deterrence.

2. *The “American” extreme: Why not permit, even stimulate, efficient breaches?*

This transactional/American approach driven to the extreme must equally be tempered. In domestic contract law, with unitary actors and a centralized court system to evaluate and award damages, the idea of stimulating efficient breach makes sense: overall the society is better off if the wrongdoer gains and the victim is fully compensated (i.e., the cost of breach to the wrongdoer is lower than that of compliance, hence, we should permit breach for as long as the victim is fully compensated).

However, the theory as applied by Sykes and others to the WTO system is not one of *economically efficient* breach. Even they will not argue that the world is better off when a country breaches WTO rules but is willing to suffer suspensions (clearly, in economic terms, both the breach and the suspension are trade restrictions and, based on standard trade economics, *both reduce overall welfare*; two wrongs do not make one good, hence, the world is worse off). Rather, in the WTO debate the notion of “efficient breach” is used in purely *political* terms: the wrongdoer considers that politically he is still better off breaching *and* suffering retaliation, than complying with the rules *and* suffering

domestic opposition. The theory only *explains* why the rules on safeguards and suspensions are there. Unlike efficient breach in private contract law, the theory as applied to the WTO does not *normatively prescribe* the current system as ideal.

Hence, although the theory of “efficient breach” can *explain* certain WTO rules from a *political*, public choice point of view, in normative terms, the “liability rule” system of unilaterally permitting breach for as long as one compensates the victim, raises serious problems at the WTO level (as noted earlier, the principle is absent in PIL; was present in GATT but is now implicitly removed at least from the DSU):

- for the breach to be efficient, all victims (possibly 150 countries) ought to be fully compensated. Quite clearly this is currently not the case: (i) WTO remedies only work prospectively, past harm remains completely uncompensated; (ii) even prospective harm is not compensated: compensation currently needs the agreement of both parties; if it does not materialize, countermeasures can be taken; however, in economic terms, closing off one’s markets does not compensate the victim (rather it causes losses to the victim’s own importers and consumers; although large country victims can obtain some terms of trade benefits from higher protection); (iii) even if in political terms suspensions rebalance the scales of trade concessions to an equilibrium, it restores the situation *ex ante*, i.e. the situation that existed *before* concessions were exchanged; unlike “expectation damages” in US domestic efficient breach theory, it does not put the victim in the situation he would have been in had the WTO rule been complied with.
- Even if somehow WTO remedies would provide for full compensation to all victims, the transaction costs required to achieve this (negotiations, collection of information, arbitration on levels of nullification, etc.) would be extremely high in a situation with potentially 150 victims. Moreover, meaningful compensation (at least in trade terms) to specific victims is made difficult because of the MFN principle: if a wrongdoer opens his market some more on another good in

compensation, such market opening cannot be limited to specific victims, through MFN it must be awarded to all WTO members (even non-victims).

- Even if the wrongdoer is willing to pay all of these transaction costs, and still considers that breach is worth it, the WTO case law above shows that due to asymmetries of information between the parties and between the arbitrators and the parties, estimating the damage caused by WTO breach to victims is very difficult. The estimates so far are also very unpredictable which makes it difficult for wrongdoers to calculate whether breach will, indeed, be less or more costly than compliance. There is, moreover, a clear tendency to under-estimate the damage. If so, compensation will be too low and there is a serious risk that breach no longer is efficient.
- Given that at the WTO wrongdoers are states, actually obtaining compensation (even if agreed to) is less assured than under domestic law where a system of centralized coercion exists (sheriffs, bailiffs, etc.).
- Crucially, all considerations so far regard wrongdoer and victim as unitary actors. As noted earlier, the private economic actors suffering from breach are not compensated by reciprocal suspensions in another sector nor by trade compensation on some other goods. In addition, while overall the two countries may restore a political balance through trade compensation or suspension, such rebalancing not only fails to compensate the private victims of the original breach, it also harms new, innocent private actors (i.e., in the wrongdoing country, the industry for which tariffs are lowered in compensation or the importers or consumers of goods suffering retaliation).
- The fact that WTO members are not unitary actors also changes their incentive structure to comply when faced with an obligation to compensate. Whilst countermeasures directly hurt one or the other industry – which in turn will put pressure on the government to comply – an obligation to pay monetary

compensation widely diffuses the cost of breach to the wrongdoer (the money comes out of the general budget and is recovered essentially from the entire population). This makes monetary compensation at the WTO a weaker instrument toward efficient breach or compliance than it is in domestic law. Indeed, on the state-to-state scene, compensation also plays less of a reputational and deterrent function than countermeasures.

- Engaging in efficient breach is likely to be easier for big players than for small ones. Big players will be more immune from pressure in other areas (e.g., development assistance, GSP lists, etc.): this is likely to make their “efficient breaches” more easy and those by weak players more difficult. Moreover, small players may be less able to pay their way out (they have less to offer in compensation). This may for all practical purposes take away the right to efficient breach from weaker countries (which would amount to a serious inequity in the system) or leave the victims of weak country breaches uncompensated (which would make the breach inefficient). The latter corresponds to the domestic law problem of “judgment-proof” wrongdoers.

In conclusion, all the points above provide strong reasons in favor of a property rule rather than a liability rule in the WTO system. In domestic law as well, when transaction costs are high, damage is hard to calculate, there is a tendency for under-compensation and damages awards risk not being paid, the problem of under-deterrence (or inefficient breaches) has led to the imposition of a property rule (as for the protection of ownership or under criminal law). Recall, however, that this would only prevent WTO members from *unilaterally* breaching WTO rules combined with compensation; a property rule remains consistent with the idea that bilateral settlements or re-negotiations can end a trade problem, *for as long as both parties agree*.

In that sense, it is a middle way between the European extreme of compliance-in-all-cases, and the American extreme of permitting unilateral breach for as long as one pays for it.

The above reasons also highlight the risks of countermeasures that are *too low* (like compensation that is too low, the system may then lead to under-deterrence). More generally, unlike what the managerial school seems to imply, countermeasures will always have a role to play in the world trade system: (i) reciprocity is what triggered the system and what holds it together; (ii) countermeasures may harm the victim of the original breach (not always, however, especially if the country is a “large” one); at the same time, they also stand to hurt the wrongdoer, if not economically, then at least politically (target industries will pressure the wrongdoing government into compliance, as they did in the US when faced with EC retaliation in the *Steel* case); (iii) countermeasures are an instrument in the sole hands of the victim; unlike compensation it does not require any positive step from the wrongdoer; hence, retaliation will always be needed as a backup in case compensation fails (as is the case in recent FTAs concluded by the US, even those providing for an obligation to compensate).

The above problems with an efficient breach approach also point in the direction of monetary compensation instead of trade compensation (given the non-unitary nature of WTO members). Monetary compensation could trickle down to harmed private operators, be it offered at the WTO level or at the domestic level (as some European companies are now trying to do, claiming compensation before the European Court of Justice against the EC itself for non-implementation of WTO rulings in *Hormones*). As noted by one author examining the evolution of liability regimes in Ancient Law:

“Subsequent to its formal regulation, the practice of literal retaliation for physical injuries [much like the WTO’s “equivalent” suspension standard] quickly fell into disuse. A system of compensation gradually replaced retaliation ... The irony of this evolution is evident: once consecrated into clear and rigorous rules, the practices of retaliation tend to be abandoned”.³⁶

³⁶ Francesco Parisi, *The Genesis of Liability Rules in Ancient Law*, *American Law and Economics Review* (2001), 82-124, at 107.

The reason why is that with a strict *obligation* to impose talionic, 1:1 punishment, the victim was induced to accept the payment of “blood money”. Retaliation gave the victim a disposable and enforceable right; this right (much like suspension in the WTO) was of most value to the original wrongdoer since he would suffer more from the retaliation than the victim would win from it (losing your eye harms *you* more than it benefits the one taking it out); thus, compensation became the price paid for the transfer of the right to retaliation to the highest valuing individual.

The problem in the WTO context is that neither compensation, nor retaliation are an *obligation* (compensation is voluntary; retaliation is only a right, not an obligation). In this context, it is harder to extract “blood money”. As Parisi noted:

“a system of voluntary compensation is deemed to collapse in the absence of a credible threat of retaliation”.³⁷

³⁷ Ibid., p. 117.