

WTO Retaliation

Effectiveness and Purposes

Michelle Limenta



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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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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.

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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.

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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 protectionism²⁸ 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 arbitrators³⁵ 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) ‘detering 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.