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Financial Compensation in the WTO

*Improving the Remedies of WTO Dispute Settlement**

Introduction

The current system of remedies in the World Trade Organisation (WTO) provides Members with a choice between trade compensation or retaliation. There is a problem in that trade compensation is only possible with the consent of the non-complying country and thus often remains theoretical. On the other hand, retaliation has the disadvantage of requiring the complaining member to "shoot itself in the foot" by restricting imports and thus hurting its own industrial users, importers and consumers.

The WTO dispute settlement system is a success. One of its main attractions is that it explicitly envisages remedies in the event of continued non-compliance when a country loses a dispute settlement procedure. Nevertheless, there are two serious problems with this system of remedies.

The first problem is that of compliance. Trade retaliation or trade compensation measures aim to exercise pressure on the non-complying country to bring its measures into conformity with the WTO law. However, trade compensation is only possible when the non-complying country offers it and the parties to the dispute agree on its scope and implementation. In reality, this rarely happens. Effectively, trade retaliation is not available to these Members, with the possible exception of the largest amongst them. The cost of imposing these measures is simply too high, and developing countries feel – often rightly so – that given the small size of their markets, retaliation will never put sufficient pressure on larger, more developed Members.

The second problem is that WTO remedies do not provide for any actual reparation for damages caused by another Member's non-compliance. In this sense, WTO law is at odds with almost any other system of domestic or international law. Consequently, for the victim, especially the developing country victim, the sum of the costs of dispute settlement and retaliation are generally too high. The chances of a positive outcome are – at best – uncertain.

Problems with the Current System

The WTO dispute settlement system has two objectives:

- to obtain a satisfactory solution to the dispute in the interest of the disputing parties, and
- to more broadly guarantee compliance in the interest of all WTO Members.

Compensation and retaliation are temporary solutions only, and are merely instruments to "restore the balance of concessions" with compliance as the ultimate objective. This system has proven quite effective. The pressure to induce compliance is exercised on the very government institution (the trade ministry) that can be expected to be the driving force behind compliance. The measures induce private parties that are affected by retaliation (or trade compensation) to pressurise their governments to comply with WTO obligations.

However, the system suffers from significant flaws and some of them are as follows. (See Box 1)

- Existing remedies are theoretical or counterproductive
- Existing remedies offer no relief to those actually damaged
- Existing remedies damage "innocent bystanders"
- Existing remedies are unwieldy

Proposals for Change

A wide range of proposals for improving the WTO's system of remedies have already been put forward. Some proposals build on the existing WTO remedies: notably *collective retaliation* or *tradeable retaliation rights*. Under the system of collective

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Box 1: Problems are Even More Acute for Developing Countries

The problems encountered by developing countries are well illustrated by the case Ecuador brought against the European Union's *Bananas* regime. Contrary to the United States, which also successfully challenged the Bananas regime, and which was authorised to impose retaliatory tariff increased on annual imports covering US$191.4mn of European goods, Ecuador did not see any realistic way to retaliate in the areas (GATT and GATS) where the WTO-violations of the EU were found to have taken place. There was simply not enough trade in non-essential goods and services between the EU and Ecuador. Ultimately, Ecuador was given the authority to cross-retaliate in the area of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs).

It could allow local wine producers to sell their red wine as 'Bordeaux', and it could permit local music pirates to sell unauthorised copies of some European hit recordings, though only for the Ecuadorian domestic market. Whereas such retaliation might have created annoyance amongst French wine producers and certain European hit artists particularly popular in Ecuador, it was unlikely to result in much political pressure on the European Commission. This case aptly illustrates that it may be hard for a country like Ecuador to effectively put in place retaliatory measures.

The WTO-arbitrators ruling on Ecuador's request to retaliate recognised this. They articulated their, and Ecuador's, frustration with the present system as follows: "(g)iven the difficulties and the specific circumstances of this case which involves a developing country Member, it could be that Ecuador may find itself in a situation where it is not realistic or possible for it to implement the suspension authorised by the DSB (WTO's Dispute Settlement Body) for the full amount of the level of nullification and impairment estimated by us in all of the sectors and/or under all agreements mentioned above combined."

retaliation, developing countries would be permitted to join forces and jointly exercise pressure on a non-complying developed WTO Member. The creation of tradeable retaliation rights would allow a developing country to sell its right to retaliate to a developed country. While recognising that the position of some developing countries merits differentiated treatment, these two proposals continue to require the retaliating country to "shoot itself in the foot", and to create costs for "innocent bystanders".

Another solution that has been proposed is *mandatory compensation*. The idea is that countries that have prevailed in a dispute, but are subsequently confronted with non-compliance, could indicate in which sectors the non-complying country *should* offer compensation for as long as it does not comply with the WTO ruling. Besides, a concern regarding the sovereignty of a country, if "mandatory compensation" amounts to no more than an obligation on the non-complying country to offer compensation, the risk is that the country not complying with a WTO-ruling will not comply with this obligation either. Domestic industries, being innocent bystanders to a particular dispute, will not accept that they have to suffer adverse consequences to resolve problems of non-compliance with the WTO in another sector.

Some other solutions have looked beyond the existing WTO remedies. For example, non-compliance could lead to *suspension of voting rights*, or *suspension of the right to use the dispute settlement system*. The suspension of voting rights in response to non-compliance with a WTO-ruling is a disproportionate countermeasure. It also risks isolating the member concerned, who may subsequently lose interest in the day-to-day business of the WTO (thereby in fact reducing the incentive of this country to comply with the WTO ruling). The suspension of dispute settlement rights would be a more limited response.

Apart from the concerns mentioned here, none of these proposals, while arguably adding to the pressure on the non-complying Member to comply, do anything to effectively compensate the affected Member for the damages of a violation of WTO law. These remedies are exclusively concerned with compliance, and not with repairing injury caused by the illegal trade measure to exporters. On a more practical level, a major problem with the current set of proposals is that there are so many of them! The proposals described here as well as a host of other ideas are now all simultaneously on the negotiating table. Developing countries seem to be betting on all the horses in the race. That, of course, is never a winning strategy.

Why Financial Compensation Works Better

An alternative to the various proposals described here (and otherwise) would be to introduce financial compensation in response to a breach of WTO law. This is not a novel idea: reparation by governments of injury for which they can be held responsible is part of the tradition of public international law. It was already proposed in the

General Agreement on Tariffs and Trade (GATT) in 1966. It has also been proposed more recently in the WTO, and it is part of the many proposals submitted in connection with the pending WTO's Dispute Settlement Undertaking (DSU) review. While this idea has not attracted much support yet, it has several compelling advantages. (See Box 2)

- Financial compensation is not trade restrictive.
- Financial compensation helps redress injury.
- In most cases financial compensation will work as well, and sometimes even better to induce compliance.
- Financial compensation does not lead to a disproportionate burden on innocent bystanders.
- Financial compensation can be a disincentive to foot-dragging.
- Financial compensation is in line with general public international law.
- Introducing financial compensation adds an element of fairness.

The Objections against Financial Compensation

Many objections have, of course, been raised against introducing financial compensation into the WTO system. Two broad categories of concerns are: a) systemic concerns and b) concerns about the effectiveness and practicability of financial compensation. There is the issue of retroactivity as well.

A first set of arguments against introducing a form of financial compensation into the WTO dispute settlement system questions whether the current system is 'ready' for such remedies. In 1966 one of the objections raised in the GATT against financial compensation payable by one sovereign country to another sovereign country was that such a weighty matter could not be left to a "mere panel of experts".

As enshrined in the Preamble to the WTO Agreement, WTO dispute settlement is about more than rule compliance and rebalancing of trade concessions by governments. It follows from the WTO's objectives (as stated in the Preamble) that WTO dispute settlement is also concerned with honouring the expectations of private entities which have invested in economic growth. It would be consistent with those objectives for the calculation of reparation that is to be paid to a Member government, to be based on private injuries that have been caused by WTO-violations.

Effectiveness and Practicability

A myriad of practical concerns, and concerns about the effectiveness of a system of monetary damages have been raised. These either do not outweigh the positive effects of financial compensation, or they are based on false premises. Nevertheless, these concerns are as follows.

Box 2: Key Elements of Financial Compensation

The WTO Dispute Settlement Undertaking would have to be amended to make explicit provision for financial compensation in the event of non-compliance with WTO dispute settlement rulings.

Financial compensation is not just about *inducing compliance*, it is also about *providing equitable reparation* for damages caused.

It is only realistic to opt for a system where each individual Member can exercise its sovereign discretion on how to distribute the received compensation sum among the private parties who have suffered actual damage.

The 'victim', the Member whose rights were infringed and who suffered damages, should have a *right to choose* between traditional trade retaliation and the (or proposed) monetary damages remedy.

As to *timing*, at the very least, financial compensation should be due as of the moment that the reasonable period of implementation of a WTO-ruling set by the WTO's Dispute Settlement Body ends.

Financial compensation should ordinarily be pre-set at a certain annual amount of financial compensation for all types of violations. This amount could be one standard sum for all beneficiary Members, or it could be linked to the size of the economy of Members or some other basis taking into account their size and level of development of their economy.

To ease the introduction of this proposal, it may make sense that only developing countries, or at least those countries with *smaller economies*, should be able to claim financial compensation for an initial period of time.

A system of financial compensation could be put in place for all covered agreements (with some minor adjustments in the actual working of the system depending on the specifics of the agreement). However, it may be more feasible to implement such a system only for certain instruments at first.

- Monetary damages are difficult to calculate.
- Monetary damages are unenforceable.
- Financial compensation may not reach the rightful recipients.
- Financial compensation is more acceptable for certain measures than for others.
- Financial compensation has less compliance-inducing effect.
- Financial compensation does not change the asymmetry that exists between large and small developed and developing countries.
- Financial compensation allows rich countries to buy themselves out of violations.
- Payment of financial compensation could violate the Most-Favoured Nation (MFN) principle of the WTO.
- Payment of financial compensation constitutes an illegal subsidy.
- Developing countries cannot afford financial compensation.
- Inequality between developing countries will increase due to financial compensation.
- Financial compensation will simply never be accepted.

Retroactivity

Temporal scope is a crucial element to consider for any system of financial compensation. Retroactivity of remedies, which currently is anathema in WTO law, remains controversial. However, there are several important arguments in favour of retroactivity. Most importantly, retroactivity in financial compensation would introduce a significant disincentive against foot-dragging, which is now perceived to be a major problem in the dispute settlement mechanism.

Concluding Remarks

This proposal for financial compensation can best be introduced as an option that is to be added to the currently available remedies of trade retaliation or trade compensation in the WTO. It makes good sense to allow WTO Members to test the benefits of financial compensation against the costs and benefits of the WTO's classic trade remedies in practice. Their choice should be informed by a healthy dose of domestic debate amongst various interested parties.

Introducing the instrument of financial compensation into the WTO dispute settlement system would benefit all Members, as well as their private constituents. It would certainly be a tremendous improvement for developing countries. It would help them realise the full potential of WTO membership, as dispute settlement is one of the central elements of the world trading system.

The real beneficiaries of this change will be the WTO membership. The WTO will become more meaningful to more countries and their citizens, as compliance with the WTO will be encouraged, while injuries can be repaired; asymmetries (notably affecting developing countries) will be reduced; innocent bystanders will no longer be implicated; and trade contraction will be avoided.

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