

BRIEFING PAPER



No. 4/2012

On Compliance in the WTO *Enforcement Amongst Unequal Disputants*

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In light of impending reforms to the Dispute Settlement Mechanism (DSM) in the World Trade Organisation (WTO), it is imperative to examine reasons of unequal enforcement capacities afforded to its participants. As is inherent in any contractual relationship, the WTO is not insulated from the risk of parties taking advantage of unequal bargaining power and consequently capitalising on an ‘incentive to cheat.’

Furthermore, the institutional machinery lacks the framework to identify these incentives, much less address them. Hence, certain parties can engage in ‘Opportunistic Exploitation’ until deviations committed by them are identified. Reforms have been underway to address these issues.

Introduction

The DSM in the WTO is touted as being one of the most effective enforcement regimes under international trade law. The Dispute Settlement Understanding (DSU) provides multiple modes of settling disputes at the WTO including consultation, adjudication by the panel and the appellate body and arbitration. The rulings given by the panels and appellate bodies are directed towards enforcing compliance. However, compliance itself is subject to the varying enforcement capacities of the different participants.

This brief identifies factors influencing participation and compliance at the WTO DSM: it outlines the general features of remedies expostulated, delineates difficulties in identifying a deviation by a developing country member, and juxtaposes the different enforcement capacities of developing countries. It also details the process of cross retaliation which is widely heralded as an equalising enforcement capacity granted under the WTO regime, and draws attention to the notion that misdirected attempts seeking to revamp the current state of affairs in entirety may result in disrupting *status quo*.

Identifying Deviations and Guaranteeing Enforcement under the Dispute Settlement Process

A. Process of Punishing Deviations in the WTO

Generally at least three prerequisites have to be fulfilled prior to seeking compliance: (i) A complaint

has to be introduced; (ii) The award must be issued against the defendant; and (iii) The defendant must have modified the impugned policies or measures under attack. At this juncture it is essential to note that as per non-violation complaints, a WTO Member can be required to pay compensation even if the WTO Member committed no wrong, but owing to a legal action undertaken by it the value of the tariff concessions diminished.¹

Apart from these three conditions, compliance could occur owing to a host of other reasons such as triggers in the political economy of the participants, ‘side payments’ (where a promise is concluded to vote for the complying party in another forum), ‘reputation costs’ (for parties who may be sensitive of the ramifications of the participants being informed that the party is resisting compliance) and ‘credibility of the threat’ in the case of non-compliance.

The WTO framework functions in a particular manner to prevent against deviation by its members. If the interests of a member of the WTO are disparaged by the practices of another, the disadvantaged member may request consultations under Article 4 of the DSU in order to resolve the issue. In the event the consultation procedure does not resolve the issue, a panel is constituted under Article 6 of the DSU.

As noted before, the WTO regime provides a remedy only after the end of the reasonable period of time during which compliance is required to have occurred. Article 22.1 of the DSU prioritises requiring the specific performance of the obligations assumed rather than using the suspension of concessions –

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compensation and suspension of concessions are to be used as a transitory solution until specific performance can be achieved.²

Article 22.4 of the DSU requires that the proposed level of suspension of concessions is 'equivalent' to the level of nullification and impairment. Compensation is voluntary and the form of compensation is not premeditated by the DSU – Box 1 deals with the first case involving the grant of monetary compensation where the dispute was referred to Article 25 arbitration to determine the amount of compensation payable – *US-Section 110(5) of the Copyright Act*.³

The remedies granted under the WTO DSM have the following features: (i) remedies are generally prospective⁴ owing to which the damage caused right from the period of commission until the end of the reasonable period of time for the compliance is uncompensated; (ii) indirect benefits cannot be recouped; (iii) the value-added is given consideration; and (iv) legal fees cannot be recovered. Punishment is imperfect for WTO Members owing to which those profiting from opportunistic behaviour are 'induced to cheat' when they remain undetected. Unfortunately, it pays to engage in Opportunistic Exploitation in cases where the opportunist may remain undetected.

Often, compliance with WTO norms is a mere façade for alternate politically motivated stratagem owing to the 'incentive to behave opportunistically' and members have little incentive to disclose the information pertaining to negotiated settlements.⁵ Attempting a comprehensive study on compliance by defaulting parties in the WTO is a quixotic exercise because of the lack of veritable information pertaining to the reasons for compliance. It is difficult to reconcile whether the WTO system itself induces compliance or if compliance occurred for reasons unrelated to the DSM.

Retaliation as an inbuilt-mechanism in the WTO DSM is aimed at enforcement. This measure is exercisable as an option only after the reasonable time for compliance has expired. The general principle of restitution is that retaliation should be effected in the same sector unless 'practicable' or 'effective'. Retaliation as a remedy should be used to effect restitution and discourage future exploitation by sufficiently disparaging the interests of the opportunist. Box 2 discusses the cases in which cross-retaliation has been permitted under the WTO DSM.

B. Unequal Capacities in Detecting Deviations: Difficulties Faced by Developing Countries

WTO Members possess unequal capacities to detect deviations which is especially true because of the absence of centralised enforcement as present in the EU.⁸ Whilst the powerful nations may rely on a highly diversified export portfolio and the presence of trade diplomacy all around the world, the weaker nations are required to rely on the Trade Policy Review Mechanism (TPRM) which offers scattered information on a periodic basis and the notification system which is based on the incentives which support disclosure.⁹ Only the member countries which possess better detecting capabilities and more sophisticated administrations are in a better position to act quickly once they identify a deviation, quickly reducing the period of impunity for the deviators.

C. Investing in Punishing: The Costs of Enforcement

After a member detects a deviation and obtains a ruling from the panel or appellate body to the effect, enforcing enforcement of the salutary ruling can be an expensive exercise. This is especially because as per Article 22.1, the WTO DSM does not contain a framework to 'punish' an erring member – the

Box 1: Monetary Compensation: US-Section 110(5) of the Copyright Act

Section 110(5) of the US Copyright Act was amended by the "Fairness in Music Licensing Act" enacted on October 27, 1998. The provision exempted certain public establishments from having to pay public performance royalties. The EC put forth that this specific provision was a violation of the US violation under Article 9(1) of the Trade Related Aspects of Intellectual Property Rights (TRIPs). The Panel dealt with the Minor Effects Doctrine under Article 13.

Article 13 of the TRIPs agreement requires that limitations and exceptions to exclusive rights comply with the following conditions: (1) Be confined to certain special cases; (2) Do not conflict with a normal exploitation of the work; (3) Do not unreasonably prejudice the legitimate interests of the right holder. The panel concluded that the Business Exemption, on account of the statistical coverage of the number of shops and food and eating establishments which would be covered by the provision, would not fall under an 'exception' and would be more in the nature of a rule.⁶

In Section 110(5) of the US Copyright Act, the US was required to make a lump-sum payment of US\$3.3mn in favour of a fund set up by performing-rights societies in the European Communities. This was the first case when monetary compensation was decided upon as "mutually acceptable compensation" after acceding to further violation. This payment was to constitute a 'mutually satisfactory temporary arrangement' pertaining to the dispute. In the event the US failed to make the requisite payment before the expiry of an identified time-frame, the EC retained the option to resume arbitration under Article 22.6.⁷

Box 2: Cross Retaliation: US-Antigua

In *US-Gambling*, Antigua, a country with the small population created a clamour in the field of dispute-settlement when it exercised cross-retaliation against the US. However, the quantitative aspects of the granted cross-retaliation can be said to have wide implications considering it allowed a suspension through the TRIPs agreement. The US prohibited international long distance gambling by the internet by Antiguan service providers whereas there was a mirroring provision in their domestic legislations which allowed for interstate gambling in the US. This was found to be a violation of the General Agreement on Trade in Services (GATS).

Antigua requested suspension to extent of the amount US\$3.433bn annually. The arbitrator limited it to the amount lost due to discrimination and brought it down to US\$21mn. The methodology used to determine the value of the denigration was to estimate the revenue Antigua lost because of not having a full access to the totality of US Gambling market. The small country argued that retaliation in the gambling sector would be ineffective and justified retaliation under the TRIPs agreement and the argument was accepted.

US-Subsidies on Upland Cotton DS 267

In *US- Subsidies on Upland Cotton*, a case under the Subsidies and Countervailing Measures (SCM) Agreement, Brazil wanted to suspend obligations under TRIPs and GATS because it was not “practicable” and “effective” for it to retaliate only in the same sector as under the principles under Article 22.3. The Panel noted that in determining whether there were “serious enough circumstances” the presumption as to whether or not there will be compliance by the complained-against party is irrelevant.

The US noted that any sanctioning country will also face trouble while imposing sanctions and the same does not justify cross-retaliation. The Panel finally allowed cross-retaliation with respect to the excessive violation calculations alone, and the cross-retaliation was allowed to extend to obligations under the TRIPs agreement on the violation of the obligations crossing a certain threshold.

objective is to merely induce compliance. This was confirmed in the *EC-Bananas III (Article 22.6, US)* in 6.3:

“Accordingly, the authorisation to suspend concessions or other obligations is a temporary measure pending full implementation by the Member concerned. We agree with the United States that this temporary nature indicates that it is the purpose of countermeasures to induce compliance (emphasis in the original).”

Even if a member were to suspend concessions, the enforcing member will have to accommodate the undeniable negative implications for consumer welfare. The best possible remedy a country can aspire to obtain is re-establishment of *status quo* because the DSU prescribes equivalence between damages and countermeasures. Further, remedies will most likely only be prospective. These factors may result in sub-optimal enforcement.

The intensity of inducement to comply is a function of the credibility of the threat: it is one thing for the EU to be excluded from the Ecuadorian market and yet quite another from Ecuador to be excluded from the EU market in terms of the impact on the Ecuadorian market. As noted before compliance can be induced on grounds unrelated to WTO because the ‘big’ guys have more ‘persuasive’ power in that they have more weapons to use when they decide to retaliate which increases their retaliatory power as Bernheim and Whinston (1990) demonstrated in their study on enforcement under the competition law regime,

Studies pertaining to Compliance: Does the Record Point to Something Different?

Empirical studies on compliance have not addressed the question of whether compliance was the result of the DSM. The studies conducted by Davey (2007) and Bagwell (2005) contribute to the discussion on compliance. The study by Bagwell *et al* (2005) identified that generally non-OECD members do not suspend concession when there is non-compliance by the OECD defendant, whereas OECD complainants have not had to exercise threat of suspending concessions in order to induce compliance by a non-OECD defendant. The study provides empirical proof that bargaining asymmetries are critical in discussions pertaining to compliance at the WTO, and the identity of the parties to the dispute must be a key component in any discussion dealing with compliance.

Two other inferences which can be gleaned from the study inform the extant discussion on compliance at the WTO are firstly that it is unclear as to why the losing non-OECD defendant alter the condemned policies, and secondly, a threat does not have to be exercised to be credible, as was duly observed in Schelling’s (1960) classic account.

Way forward in DSM Reforms: Preventing against Misdirected Reforms

Whilst innate problems on detecting deviations and identifying the motivation for compliance persist, vestigial reforms pertaining to issues like sequencing which have been resolved through practice and issues

of secondary importance like providing for remand authority for the Appellate Body pertaining to the DSU have been tabled at the WTO. Proposals on enforcement include proposals for monetary compensation which does not address the question of the defendant defaulting and refusing to pay, and proposals to regard 'partial' compliance.

There are some suggestions which seek to address the problem of asymmetric bargaining power such as tradable remedies¹⁰ (which is not under consideration) and other suggestions which are yet to gather pace

like deriving the 'right to vote' or to submit a dispute from records of prior compliance. As noted before, the EU had addressed some of these deficiencies through centralised enforcement.

It is critical to ensure that the reforms which are being tabled as mere 'cosmetic changes' lack the ability to diminish the stability in the current regime. The proponents of these changes should be mindful of these concerns and ask themselves whether the candle is worth the flame.

Endnotes

- 1 NVCs represent a sizeable proportion of all disputes submitted to the WTO, see Horn *et al.* (2011).
- 2 See also Art. 22.8 DSU.
- 3 Grossman and Mavroidis (2003).
- 4 Petersmann (1993) refers to five GATT cases where retroactive remedies had been recommended. The DSU is silent on this issue: prospective remedies area creation of WTO case law. With one exception all WTO Panels have recommended them.
- 5 Collins-Williams and Wolfe (2010) make a persuasive case why incentives drive the quantity and quality of notifications.
- 6 Panel Report, *United States – Section 110(5) of the U.S. Copyright Act*, WT/DS160/R (June 16,2000).
- 7 *United States- Section 110(5) of the US Copyright Act- Notification of a Mutually Satisfactory Temporary Arrangement*, WT/DS160/23, 26 Jun 2003, found online at http://trade.ec.europa.eu/doclib/docs/2003/november/tradoc_114303.pdf.
- 8 Hoekman and Mavroidis (2000).
- 9 While most commentators celebrate the record before the TBT and the SPS Committee, they deplore the record before the ILC and the SCM Committees, see Collins-William and Wolfe (2010).
- 10 A country which has exhibited that it has a right to enforce compliance by a defaulting member, or a country which has exhibited that its benefits under the agreement have been nullified or impaired may auction of its right to impose countermeasures. This gains relevance in cases where a small country exercising countermeasures does not prove effective or induce compliance when the default is committed by a country with significant trading clout - Bagwell et al (2005).

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