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FINANCIAL COMPENSATION IN THE WTO

IMPROVING THE REMEDIES OF WTO DISPUTE SETTLEMENT

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ABSTRACT

The current system of remedies in the 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, while 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. Such retaliatory restrictions also hurt innocent bystanders abroad: private parties who are not involved in a dispute lose their export markets. As importantly, the current system does not provide for effective reparation of damages suffered by the WTO Member and private parties concerned. These problems are even more urgent for developing countries. Many of them cannot effectively retaliate: their economies are too small to make an impression on the infringing country, and the negative effects of such countermeasures would be felt disproportionately by their own economies and businesses. Introducing financial compensation could be a solution. Financial compensation does not restrict trade, helps to compensate injured Members and industries, avoids hurting innocent bystanders, and can contribute to more effective compliance. In addition to analysing the problems with current remedies and the pros and cons of financial compensation, this article outlines what financial compensation in the WTO could look like.

INTRODUCTION

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.

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The first problem is compliance. The classic remedies of the WTO system are trade retaliation or trade compensation. These measures aim to exercise pressure on the non-complying country to bring its measures into conformity with 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. Trade retaliation may do better in inducing compliance in some instances, but it requires the winning complainant to 'shoot itself in the foot' to do so. As so often, the problem is felt most by those who are most vulnerable: developing country WTO Members. 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.

This article will analyze in more detail the problems with the current system of remedies in the WTO (section I), followed by a discussion of some of the current proposals for change (section II) and the arguments for (section III) and against financial compensation (section IV). We will end with an outline of a practical proposal for financial compensation as one of the remedies in the WTO's dispute settlement system (section V), and some concluding remarks.

I. PROBLEMS WITH THE CURRENT SYSTEM OF WTO REMEDIES

The WTO dispute settlement system's objective is twofold: (i) to obtain a satisfactory solution to the dispute in the interest of the disputing parties, and (ii) more broadly to guarantee compliance in the interest of all WTO Members. When a Member is temporarily unable or unwilling to comply with a WTO dispute settlement ruling, the complainant currently has a right to try to negotiate compensation, in the form of alternative trade concessions. When the parties do not reach agreement on compensation, the complainant can be authorized to suspend concessions toward the non-complying party (retaliation). Compensation and retaliation are temporary solutions only, and are merely instruments to 'restore the balance of concessions' with compliance as the ultimate objective.[1]

[1] J. H. Jackson, 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out" ', 98 A.J.I.L. (2004), at 109; J. H. Jackson, 'The WTO Dispute Settlement Understanding – Misunderstanding on the Nature or Legal Obligation', 91 A.J.I.L. (1997), at 60. *Contra*, J. Bello, 'The WTO Dispute Settlement Understanding: Less is More', 91 A.J.I.L. (1996), at 416, who argues that defendants have the option of non-compliance and can opt for payment of compensation or the endurance of suspension of obligations; A. O. Sykes, 'The Remedy for Breach of Obligations under the WTO Dispute Settlement Understanding: Damages or Specific Performance?',

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, and the measures induce private parties that are affected by retaliation (or trade compensation) to pressure their government to comply with WTO obligations.

However, it has also become clear that the system suffers from significant flaws.

Existing remedies are theoretical or counterproductive. Compensation is theoretical because it can only be brought about when the losing party agrees. Trade retaliation amounts to trade contraction, and therefore goes against the very trade liberalizing principles the GATT/WTO system stands for.[2] Apart from imposing a burden on the world trading system as such, the retaliating country shoots itself in the foot, as the imports subject to retaliation will become more expensive or even inaccessible to its consumers.

Existing remedies offer no relief to those actually damaged. Retaliation does not offer any relief to the exporters who are injured by a WTO-illegal measure. Whereas compensation might offer the economy in general some temporary benefits, it often concerns product categories different from those directly affected by the WTO-illegal measure. For instance, the injury suffered by EU exporters of steel as a result of the recently withdrawn US steel safeguard would not have been remedied by restrictions on imports of US paper products into the EU. The problem of inadequate reparation of injury is exacerbated by the current principle that WTO-remedies are prospective only.[3] Prospective remedies effectively give a premium to non-complying countries that drag their feet in implementing a WTO ruling, as they do not have to worry about the past.

Existing remedies damage 'innocent bystanders'. Trade retaliation puts a disproportionate burden on innocent bystanders. Industries who are not at all involved in the particular trade dispute will suffer from trade retaliation.[4] In fact, the very objective of the current system is to make innocent bystanders suffer, in order for them to put pressure on their non-complying government

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in M. C. E. J. Bronckers and R. Quick (eds), *New Directions in International Economic Law: Essays in Honour of John H. Jackson* (Kluwer, 2000), at 347–57. Most recently, the view that suspension of concessions or other obligations is intended to induce compliance was discussed by the Arbitrator in *US – Continued Dumping and Subsidy Offset Act of 2000 ("Byrd") WT/DS217 – Recourse to Arbitration by the US under Art. 22.6 DSU* (at paras 3.73–3.74), with reference to *EC – Bananas III (US), Recourse to Arbitration by the US under Art. 22.6 DSU*, para 6.3.

[2] Similarly, if a country were to suspend obligations under the TRIPS Agreement by way of a retaliatory measure (as envisaged in Art. 22(3) DSU), this would weaken intellectual property protection, and would therefore run counter to the principles of the TRIPS/WTO system. For ease of discussion, we will focus here on the implications of retaliation in the goods area, where most of (the threats of) retaliation occurred to date.

[3] Reference is made to the controversy surrounding the WTO Article 21.5 Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather* ("*Australia – Automotive Leather*"), WT/DS126/RW, 11 February 2000, para 6.27ff., which took the heterodox position that remedies could be retrospective.

[4] For instance, US trade retaliatory restrictions on imports of Italian batteries in response to the EU's decision not to amend the Bananas regime within a reasonable period.

to bring its measures into conformity with a WTO ruling. That only some citizens must carry the burden of a governmental decision that is supposed to benefit the public as a whole (in this case: the decision not to comply with the WTO) goes against basic principles of administrative justice.[5]

Existing remedies are unwieldy. The larger the percentage of a Member's trade affected by a WTO-illegal measure, the more difficult it becomes for that winning country to find imports that can be restricted without unduly hurting consumers and consuming industries. This is not just a problem for developing countries. A case in point is the *US – FSC* case, where the EU has shown itself quite reluctant to exercise its right to impose restrictions on some US$ 4 billion in US imports, in part because of strong resistance by European industry concerned about losing its suppliers.

Problems are even more acute for *developing countries*. Trade retaliation is easily more counterproductive for them. The effects of 'shooting yourself in the foot' with retaliatory measures hurt countries with already weak economies disproportionately. They cut themselves off from access to foreign goods or make those goods more expensive for their domestic customers. They do so at the peril of their own economic development and position in world markets. If, nevertheless, they would want to retaliate, their markets are too small to exercise retaliatory pressure on non-complying WTO Members,[6] with the possible exception of the largest among them, such as the so-called new Quad countries (Brazil, China, India and South Africa). Furthermore, as in the case of developed countries, trade retaliation does not offer any relief to their exporters who suffer from WTO-illegal measures, and whose performance itself can be a centerpiece to their country's development achievements.

In addition, the Dispute Settlement Body has the opportunity (but not the obligation) to suggest ways for the Member to bring its measures into compliance. Although compliance review is possible under the DSU (Article 21.5), and the losing party has to submit status reports to the DSB, there is no requirement for it to specify the measures it intends to use to achieve compliance, nor to show any kind of schedule for implementation. Thus, to a large extent, it is up to the complainant itself to monitor compliance and to follow-up in case of continued non-compliance. This is disproportionately burdensome for smaller developing countries because (i) they do not have the same monitoring abilities that the larger Members have; (ii) they cannot put equally effective pressure on the larger Members to comply more rapidly; and, consequently, (iii) more powerful, larger or developed countries may be encouraged to play for time.

[5] This principle is aptly captured in the French maxim '*égalite devant les charges publiques*' (roughly translated: citizens are entitled to equal treatment whenever a government imposes a tax or other financial burdens on them).

[6] Smaller developed countries of course may face this problem too. See the only case in the history of GATT 1947, where retaliation was authorized yet never exercised by The Netherlands against the United States for maintaining GATT-illegal restrictions on Dutch dairy imports. See GATT, 1st Supp. BISD 62 (1953).

The problems encountered by developing countries are well illustrated by the case Ecuador brought against the EC's *Bananas* regime. Contrary to the United States, which also successfully challenged the Bananas regime, and which was authorized to impose retaliatory tariff increases on annual imports covering USD 191.4 million of European goods,[7] 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 TRIPS. It could allow local wine producers to sell their red wine as 'Bordeaux', and it could permit local music pirates to sell unauthorized 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 EC. 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 recognized 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 authorized by the DSB 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.[8]

We would add that any retaliatory measures taken by Ecuador against EU goods or services, even if they could have captured the full amount of nullification or impairment suffered by Ecuador, would have offered no relief to Ecuador's exporters of bananas. The damages these exporters suffered as a result of the EU's regime were not, and under the WTO's current system, could not be repaired. There was also no incentive for the EC to bring its Bananas regime into compliance with WTO rules promptly, as any remedies Ecuador would have imposed could only have been prospective in nature.

[7] WTO Article 22.6 Arbitrators' Report, *EC – Regime for the Importation, Sale and Distribution of Bananas* – Recourse to Arbitration by the EC under Article 22.6 DSU, WT/DS27/46, WT/DS27/ARB, of 9 April 1999, para 8.1.

[8] *EC – Regime for the importation, sale and distribution of bananas – recourse to arbitration by the EC under Article 22.6 DSU*, Decision by the Arbitrators, WT/DS27/ARB/ECU, of 24 March 2000, para 177. We note that in mid-2004, Brazil was also considering 'cross-retaliation' in the *US – Cotton Subsidies* case (WT/DS267/R, of 18 June 2004) based on the same concern that traditional retaliation – even by Brazil, despite being so much larger an economy than Ecuador – would not exercise sufficient pressure on the US to comply. BNA, Daily Report for Executives, 17 June 2004, 'Brazilian Farmers Eye Retaliatory Options if US Fails to Comply with Cotton Ruling'.

Ecuador's experiences in the *Bananas* case point to a fundamental concern for developing countries, especially the smaller and poorer ones. More often than not, they cannot expect to exercise retaliatory pressure in case their opponent would refuse to comply with a WTO ruling. They also cannot expect relief for the injury their exporters have suffered from the WTO-illegal measure. Accordingly, to them the costs of WTO litigation will frequently appear to dwarf the potential benefits. As a result, their access to the current system of WTO dispute settlement is not equal to that of developed countries, and in fact largely illusory.

This is a crucial issue for the WTO, not just for these developing countries, but also for the developed world. In fact, one might even go further, and say that these are not just trade-related issues. With the ever more emerging problem of failed states, as havens for terrorists, weapons proliferation, and organized crime, economic and political stability and worldwide growth have shown themselves to be major policy concerns also from a broader macro-political and -economic perspective.[9] Cancun, the emergence of the G20(+), the debates on Cotton, and the Public Health saga, have all shown that one cannot just treat developing countries as 'second rate citizens', who should be happy to stay where they are in the system, because of the Special & Differential Treatment they can claim and the free rides they obtain through the operation of the Most-Favored-Nation principle.[10] Fairness and greater inclusiveness of the WTO system are critical to all WTO Members.

II. PROPOSALS FOR CHANGE

A wide range of proposals for improving the WTO's system of remedies has already been put forward.[11] Some proposals build on the existing WTO remedies: notably *collective retaliation* or *tradeable retaliation rights*. Under a system of collective retaliation, developing countries would be permitted to join

[9] Cf. The National Security Strategy of the United States, September 2002, Chapter VI; R. Cooper, *The Breaking of Nations, Order and Chaos in the 21st Century* (Atlantic, 2003).

[10] See R. Z. Lawrence, *Crimes & Punishments? Retaliation under the WTO* (Institute for International Economics, Washington DC, 2003), at 95–96.

[11] For a fairly complete overview of proposals made by members in the context of the DSU Review see the website of the Institution of International Economic Law, at www.law.georgetown.edu/iiel/research/projects/dsureview/synopsis.html. See also on current remedies and the need for reform: J. Pauwelyn, 'Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach', 97 A.J.I.L. (2001), at 335–447; T. M. Reif and M. Florestal, 'Revenge of the Push-me, Pull-you: The Implementation Process under the WTO Dispute Settlement Understanding', 32 International Lawyer (1998) 3; A. Subramanian and J. Watal, 'Can TRIPS Serve as an Enforcement Mechanism for Developing Countries in the WTO?', 3 JIEL (2000), at 403–16; P. C. Mavroidis, 'Remedies in the WTO Legal System: Between a Rock and a Hard Place', 11 E.J.I.L. (2000) 4, at 763–814; S. Charnovitz, 'Rethinking WTO Trade Sanctions', 95 A.J.I.L. (2001) 4, at 792–832; P. Grané, 'Remedies under WTO Law', 4 JIEL (2001), at 755–72; K. Anderson, 'Peculiarities of Retaliation in WTO Dispute Settlement', 1(2) World Trade Review (2002), at 123–34; V. Mosoti, 'In Our Own Image, Not Theirs: Damages as an Antidote to the Remedial Deficiencies in the WTO Dispute Settlement Process: A View from Sub-Saharan Africa', 19 B.U. International L.J. (2001), at 231.

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 recognizing 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. In the case of tradeable retaliation rights, one can also seriously wonder why one country would buy another country's problems, only to then shoot itself in the foot on someone else's behalf.

Another solution that has been proposed is *mandatory compensation*. As indicated above, in the present system the non-complying country has the choice between offering compensatory concessions to or face retaliatory restrictions from the WTO Member that has prevailed in a WTO dispute.[12] Compensation in the classic GATT or WTO sense is generally understood not to refer to financial compensation. Rather, it denotes that the non-complying country will offer additional trade concessions (e.g., a tariff reduction), normally in another product category, for as long as it fails to bring the WTO-illegal measure into compliance. The advantage of trade compensation, as opposed to retaliation, is that compensation does not restrict trade but actually opens up trade, albeit temporarily, for as long as the non-complying measure remains in place.

It turns out, however, that compensation is hardly ever offered. This is not surprising. In other contexts where WTO rules also envisage (trade) compensation, for instance in the context of safeguards[13] or tariff modifications,[14] it has also proven to be very difficult for countries to find and offer compensatory reductions of trade restrictions. The reason is simple. Innocent bystanders in the importing country (say, car manufacturers) will oppose any proposal from their government to expose them to more foreign competition as a means of compensating another country for problems created in a different sector (say, agriculture). This, they will argue, is not and should not become their problem.

The idea behind mandatory compensation 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. To begin with, there is a sovereignty concern here. It is odd to think that a WTO Member would accept that any part of its trade regime could be changed unilaterally, if only temporarily, by another WTO Member.[15] Yet if 'mandatory

[12] See Art. 22.1 DSU.

[13] See Art. XIX (2) GATT, and art. 8 of the WTO Agreement on Safeguards.

[14] See Art. XXVIII GATT.

[15] A creative proposal was recently made, pursuant to which WTO Members would indicate in advance sectors and forms of trade compensation (referred to as 'Contingent Liberalization Commitments', or 'Liberalization Security Deposits'), which they would be prepared to concede in case they did not comply with a WTO ruling, and from which the WTO Member having won a WTO dispute might

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 still not accept that they have to suffer adverse consequences to resolve problems of non-compliance with the WTO in another sector. Indeed, here as well one could see an element of unfairness in forcing one particular segment of society to shoulder the consequences of a country's non-compliance with a WTO ruling. If a country believes it is in the public interest not to comply forthwith with a WTO-ruling, and the sector concerned cannot accept alternative concessions, the public as a whole should pay for this choice rather than a specific segment of the public (whether it be a particular domestic industry that is exposed to retaliatory measures from the country having prevailed in the WTO-dispute, or a domestic industry having to accept additional import competition because its non-complying government must offer trade compensation).[16]

Moreover, there is no guarantee that mandatory compensation will do anything to repair the damage of exporters suffering from a trade barrier or measure, which is not brought into compliance with a WTO-ruling. In fact, reparation of injury is rather unlikely. Trade compensation often has to be found in a product category that is not involved in the original dispute.

Some other solutions have looked beyond the existing WTO remedies: e.g., non-compliance could lead to *suspension of voting rights*, or *suspension of the right to use the dispute settlement system*. At first sight, these solutions appear more attractive, as they create no concerns about trade contraction. Yet the suspension of voting rights in response to non-compliance with a WTO-ruling is a disproportionate countermeasure.[17] 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 DSU rights would be a more limited response. Still, it seems a disproportionate response to non-compliance with a particular WTO ruling.[18]

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choose in exercising its mandatory compensation rights. See, e.g., Lawrence, above n 10, at 86ff. In view of the other drawbacks attached to trade compensation, discussed in the text, we would not favor spending negotiating resources on the creation of such a system.

[16] Again, reference is made to the French maxim '*égalité devant les charges charges publiques*', above n 5. The unfairness of singling out a specific industry for special treatment in order to resolve a problem elsewhere in society remains, even if it can be argued that such special treatment (exposure of 'innocent bystanders' to more import competition, i.e. to an additional measure of trade liberalization) would be beneficial to the non-complying country as a whole.

[17] Perhaps the suspension of voting rights of a WTO Member could be considered an appropriate response in the more unusual case where this Member fails persistently to comply with WTO rulings.

[18] Again, perhaps the suspension of the right to bring dispute settlement proceedings of a WTO Member could be considered an appropriate response in the more unusual case where this Member fails persistently to comply with WTO rulings.

Apart from the concerns mentioned so far, 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. As a result, they also do not significantly change the outcome of the cost-benefit analysis that any country undertakes prior to initiating litigation. This, we submit, is also a problem with the otherwise useful tools to encourage countries' compliance with international law as developed in the theory of international relations.[19] As such, the WTO's system of remedies remains in stark contrast to an age-old adage of law: '*ubi ius, ibi remedium*'. In the WTO, there may be law, but there is not always a remedy.

Finally, and 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 above as well as a host of other ideas are now all simultaneously on the negotiating table. Developing countries seem to betting on all the horses in the race. That, of course, is never a winning strategy. Our strategic advice would be to bet on one horse: financial compensation.

III. WHY FINANCIAL COMPENSATION WORKS BETTER

An alternative to the various proposals discussed above would be to introduce financial compensation in response to a breach of WTO law.[20] 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.[21] It was already

[19] See, e.g., J. K. Setear, 'An Iterative Perspective on Treaties: A Synthesis of International Relations Theory and International Law', 37 Harvard J. Int'l L. (1996), at 139–229; D. Snidal, 'The Limits of Hegemonic Stability Theory', 39 Int'l Organization (1985), at 579–614; A. Chayes and A. Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Cambridge, MA: Harvard University Press, 1995), at 25ff.; A. Wendt, 'Constructing International Politics', 20 Int'l Security (Summer 1995), at 71ff.; H. Koh, 'Why Do Nations Obey International Law?', 106 Yale L.J. (1997), at 2602–603. For an overview of the various theories relevant to WTO enforcement and compliance issues see N. van den Broek, 'Power Paradoxes in Enforcement and Implementation of World Trade Organization Dispute Settlement Reports – Interdisciplinary Approaches and New Proposals', 37(1) Journal of World Trade (2003), at 127, 134ff.

[20] See also M. Bronckers, 'More Power to the WTO?', 4 JIEL (2001) at 41, 62–63; M. Bronckers, 'Towards Remedies which Expand rather than Contract Trade', 5(2) Journal of World Investment and Trade (2004), at 353–56, followed by the transcript of a discussion with various contributors at the 10th Global Arbitration Forum in Geneva (December 2003), at 361–67; S. Esserman and R. Howse, 'The WTO on Trial', 82(1) Foreign Affairs (2003), 130, at 135.

[21] See *Draft Articles on Responsibility of States for Internationally Wrongful Acts*, adopted by the International Law Commission at its 53rd session (September 2001), Supplement No. 10 (A/56/10), chp.IV.E.1, at http://www.un.org/law/ilc/convents.htm (this site also contains the authoritative commentaries). The ILC Draft is discussed in D. Shelton, 'Righting Wrongs: Reparations in the Articles on State Responsibility', 96 A.J.I.L. (2002), at 833. For the classic case law see PCIJ, *Chorzow Factory* case (jurisdiction) (1927), PCIJ, Series A, No. 9, at 21; PCIJ, *Chorzow Factory* case (indemnity) (1928), PCIJ, Series A, No. 17, at 29, 47; ICJ, *Corfu Channel* case (1949), at 23.

proposed in the GATT in 1966.[22] It has also been proposed more recently in the WTO,[23] and it is part of the many proposals submitted in connection with the pending DSU review.[24] While this idea has not attracted much support yet, it has several compelling advantages:

1. Financial compensation is not trade restrictive

The obligation to pay financial compensation is not trade restrictive, which is attractive both systemically (no further disturbance of optimal allocation of production), as well as from the point of view of the country imposing the measures (no need to shoot oneself in the foot).

2. Financial compensation helps redress injury

Financial compensation also helps to redress the injury of the country and/or the private interests who actually suffer from the WTO-illegal measure, because it means at least partial reparation of damages caused by the WTO illegal act. In this respect, we submit that it can be left to the individual WTO Members to decide whether and how to redistribute the compensation received.[25]

3. In most cases financial compensation will work as well, and sometimes even better to induce compliance

Partly as a result of these two principal characteristics (not trade restrictive and redressing injury), the deterrent or persuasive effect of monetary compensation will often be no less than that of traditional trade retaliation. In the hands of developing countries, financial compensation is in fact likely to be more effective against non-complying (larger) developed countries than the current instruments of compensation and retaliation. Yet countries could still be given a choice between classic trade retaliation and the new instrument of financial compensation.

4. Financial compensation does not lead to a disproportionate burden on innocent bystanders

The obligation to pay financial compensation would be equally distributed as a charge on the non-complying country's budget, and not constitute a disproportionate burden on particular groups of innocent bystanders.

5. Financial compensation can be a disincentive to foot-dragging

Financial compensation can be a disincentive to foot-dragging, particularly if some retroactivity would be introduced in the WTO dispute settlement

[22] See Report of the Ad Hoc Group on Legal Amendments to the General Agreement, COM.TD/F/4, (4 March 1966).

[23] See, e.g., 'Preparations for the 1999 Ministerial Conference – The Dispute Settlement Understanding (DSU), Communication from Pakistan to the General Council', WT/GC/W/162 (1 April 1999).

[24] Least Developed Countries' proposal, TN/DS/W/17, of 9 October 2002, at point 13; see also the proposal of Ecuador, TN/DS/W/33, of 23 January 2003, at 4.

[25] Reference is also made to the various ways in which this is arranged in other areas of public international law and where compensation is either due to a foreign government or a private party, and where it is up to a government receiving compensatory payments to decide for itself whether or not it redistributes to private parties.

system.[26] This is an advantage both from a bilateral perspective for the country faced with the WTO-illegal measures, and for the WTO system as such by lowering the overall cost of WTO dispute settlement and the pressure on the system caused by long-term non-compliance.

6. Financial compensation is in line with general public international law

Providing instruments both for compensation or reparation, and for compliance inducement, is fully in line with general public international law. The International Law Commission's Draft Articles on State Responsibility,[27] as well as public international law in general[28] recognize both instruments of compliance inducement, and instruments aimed at full reparation. In public international law, an unlawful act calls for two reactions: (i) compliance, which is an obligation both toward the injured state and to the international community and the legal system as a whole; and (ii) reparation for remedial purposes, to make good the damages caused to the injured state.

7. Introducing financial compensation adds an element of fairness

Providing for reparation of damages caused by an illegal measure, especially *vis-à-vis* developing countries can also add an element of 'fairness' to the WTO legal system. It has been shown quite convincingly that such 'fairness' plays an important role in explaining compliance with domestic and international law,[29] and in the governance of the international system in general.[30]

IV. THE OBJECTIONS AGAINST FINANCIAL COMPENSATION

The authors recognize of course that many objections have been raised against introducing financial compensation into the WTO system. For purposes of this discussion, we distinguish two broad categories of concerns: (1) systemic concerns and (2) concerns about the effectiveness and practicality of financial compensation. Finally, we will deal separately with the issue of retroactivity.

A. Systemic concerns

A first set of arguments against introducing a form of financial compensation into the WTO dispute settlement system questions whether the current system

[26] See, e.g., P. Grané, above n 11; N. van den Broek, above n 19, proposing retroactivity in particular cases of *mala fide* non-compliance.

[27] See, above n 21 (particularly Articles 29–31).

[28] Umpire Parker in the 'Lusitania' cases (US/Germany) 7 RIAA 32, 39 (1923), at 100–01; ICJ, '*Chorzow factory*' cases, above n 21. For a further comparison between the rules on remedies on public international law and WTO law, see P. Mavroidis, above n 11, at 766 et seq; P. Grane, above n 11.

[29] See, e.g., A. Chayes and A. Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Harvard University Press, 1995); Th. Frank, *Fairness in International Law* (Clarendon, 1998).

[30] Cf., for example Joseph S. Nye, *Soft Power, The Means to Success in World Politics* (Public Affairs, Inc. 2004).

is 'ready' for such remedies; whether such an instrument was ever intended to be part of the GATT system and presently 'fits' the WTO system. Upon closer inspection, and taking into account what the WTO system looks like today, these counterarguments fail to persuade.

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'.[31] While this may have rung true where GATT panels were concerned, this objection cannot be maintained after the changes in dispute settlement introduced by the WTO Agreements. Panels, and especially the WTO Appellate Body, have earned and received considerable respect.

Some have also claimed that financial compensation would run counter to the objective of GATT dispute settlement, the principles of which were confirmed in the WTO's Dispute Settlement Understanding. In their view, the objective of GATT dispute settlement was to restore a balance of concessions between governments. However, this view does not correspond anymore with the rule-based system established by the WTO, which has moved beyond a reciprocal exchange of concessions (consider, e.g., the SPS, TBT, and TRIPS agreements). Rule compliance has become the norm.

Moreover, private initiative is key to achieving the WTO's objectives. As one WTO panel noted:

> Many of the benefits to [WTO] Members which are meant to flow as a result of the acceptance of various disciplines under the GATT/WTO depend on the activity of individual economic operators in the national and global market places. The purpose of many of these disciplines, indeed one of the primary objects of the GATT/WTO as a whole, is to produce certain market conditions which would allow this individual activity to flourish.[32]

Indeed, the success of the WTO, increasing the world's economic welfare, depends to a considerable extent on private initiative.[33] Thus, the preamble of the WTO, defines as its objectives 'raising standards of living, ensuring full

[31] See, above n 22.

[32] WTO Panel Report, *US – Sections 301–310 of the Trade Act of 1974*, WT/DS152/R, of 22 December 1999, at paras 7.72ff. This view contrasts sharply with the European Court of First Instance (CFI), Joined Cases T-174/00 and T-210/00, *Biret International SA*, of 11 January 2002, [2002] ECR II-17, at para. 62 ('The purpose of the WTO agreements is to govern relations between States or regional organizations for economic integration and not to protect individuals'). We suggest, with respect, that this contrary view recently expressed by the European Court of First Instance is outmoded. We also note that this judgment was overturned on appeal, albeit on other grounds, by the European Court of Justice (ECJ), Joined Cases C-93/02 and 94/02, *Biret International SA*, of 30 September 2003, [2003] ECR, *n.y.r.*

[33] Some have even gone as far as distinguishing the WTO from other treaties, arguing that the success of other treaties (such as nuclear disarmament and human rights treaties) depends primarily on state actions. This distinction between treaties was drawn by A. Davies, 'Reviewing dispute settlement at the World Trade Organization: a time to reconsider the role of compensation', mimeo (Swansea University (UK), September 2004).

employment and a large and steadily growing volume of real income and effective demand, and expanding the production of goods and services . . . '. The engine for such economic growth is fuelled by private activity, and the WTO obligations generally limit government's interference with this activity. As the preamble also indicates, the role of government is more to take flanking measures so as to ensure 'sustainable development', and the observance of other public policies that are recognized in the WTO Agreements as exceptions to liberal trade.

WTO dispute settlement therefore is about more than rule compliance and rebalancing of trade concessions by governments. It follows from the WTO's objectives that WTO dispute settlement is also concerned with honoring the expectations of private entities who 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. Yet – largely for pragmatic reasons – we would submit that it can be left to the individual WTO Members to decide whether and how to redistribute the compensation they would receive through WTO dispute settlement.[34]

B. Concerns about effectiveness and practicalities of monetary damages

A myriad of practical concerns, and concerns about the effectiveness of a system of monetary damages have been raised. In our view, these either do not outweigh the positive effects described in section III above, or they are based on false premises.

1. Monetary damages are too difficult to calculate

Some would say that financial compensation is too difficult to calculate. This depends, first of all, on the standard one would choose to fix damage amounts. If one does not want to end up with very high amounts that will have more the character of fines, financial compensation should not equal lost trade volumes, but be limited to lost profits or lost trade volumes. That calculation will undoubtedly encounter complications, although these complications also arise in normal private contractual disputes. Furthermore, calculating the right amount of trade volumes in connection with trade retaliation is not necessarily easier.[35] Furthermore, one can alleviate this calculation problem through the establishment of liquidated damages, which is a tested and proven technique in contract law.

For instance, one could establish the rule that for each year in which any WTO violation occurs the non-complying country is to pay the aggrieved

[34] See above, at n 25.

[35] See, e.g., WTO Arbitrator's Report, *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, WT/DS222/ARB, of 17 February 2003; WTO Arbitrator's Report, *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, WT/DS46/ARB, of 28 August 2000.

country the equivalent of 10 million SDRs in damages.[36] In fact, some have argued that one could include a rule that with each year of non-compliance following a WTO dispute settlement ruling, this annual amount would increase by a certain percentage.[37] This would be in recognition of the fact that each year of non-compliance creates additional damages, and that increases in budgetary expenditures are bound to attract more parliamentary attention in the non-complying country – though these increases ought in any event not be so significant as to transform the principle of financial compensation into a system of punitive damages.[38] A WTO Member which believes that these amounts of liquidated damages are disproportionately low or disproportionately high could ask for review through arbitration, while carrying the burden of showing what the proper amount would need to be.

2. Monetary damages are unenforceable

Then there are those who argue that any WTO awards of financial compensation cannot be enforced. In contrast to trade retaliation, which upon authorization can be imposed unilaterally, financial compensation is a 'self-help remedy'. A WTO Member depends on the cooperation of the non-complying country to collect the compensation due.

To start with, this possible disadvantage of financial compensation is clearly outweighed by its advantages. For one thing financial compensation does not result in damages to innocent bystanders in the retaliating country itself, and smaller and developing countries actually have a possibility to use this remedy. They may never be able to impose trade retaliation in the first place, but they can claim financial compensation. In addition, the fact that

[36] In this connection we submit that the money should actually be paid by the non-complying country to the complaining country. Merely shifting Special Drawing Rights from one country to another country's IMF account, even if this were possible on the basis of a WTO ruling, may be inadequate, if a Member chooses to channel damages payments towards private parties, as this would not easily allow effective payments to the injured private parties.

[37] The idea of incremental, annual increases of the amounts in liquidated damages was suggested to us by Prof. W.J. Davey, at a discussion of our proposals at the 4th Annual Conference on WTO Dispute Settlement sponsored by the British Institute of International and Comparative Law in London (May 2004). We also note in this context the Arbitrator's *Report in US – Continued Dumping and Subsidy Offset Act of 2000 ("Byrd"), Recourse to Arbitration by the US under Art. 22.6 DSU*, WT/DS217/ARB/EEC of 31 August 2004 (see discussion at 4.17–4.27) in which the arbitrator imposed a level of concessions that would be adjusted each year according to a certain formula in order to take into account the actual level of disbursements under the 'Byrd amendment'. Although the situation is quite different from that of a system of financial compensation based on a liquidated damages formula with annually increasing amounts, we note that the arbitrator's reasoning indicates that even under the current DSU framework, annual adjustments to the level of remedies are already possible. In addition, para 4.27 describes the possibility of recourse to dispute settlement in case the application of the suspension is thought to exceed for a given period the level of nullification or impairment sustained.

[38] Similarly, the EC's system of increasing trade retaliation tariffs every month by one percent in response to the WTO-illegal (FSC) system is credited with attracting repeated and increasing attention in US Congress.

financial reparation is not a 'self-help remedy' has clearly not been a reason to exclude it from other, general systems of public international law.[39]

Furthermore, although we recognize that budgetary mechanisms may need to be made available for this, perhaps even some clearance and settlement mechanisms, and that this may be an impediment in some cases, experience shows that governments do pay financial awards issued against them. Consider, for example, state-investor disputes, in ICSID or NAFTA; or claims paid by Iran and the United States to private interests on the basis of awards granted by the Iran-United States Claims Tribunal.

Also in the trade area there are examples of financial compensation. For example, provisions for financial compensation to be granted under certain conditions have been included in Free Trade Agreements recently negotiated by the United States.[40] The United States recently also agreed to pay financial damages of Euro 1,219,900 annually to the European music industry for as long as US copyright legislation was not brought into compliance with the WTO ruling that held that this US legislation wrongfully withheld royalties to recording artists whose music was played in small bars and restaurants.[41] The annual amount of damages incurred was established through WTO arbitration[42] illustrating that there is no impediment as such to establishing financial damages in the WTO framework. In September 2003, a (first) lump sum payment of 3.3 million Euro was made to the European Grouping of Societies of Authors and Composers (GESAC).[43]

[39] 'Self-help remedies' against treaty violations are in fact exceptional in international law. The principle of 'exceptio non adimpleti contractus' does not generally apply in multilateral treaties. One party is not absolved from its obligations to the other parties, just because one of those other parties does not fulfill its obligations, except in specific circumstances in case of a 'material breach' (see, e.g., Article 60 of the Vienna Convention on the Law of Treaties).

[40] E.g., the US – Morocco FTA (http://www.ustr.gov/new/fta/Morocco/final/index.htm), Articles 20.11(5) (as an alternative to suspension of concessions), and 20.12 (in labor or environmental law disputes); US – Chile (http://www.ustr.gov/new/fta/Chile/final/index.htm) FTA, at Articles 22.15(5) (as an alternative to suspension of concessions), and 22.16 (in labor or environmental law disputes); and the US – Singapore (http://www.ustr.gov/new/fta/Singapore/final/2004-01-15-final.pdf) FTA, Articles 20.6(4) (as an alternative to suspension of concessions) and 20.7 (in labor or environmental law disputes). The inclusion of monetary sanctions in areas concerning environmental and labor rules was needed to generate Congressional support for these agreements (see, e.g., *Inside US Trade*, 27 April 2001, 'Dooley says sanctions needed for trade enforcement to get votes'). In fact, it was notably the US that, in comments of 22 October 1997 to the ILC's Draft Articles on State Responsibility, above n 21, pointed out that more guarantees supporting the well-established principle of 'full reparation' needed to be added (US Dep't of State, Draft Articles on State Responsibility: Comments of the Government of the United States of America).

[41] WTO Panel Report, *US – Section 110(5) of the US Copyright Act*, WT/DS160/R, of 15 June 2000; see also: GESAC, Press Release, 'WTO procedure on Section 110(5)(b) of the American Copyright Act: Payment of funds covered by the Americans', Brussels, 5 September 2003.

[42] WT/DS/160/ARB25/1, Recourse to Article 25 of the DSU, Award of the Arbitrators, 9 November 2001.

[43] For further details on the implementation of the US–EU agreement in this case and further background, see: B. O'Connor and M. Djordjevic, 'Practical Aspects of Monetary Compensation: The *US – Copyright* Case', elsewhere in this issue of JIEL.

Alternative remedies only rarely will be able to reach the same kind of results in terms of indemnifying private parties who have suffered from the breach of WTO law. There is one notable exception to this. In the *Japanese liquor taxes* case, Japan was found to impose discriminatorily high liquor taxes on imported liquors such as cognac and whiskey compared to domestic shochu. When the Japanese government needed more time to amend its domestic tax laws than envisaged in the DSU,[44] Japan offered a reduction in the customs duties on imports of foreign liquor by way of compensation. Though interesting, this is an unusual example. It is difficult to conceive of many cases where alternative, 'interim' relief could be given to the private interests suffering injury from a WTO-illegal trade measure.

Mechanisms such as suspension of voting rights, or of the right to bring complaints under the dispute settlement system, as suggested by some to enforce payment of monetary compensation do not seem politically feasible or even desirable.[45] In our proposal financial compensation would be an additional choice for injured Members, not a replacement for trade compensation or retaliation. If worse comes to worst, and the violating Member does not live up to its obligation to pay monetary compensation, the aggrieved Member could still be given the option to go back to retaliation.[46] And if an alternative solution can be achieved, like in the *Japanese liquor taxes* case, nothing would prevent the parties from opting for it.

3. Financial compensation may not reach the rightful recipients

One other concern is that one cannot be sure that financial compensation will actually reach the private interests that were injured by the WTO-illegal measure. Experience shows, however, that it is possible to tailor-make compensation mechanisms to ensure that private parties will be compensated.[47] In any event, we recall our earlier submission that it should be left to the discretion of the individual Member governments who receive damages, to decide if and how the money should be redistributed to private parties.[48] We note that even if the payments do not reach those who actually suffered damages, financial compensation can still meet most of its purposes (pressure to comply; disincentive against foot-dragging; no restraint on trade).

Furthermore, it is to be noted that the logistical problem of paying out money to large groups of people, who may not receive full compensation for the damage they have suffered, is not unique to trade law. Consider the distribution of amounts paid out in class action suits, for instance in the case of antitrust

[44] According to art. 21(1) and (3) DSU, a non-complying member must implement a WTO ruling to this effect 'promptly', or if this is not possible 'within a reasonable period', which is generally taken to be not longer than 15 months following the adoption of the relevant panel or Appellate Body report.

[45] See, above text at nn 17–18.

[46] This refinement was suggested to us by Prof. M. Matsushita, at a discussion of our proposals during the 10th Global Arbitration Forum in Geneva (December 2003). See, above n 20 at 367.

[47] See, e.g., the *US – Section 110(5) Copyright Act* case, as referred to, above nn 41–43.

[48] See, above text at n 25.

violations.[49] Not all parties who were injured may be able to claim compensation, and those who do receive something may feel that this does not fully offset their damages. But even a less than optimal result is better than nothing.

4. Financial compensation is more acceptable for certain measures than for others

We also need to address the suggestion that financial compensation might be more acceptable as a remedy against WTO-illegal administrative remedies, than in response to illegal legislative measures. One reason given for this suggestion is that it is likely more difficult to identify and reimburse private interest groups that are adversely affected by an illegal legislative measure than by an administrative measure. For the reasons discussed under the previous heading, we do not believe that such a practical consideration is compelling. Furthermore, whether or not a particular form of government intervention is characterized as an administrative or a legislative measure can differ from one country to another. For example, antidumping duties are imposed by regulation (a legislative measure) in the EU, and by order (an administrative measure) in the United States. Rather than formulating a prior limitation on the types of measures against which financial compensation may be claimed, we therefore remain of the view that the complaining country is best placed to decide whether, in response to a WTO-illegal measure, it makes more sense to seek either financial compensation, trade retaliation or trade compensation.

5. Financial compensation has less compliance-inducing effect

Some, and not the least, have also argued that the obligation to pay financial compensation will have less compliance-inducing effect than trade retaliation.[50] In Hudec's words, shooting oneself in the foot hurts, but it can also send a pretty powerful political message.[51] We recognize that this political signaling, letting domestic industries lobby in favour of compliance, is probably among the main explanations of why even more powerful countries so often comply. Similarly, it has been argued that compensation and damages do not give the same 'moral' sign to the Member violating its obligations. Financial compensation, so this argument goes, is just money. And money paid out of the government's budget has no direct political implications for any part of a government's constituency.

However, recent experiences the world over certainly show that the budget is one of the main political concerns. 'It's only money' is not a winning slogan in most political systems. We also recall that in our proposal WTO Members would be left the choice between asking for financial compensation or imposing

[49] See, e.g., Sotheby's press releases 'Auction Houses Settle International Antitrust Litigation' of 11 March 2003 (http://www.shareholder.com/bid/news/20030311-103604.cfm), and 'Statement from the Board of Directors of Sotheby's Holdings Inc.' of 24 September 2003 (http://www.shareholder.com/bid/news/20000924-23952.cfm).

[50] R.E. Hudec, *The GATT Legal System and World Trade Diplomacy* (2nd edn, Butterworth, 1990), at 199–200.

[51] Id.

trade retaliation, or perhaps even a sequence of the two. Thus, depending on the specific situation, and depending on its own preferences and expectations, the winning WTO Member can opt for either the classic remedies, or financial compensation, to obtain what it perceives to be the optimal results in terms of compliance inducement and reparation of damages.

6. Financial compensation does not change the asymmetry that exists between large and small developed and developing countries

Whatever instrument one uses, as long as the level of retaliation, compensation or monetary compensation is calculated the way it currently is (e.g., based on the level of trade concerned in the case of GATT violations), a small (developing) economy is at a disadvantage compared to a large (developed) country in terms of the pressure it can exercise on a non-complying Member. Financial compensation will at least enable those countries that are now simply unable to take on the burden of withdrawing concessions and shooting themselves in the foot to send a signal. In addition, it provides these countries with at least some form of reparation for the damages caused by non-compliance.

7. Financial compensation allows rich countries to buy themselves out of violations

Another criticism against introducing financial compensation in the WTO is that this proposal does not help developing countries either. Rich countries will be able to buy themselves out of violations, so the argument goes. Yet this concern is unwarranted, as long as the system is properly crafted. First of all, financial compensation would be temporary, for as long as the violation lasts, just as trade retaliation is supposed to be temporary. Accordingly, the obligation to pay financial compensation would in no way obviate the priority and legal necessity of compliance with WTO law. As we have argued above, in many cases there is no reason to assume that the obligation to pay financial compensation will be a less effective enforcement mechanism than traditional retaliation. In addition, Members would still have the choice to impose traditional trade retaliation rather than to demand damage payments if they deem this a better way of inducing compliance in the particular circumstances of their case.

Some would even argue that there is an element of efficiency,[52] or a sense of political realism, in creating an option for countries to 'buy themselves out of violations'. Consider, for example, the recent proposal of outgoing EU Trade Commissioner Pascal Lamy to create a new safeguards clause, allowing WTO Members to protect their 'collective preferences', their deeply felt social choices, through trade restrictions against payment of compensation.[53] We see a number of problems with such an approach, pursuant to which

[52] Cf., Alan O. Sykes, above n 1.

[53] See P. Lamy, 'The Emergence of collective preferences in international trade: implications for regulating globalisation', speech at the Conference on *Collective preferences and global governance: what future for the multilateral trading system* in Brussels (15 September 2004). http://trade-info.cec.eu.int/doclib/docs/2004/september/tradoc_118929.pdf (visited 1 December 2004).

WTO Members could unilaterally impose their values on others, rather than to negotiate multilateral solutions.[54] Yet however that may be, in our view a properly devised financial compensation instrument as well as the alternative of trade retaliation would not allow Members to 'buy themselves out of' their obligation to comply with WTO law. Again, the payment of financial compensation (or trade retaliation) does not detract from the primary obligation of compliance.

8. Payment of financial compensation could violate the MFN principle

Some have argued that the payment of financial compensation by the US to European copyright holders as compensation for non-compliance in the *US – Copyright* case, amounts to a violation of the MFN principle and may diminish the rights of Members other than the complaining (i.e., compensated) Member.[55] This argument is unconvincing. To begin with, when a government pays financial compensation to repair the injury it has caused through a WTO-illegal measure, this can hardly be characterized as an 'advantage, favour, privilege or immunity', within the meaning of the usual MFN language.[56] Furthermore, the Member that has won its WTO case and now has a right to financial compensation need not be treated differently from other Members. Either other WTO Members have not been troubled by the WTO-illegal measure (consider the example of an illegal antidumping duty, which by definition affects only a select group of exporters that have been found to be dumping). Or if other Members are affected too by the illegal measure (as conceivably might be true in the *US – Copyright* case), they are entitled as well to claim compensation on the same grounds, though they may have to initiate or join dispute settlement proceedings in their own name to enforce their compensation claim.

In any event, our proposal does not involve an interpretation, but rather an amendment of existing WTO law. When agreeing to that amendment to the WTO's Dispute Settlement Understanding, the Members would do well to specify the beneficiaries of financial compensation, in order to avoid unnecessary litigation about the MFN rule. For this reason they should also specify any differentiation between developing countries.

9. Payment of financial compensation constitutes an illegal subsidy

Some have suggested that payment of monetary damages to private parties (directly or by their own government) could constitute an illegal subsidy. This is an untenable proposition. Monetary damages are paid as compensation for and (thus) only up to the level of the damages actually incurred by those private parties. Thus, at least one essential condition for the existence of a subsidy in

[54] This proposal is further discussed in M. Bronckers, 'Exceptions to Liberal Trade in Foodstuffs: The Precautionary Approach and Collective Preferences', to be published in *The EFTA Court: Ten years on* (Hart Publishing, 2005).

[55] O'Connor and Djordjevic, above n 43.

[56] See Art. 4 TRIPS or Art. I GATT.

the sense of the WTO's SCM Agreement is not fulfilled: no benefit is transferred to the private party.

10. Developing countries cannot afford financial compensation

Our proposal could also be seen to create yet another problem for many developing countries, as they may be unable to pay financial compensation. Whether this problem always arises, or is always legitimate,[57] is questionable. Rather than creating a blanket exception for developing countries, it is conceivable to address this concern by allowing developing countries to plead a special defense against financial compensation, relating to payment difficulties they may have. Alternatively, the amounts payable by developing countries could be capped. If this were not enough to assuage the concerns of developing countries, the obligation to pay financial compensation could be limited, at least for an initial period, to developed countries.

11. Inequality between developing countries

Even if they would agree to such differential treatment of developing countries, the developed countries are unlikely to accept that they would have to pay financial compensation to *all* developing countries, without having the right to claim financial compensation from *any* one of them. This political problem arises notably in respect of the largest of the developing countries, notably the 'new Quad' Brazil, China, India and South Africa, and probably also in relation to the richest developing countries such as Singapore and China Hong Kong. It is a problem that arises too in other areas of WTO negotiations where special and differential treatment for developing countries is being considered. Finding a solution to this problem is a nettlesome exercise, as developing country status traditionally is obtained through self-election.[58] And while it is difficult to deny that not all developing countries suffer equally from asymmetries in WTO dispute settlement, it will be very difficult for the WTO membership to agree on criteria to exclude some members from the benefits of developing country status. Still, such an approach, of excluding certain developing countries from specific WTO rules, without entering the more fundamental debate on developing country status, was followed for instance in the WTO Subsidies Agreement.[59]

One can think of alternative approaches. For example, certain developing countries could elect voluntarily not to invoke the remedy of financial

[57] For instance, if a developing country is found to have levied antidumping duties that constitute an egregious violation of WTO law, it is not immediately obvious that this country would be justified in not reimbursing these duties on the grounds of its overall budgetary limitations.

[58] The only limitation here appears to be OECD-membership, which is generally thought to confer the status of a developed country, also to countries that previously elected developing country status (e.g., Korea or Mexico). Still, such 'graduation', depending on OECD membership, is not yet formally recognized in any binding WTO decision.

[59] Article 27(2) (a) SCM Agreement, jo. Annex VII to the SCM Agreement (creating an exception to the prohibition on export subsidies for least developed countries, and certain other developing countries for as long as their GNP remains less than $1,000 per year).

compensation (for as long as they are unwilling to pay financial compensation to developed countries). This approach recently proved fruitful in resolving the controversy surrounding access to medicines for developing countries.[60] Furthermore, an initial class of beneficiaries for this remedy could be defined, limited to countries having a relatively small share in world trade, regardless of their developing country status. This market share could be a proxy for their lack of retaliatory power.[61]

12. Financial compensation will simply never be accepted

Unacceptability is the showstopper whenever change is proposed. Yet it is not a very meaningful objection, as the history of the WTO shows that surprises can happen. Few would have believed in the late 1980s that an integrated, compulsory and exclusive system of dispute settlement would ever be accepted as part of a single package of WTO agreements, which did become a reality in 1994. Furthermore, if developing countries would rally around this proposal, instead of pursuing multiple proposals for DSU reform which may not all be equally important for them, they increase the chances of this proposal being accepted by the developed countries as the price to pay for developing countries' acceptance of the Doha Round results.

There may also be a role for the EU and the US, as the largest traders and leading players in the world trading system, to take the initiative and agree to a system of financial compensation on a bilateral basis.[62] Such a step could be an incentive for others to follow, and would certainly be welcomed by industry and consumers, long the victims of retaliatory sanctions and recurring trade wars.

C. Retroactivity

Temporal scope is a crucial element to consider for any system of financial compensation. In our view, the option of financial compensation in the WTO would benefit from a measure of retroactivity. We recognize that retroactivity of remedies, which currently is anathema in WTO law,[63] remains controversial. However, there are several important arguments in favor of retroactivity.

[60] See in this regard the Decision of the General Council of 30 August 2003, on Implementation of Paragraph 6 of the Doha Declaration on the TRIPS Agreement and Public Health, WT/L/540; and the Statement of the Chairman of the General Council of 30 August 2003 (JOB (03)/177 or WT/GC/M/82).

[61] This neutral approach, based on domestic market size, was suggested to us by Prof. D. Gervais at an earlier discussion of our proposals during the 10th Global Arbitration Forum in Geneva (December 2003). See, above n 20, at 366.

[62] See M. Bronckers and N. van den Broek, 'Trade Retaliation Is a Poor Way to Get Even', *Financial Times*, 24 June 2004.

[63] See, above text at n 3. The commentaries to the ILC's Draft Articles on State Responsibility, above n 21, recall in footnote 863 to Article 55 the prospective character of WTO remedies as being an example of a *lex specialis*. For general background and a discussion of the notable exceptions (most recently the *Australia – Automotive Leather* case) see Grane, above n 11, at 763ff. (including a powerful plea for some form of retroactivity in WTO remedies); Gavin Goh and A. R. Ziegler, 'Retrospective Remedies in the WTO after Automotive Leather', 6(3) JIEL (2003), at 545–64; see also Mavroidis, above n 11, at 789–90.

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. As DSU proceedings can take a long time, some members are seen to exploit this to maintain WTO-illegal measures.[64] Also, retroactivity more accurately remedies the injury suffered by private traders by providing reparation for the period when the injury actually occurred.

We recognize that some may be concerned that, when applied to financial compensation, retroactivity could lead to very large financial liabilities arising out of WTO dispute settlement. This, in turn, could actually deter members from remaining in the WTO or from accepting new commitments. Though a valid concern, it does not militate against the introduction of financial compensation, or against the recognition of retroactivity. It is a concern that can be addressed in different ways, for instance in capping the damages that can be awarded in WTO dispute settlement, and by introducing a limitation on the extent of retroactivity to a certain number of years, perhaps depending on the seriousness of the infringement. In addition, different forms of retroactivity might also be worth considering, depending on the type of obligation breached.

Thus, Members could agree that a panel can award financial compensation from the year a measure was introduced in case of an egregious WTO violation, while it can only award financial compensation from the date a panel request was filed, or even from the end date of the reasonable period of time set for implementation in case it considered the violation to be more of an honest mistake. Members could agree that the complainant bears the burden of proving that the infringement constituted a clear enough violation from the start in order for retroactivity to apply, rather than a measure of more ambiguous legality or a measure of which the illegality only occurred over time (for instance, the fact that a balance-of-payment restriction was found to be clearly unjustified as of 1 January 2005 does not mean that it has been illegal as of the date of its enactment say on 1 January 1975).[65] For its part, the defendant would have the possibility to prove that the infringement was committed under extenuating circumstances. Thus, a type of 'good faith' test would be introduced.[66]

As a practical matter, we also note that in many cases, measures are challenged in the WTO relatively soon after their adoption (e.g., trade remedy cases; *Shrimp/Turtle*; *Havana Club*).

[64] See, e.g., *Negotiations on Improvements and Clarifications of the Dispute Settlement Understanding, proposal by Mexico*, TN/DS/W/23, of 4 November 2002, at 2; see also, N. van den Broek, above n 19, at 159.

[65] Such possible distinctions between retroactivity were suggested to us by Prof. D. Gervais, at a discussion of our proposals during the 10th Global Arbitration Forum in Geneva (December 2003) (see, above n 20, at 366); and by Prof. J. Pauwelyn.

[66] See, e.g., Article 26 of the Vienna Convention on the Law of Treaties; see also, N. van den Broek, above n 19, at 159.

Nevertheless, the recognition of retroactive remedies will be a politically sensitive step in the WTO. Gradual introduction might be a solution. One could start with the reimbursement to the importers of any antidumping, countervailing, safeguards or customs duties generally that they paid and that are found to be WTO-illegal.[67] Such reimbursement would not necessarily capture the financial damage caused by these WTO-illegal duties to exporters, as it would not reflect any loss of market share and resulting loss of sales they would have suffered in the importing country as a result of these WTO-illegal duties, but it would be a start.[68] In addition, as part of a gradual introduction of retroactive financial compensation, financial damages to exporters in such cases could be limited to certain amounts of liquidated damages, as discussed above.[69]

V. KEY ELEMENTS OF FINANCIAL COMPENSATION

We have tried to write this article in the spirit of pragmatism. In that same spirit, we will now summarize the key elements of a mechanism for financial compensation in the WTO, as a practical roadmap for negotiators.

- *The DSU would have to be amended*, and make explicit provision for financial compensation in the event of non-compliance with WTO dispute settlement rulings. This is not just a matter of creating legal certainty or clarification. This is necessary, as WTO panels and the Appellate Body have no powers under the current law to award financial compensation to a party that has prevailed in WTO dispute settlement proceedings. Specifically, no such powers can be implicitly derived from customary international law on the grounds, for instance, that the DSU does not explicitly exclude the award of financial damages.[70] In our view, the DSU must be deemed a *lex specialis*, which sets forth its own system of remedies, and which limits the relevance and application of general principles of public international law to specific instances (notably, on

[67] It has sometimes been argued that importers should not be entitled to the reimbursement of WTO-illegal customs duties, as they may have passed on the effect of such duties to consumers already. We disagree. The possibility that importers may have increased their prices, with the attendant risks of reduced sales, does not entitle the government to hold on to duties which have been found to be WTO-illegal. Moreover, if governments know that any illegal duties will have to be repaid this would be an important deterrent against their foot-dragging in implementing WTO law (especially if an interest rate were to be applied to such reimbursement). An obligation to reimburse WTO-illegal duties may in fact encourage WTO Members to verify more attentively the legality of any customs duty increases to begin with.

[68] Strictly speaking, the reimbursement of duties or taxes levied illegally should be considered restitution rather than compensation for damages. See Articles 34–36 of the ILC's Draft on State Responsibility, with the relevant commentaries, above n 21.

[69] See, above, text at nn 36–37.

[70] Implied, for example, by V. Mosoti, 'The Award of Damages under WTO Law: An African Take on the Debate', 6(4) BRIDGES (May 2002), at 9.

interpretation[71]). Moreover, neither the DSU nor the dispute settlement system of its predecessor, the GATT, has ever been interpreted or applied to cover financial compensation (no state practice).[72]

- A crucial element of our proposal is the idea that financial compensation is not just about *inducing compliance*, it is also about *providing equitable reparation* for damages caused. On the other hand, we do not necessarily see a reason, or perhaps we should say a justification, for adding punitive elements. WTO/GATT history shows that this was not among the original intentions or economic and political underpinnings of the system. In general public international law the acceptability of such a punitive element in damages is highly debatable as well. The only exception to this we could envisage, would be to add to the monetary compensation mechanism a minor annual increase in the amount of damages due.
- We think that 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. Similarly, it is up to each Member to ensure that the required domestic arrangements are made for the payment of compensation if awarded (i.e., pre-fixed appropriated funds, possibilities to appropriate funds 'on the spot' without unnecessary delay, etc.).
- The 'victim', the Member whose rights were infringed and who suffered damages, should have a *right to choose* between traditional trade retaliation and the new monetary damages remedy. Thus, when a country believes traditional retaliation would be more effective in inducing compliance, for example because of the specific political sensitivities of a certain dispute, it may opt for trade retaliation. Similarly, when, like in *Japan – Liquor*, trade compensation can actually provide an effective remedy, a Member may choose to prefer this option.
- *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 DSB ends. In our view, however, it would be better to go back further. We would propose to go back to the beginning of the infringement (i.e., adoption of legislation, or start of a policy), or the initiation of dispute settlement proceedings (request for a panel). Still, to remain practicable in the case of very clear, or 'bad faith' violations (e.g., red light subsidies), the number of years to which financial compensation can be applied retroactively should probably be capped. The cap on

[71] See Art. 3.2 DSU, referring to 'customary rules of interpretation of public international law', which the Appellate Body has read to be a reference to art. 31 and 32 Vienna Convention Law of Treaties; see also above n 63.

[72] In the exceptional arrangement reached in the *Irish Copyright* case, above nn 41–43, the parties did not pretend they were negotiating 'compensation' within the meaning of Art. 22 DSU. Instead, to determine the amount of financial compensation, the parties opted for arbitration pursuant to Article 25 DSU.

retroactivity could for example be a maximum of 3 or 5 years. For less clear-cut violations, or violations that fall in a grey zone (e.g., administrative measures that may or may not be found to be discriminatory *de facto)*, we would favor compensation to be due as of the moment of the panel or Appellate Body decision, or as of the moment the reasonable period for implementation set by the DSB has ended. We have made proposals as to the division of the burden of proof and the possibility of recognizing certain extenuating circumstances that would limit the liability of a WTO Member in time.

- We propose a *'liquidated damages formula'*. Financial compensation would ordinarily be pre-set at a certain annual amount of financial compensation for all types of violations. This amount could be one standard sum (e.g., SDR 10 million) 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. Arbitration would allow complainants to show that this results in a disproportionally low level of compensation by proving actual damages, or the 'losing' Member to show grounds for mitigation of the amount.
- 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. Alternatively, through a formula of capping the amount payable by such developing countries based on market size and economic development their special position may be adequately taken into account. For the larger or richer developing countries *an opt-out clause* could be conceived. By invoking the opt-out, they would no longer be liable to pay financial compensation, but would also not be able to claim such compensation from other Members.
- In our view 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. One could think, for example, of measures with a limited application in time, such as certain subsidies, safeguards, anti-dumping measures, or one-off government procurement contracts.[73]

CONCLUDING REMARKS

Having come out strongly against trade retaliation at the beginning of this paper, we have also recognized that our proposal for financial compensation is best introduced as an option that is to be added to the currently available

[73] See along these lines also Grané, above n 11, at 770.

remedies of trade retaliation or trade compensation in the WTO. This may strike some observers as inconsistent, or at least reflecting a lack of intellectual rigor. We admit to a measure of pragmatism in presenting our proposal. More importantly, we believe 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. We hope their choice will be informed by a healthy dose of domestic debate amongst various interested parties.

In our view, 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 realize the full potential of WTO membership, as dispute settlement is one of the central elements of the world trading system. While it may not be easy to get all Members to support this proposal, we think that if developing countries and private business would rally around it, instead of pursuing multiple proposals for DSU reform, there is a fair chance of getting this one through. In particular, it could be the price to pay for developing countries' acceptance of the Doha Round agreements.

Finally, a word about self-interest. We are two private lawyers arguing for financial compensation in the WTO system. Yes, that may make it easier for certain developing countries to afford good legal assistance, and yes that would also be good for our profession. But will only private lawyers benefit from the introduction of financial compensation as a remedy against WTO violations? We do not think so. 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.