World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness

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INTRODUCTION

The remedial regimes established by international treaties exhibit considerable diversity. Some treaties merely provide review mechanisms and do not permit further action against the violating state, while others allow for the imposition of punitive fines. Some agreements respond to non-compliance with individually tailored packages of incentives and disincentives, while others provide for the award of compensatory damages enforceable in domestic courts. This Article examines the remedial regime established under what is arguably the most complex multilateral treaty arrangement in the world today: the World Trade Organization (“WTO”) Agreements.

Within the WTO system, the remedy for a continuing violation of WTO obligations is the right granted to the affected WTO Member State to suspend “concessions or other obligations” owed to the violating WTO Mem-

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3. For example, the non-compliance procedures established pursuant to the Montreal Protocol on Substances that Deplete the Ozone Layer art. 8, Sept. 16, 1987, 1522 U.N.T.S. 3, allow for the provision of technical and financial assistance as well as the suspension of privileges. See, e.g., Fourth Meeting of the Parties to the Montreal Protocol on Substances that Deplete the Ozone Layer, Annex V, U.N. Doc. UNEP/OzL.Pro.4/15 (Nov. 25, 1992).
Thus, WTO remedies take the form of a response “in kind” — the remedy for one violation of the treaty is an offsetting violation of the treaty. In domestic law, one rarely encounters situations where the remedy for a violation of law is a right granted to the affected party to violate the law as well. In contrast, remedies in international law frequently take this form. In fact, given the absence of coercive and centralised enforcement mechanisms at the international level, the ultimate remedy for the breach of an international treaty will usually take the form of a further violation, or “countermeasure.”

This Article examines a basic issue that is confronted in every instance in which this remedy is sought: How far can the retaliating state go in responding to the breach of WTO obligations owed to it? It analyzes the limitations on retaliation in the WTO Agreements and the manner in which WTO arbitral panels have confronted and resolved this issue.

The limitations on the right to retaliate are important for a variety of reasons. First, they determine the dimensions of any ensuing retaliation and, therefore, are of considerable practical significance for WTO Members in making decisions about whether to comply with their obligations and whether to seek to enforce their rights. Second, these limitations are important because they shed light on broad theoretical questions about the nature of WTO rights and obligations. Finally, an understanding of the WTO regime may carry lessons both for negotiators of remedial regimes for other trade treaties and for those called upon to apply similar remedial regimes installed in bilateral or regional trade agreements.


9. See Fernando Piérola & Gary Horlick, WTO Dispute Settlement and Dispute Settlement in the “North-South” Agreements of the Americas: Considerations for Choice of Forum, 41 J. WORLD TRADE (forthcoming.)
The Article is organized as follows. Parts I and II outline the procedural and substantive context in which WTO arbitrators make assessments about the permissible intensity of retaliation. Part III explores the negotiating history of current WTO remedial regime. Part IV scrutinizes the manner in which arbitral panels have assessed the permissible intensity of retaliation to date. It organizes the jurisprudence into two broad approaches and analyzes the issues that arise when these approaches are applied in concrete cases. Part V then considers the possible purposes that may be served by the WTO remedial regime and examines whether this regime coherently promotes any or all of these purposes. The Article argues that the remedial regime and the jurisprudence are difficult to justify by reference to instrumental purposes such as ensuring compliance, providing compensation, rebalancing the bargain or facilitating efficient conduct. A retributive rationale can justify the regime but this rationale is difficult to defend. It concludes by arguing that the true value of arbitral review lies in its escalation prevention function. Part VI explores certain implications of the absence of a guiding rationale for the WTO remedial regime.

I. The Process of Gaining Authorization To Retaliate

The question of retaliation arises when a WTO Member State found to have acted inconsistently with its WTO obligations fails to bring itself into compliance with its treaty obligations within the so-called "reasonable period of time for implementation." Retaliation is not meant to address violations of WTO law that occurred prior to the expiration of the reasonable period of time for implementation. In this sense, retaliation is a remedy for prospective rather than retrospective conduct. Only the WTO Member States that invoked the dispute settlement procedures (and not others) can request authorization to retaliate.

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2007) (manuscript ¶ 79, on file with author) (referring to regional trade agreements where the level of retaliation is to be calculated in the same manner as the WTO remedial regime).

10. DSU, supra note 6, art. 21.3. This is the period within which the violating state must bring itself into conformity with its WTO obligations. It follows the adoption of an adverse ruling by the WTO’s Dispute Settlement Body (“DSB”).

11. DSU, supra note 6, art. 19.1 is understood to preclude retrospective remedies because it requires that panels only recommend that a violating WTO Member "bring its measures into conformity." This prevents panels from recommending that the violating WTO Member make reparations for the damage caused prior to the panel ruling. See Panel Report, United States – Import Measures on Certain Products from the European Communities, ¶ 6.306, WT/DS165/R (Jul. 17, 2000), available at http://www.wto.org/english/docs_e/docs_e.htm. But see Panel Report, Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the U.S., ¶ 6.35–6.38, WT/DS126/RW (Jan. 21, 2000), available at http://www.wto.org/english/docs_e/docs_e.htm (requiring Australia to repay a prohibited export subsidy based on specific language in Article 4.7 of the SCM Agreement); Petros Mavroidis, Remedies in the WTO Legal System: Between a Rock and a Hard Place, 11 Eur. J. Int'l L. 765, 789–90 (2000). For a critique of this case, see Gavin Goh & Andreas Ziegler, Retrospective Remedies in the WTO after Automotive Leather, 6 J. Int'l Econ. L. 545 (2003).

12. DSU, supra note 6, art. 22.2.
The WTO Member State that seeks to retaliate ("retaliating state" or "State R") must request authorization to retaliate from the WTO’s Dispute Settlement Body ("DSB") twenty to thirty days after the expiry of the period of time specified for implementation. The WTO Member State that has not brought itself into compliance with its treaty obligations ("violating state" or "State V") has the right to object to this request on the ground that that the substantive requirements set out in the WTO Agreements are not met and refer the matter to arbitration under Article 22.6 of the Dispute Settlement Understanding ("DSU").

The task of the arbitral panel under Article 22.6 is to determine whether the retaliation request complies with the requirements regarding the “form” of retaliation set out in Article 22.3 of the DSU, and the requirements regarding the “intensity” of retaliation under Article 22.4 of the DSU. These requirements are discussed below. Article 22.7 of the DSU specifies that the arbitral panel is not allowed to examine the “nature of the concessions or other obligations to be suspended” while carrying out this task.

The meaning of this limitation on the arbitrators’ mandate is not entirely clear. It has been understood to prevent any scrutiny of the products targeted by retaliatory measures or the extent of proposed tariff increases as chosen by State R. During the course of the arbitration, the right to retaliate remains suspended and the burden of proof is on the violating state to establish that the proposed retaliation is inconsistent with the substantive requirements set out in the WTO Agreements.

After the issuance of the award, the retaliating state places a second request for authorization to retaliate before the DSB. If this second request is consistent with the arbitral award it must be approved by the DSB. Following the grant of authorization by the DSB, the retaliating state can proceed to act against the violating state. The authorization to retaliate is

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13. Id. arts. 22.2, 22.6.
14. Id. art. 22.6.
15. Id. arts. 22.3–4, 22.6.
16. Id. art. 22.7.
17. See Decision by the Arbitrators, European Communities — Measures Concerning Meat and Meat Products (Hormones) — Original Complaint by the United States – Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU, ¶ 19, WT/DS26/ARB (July 12, 1999), available at [link]
18. DSU, supra note 6, art. 22.6 provides that “[c]oncessions or other obligations shall not be suspended during the course of the arbitration.”
19. See, e.g., Decision by the Arbitrators, European Communities — Measures Concerning Meat and Meat Products (Hormones) — Original Complaint by Canada – Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU, WT/DS48/ARB (July 12, 1999), available at [link].
20. Arbitral awards under Article 22.6 of the DSU (like other WTO panel and Appellate Body reports) do not bind future panels. See, e.g., Decision by the Arbitrator, United States – Continued Dumping and Subsidy Offset Act of 2000 – Original Complaint by Brazil – Recourse to Arbitration by the United States Under Article 22.6 of the DSU, ¶ 3.70, WT/DS217/ARB/BR (Aug. 31, 2004), available at [link].
21. DSU, supra note 6, art. 22.6.
conditional on continuing non-compliance by the violating state; however, there is no clear procedure for determining whether or not the conditions for retaliation continue to exist.23

II. AN OUTLINE OF THE SUBSTANTIVE REQUIREMENTS

The treaty regime limits State R’s right to retaliate by controlling both the form and the intensity of its retaliatory response. As far as the form of retaliation is concerned, Article 22.3 of the DSU provides that the obligations or concessions suspended should usually be in the same “sector” and “agreement” as the “sector” and “agreement” in which the underlying violation occurred.24 The terms “sector” and “agreement” have a specific meaning in this context.25 Article 22.3 only permits retaliation in a different sector if retaliation in the same sector is not “practicable or effective.”26 Moreover, if “the circumstances are serious enough,” retaliation is permitted in sectors under another agreement.27 Article 22.3 is thus often characterized as a limited restraint on “cross-retaliation.” Cross-retaliation refers specifically to retaliation that crosses between the three basic areas regulated by the WTO Agreements: trade in goods, trade in services, and protection of intellectual property rights. Responding to a violation of obligations relat-

22. Id. art. 22.8.
23. This issue is currently the subject of two ongoing WTO panel proceedings initiated by the European Communities (“EC”) against Canada and the United States. In both cases the EC contends that retaliation is no longer warranted because it has complied with its WTO obligations. See, e.g., Request for the Establishment of a Panel by the European Communities, United States – Continued Suspension of Obligations in the EC-Hormones Dispute, WT/DS320/6 (Jan. 14, 2005), available at http://www.wto.org/english/docs_e/docs_e.htm; Request for the Establishment of a Panel by the European Communities, Canada – Continued Suspension of Obligations in the EC-Hormones Dispute, WT/DS321/6 (Jan. 14, 2005), available at http://www.wto.org/english/docs_e/docs_e.htm.
24. DSU, supra note 6, art. 22.3(a) states: “[T]he general principle is that the complaining party should first seek to suspend concessions or other obligations with respect to the same sector(s) as that in which the panel or Appellate Body has found a violation or other nullification or impairment.”
25. Under this scheme, any given WTO obligation can be classified under a particular “agreement” and “sector.” There are three “agreements” for the purpose of Article 22.3: (1) Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994), reprinted in LEGAL TEXTS, supra note 5, at 320 [hereinafter TRIPS] (relating to intellectual property rights); (2) General Agreement on Trade in Services, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, Legal Instruments – Results of the Uruguay Round, 33 I.L.M. 1125 (1994), reprinted in LEGAL TEXTS, supra note 5, at 284 [hereinafter GATS] (relating to trade in services); and (3) all thirteen Annex 1A Agreements which relate to trade in goods. 33 I.L.M. 1125, reprinted in LEGAL TEXTS, supra note 5, at 16-283. Within these three “agreements” there are further sectors. All obligations arising from the thirteen Annex 1A Agreements relating to goods are considered to fall within a single “sector.” Within GATS, each principal sector identified in the “Services Sectoral Classification List” constitutes a single “sector.” Each category of intellectual property rights in Part II of the TRIPS Agreement constitutes a single “sector,” as does Part III of the TRIPS Agreement dealing with enforcement, and Part IV of the TRIPS Agreement dealing with acquisition of intellectual property rights. DSU, supra note 6, art. 22.3.
26. DSU, supra note 6, art. 22.3.
27. Id.
ing to trade in goods by suspending obligations relating to trade in services or responding to violations of obligations relating to intellectual property rights by suspending obligations relating to trade in goods are examples of cross-retaliation.

The restraints on the form of retaliation have rarely been tested in arbitral proceedings. Thus, there is a lack of practical experience with cross-retaliation because WTO Members have, by and large, sought to retaliate only in the same sector/agreement as the sector/agreement in which the underlying violation occurred. To date, only three requests to cross-retaliate have been made by WTO Members and only one arbitral panel has had to rule on the substantive requirements of Article 22.3. The focus of the present paper is not on the Article 22.3 restraints on the form of retaliation. Instead, it is on the second aspect of the proportionality analysis — restraints on the intensity of retaliation.

As far as the intensity of retaliation is concerned, the general standard contained in Article 22.4 of the DSU provides that the “level of suspension of concessions or other obligations” must be “equivalent” to the level of nullification and impairment. However, special standards apply in cases involving actionable and prohibited subsidies. Article 7.9 of the Agreement on Subsidies and Countervailing Measures (“SCM Agreement”) applies in cases involving actionable subsidies, i.e., subsidies that cause adverse effects for other WTO Members, and requires that countermeasures be

28. Communication from Brazil, United States — Subsidies on Upland Cotton — Recourse to Article 7.9 of the SCM Agreement and Article 22.2 of the DSU by Brazil, WT/DS267/26 (Oct. 7, 2005), available at http://www.wto.org/english/docs_e/docs_e_e.htm (seeking authorization to respond to the grant of actionable subsidies to goods producers by suspending TRIPS and GATS obligations); Communication from Brazil, United States — Subsidies on Upland Cotton — Recourse to Article 7.9 of the SCM Agreement and Article 22.2 of the DSU by Brazil, WT/DS267/21 (July 5, 2005), available at http://www.wto.org/english/docs_e/docs_e_e.htm (seeking authorization to respond to the grant of prohibited subsidies to goods producers by suspending TRIPS and GATS obligations); Communication from Ecuador, European Communities — Regime for the Importation, Sale and Distribution of Bananas — Recourse by Ecuador to Article 22.2 of the DSU, WT/DS27/52 (Nov. 9, 1999), available at http://www.wto.org/english/docs_e/docs_e_e.htm (seeking authorization to respond to the grant of tariff preferences on goods by suspending TRIPS and GATS obligations).

29. Decision by the Arbitrators, European Communities — Regime for the Importation, Sale and Distribution of Bananas — Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU, WT/DS27/ARB/ECU (Mar. 24, 2000), available at http://www.wto.org/english/docs_e/docs_e_e.htm [hereinafter EC-Bananas III (Ecuador)] (Article 22.6)). In this case the Arbitral Panel confronted and attempted to resolve a number of issues left open in the text of Article 22.3. The Arbitrators partially allowed the request to cross-retaliate because of the likely negative impacts that same sector or same agreement retaliation would have on Ecuador’s economy, practical difficulties of applying such retaliation, the limited impact that such retaliation would have on the EC and the considerable economic inequality between Ecuador and the EC. Id. ¶¶ 93–96, 101, 103, 110–14, 117–18, 125–26, 173.

30. DSU, supra note 6, art. 22.4.

31. In cases where the underlying violation takes the form of a prohibited subsidy, Article 4.11 of the SCM Agreement provides that the arbitrator must determine whether the retaliation request complies with the specific requirements set out in Article 4.10 of the SCM Agreement. Likewise, in cases where the underlying violation takes the form of an actionable subsidy, i.e., subsidies that cause adverse effects to other WTO Members, Article 7.10 of the SCM Agreement provides that the arbitrator must determine whether the retaliation request complies with the specific requirements set out in Article 7.9 of the SCM Agreement. SCM Agreement, supra note 6, arts. 4.10–11, 7.9, 7.10.
“commensurate” with the degree and nature of the adverse effects determined to exist.\textsuperscript{32} Article 4.10 of the SCM Agreement applies in cases involving prohibited subsidies, i.e., export subsidies and import substitution subsidies, and requires that countermeasures be “appropriate.”\textsuperscript{33} We discuss each of these three provisions in turn.

Article 22.4 of the DSU sets out the general standard that limits the intensity of retaliation to equivalent measures.\textsuperscript{34} The Article 22.4 equivalence standard appears to envisage a comparison between two items: (1) the level of suspension of concessions or other obligations by State R, and (2) the level of nullification or impairment (resulting from the underlying violation of WTO law by State V). This provision may give the impression that the arbitrators’ role under Article 22.4 consists of a mechanical comparison of two clearly discernable and commensurable quantities. That impression is worth dispelling.

The items referred to in Article 22.4 are not well understood or, indeed, quantifiable in any straightforward way. The text requires that the items be equivalent but provides no further guidance about what it is that arbitrators are meant to equalize. State R could easily propose a retaliatory action or a set of retaliatory actions that are inconsistent with WTO law. How are these actions to be quantified so that one arrives at an appropriate “level” of retaliation? Nullification or impairment is understood to be the usual result of a violation of General Agreement on Tariffs and Trade (“GATT”)\textsuperscript{35} or WTO law and refers to the adverse impact suffered by a WTO Member. But how is the level of nullification and impairment to be quantified? There are no answers to these questions in Article 22 of the DSU.\textsuperscript{36}

\textsuperscript{32} SCM Agreement, supra note 6, art. 7.9 reads:

In the event the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body report, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist...

\textsuperscript{33} SCM Agreement, supra note 6, art. 4.10 reads: “In the event the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel’s report or the Appellate Body’s report, the DSB shall grant authorization to the complaining Member to take appropriate countermeasures...” A footnote to this provision states that this legal standard is not meant to permit countermeasures that are “disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.” Id. n.9.

\textsuperscript{34} DSU, supra note 6, art. 22.4 reads: “The level of the suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of the nullification or impairment.”


\textsuperscript{36} See John Jackson, World Trade and the Law of GATT 181 (1969) (“Clearly the most troublesome concept in Article XXIII is the concept of nullification and impairment. These terms have been variously defined and may be so imprecise as to admit of no satisfactory definition.”). During the GATT era, questions arose about the circumstances that could result in a finding of nullification and impairment. See generally Frieder Roessler, The Legal Structure, Functions and Limits of the World Trade Order 69-92 (2000). However, quantification of the amount of nullification and impair-
Article 7.9 of the SCM Agreement also appears to envisage a comparison between (1) the countermeasures taken by State R, and (2) the degree and nature of the adverse effects determined to exist as a result of the actionable subsidies provided by State V.\textsuperscript{37} Like Article 22.4 of the DSU, Article 7.9 of the SCM Agreement does not elaborate on the manner in which this comparison is to be conducted.

Article 4.10 of the SCM Agreement requires that countermeasures be "appropriate" and not "disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited."\textsuperscript{38} This terminology does not necessarily require an arbitrator to conduct a comparison. Although an examination of proportionality/appropriateness may involve a comparative assessment, it can also refer to an instrumental inquiry into whether the means chosen are proportionate to certain ends. Once again, Article 4.10 does not specify the objectives that countermeasures are meant to fulfil or the manner in which any comparison is to be conducted.

This survey leads to two conclusions. First, depending on the applicable legal standard, arbitrators may either be required to conduct a \textit{comparative} inquiry or an \textit{instrumental} inquiry involving the fit between means and certain ends. Under the general Article 22.4 "equivalence" standard, the task appears to be comparative. The same holds true for the "commensurate" standard in Article 7.9 of the SCM Agreement, which applies in cases involving actionable subsidies. Under the Article 4.10 "appropriateness" standard for prohibited subsidies, the arbitrator may be permitted to carry out an instrumental inquiry into whether the means (the proposed retaliation) proportionately achieve certain ends (for instance, forcing compliance).

Second, the treaty text leaves many fundamental issues unresolved. Article 22.4 of the DSU and Article 7.9 of the SCM do not specify the yardsticks that arbitrators should use to conduct the comparisons envisaged. Similarly, Article 4.10 does not specify the purposes against which arbitrators must gauge the appropriateness of any proposed retaliatory response. The consequence of these gaps in the treaty text is that arbitrators must make their own choices about how to assess proportionality. Moreover, significant parts of the law relating to WTO remedies must, by necessity, emerge from arbitral rulings rather than negotiated treaty text. Before examining how arbitrators have grappled with these issues in the nine Article 22.6 cases decided to date,\textsuperscript{39} however, I will briefly discuss the negotiating history of the WTO remedial regime.

\textsuperscript{37} SCM Agreement, \textit{supra} note 6, art. 7.9.

\textsuperscript{38} Id. art. 4.10.

\textsuperscript{39} The cases listed in chronological order are: (1) Decision by the Arbitrators, \textit{European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities Under Article 22.6 of the DSU}, WT/DS27/ARB (Apr. 9, 1999), \textit{available at} \texttt{http://www.wto.org/english/docs_e/docs_e.htm} [hereinafter EC-Bananas III (U.S.) (Article 22.6)]; (2) EC-Hormones (Canada)
III. HISTORICAL BACKGROUND

In order to place the WTO remedial regime in context, it is useful to compare it with its predecessor, the remedial regime under the GATT, and briefly consider the negotiating process through which the current remedial regime came into being. Retaliation under the GATT was governed by Article XXIII:2 of the GATT 1947. This simple provision allowed the Contracting Parties to “authorize a contracting party or parties to suspend the application to any other contracting party or parties of such concessions or other obligations under this Agreement as they determine to be appropriate in the circumstances.”40 Because the GATT Contracting Parties operated according to the principle of consensus, retaliation could only be authorized with the consent of the country on the receiving end of the retaliation. Not surprisingly then, Article XXIII:2 was utilized only once in the entire forty-seven year history of the GATT. In the 1953 United States — Import Restrictions on Dairy Products case, the GATT Council authorized the Netherlands to retaliate on account of the United States’ failure to comply with a ruling regarding illegal import quotas imposed on dairy products.41 The Working Party, which was charged with assessing the “appropriateness” of the proposed retaliation, ultimately reduced the retaliatory quota volumes proposed by the Netherlands by 3,000 tonnes to 12,000 tonnes. In reality, this figure was not generated through any systematic methodology — it was a compromise figure arrived at with the consent of both parties.42

42. The Working Party acknowledged that there were “difficulties inherent in fixing, with any real precision, the point at which any proposed measure could no longer be considered reasonable.” Id. at 2. Robert Hudec notes that this figure actually resulted from an informal compromise brokered by the
The principles governing the level of permissible retaliation under Article XXIII:2 were not the subject of detailed discussion by the GATT Contracting Parties again until 1988, when the European Communities ("EC") sought authorization to retaliate on account of the United States’ non-compliance in the U.S.-Superfund case. The discussions regarding this matter in the GATT Council shed some light on the prevailing views of the GATT Contracting Parties regarding these issues. The Legal Adviser of the GATT Secretariat stated that the “appropriate in the circumstances” standard in Article XXIII:2 should be distinguished from the “withdrawal of substantially equivalent concessions” standard contained in Article XIX and XXVIII. The wording of the former was “wider . . . which meant that there was a wider leeway in calculating the retaliatory measures under Article XXIII than under Articles XIX or XXVIII.”

During the Uruguay Round of the WTO dispute settlement negotiations, the primary issue was whether the losing party’s veto power over the adoption of panel reports should be maintained or removed. As we know, the Uruguay Round negotiators eventually opted for an automatic, and therefore binding, dispute settlement system without an opportunity for a veto. The related issue of how non-compliance with an automatically adopted panel report should be treated was not, however, the subject of detailed scrutiny in the early phases of the negotiations. It appears that negotiators assumed that the predecessor GATT system for sanctioning retaliation would be largely left intact.


45. Id.


47. The United States appeared to favor the maintenance of the “appropriate in the circumstances” standard of GATT Article XXIII but noted that “it would be necessary to adopt guidelines to assist arbitration panels in asessing trade damage.” Communication from the United States, at 6-7, GATT Doc. MTN.GNG/NG13/W/40 (Apr. 6, 1990), available at http://www.wto.org/english/docs_e/gattdocs_e.htm. The EC noted that a request for authorization to retaliate should be approved “if the request was considered to be consistent with the degree of injury suffered.” Statement by the European Community, at 2, GATT Doc. MTN.GNG/NG13/W/59 (Apr. 5, 1990), available at http://www.wto.org/english/docs_e/gattdocs_e.htm. Canada noted that any determination of appropriateness should examine “the amount of nullification or impairment caused by the failure to implement.” Communication from Canada, at 4-5, GATT Doc. MTN.GNG/NG13/W/41 (June 28, 1990), available at http://www.wto.org/english/docs_e/gattdocs_e.htm. Mexico proposed that the amount of retaliation should be determined by the Appellate Body, which could “confirm or modify [the] amount taking into account the nature of the dispute.” In non-violation cases, “the extent of the suspension shall be based on the concept of ‘substantially equivalent concessions.’ In other cases, the suspension may be greater than under that concept, according to the circumstances.” Proposal by Mexico, at 5, MTN.GNG/NG13/W/42 (July 12, 1990), available at http://www.wto.org/english/docs_e/gattdocs_e.htm.
Differing views about remedies only came to the forefront with the Secretariat Draft Text of September 21, 1990,\(^{48}\) which set out four possible options regarding the calculation of the level of permissible retaliation.\(^{49}\) While the November 26, 1990 Brussels Draft Text\(^ {50}\) did not resolve the issue whether adoption of panel reports would be automatic,\(^ {51}\) it did endorse the loose “appropriate in the circumstances” standard for assessing the proportionality of retaliation.\(^ {52}\)

On December 20, 1991 the Director-General of the GATT, Arthur Dunkel, issued the so-called Dunkel Draft Text of the results of the Uruguay Round negotiations.\(^ {53}\) The Dunkel Draft Text proposals were accepted by the Uruguay Round negotiators and found their way into the current DSU. So it is the genesis of the Dunkel Draft Text that is crucial for understanding the current system of WTO remedies.

The Dunkel Draft Text provided for a binding dispute settlement system\(^ {54}\) and an automatic authorization to retaliate.\(^ {55}\) This development represented a radical strengthening of the enforceability of treaty obligations when compared to the predecessor non-binding GATT system. However, the Dunkel Draft Text also contained a number of features that limited the enforceability of WTO treaty obligations. First, the Dunkel Draft Text proposed an “equivalence” standard to assess proportionality.\(^ {56}\) As we have seen, this standard was considerably stricter than the “appropriate in the circumstances” standard.

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\(^{49}\) The draft text set out the following four options: (1) The arbitrator was to determine whether the proposed retaliatory measures were “excessive in their trade effects.” This option allowed the Membership to choose whether to adopt a “commensurate to the damage suffered” or an “appropriate in the circumstances” standard for this determination. (2) The arbitrator was to determine whether the “amount of trade covered by the suspension is . . . substantially equivalent to the nullification and impairment.” (3) The arbitrator was to “examine the amount of trade likely to be affected by the proposed suspensions and its relation to the amount of nullification or impairment caused by the offending measure.” (4) The GATT Council was to approve of retaliation that it “determines to be appropriate in the circumstances.” This option did not envisage automatic approval of retaliation. *Id.* at 4–5.


\(^{51}\) See Commentary to the Understanding on the Interpretation and Application of Articles XXII and XXIII of the General Agreement on Tariffs and Trade, Brussels Draft Text, *supra* note 50, at 352.

\(^{52}\) The Brussels Draft Text proposed that “[t]he amount of trade covered by the suspension of concessions or other obligations authorized by the Council or determined by arbitration shall be appropriate in the circumstances.” Understanding on the Interpretation and Application of Articles XXII and XXIII of the General Agreement on Tariffs and Trade, ¶ L.4, Brussels Draft Text, *supra* note 50, at 364.


\(^{55}\) *Id.* ¶ 20.3, at 768.

\(^{56}\) "The level of suspension of concessions or other obligations authorized by the Council or determined by arbitration shall be equivalent to the level of nullification or impairment." *Id.* ¶ 20.4, at 768.
The equivalence standard contained in Article XXIII:2 of the GATT 1947 and proposed in the Brussels Draft Text. This equivalence standard eventually became Article 22.4 of the DSU. Second, attached to the Dunkel Draft Text on Dispute Settlement procedures was a further text titled "Elements of an Integrated Dispute Settlement System."57 This text contained certain limitations on cross-retaliation that eventually became Article 22.3 of the DSU.

The Dunkel Draft Text is therefore somewhat incongruous. On one hand, it considerably strengthened the enforceability of WTO treaty obligations by creating an automatic and binding dispute settlement system. On the other, it imposed stringent limitations on the form and intensity of retaliation, which weakened the ability of individual WTO Members to enforce their treaty obligations. Like many aspects of the WTO Agreements, the Dunkel Draft structure probably reflects a compromise between divergent forces.

Countries that were unhappy with particular substantive obligations may have sought to limit the enforceability of these obligations. This phenomenon may explain the restraints on cross-retaliation that eventually became Article 22.3 of the DSU. For instance, the Dunkel Draft Text incorporated intellectual property and services obligations into a system of binding dispute settlements.58 This development favored the developed country demanders of the Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS") and the General Agreement on Trade in Services ("GATS") disciplines over the developing countries that had resisted these two disciplines throughout the Uruguay Round.59 It is likely60 that Article 22.3 of the DSU resulted from an attempt by developing countries to limit the enforceability of these disciplines.61 Because a developing country is unlikely to have intellectual property rights or services interests in developed countries, retaliation by a developed country that is confined within these areas could only have a limited impact on the concerned developing country.

Likewise, developed countries also attempted to minimize the impact of areas of the Uruguay Round package that they perceived to be against their interests. The bar on awarding retrospective remedies is an enforcement-
discouraging device that was installed at the behest of the United States. Here the United States was attempting to minimize the impact of the binding effect of anti-dumping measures. By allowing only prospective remedies under the DSU, the United States could rest assured that it would not need to refund illegally imposed anti-dumping duties. The absence of collective retaliation can also be viewed as a device that operates to concentrate enforcement power in the hands of developed countries (which tend to have large import markets and hence greater individual enforcement power) and away from developing countries (which tend to have smaller import markets and hence lower individual enforcement power).

It is clear then that the DSU embodies a mixture of enforcement-encouraging devices (automatic dispute settlement and retaliation, the bar on arbitrators policing the nature of the retaliatory response under Article 22.7 of the DSU) and enforcement-discouraging devices (the strict equivalence standard for assessing permissible intensity, the limits on the form of retaliation, the absence of retrospective remedies and collective retaliation). This structure reflects fundamental differences between countries about the extent to which WTO obligations should be enforced. There was certainly no consensus that compliance should occur in all circumstances, and many developing countries would have been reluctant to endorse such a principle, given the widespread perception that intellectual property obligations were contrary to their interests.

IV. Approaches Applied by Arbitrators in Determining the Permissible Intensity of Retaliation

To date, arbitrators have employed two broad approaches while assessing the permissible intensity of retaliation. The first approach has been applied in all cases conducted under the general Article 22.4 equivalence standard.

62. Frieder Roessler, The Responsibilities of a WTO Member Found To Have Violated WTO Law, in The WTO in the Twenty-first Century: Dispute Settlement, Negotiations, and Regionalism in Asia 141, 144 (Yasuhei Tamiguchi et al. eds., 2007).

63. The United States also pursued this objective by other means: the deferential standard of review contained in Article 17.6 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1A, Legal Instruments — Results of the Uruguay Round, 33 I.L.M. 1125 (1994), reprinted in Legal Texts, supra note 5, at 147 is an enforcement discouraging device that operates to give the United States greater freedom in the anti-dumping field. For an insider’s view of the negotiating objectives of the United States in this area, see William D. Hunter, WTO Dispute Settlement in Antidumping and Countervailing Duty Cases, in The Commerce Department Speaks on International Trade and Investment, at 549 (PLI Corporate Law & Practice, Course Handbook Series No. B-863, 1994).

64. This mixture can be somewhat contradictory. For instance, Article 22.4 requires arbitrators to ensure “equivalence” between two actions, but Article 22.7 prevents them from examining the “nature” of one of those actions. DSU, supra note 6, arts. 22.4, 22.7.

Under this approach, arbitrators have considered two actions — the continuing violation of WTO law by State V and the proposed retaliatory departure from WTO law by State R — and have compared these actions in terms of their detrimental effects. I term this approach the “equality-of-harm” approach. The second approach has only been applied in prohibited subsidies cases conducted pursuant to the special standard set out in Article 4.10 of the SCM Agreement. Under this approach, arbitrators consider the detrimental effect of the action of State R alongside the total amount of the prohibited subsidy granted by State V. I term this approach the "amount-of-subsidy" approach.

A. Approach 1: The Equality-of-Harm Approach

The equality-of-harm approach was first developed in the EC-Bananas III (U.S.) (Article 22.6) case, and has been followed in some form or another in all cases decided under the Article 22.4 equivalence standard. In EC-Bananas III (U.S.) (Article 22.6), the Arbitral Panel had to determine whether the retaliatory measure proposed by the United States (the imposition of increased duties on products imported from the EC) was equivalent to the continuing violation of WTO law by the EC (a discriminatory banana import regime in which Latin American exporters of bananas and U.S. providers of distribution services were placed at a competitive disadvantage). In broad terms, the solution that the Arbitral Panel in EC-Bananas III (U.S.) (Article 22.6) adopted was to compare these two measures in terms of their detrimental effects.

The Arbitral Panel read the equivalence test in Article 22.4 as requiring that the level of detriment experienced by State R as a result of the violation of WTO law by State V be equal to the level of detriment experienced by State V as a result of the retaliatory action by State R. Therefore, a retaliatory response is equivalent within the meaning of Article 22.4 when:

\[
\{\text{Detrimental effect on State V of retaliatory response by State R}\} = \{\text{Detrimental effect on State R of underlying violation by State V}\}
\]

This approach is reminiscent of the biblical remedial principle — an eye for an eye, a tooth for a tooth. The Arbitral Panel had a textual basis for choosing such an approach. Article 22.4 of the DSU refers to “nullification and impairment,” which is the term of art used in the GATT/WTO treaty texts to refer to detrimental effects on a WTO Member State. In effect, the Arbitral Panel interpreted equivalence to require that the nullification and impairment caused by the underlying violation be equal to the nullification

66. In EC-Bananas III (U.S.) (Article 22.6), supra note 39, the underlying violations concerned the EC’s import regime for bananas in which (1) distribution service providers from the United States were disfavored relative to distribution service providers from the EC and certain African and Caribbean countries; and (2) tariff rate quotas for bananas were not allocated properly. The United States proposed to retaliate by imposing 100 percent duties on imports of specified EC products.
and impairment caused by the retaliatory response. While the Arbitral Panel did not attempt to expressly justify their choice of approach, justification may not have been necessary because this equality-of-harm approach appears to have been impliedly supported by both parties.67

Of course, the key issue in applying this approach is determining how to measure the magnitude of the relevant detrimental effects. In EC-Bananas III (U.S.) (Article 22.6), the Arbitral Panel resorted to what can be termed the "value-of-trade-blocked" metric to represent the relevant detrimental effects. When using this metric, arbitrators consider detrimental effects in terms of the value of trade blocked as a result of the measures taken by both countries. So, if the continuing violation of WTO law by State V blocks X dollars of trade from State R and the proposed retaliatory departure from WTO law by State R blocks Y dollars of trade from State V, equivalence is found if X is equal to Y.68

The exercise of determining whether the two measures involve equivalent detrimental effects is a complicated one. Arbitrators have to (1) specify the baseline from which they wish to assess the detrimental effects of the concerned measures; (2) settle on a metric for measuring these effects; (3) determine which detrimental effects will be considered; and, (4) resolve any empirical issues that may arise. In the remainder of this section, I will use this framework to survey the issues that have arisen while applying the equality-of-harm approach.

1. The Task of Specifying the Baseline or Counterfactual

In order to assess the detrimental effects resulting from an illegal measure, an arbitrator must have a sense of the situation that would prevail if the illegality were removed. This, in turn, means that the arbitrator must utilize some sort of counterfactual regime as a comparator.

The EC-Hormones (Article 22.6) arbitrations provide a good illustration of the use of counterfactuals. In the EC-Hormones (Article 22.6) cases, the underlying violation of WTO law was the EC’s scientifically unsupported ban on imports of hormone-treated beef. The Arbitrators decided to measure the detrimental effect caused by this violation by calculating “the trade foregone due to the ban’s continued existence.”69 In order to make this calculation,

67. The Arbitral Panel set out its approach in an initial decision that was circulated to both parties. The parties criticized certain aspects of the initial decision but neither party objected to the basic approach adopted by the Arbitral Panel. See EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶¶ 2.10-11 (discussing the initial decision), 4.10-15 (discussing certain EC objections to the initial decision), 6.19 (discussing certain U.S. objections to the initial decision). It appears that the United States may have based its retaliation request on a similar approach. The United States was statutorily obliged to ensure that the retaliation in the EC-Bananas III (U.S.) (Article 22.6) case affected foreign imports “in an amount that [was] equivalent in value to the burden or restriction imposed . . . on U.S. commerce.” See Trade Act of 1974 § 301(a)(3), 19 U.S.C. § 2411(a)(3) (2000).

68. See discussion infra Part IV.A.2.

69. EC-Hormones (Canada) (Article 22.6), supra note 19, ¶ 41; EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 42.
the Arbitrators compared, on an annual basis, (1) the value of beef exports under the current WTO-inconsistent EC regime, with (2) the value of beef exports that would have occurred in a WTO-consistent EC import regime.\^70

However, the EC could have brought itself into compliance with WTO law in at least two ways: (1) the EC could have withdrawn the import ban altogether, or (2) it could have kept the import ban in place and taken steps to support the import ban with a scientifically adequate risk assessment. The choice of either of these two scenarios as the relevant counterfactual critically affects the calculations of arbitrators. In the EC-Hormones (Article 22.6) cases, the Arbitrators opted for the first scenario and this was not contested by the EC.\(^71\) Similarly, in the EC-Bananas III (Article 22.6) cases, the Arbitrators selected one counterfactual from among several possible options without providing any reason for their choice.\(^72\) Just as in the EC-Hormones (Article 22.6) cases, this choice made a critical difference to the calculation of the amount of blocked trade.\(^73\)

The DSU does not provide any guidance on how to choose between various available counterfactuals and, in practice, arbitrators do not even attempt to justify their choice of counterfactual.\(^74\) Moreover, there may not be any principled way to choose between possible counterfactuals. As a consequence, all calculations of detrimental effects suffer from a certain degree of arbitrariness.

A GATT panel also once reached a similar conclusion about the use of counterfactuals. In the U.S.-Superfund case, the GATT panel observed that the existence of several possible options by which WTO Members could come into compliance entailed that “it is . . . not logically possible to determine the . . . trade impact from non observance of [the GATT obligation at issue in that case].”\(^75\) The key point here is that the determination of the extent of detrimental effects resulting from a violation is a comparative exer-

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70. EC-Hormones (Canada) (Article 22.6), supra note 19, ¶ 42; EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 43.

71. EC-Hormones (Canada) (Article 22.6), supra note 19, ¶ 37; EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 38.

72. EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶¶ 7.4–7; EC-Bananas III (Ecuador) (Article 22.6), supra note 29, ¶¶ 166-67.

73. On the counterfactual chosen by the Arbitral Panel, the nullification and impairment calculated for the United States was $191.4 million per year. Holger Spamann recently noted that it is arguable that if another counterfactual were used (i.e., a regime where banana import licenses were auctioned off to the highest bidder) the real level of impairment experienced by the United States in terms of lost private quota rents would be zero. See Holger Spamann, The Myth of “Rebalancing” Retaliation in WTO Dispute Settlement Practice, 9 J. Int’l Econ. L. 31, 52-53 (2006).


cise that requires the adoption of a baseline. Because there are no clear governing principles, the choice of this baseline could be controversial.

2. The Metric Used to Measure the Magnitude of Detrimental Effects

As noted, arbitrators need to use a metric to measure the detrimental effects of the underlying violation and the retaliatory response. In theory, detrimental effects can be assessed using a variety of metrics such as lost profits, decreases in market share, number of jobs lost, increases in the burden of customs duties, etc.76 As we have seen in the leading EC-Bananas III (U.S.) (Article 22.6) case, the Arbitrators opted for a “value-of-trade-blocked” metric77 that attempts to derive the gross value of trade flows that are prevented on account of the measures in question.78 Under this metric, an action that blocks a high value of trade causes more nullification and impairment than an action that blocks a low value of trade. Actions that block identical values of trade are equivalent.79

The value-of-trade-blocked metric has been extraordinarily popular with arbitrators and WTO Members. In the nine Article 22.6 arbitrations conducted to date, at least one party to the arbitration has argued for the use of this metric in one form or another. Arbitrators have applied this metric in all but one of the cases, where the equality-of-harm approach was adopted instead.80

In the U.S.-Byrd Amendment (Article 22.6) case,81 the United States went so far as to argue that detrimental effects must always be measured by the “trade effect” approach (i.e., the value-of-trade-blocked metric).82 The Arbitrators rejected the United States’ argument, although they adopted the

77. EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶¶ 6.12, 7.1. R
78. Spamann terms this metric the “trade effects comparator.” Spamann, supra note 73, at 39. The WTO Secretariat uses the phrase “trade effects approach.” WORLD TRADE REPORT 2005, supra note 74, at 180. R
79. Spamann points out that, although arbitral panels apply a value-of-trade-blocked metric in order to assess the detrimental effects of the underlying violation, they actually use a slightly different metric to assess the detrimental effects of the retaliatory response — a value-of-trade-affected metric. Spamann, supra note 73, at 45–47. Arbitral panels appear to assume that the retaliatory response sought (which usually takes the form of tariffs set at an ad valorem rate of 100 percent) will effectively prohibit trade. In this situation the value of trade affected is the same as the value of trade blocked, all trade which is affected by the measure will be blocked. See, e.g., EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶¶ 13, 21 (noting that the retaliatory response would take the form of 100 percent duties, which are assumed to be prohibitive); U.S.-Byrd Amendment (Article 22.6), supra note 20, ¶ 4.11 (encouraging the use of 100 percent duties). Spamann acknowledges that the difference in metrics does not matter where prohibitive measures are involved. Spamann, supra note 73, at 46. R
80. The exception is the U.S.-1916 (Article 22.6) case, supra note 39, discussed below. See infra text accompanying note 99. R
81. In U.S.-Byrd Amendment (Article 22.6), supra note 20, the underlying violation was U.S. legislation that responded to dumped imports by granting subsidies to the U.S. producers affected by these imports. The successful complainants requested authorization to respond to this measure by imposing increased duties on imports of U.S. goods into their markets. R
82. Id. ¶ 3.70.
value-of-trade-blocked metric for the purposes of that case. The Arbitrators ruled that while the value-of-trade-blocked metric is a valid means of assessing detrimental effects, it is not the only means of assessing detrimental effects. This ruling implies that arbitrators would be entitled to resort to alternative metrics in other cases.

Such an alternative metric seems to have been used in the U.S.-1916 Act (Article 22.6) case, in which the Arbitrators were asked to evaluate a proposal to apply legislation that mirrored the violation of WTO law. The Arbitrators appear to have measured the retaliation and the violation in terms of an “amount-of-monetary-costs-imposed” metric rather than the value-of-trade-blocked metric. In the U.S.-Section 110(5) of the U.S. Copyright Act arbitration, the Arbitrators measured the nullification and impairment caused by a U.S. measure “in terms of the royalty income foregone by EC right holders.” Thus, the Arbitrators used a “royalty foregone” metric.

An arbitral panel’s choice of metric has significant effects on the structure of its equivalence analysis. Indeed, more than anything else, it is the choice of metric that tells us “what” is being equalized under Article 22.4 of the DSU.

3. Which Detrimental Effects Can Be Considered?

In applying the equality-of-harm approach, arbitrators frequently have to resolve disagreements about the range of detrimental effects that can be considered in their calculations. The Arbitral Panel in the U.S.-Byrd Amendment (Article 22.6) case had to grapple with a question of this type. In that case, certain WTO Members requested the right to take measures that would conjunctively inflict on the United States detrimental effects equivalent to the detrimental effects the United States had inflicted on the entire WTO Membership. The United States responded that what was relevant to the

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83. Id. ¶¶ 3.70—72.
84. In the U.S.-1916 Act (Article 22.6) case, supra note 39, the underlying violations arose from U.S. legislation that provided for the imposition of monetary fines on foreign companies engaged in the practice of “dumping.” The EC requested authorization to retaliate by applying similar measures to U.S. companies engaged in the practice of “dumping” in the EC market.
85. See id. ¶¶ 5.58, 5.61 (calculating nullification and impairment in terms of “cumulative dollar or monetary value”).
86. Award of the Arbitrators, United States – Section 110(5) of the U.S. Copyright Act – Recourse to Arbitration Under Article 25 of the DSU, WT/DS160/ARB25/1 (Nov. 9, 2001), available at http://www.wto.org/english/docs_e/docs_e.htm [hereinafter U.S.-Section 110(5) of the U.S. Copyright Act]. In this arbitration, the EC and the United States asked the Arbitrators to quantify the nullification and impairment resulting from certain copyright exemptions granted to public establishments under U.S. law. This figure was then used as the basis of a temporary settlement under which the United States made direct payments to the EC. The arbitration was conducted pursuant to Article 25 of the DSU, which requires the consent of both parties and can be resorted to in order to resolve all “issues clearly defined by the parties.” DSU, supra note 6, art. 25. In contrast, as discussed above, Article 22.6 arbitrations are solely concerned with the proportionality of proposed retaliation, and the consent of State R is not required.
88. U.S.-Byrd Amendment (Article 22.6), supra note 20, ¶ 4.3.
task of the Arbitrator was the detrimental effect on the particular Member seeking retaliation. According to the United States, a WTO Member cannot retaliate for detrimental effects experienced by third countries. The Arbitral Panel accepted the United States' position. This ruling requires panels to segregate and allocate detrimental effects to individual WTO Members. As we shall see, this bilateral focus distinguishes the equality-of-harm approach from the amount-of-subsidy approach.

In other cases, arbitrators have had to determine whether a proposed detrimental effect is too remote to be included in its calculations. In EC-Bananas III (U.S.) (Article 22.6), the United States contended that the EC's discriminatory measures had the effect of reducing its exports of agricultural inputs to certain Latin American countries and that these blocked exports should also be included in the Arbitrators' calculations of detriment experienced by the United States as a result of the EC's measures. The Arbitrators refused to include these lost exports to third countries in its calculations, though the reasoning on this issue is not entirely clear. The Panel appears to have taken the view that the EC's measures did not worsen the conditions of competition between U.S. agricultural input manufacturers and agricultural input manufacturers from other origins, and therefore could not be the proximate cause of the claimed losses. The Arbitral Panel also noted that allowing the United States' request could result in double counting if the relevant Latin American countries also requested retaliation rights with respect to their own lost downstream exports of bananas.

In the EC-Hormones (U.S.) (Article 22.6) case, the United States argued that if the EC had lifted its import ban, U.S. exporters would have embarked on marketing and promotional efforts and that these promotional efforts would have led to increased exports of edible beef offal worth $20.1 million. The United States also contended that the Arbitral Panel must consider these allegedly blocked increases in exports in its calculations of the value of trade blocked on account of the EC's import ban. The Arbitral Panel refused to include these marketing effort driven additional exports in its calculations. It ruled that the "causal link" between the import ban and these additional exports was "too remote" and taking these exports into

89. Id. ¶ 3.1.
90. The panel ruled that "a Requesting Party may only request suspension of concessions or other obligations with respect to the trade effect caused by disbursements under the [Continued Dumping and Subsidy Act of 2000] relating to its own exports." U.S.-Byrd Amendment (Article 22.6), supra note 20, ¶ 4.16 (emphasis added).
91. The United States argued that if the EC removed its discriminatory measures, banana exports from Latin America would have increased and in turn exports of agricultural inputs from the United States to Latin America would have correspondingly increased. EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶ 6.6.
92. Id. ¶¶ 6.11–12.
93. Id. ¶¶ 6.14–17.
94. EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 76.
95. Id.
96. Id. ¶ 77.
account would be too "speculative." It appears that the Arbitrators were simply not convinced that, as a factual matter, marketing efforts by U.S. exporters would have had such significant effects in the short period of time involved.

In the U.S.-1916 Act (Article 22.6) case, the Arbitrators were faced with the question of how to deal with two alleged effects of the underlying violation: (1) "litigation costs" borne by European defendants while contesting proceedings under the 1916 Act, and (2) deterrent or "chilling effects" on the commercial behavior of European companies. The Arbitral Panel refused to include both of these effects in its calculations. The Arbitrators’ ruling seems correct for the so-called “chilling effect” on trade because it is impossible to quantify this effect using the "amount of monetary costs imposed" metric it used in that case. In contrast, the ruling on litigation costs is difficult to understand. Litigation costs are capable of quantification in monetary terms, but the Arbitral Panel simply noted that it was “not aware of any basis in the WTO Agreements to support the view . . . that legal fees can be claimed as the loss of a benefit accruing to a WTO Member.”

These examples show that in applying the broad equality-of-harm approach, arbitral panels frequently limit the range of detrimental effects that they will consider in their calculations. They have done so in past arbitrations because alleged detrimental effects (1) were not experienced by the retaliating state; (2) could not be adequately quantified; (3) were not a proximate consequence of the violation; or (4) were unlikely to occur.

4. Empirical Issues

Arbitrators have had to resolve a heterogeneous set of empirical questions when applying the equality-of-harm approach and the value-of-trade-blocked metric. These range from questions about the representativeness of data and the reasonableness of price estimates, to questions about the appropriate econometric model to be used to estimate a particular trade effect. Arbitrators are also required to estimate the values of particular variables and to make empirical assumptions in the course of their analysis.

97. Id.
98. U.S.-1916 Act (Article 22.6), supra note 39, ¶¶ 5.69, 5.78.
99. Id. ¶ 5.76. The Arbitrators fail to explain how the payment of fines can be understood as a loss of benefit accruing to a WTO Member while the payment of litigation costs cannot. The Arbitrators also stated that the EC had not meaningfully quantified these effects because it did not provide “an overall verifiable tabulation.” Id. ¶ 5.77. The need for “tabulation” is unclear given that the Arbitrators themselves did not resort to any sort of historical tabulation of fines or settlements when they included claims relating to those items in their calculations. See id. ¶¶ 5.58–63.
100. See, e.g., EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 47.
101. See, e.g., EC-Hormones (Canada) (Article 22.6), supra note 19, ¶ 52; EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 59.
102. See, e.g., U.S.-Byrd Amendment (Article 22.6), supra note 20, ¶¶ 5.80–119.
103. See, e.g., id. ¶¶ 5.139–144.
104. See, e.g., EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 63.
We do not propose to describe in detail how arbitrators have dealt with these types of questions in the cases decided so far. Arbitrators have, in most cases, preferred extremely simple methods for assessing trade effects “even if that means sacrificing some accuracy in determining the exact amount of damages.” However, the U.S.-Byrd Amendment (Article 22.6) case is an exception. Here, the Arbitrators employed an econometric model to estimate the total decrease in exports that would result from the cash transfers granted to the domestic industry. The empirical results reached by the Arbitrators have been severely criticized. It is an inescapable feature of these empirical exercises that, despite the external appearance of neutrality, the results depend critically on subjective assumptions and choices made by the concerned arbitrators.

B. Approach 2: The Amount-of-Subsidy Approach

A second approach to assessing the permissible intensity of retaliation emerged in the Brazil-Aircraft (Article 22.6) case. This was the first case conducted pursuant to the special “appropriateness” standard of Article 4.10 of the SCM Agreement, which applies to prohibited subsidies disputes. This amount-of-subsidy approach has been applied in all subsequent arbitrations conducted under this standard. However, in contrast to the equality-of-harm approach, the resort to this approach has consistently been a matter of controversy between the parties.

1. Brazil-Aircraft (Article 22.6)

The underlying violation in the Brazil-Aircraft (Article 22.6) case was the grant by the Brazilian government of illegal export subsidies to its regional aircraft industry. In response, Canada requested authorization to impose prohibitive import duties of 100 percent on exports of goods from Brazil and to depart from various other obligations it owed to Brazil. Specifically, Canada requested the authorization to retaliate “in the amount of Can$700 million per year.” It based this figure on its calculations of the total annual value of prohibited export subsidies that the Brazilian government granted to its regional aircraft industry rather than any detrimental effect suffered by Canadian exporters. Thus on the approach proposed by Canada, a retaliatory response is “appropriate” within the meaning of Article 4.10 of the SCM Agreement when:

105. A good account is contained in World Trade Report 2005, supra note 74, at 183–89.
109. Brazil-Aircraft (Article 22.6), supra note 39, ¶ 1.1.
{Value of trade from State V affected by State R's retaliatory response} = {Amount of subsidy involved in the underlying violation by State V}

Brazil vigorously contested Canada’s approach. It proposed that the level of countermeasures should correspond to the level of nullification and impairment caused by Brazil’s grant of prohibited subsidies and that this level should be determined using a value-of-trade-blocked metric.\footnote{Id. \¶¶ 3.23–26, 3.30.} In other words, Brazil argued for the equality-of-harm approach. Brazil noted that this approach had “always been the yardstick in GATT 1947 and it ha[s] been carried into the WTO Agreement.”\footnote{Id. \¶ 3.41.}

The Arbitrators rejected Brazil’s position and refused to apply the traditional equality-of-harm approach. In essence, the Arbitrators took the position that, given the textual differences between Article 22.4 of the DSU and Article 4.10 of the SCM Agreement, the approach required under the former provision was not necessarily required under the latter provision.

The Arbitrators latched onto two textual contrasts. First, they relied heavily on the absence of any reference to the concept of nullification and impairment in Article 4.10 of the SCM Agreement.\footnote{Id. \¶¶ 3.46–47.} Second, they noted that in Article 7.9 of the SCM Agreement, the drafters used specific language to install a strict requirement of proportionality between the countermeasure and the detrimental effects of the subsidy.\footnote{Id. \¶ 3.49.} The Arbitrators viewed the omission of similar language in Article 4.10 of the SCM Agreement as a signal that this provision does not require an Arbitral Panel to adopt the equality-of-harm approach.\footnote{Id. \¶¶ 3.51, 3.57.}

Having rejected Brazil’s position, the Arbitrators then accepted Canada’s approach with the terse statement that “when dealing with a prohibited subsidy, an amount of countermeasures that corresponds to the total amount of the subsidy is ‘appropriate.’”\footnote{Id. \¶ 3.60.} However, the Arbitral Panel did not provide any affirmative reason for why this approach yielded a figure for retaliation that was appropriate. In their award, the Arbitrators provide only one comment about the substantive content of the term “appropriate”: “We conclude that a countermeasure is ‘appropriate’ \textit{inter alia} if it \textit{effectively} induces compliance.”\footnote{Id. \¶ 3.44.} However, the award contained no further reasoning of why, in general terms, countermeasures affecting trade of value equal to the total amount of the prohibited subsidy would be sufficient to induce Brazil to withdraw the subsidy. The inducing compliance standard therefore does not provide an adequate justification for the approach proposed by Canada.

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110. Id. \¶¶ 3.23–26, 3.30.
111. Id. \¶ 3.41.
112. Id. \¶¶ 3.46–47.
113. Id. \¶ 3.49.
114. Id. \¶¶ 3.51, 3.57.
115. Id. \¶ 3.60.
116. Id. \¶ 3.44.
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and used by the Arbitrators, and the Arbitrators did not attempt to provide any further legal justification for the approach adopted. 117 Such a lack of justification is a critical gap in the reasoning of the Arbitrators.

2. U.S.-FSC (Article 22.6)

Unlike in Brazil-Aircraft (Article 22.6), the issue of the legal justification for the amount-of-subsidy approach was central to the U.S.-FSC (Article 22.6) case. In this case, the EC requested authorization to impose prohibitive tariffs of 100 percent on imports in response to the United States’ failure to withdraw certain prohibited export subsidies. The EC based its request on the amount-of-subsidy approach and requested authorization to block trade of a value equal to the amount of export subsidies granted by the United States. 118

The United States argued that countermeasures of this amount were not “appropriate” because the level of countermeasures was being linked to the trade effect of the export subsidy on the EC. The core of the United States’ objection was that the EC was seeking to inflict much greater damage on the United States than the United States had inflicted on the EC. 119 In essence, the United States was requesting that the Arbitrators reject the amount-of-subsidy approach and apply the equality-of-harm approach. The key payoff for the United States of using the equality-of-harm approach was that retaliation would become linked to the specific harm experienced by the EC. This impact would presumably be a small proportion of the worldwide impact of the United States’ measure. 120 In contrast, the amount-of-subsidy approach would not necessarily demand a careful scrutiny of the effects specific to the retaliating Member. Thus, the United States argued that following the equality-of-harm approach would be more coherent with the overall scheme of the DSU and other provisions of the SCM Agreement than the amount-of-subsidy approach. 121 It also mounted a direct attack on the reasoning in Brazil-Aircraft (Article 22.6). 122

117. The Arbitral Panel noted that the amount-of-subsidy approach was preferable to alternative approaches because it “could lead to a more objective result.” Id. ¶ 3.60 n.58.
119. U.S.-FSC (Article 22.6), supra note 39, ¶ 3.1.
120. In this case, the total amount of the subsidy was estimated at $4.043 billion per year. This amount consists of figures for export subsidies granted to a wide range of U.S. exporters who operated in numerous sectors all over the world. Presumably only a fraction of the total recipients of these subsidies actually competed with EC enterprises. Id., Annex A.
121. Id. ¶ 5.29.
122. Second Submission of the United States, United States – Tax Treatment for “Foreign Sales Corporations” – Recourse by the United States to Article 22.6 of the DSU and Article 4.11 of the SCM Agreement, ¶¶ 45–63, (Feb. 26, 2002), available at http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforce-
Like the Brazil Aircraft (Article 22.6) Arbitral Panel, the Arbitrators ruled that coherence with the DSU standards was precisely what was ruled out when the drafters of Article 4.10 of the SCM Agreement used language that was different from the language used in Article 22.4 of the DSU123 and Article 7.9 of the SCM Agreement.124 Having rejected the equality-of-harm approach, the Arbitral Panel still had to resolve the issue of what the standard of appropriateness demanded and how the adoption of the amount-of-subsidy approach ensured that the resulting retaliation was somehow “appropriate.” On this issue, the reasoning of the Arbitrators was muddled and ultimately unconvincing.

The Arbitrators implied that countermeasures that induced compliance were appropriate.125 However, the Arbitral Panel did not discuss the level of trade disruption required for the U.S. Congress to come into compliance or how the amount-of-subsidy approach resulted in a figure that would induce compliance.126 The Arbitrators also appeared to place considerable weight on the “numerical equivalence” between the financial contribution by the United States and the value of trade that would be blocked by the countermeasures,127 but this observation amounted to a restatement of the approach proposed by the EC. It cannot constitute a justification for that approach.128

The Arbitrators noted that the principle being effectively followed was the “imposition on firms of the Member concerned of expenses at least equivalent to those initially incurred by the treasury of the Member concerned in granting benefits to its firms.”129 Under this theory, the amount-of-subsidy approach ensures some sort of neutralization of wrongful gain.130 This account is the closest we get to a justification for the amount-of-subsidy approach in any of the three cases where arbitral panels have applied it. However, this argument fails to convince. The measure of wrongful gain is not the financial contribution involved in an export subsidy, but the benefit conferred on the exporter. However, the amount-of-subsidy approach does
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not consider benefit; it considers the altogether different concept of financial contribution.131

Interestingly, the Arbitral Panel failed to adequately address a serious difficulty with the amount-of-subsidy approach. It appears that if this approach were to be applied in cases involving several complainants, it could result in inappropriate levels of retaliation. To see how this is so, imagine that, pursuant to the amount-of-subsidy approach, the EC were granted the right to retaliate up to the full amount of the FSC subsidy. Now Australia comes along and challenges the FSC scheme. Applying the amount-of-subsidy approach, Australia would also be entitled to retaliate up to the full amount of the subsidy. The net result would be that the United States would be subject to retaliation equal to double the amount of the subsidy — a result that is disproportionate by the Panel’s reasoning, as there would no longer be numerical equivalence and it would go beyond the amount necessary to neutralize wrongful gain. The Panel’s disingenuous response to this concern was that because there was only one complainant in this case, the issue was merely hypothetical and need not be resolved.132 In light of the shortcomings discussed above, as well as several others,133 it is difficult to disagree with the United States’ view that the U.S.-FSC (Article 22.6) arbitral award is a “seriously flawed document.”134

3. Canada-Aircraft (Article 22.6)

The third and final case in which the Brazil-Aircraft (Article 22.6) approach was applied was the Canada-Aircraft (Article 22.6) case. In this case, Brazil requested authorization to retaliate in the amount of $3.36 billion in response to the grant of prohibited export subsidies by Canada.135 Brazil based its calculations on the equality-of-harm approach and used the value-of-trade-blocked metric to measure the detrimental effects of the Canadian measures.136 Canada argued that the Arbitrators should adopt the amount-of-subsidy approach and then reduce the amount of authorized retaliation by 50 percent on account of mitigating factors.137

In this case, the Arbitrators first attempted to apply the equality-of-harm approach. The Arbitrators ruled that Brazil had failed to substantiate the causal link between the grant of the subsidy and the loss of sales by the

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131. The Arbitrators attempt to sidestep this issue by arguing that benefit is impossible to quantify. See U.S.-FSC (Article 22.6), supra note 39, ¶ 6.22. This is difficult to reconcile with the Arbitrators’ endorsement of a U.S. Treasury Report that attempted to quantify the benefits conferred by the FSC scheme. See id. ¶¶ 6.43—57.

132. Id. ¶¶ 6.26—29.

133. See Howse & Neven, supra note 126, for a wide ranging critique of this arbitral award.


135. Canada-Aircraft (Article 22.6), supra note 39, ¶ 1.2.

136. Id. ¶ 3.1.

137. Id. ¶ 3.2.
relevant Brazilian company and therefore could not prove that it had experienced any detrimental effects because of Canada’s measures. However, the Arbitrators did not stop there. They turned to the amount-of-subsidy approach championed by Canada and decided to use that approach as an alternative basis for their calculations. The use of this approach meant that Brazil could retaliate up to the level of the export subsidy (i.e., $206,497,305).

The Arbitrator also added a 20 percent top-up, or premium, to the award, in response to Canada’s acknowledgement that it did not intend to withdraw the subsidy. It based this adjustment on what it called “the ‘inducing compliance’ function of countermeasures.” The Arbitrators reasoned that an upward variation of the level of countermeasures would assist in inducing compliance by Canada. The Arbitrators acknowledged that this adjustment “cannot be precisely calibrated” or derived from a “scientifically based formula.”

The Canada-Aircraft (Article 22.6) arbitral award is interesting because it is the only award in which arbitrators have applied two different approaches for the purpose of deriving the permissible intensity of retaliation. It is also noteworthy because the Arbitrators went beyond the basic approach utilized (the amount-of-subsidy approach) and considered whether they should adjust their award in light of various contextual considerations advanced by the parties.

In conclusion, the amount-of-subsidy approach has been used in every prohibited subsidy case decided pursuant to the special “appropriateness” standard in Article 4.10 of the SCM Agreement. It differs markedly from the equality-of-harm approach, as the detrimental effects experienced by State R are completely irrelevant to the calculation of its corresponding right to retaliate. Moreover, it appears to allow one WTO Member to retaliate for consequences inflicted on the entire WTO Membership. Remarkably, this approach is not anchored in any plausible legal interpretation of the term “appropriate.”

C. Other Approaches?

The above survey shows that the equality-of-harm approach and the amount-of-subsidy approach are the only approaches that have been applied by arbitrators to date. However, it is not excluded that other approaches to

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138. Id. ¶¶ 3.20–23.
139. Id. ¶ 3.51.
140. Id. ¶ 3.89.
141. Id. ¶ 3.102.
142. Id. ¶ 3.122.
143. Id.
144. Id. ¶¶ 3.37–49.
145. It may even contemplate retaliation that is a multiple of the total amount of the subsidy if more than one WTO Member seeks to retaliate.
assessing “equivalence” or “appropriateness” may be proposed and accepted in the future. In this regard it is worth noting that in the U.S.-1916 Act (Article 22.6) case, the EC proposed an alternative “qualitative” approach under which equivalence was to be assessed in terms of the nature of the measures themselves rather than their effects.146 Using this approach, the EC argued that it was entitled to apply measures that mirrored the illegal measures taken by the United States.147 The United States’ objection to this approach was that it provided no guarantee that the detrimental effects of the underlying violation of WTO law (the 1916 Act) and the proposed retaliation (the EC’s mirror legislation) would be equal.148 In essence, the United States argued that equivalence can only be assessed in terms of detrimental effects.

The Arbitrators accepted the United States’ argument. They based their ruling on the need to ensure equivalence of nullification and impairment under Article 22.4 of the DSU.149 In their view, the use of the term nullification and impairment implies that an effects-based analysis is required.150 Accordingly, because the qualitative approach provided no guarantee that the detrimental effects of its mirror legislation would not be greater than the detrimental effects caused by the United States’ 1916 Act, the Arbitrators refused to apply it.151

Another approach could be to assess equivalence or appropriateness in terms of whether the proposed retaliatory measure suffices to directly compensate for the nullification and impairment caused by the underlying violation of WTO law. A hint of this approach can be discerned in the EC’s retaliation request in the U.S.-Section 110(5) of the U.S. Copyright Act case. In that request, the EC requested the right to levy special fees on U.S. nationals “in connection with the border measures concerning copyright goods.”152 It undertook to “fix the amount of the special fee . . . so as to ensure that the level of affected U.S. benefits will not exceed the level of EC benefits nullified or impaired as a result of [the underlying violation].”153 The EC seems to have proposed a retaliatory measure that would collect fees from the U.S. nationals such that the total amount of money collected would suffice to compensate the EC for the losses inflicted on it by the U.S. measures.

Though this issue was never referred to Article 22.6 arbitration because the parties reached a “mutually satisfactory temporary arrangement” shortly

146. U.S.-1916 Act (Article 22.6), supra note 39, ¶¶ 5.9–12, 5.17.
147. Id. ¶ 2.1.
148. Id. ¶¶ 5.13–15.
149. Id. ¶¶ 5.21–23.
150. Id. ¶ 5.23.
151. Id. ¶¶ 5.31–32, 5.34.
153. Id. The EC noted that the level of nullification and impairment it experienced on account of the underlying violation was €1,219,900.
afterwards,\textsuperscript{154} assessing equivalence on this approach would require a determination of whether the retaliatory measure was necessary in order to wipe out the detrimental effects of the violation. However, it is unlikely that an increase in import duties would have the effect of transferring rents from foreign exporters to the importing state. In all likelihood this increase will simply be passed on to consumers in State R. As a result, it will be consumers in State R rather than exporters from State V that are doing the compensating.

Having provided a descriptive account of the approaches adopted by arbitral panels in assessing "equivalence" and "appropriateness," we now turn to the task of evaluating these approaches.

V. THE OPAQUE PURPOSES OF REMEDIES IN THE WTO SYSTEM

"\textit{It is not completely clear what role is to be played by the suspension of obligations in the DSU . . . .}"

Decision by the Arbitrator, \textit{U.S.-Byrd Amendment (Article 22.6)}\textsuperscript{155}

A view about when the intensity of retaliation is too much or too little would appear to require a theory about the purpose intended to be served and the corresponding effects sought to be produced by WTO remedies. Think of the manner in which criminal sanctions or civil damages are evaluated in domestic law. Evaluative statements about remedies such as "one month of imprisonment is insufficient to deter serious theft" or "damages of $300,000 are adequate to place the plaintiff in the position he would have been if he was not negligently injured by the defendant" invariably refer to a particular purpose or specific effect that ought to be promoted by the remedy. Likewise, it would appear that a theoretical evaluation of individual arbitral awards (or even of the WTO remedial regime as a whole) requires one to adopt a view about the proper purposes of WTO remedies.

Abstract considerations of this kind can even become relevant in concrete cases. Arbitrators may seek guidance from views about the proper purposes of WTO remedies in order to choose between various textually possible approaches to equivalence. Likewise, the appropriateness standard in Article 4.10 of the SCM Agreement may also require arbitrators to posit a specific purpose for retaliation.\textsuperscript{156}

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\textsuperscript{155} \textit{U.S.-Byrd Amendment (Article 22.6)}, supra note 20, ¶ 6.4.\textsuperscript{R}
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\textsuperscript{156} The specific purpose sought to be served by retaliation may also become relevant in assessing requests for cross-retaliation under Article 22.3 of the DSU. Article 22.3 of the DSU, supra note 6, allows cross-retaliation when same sector or same agreement retaliation is not "effective." Presumably "effectiveness" must be assessed in relation to a specific purpose or outcome.\textsuperscript{R}
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It is therefore not surprising that significant portions of the academic literature regarding WTO remedies are devoted to the purposes that should be served by WTO remedies and related theories about the nature of the WTO remedial regime.157 In this section we examine various possible theories of WTO remedies. However, as we shall see for a variety of reasons, individual theories often turn out to be inadequate both for the purposes of evaluating the jurisprudence under Article 22.6 and for providing guidance to arbitrators.

A. Inducing Compliance

“The suspension of concessions under Article 22 was an essential element of an important objective of the DSU, namely compliance with the WTO rules. The Arbitrators had recognized this and had agreed that the purpose of countermeasures was to induce compliance.”

Statement by the United States to the DSB on April 19, 1999 regarding the EC-Bananas III (U.S.) (Article 22.6) case158

“The United States also welcomed the Arbitrators’ rejection of the argument that the ‘ultimate goal’ of the suspension of concessions or other obligations was to ‘induce compliance.’”

Statement of the United States to the DSB on November 26, 2004 regarding the U.S.-Byrd Amendment (Article 22.6) case159

Retaliation can be understood as a means of inducing the violating state to alter its WTO-inconsistent conduct and bring its measures into compliance with the rulings of the DSB.160 After all, the commercial interests behind the launching of a WTO case usually calculate that compliance by State V will improve their commercial situation. The whole purpose of the


160. See, e.g., Naboth van den Broek, Power Paradoxes in Enforcement and Implementation of World Trade Organization Dispute Settlement Reports – Interdisciplinary Approaches and New Proposals, 57 J. WORLD TRADE 127, 139 (2003) (“[T]he point is not remedying, it is compliance.”); Jide Nzelibe, The Credibility Imperative: The Political Dynamics of Retaliation in the World Trade Organization’s Dispute Resolution Mechanism, 6 THEORETICAL ENQUIRIES IN L. 215, 245 (2005) (“In the end, the objective of retaliation is not to compensate protectionist interest groups, but to induce compliance by scofflaw states.”). The compliance view is also defended textually on the ground that Article 22.1 of the DSU, supra note 6, specifies that retaliation is a temporary measure pending withdrawal of the illegal measure.
proceeding for them is to ensure that compliance is achieved. Retaliation can contribute to this goal by blocking the market access of enterprises from State V. These enterprises will then lobby State V to remove the WTO-inconsistent measure so that their market access can be restored. In this manner, the WTO remedial regime provides State R with a mechanism to force State V to alter its conduct and comply.  

The problem with this understanding of the purpose of the WTO remedial regime is that it is difficult to reconcile with the limitations on the intensity and form of retaliation set out in Article 22 of the DSU and specific provisions of the SCM Agreement. An unconstrained right to retaliate is more likely to induce compliance than a constrained right to retaliate. Nevertheless, the drafters chose to constrain this right. Likewise, punitive retaliation is more likely to result in compliance than non-punitive retaliation.  

Most importantly, the general Article 22.4 equivalence standard is difficult to understand as permitting any means-ends assessment into whether the proposed retaliation suffices to bring about compliance. Instead, the concept of equivalence appears to refer to a comparative assessment. A comparative assessment of the nullification and impairment caused by two measures is quite different from a means-ends assessment into whether a retaliatory measure is adequate to achieve the objective of compliance. By insisting on a comparative assessment, Article 22.4 simply does not allow compliance into an arbitrator’s calculus. One can therefore draw the implication that the drafters of Article 22.4 of the DSU did not intend the inducement of compliance to be the exclusive function of the general WTO remedial regime.

In this regard it is worth noting that, to date, determinations of equivalence under Article 22.4 of the DSU have not been based on an assessment of the level of countermeasures that would be required to force State V to alter its measure. Although the inducing compliance function is the only function of WTO remedies that has been mentioned in any detail in Article 22.6 arbitrations, it has not guided the rulings of arbitrators pursuant to.


162. Cf. Hudic, supra note 46, 389–90 (arguing that strict limitations on retaliation can indirectly promote compliance).

163. See e.g., EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶ 6.3; U.S.-FSC (Article 22.6), supra note 39, ¶ 5.62, U.S.-1916 Act (Article 22.6), supra note 39, ¶ 5.8.

164. For a similar conclusion see Lawrence, supra note 157, at 35–36. See also David Palmer & Stanimir Alexandrov, “Inducing Compliance” in WTO Dispute Settlement, in THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW 646, 651 (Daniel L. M. Kennedy & James D. Southwick eds., 2002); Sykes, supra note 8, at 351-52.

165. In the early Article 22.6 cases, arbitrators stated that the function of retaliation is to “induce compliance.” EC-Bananas III (U.S.) (Article 22.6), supra note 39, ¶ 6.3; EC-Hormones (Canada) (Article 22.6), supra note 19, ¶ 76; EC-Hormones (U.S.) (Article 22.6), supra note 17, ¶ 40; EC-Bananas III (Ecuador) (Article 22.6), supra note 29, ¶ 76. In subsequent prohibited subsidies disputes, arbitrators observed that one of the functions of retaliation is to induce compliance. See, e.g., Brazil-Aircraft (Arti-
the Article 22.4 equivalence standard in any way. No arbitrator or party has argued that retaliation is equivalent or appropriate because it would inflict costs that would be adequate to force the European Commission or the U.S. Congress to pass implementing legislation. To the contrary, arbitrators have invariably followed the equality-of-harm approach.

Of course, this is not to deny that under the special appropriateness standard in Article 4.10 of the SCM Agreement, there is scope to argue that countermeasures are appropriate if they induce compliance. Indeed, as we have seen, the inducing compliance rationale was used in one case conducted pursuant to this standard to award a premium of 20 percent. Still, the fact remains that the general equivalence limitation in Article 22.4 of the DSU is difficult to reconcile with the proposition that the drafters of the DSU intended that the sole or even primary function of retaliation is to induce compliance.

B. Providing Compensation

"On the other hand . . . (the equivalence requirement) seems to imply that suspension of concessions or other obligations is only a means of obtaining some form of temporary compensation . . . .”

Decision by the Arbitrator, U.S.-Byrd Amendment (Article 22.6)

If it is difficult to understand retaliation in terms of forcing State V to change its measures and come into compliance, is it possible to see retaliation as a means of placing State R into the position it would have occupied if State V complied? In other words, can retaliation be understood as serving a compensatory function?

In a domestic law setting, the primary function of private law remedies is to compensate the plaintiff for the breach of a legal duty owed to him or her. The idea is that the injured party is made whole, i.e., put in the position that he/she would have been if the legal duty was carried out. So in the contractual context, this usually involves the award of so called “expectation damages.” Expectation damages refers to the sum of money that would place the injured party in the position that he/she would have been if the contract had been performed. A similar principle is followed in tort law. The successful plaintiff is provided a sum of money that would put him/her in the position that he/she would have been in had the tort not been committed.
Alan Sykes and Warren Schwartz have developed a theory of the WTO remedial system that assumes that retaliation operates to place State R in the position in which it would have been if State V had complied with WTO law; i.e., retaliation should provide State R with expectation damages. As discussed in greater detail below, they define “injury” in a very specific sense. More recently, the Arbitrators in the U.S.-Byrd Amendment (Article 22.6) case suggested that one understanding of retaliation is that it is “only a means of obtaining some form of temporary compensation.”

The primary objection to this view is a practical one. Given the nature of the obligations that can be suspended under the WTO Agreements, it is extremely unlikely that retaliation will have the effect of compensating State R. In the typical WTO case, entities in State R have lost competitive opportunities as a result of State V’s breach of WTO law. These entities are not made whole in any coherent sense by the imposition of retaliation on State V. For instance, the profits that Chiquita International lost on account of the EC’s non-compliance with WTO law in EC-Bananas III (U.S.) (Article 22.6) are not regained in any meaningful manner as a result of the United States’ blocking of imports of Italian Pecorino cheese by way of prohibitive retaliatory duties. The point is that retaliation usually cannot bridge the gap between the situation of present non-compliance and the hypothetical situation of legally required WTO compliance. This is because the suspension of WTO obligations is unlikely to result in a transfer of assets from State V to State R. Moreover, if one assumes that WTO obligations are welfare-enhancing, the result of any retaliation is likely to be an overall welfare loss for State R rather than a welfare gain.

167. See Schwartz & Sykes, supra note 157, at S181-83; Sykes, supra note 8, at 551.
168. U.S.-Byrd Amendment (Article 22.6), supra note 20, ¶ 6.3.
169. Certain WTO violations, however, are difficult to understand in terms of lost competitive opportunities. For instance, TRIPS obligations require the provision of monopoly rights to foreign enterprises rather than competitive opportunities. TRIPS, supra note 25. Likewise, Article X.3 of the GATT imposes certain obligations to treat exporters fairly rather than provide particular competitive opportunities vis-à-vis other enterprises. GATT 1947, supra note 35, art. X.3.
172. See McCall Smith, supra note 25, at 245.
173. See Subramanian & Watal, supra note 61, at 406 (noting that “[u]nder most circumstances, the implementation of trade retaliation leads to a decline in economic welfare of the retaliating country”). Based on economic simulations, Fritz Bruess concludes that in three out of four EC-U.S. disputes, retaliation resulted in welfare losses on both sides. The exception is the U.S.-FSC (Article 22.6) case, where Bruess concludes that the EC gained from retaliation. See Fritz Bruess, WTO Dispute Settlement: An Economic Analysis of Four EU-U.S. Mini Trade Wars – A Survey, 4 J. OF INDUS., COMPETITION AND TRADE 275, 500-01 (2004).
In sharp contrast, the award of monetary damages in domestic law can compensate the injured party. Consider the situation of a party to a commercial contract that receives a payment of monetary compensation in a case involving a breach of contract for sale of goods. In this case, the injured party is as well off as he would have been had the contract been performed. The same cannot be said of retaliation in the WTO system.\footnote{See Lawrence, supra note 157, at 37 (pointing out the disanalogy between contractual expectation damages and WTO retaliation).} For this practical reason it is difficult to see how retaliation can be understood as a means of providing the benefit of the bargain to State R.

Sykes and Schwartz are fully aware of these difficulties and therefore they do not actually argue that the concerned exporters can be compensated as a result of retaliation. Instead, they focus on those who hold political office rather than traders or industry interests. Most importantly, they evaluate injury to these actors in terms of political support rather than financial harm or loss of overall welfare.\footnote{See Schwartz & Sykes, supra note 157, at S184 ("And the theory of public choice suggests that the metric of welfare for each signatory to a trade agreement will not be money, but instead will be the political welfare (votes, campaign contributions, graft, as the case may be) of its political officials."); Sykes, supra note 8, at 355 ("Theory suggests that the damages in question are a loss of political support to foreign officials, which proceeds from a loss of rents abroad due to the violation.").} Sykes and Schwartz argue that the politicians of a given WTO Member are compensated by retaliation because they gain political support from domestic constituents in return for the increased protection that they can deliver to these constituents through retaliation.

Viewing injury and compensation in this manner rests on the assumption that compliance and non-compliance with WTO Agreements has a clear relationship to losses and gains in domestic political support. In particular, one must assume that domestic politicians will experience losses in political support because of the actions of foreign governments. For example, in the EC-Hormones (Article 22.6) cases, it is unclear why Canadian or American politicians would experience losses in domestic political support as a result of the EC’s decision to ban imports of hormone-treated beef. To reach such a conclusion we must assume that American and Canadian cattle farmers would hold their own officials responsible for the actions of foreign governments. This is a difficult assumption to defend. Likewise, one must also assume that any violation of the WTO Agreements by a government would invariably lead to an increase in that government’s domestic political support and hence “compensate” the politicians concerned. It should be noted that Sykes and Schwartz’s position that retaliation operates to compensate State V in these terms is part of a larger overarching theory positing that the WTO remedial system is designed to facilitate efficient breach. We discuss the full theory in greater detail below.\footnote{See infra Part IV.D.}

A further difficulty for any compensation theory arises from the fact that the WTO remedial regime does not allow for retrospective remedies. Retali-

\footnotesize{174. See Lawrence, supra note 157, at 37 (pointing out the disanalogy between contractual expectation damages and WTO retaliation).

175. See Schwartz & Sykes, supra note 157, at S184 ("And the theory of public choice suggests that the metric of welfare for each signatory to a trade agreement will not be money, but instead will be the political welfare (votes, campaign contributions, graft, as the case may be) of its political officials."); Sykes, supra note 8, at 355 ("Theory suggests that the damages in question are a loss of political support to foreign officials, which proceeds from a loss of rents abroad due to the violation.").

176. See infra Part IV.D.}
C. Rebalancing the Bargain

"The purpose of counter-measures in the WTO is . . . to maintain the balance of reciprocal trade concessions negotiated in the WTO Agreements."

David Palmeter and Stanimir Alexandrov

"While WTO remedies achieve several goals simultaneously, the goal achieved most precisely is maintaining reciprocity."

Robert Lawrence

The WTO Agreements emerged from negotiations conducted on the basis of reciprocity, i.e., the obligations undertaken by a given WTO Member are provided in exchange for the obligations that other WTO Members undertake. Given this feature, it is frequently argued that the purpose of retaliation is to rebalance this underlying bargain.

Under this theory, State V’s violation of WTO law has the result of upsetting its bilateral bargain with State R. The only way State R can restore the

177. Palmeter & Alexandrov, supra note 164, at 647.
178. LAWRENCE, supra note 157, at 47.
179. Article XXVIII bis of the GATT specified that the GATT contracting parties could sponsor tariff negotiations on a “reciprocal and mutually advantageous basis.” GATT 1947, supra note 35, art. XXVIII bis. The Uruguay Round was conducted “under the framework and within the aegis of the GATT.” GATT, Ministerial Declaration of 20 September 1986, at 1, GATT Doc. No. MIN.DEC. The Ministerial Declaration also provided in part B(i) that negotiations would be conducted “consistent with . . . the principles of the General Agreement in order to ensure mutual advantage and increased benefits to all participants.” Id. at 2.
181. The most developed account is in LAWRENCE, supra note 157, at 43–44. See also Palmeter & Alexandrov, supra note 164, at 648 (“The purpose of counter-measures in the WTO is not to induce compliance, but to maintain the balance of reciprocal trade concessions negotiated in the WTO Agreement.”); Rufus Yerxa, WORLD TRADE ORG., THE POWER OF THE WTO DISPUTE SETTLEMENT SYSTEM, in KEY ISSUES IN WTO DISPUTE SETTLEMENT: THE FIRST TEN YEARS 3, 4 (Rufus Yerxa & Bruce Wilson eds., 2005) (“The violation of WTO rules by one Member gives adversely affected Members the right to withdraw some equivalent value of commitments in order to rebalance their respective rights and obligations.”). In the GATT context, see DAM, supra note 172, at 79 (“The consequence of nonperformance is thus merely the reestablishment, at the option of an interested party and subject to the approval of the contracting parties, of the preexisting situation (although the retaliatory suspension may be on items not originally negotiated with the offending contracting party.”)); J. JACKSON, supra note 36, at 170 (“The third major goal for these provisions of GATT was to provide a means for ensuring continued reciprocity and balance of concessions in the face of possibly changing circumstances.”); OLIVIER LONG, LAW AND ITS LIMITATIONS IN THE GATT MULTILATERAL TRADE SYSTEM 76 (1985) (“The objective, therefore, is not to penalize a breach of the rules. It is to restore, with the minimum interference with trade, the balance of concessions and advantage between the parties in dispute.”).
bargain without cooperation by State V is to retaliate and, hence, adjust the content of its obligations towards State V. If no adjustment were made, State V would gain a benefit from State R for which it has not “paid.” Conversely, State R would be subject to an obligation without having received the corresponding “payment” from State V. The purpose of retaliation is to ensure that the terms of the bilateral obligations between State V and State R adequately reflect the original bargain. It is worth noting that this is not a permanent rewriting of the terms of agreement. If State V brings itself into compliance, the authorization to retaliate lapses and the terms of the original legal relationship are reinstated. Accordingly, retaliation merely involves a temporary adjustment of the legal terms of the bilateral relationship.

But how precisely is this restoration of the bargain to be achieved? Presumably one must adjust the legal relationship between the parties so that it approximates the treaty that would have been reached by the parties if they were aware that State V would not assume the particular obligation that is presently being violated. This adjustment involves a complex counterfactual exercise. For instance, in the EC-Hormones (U.S.) (Article 22.6) case, the Arbitrator should have first determined the obligations towards the EC that the United States would not have undertaken during the Uruguay Round if it had known that the EC would refuse to adhere to the discipline of the Agreement on the Application of Sanitary and Phytosanitary Measures (“SPS Agreement”)\(^{182}\) with respect to its ban on hormone-treated beef. The Arbitrator should then allow retaliation that would release the United States from these specific obligations. In other words, the Arbitrator should permit the United States to suspend the concessions or obligations with which it “paid” for the EC’s assurance that the EC would adhere to the obligations contained in the SPS Agreement with respect to imports of hormone treated beef.\(^{183}\)

In effect, under this approach arbitrators are being asked to rewrite the WTO Agreements between two WTO Member states. But they have no guidance about what the reformulated agreement should look like. To arrive at this reformulated agreement they would need to know, at the outset, the precise content of the underlying bilateral bargain between the concerned countries. However, this knowledge is simply not attainable. For a variety of reasons, an arbitrator has no practical way to determine the “price” paid by State R for State V’s commitment to abide by the obligation breached.

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183. It appears that the drafters of the GATT had a similar concept in mind when they referred to withdrawal of “substantially equivalent” concessions in the context of Article XXVIII renegotiations. For an example, see the statement of the Chairman of the ad-hoc Sub-Committee that drafted Article XXVIII.3 quoted in 2 WORLD TRADE ORG., GUIDE TO GATT LAW AND PRACTICE 947 (6th ed. 1995): “What was a substantially equivalent concession would be determined in the light of what the party concerned had paid for the concession which had been withdrawn.”
Although GATT/WTO negotiations are conducted on the basis of reciprocity, there is no common definition of this concept. As Anwarul Hoda has explained:

There is no provision on the manner in which reciprocity is to be measured and even the rules of various rounds of negotiations did not spell out any guidelines on the issue. The understanding has always been that governments participating in negotiations should retain complete freedom to adopt any method for evaluating the concessions.184

In a similar vein, Arthur Dunkel, while he was the Director-General of the GATT stated that "[r]eciprocity cannot be determined exactly; it can only be agreed upon."185 Given this fundamental indeterminacy about the nature and quantum of the reciprocal concession received by State V from State R in exchange for its promise not to commit the particular breach in question, it is simply not possible for an arbitrator to achieve the goal of restoring the balance of the actual bargain by releasing State V from the relevant concession.

One response to this objection would be to acknowledge the practical impossibility of ascertaining the actual bargain reached by the concerned WTO Members, but to posit that the arbitrator's role is to arrive at some sort of rough approximation of the equilibrium that would have been reached between State V and State R. A proponent of this approach might argue that arbitrators can arrive at an approximation of the underlying bargain using the equality-of-harm approach or the amount-of-subsidy approach that we have discussed at length above. However, such a response ultimately would be unsuccessful.

The equality-of-harm approach in conjunction with the value-of-trade-blocked metric could only yield a measure of the price paid by State R for the treaty obligation that is now breached if one assumes that WTO Members treat the value of trade flows as the exclusive currency of payment during a negotiating round. Although this is a popular view about the manner in which trade negotiators operate,186 one cannot assume that it is accurate.

First, the assumption that WTO Members evaluate reciprocity exclusively in terms of changes in trade flows is not empirically supported. A study by Finger et al. regarding the nature of bargaining during the Uruguay Round concluded that: "[W]e found little evidence that governments evaluate their own performance [in the Uruguay Round] by a mercantilist standard of export concessions received less import access concessions given.

185. This statement is quoted in J. Michael Finger, A Diplomat’s Economics: Reciprocity in the Uruguay Round Negotiations, 4 WORLD TRADE REV. 27, 30 (2005).
None of the delegations we interviewed were aware of such calculations, either by their own governments or by others.\textsuperscript{187}

Second, it is impossible to evaluate the bargaining over numerous parts of the WTO Agreements in terms of trade flows. Consider both the TRIPS Agreement, which does not involve any discernable international trade flows, and the WTO obligations relating to transparency and notification requirements, which cannot be easily connected to changes in bilateral trade flows.\textsuperscript{188}

Third, even for those parts of the WTO Agreements that give rise to easily discernable effects on trade flows, it is difficult to understand why this effect would be of central concern to WTO Members. There is, after all, no intrinsic value in increasing the value of exports from a given WTO Member. Presumably, WTO Members have other more pertinent concerns, such as aggregate national welfare, the political welfare of those in power, or the impact on profits of exporters. The value of net exports is not a reliable measure of these matters. As Kym Anderson has pointed out, the welfare and value of trade blocked would only coincide coincidentally.\textsuperscript{189} Likewise, trade flows by themselves do not provide any clear indication of political impact.\textsuperscript{190}

Similarly, the amount-of-subsidy approach would only yield a figure for the price paid for the SCM Agreement’s prohibition on export subsidies if one assumes that participants in the Uruguay Round negotiations on export subsidies were involved in a process whereby demanders provided a dollar of market access in exchange for every dollar reduction in export subsidies they could obtain from other Members. Needless to say, this account bears no connection to reality. Prohibited subsidy discipline negotiations were not conducted on such a basis; instead the approach applied was one of across-the-board harmonization.\textsuperscript{191} For these reasons, it is difficult to conclude that either the equality-of-harm approach or the amount-of-subsidy approach are capable of yielding even a rough measure of the price paid by State R for the WTO obligation that is now breached.

In all likelihood, the difficulty is not merely one of measurement but of a far more fundamental nature. In the context of the WTO Agreements, underlying bilateral bargaining may not exist in any meaningful sense. One can refer to a bilateral bargain in the context of purely bilateral negotiations. The best example of this in the GATT/WTO context are the tariff level negotiations conducted among a small number of countries pursuant to the


\textsuperscript{188} See Jackson, supra note 157, at 121–22.

\textsuperscript{189} Anderson, supra note 157, at 129.

\textsuperscript{190} See Spamann, supra note 73, at 43.

\textsuperscript{191} See Croome, supra note 58, at 60–63.
so-called "request-and-offer" procedure in the early days of the GATT. However, the vast majority of current WTO obligations did not emerge from any process. Instead, they emerged from multilateral negotiations where a harmonization approach was used.

In multilateral negotiations of this nature the resulting bargain is an aggregate one. A particular state assesses the aggregate obligations it has undertaken against the aggregate obligations undertaken by all other WTO Members. There is no sensible way to segregate the overall result of such a negotiation into differing bilateral bargains because there is no real bilateral exchange of promises. In that sense, the Uruguay Round bargain is far more diffuse and complicated than the purely bilateral bargains required for the rebalancing approach to work.

Finally, it is worth noting that the restraints on cross-retaliation are difficult to reconcile with this theory. It is well known that in the Uruguay Round, developing countries accepted TRIPS and GATS obligations in exchange for market access to developed country markets for textiles and clothing. Given the structure of this bargain, one would expect that cross-retaliation would often be required, and certainly not discouraged, under the rebalancing theory. The fact that the drafters of the DSU chose to discourage cross-retaliation indicates that they did not see retaliation solely as a means of re-establishing the bargain.

D. Incentives To Maximize Joint Political Welfare

"In the parlance of contract theory, the objective is to deter inefficient breaches but to encourage efficient breaches."

Warren Schwartz and Alan Sykes

Law and economics theorists often argue that the function of law should be to induce efficient behavior. Applying this point of view to the law of WTO remedies, Sykes and Schwartz have argued that the function of retaliation is to deter “inefficient” breaches but to encourage “efficient” breaches of WTO obligations. Under their theory, which is based on classical law

192. For an account of the evolution away from the bilateral offer-request approach and toward the formula approach in the GATT, see Alice Enders, Reciprocity in the GATT 1947: From 1942 to the Kennedy Round, in GOING ALONE: THE CASE FOR RELAXED RECIPROCITY IN FREEING TRADE, supra note 180, at 85.

193. In regulatory areas such as trade remedies, SPS, and TRIPS, the bargain takes the form of an agreement by all parties to observe similar rules (i.e., harmonize). Likewise, tariff negotiations conducted using the so-called formula approach can also be understood as involving harmonized change of tariff commitments. Under a formula approach, tariff cuts in a negotiating round are based on the application of a single reduction formula (for instance “reduce all bound tariffs by 20 percent”) to all participants in the negotiation.


196. Id.
and economics analysis of remedies in domestic contract law, the function of the WTO remedial regime is to provide appropriate incentives so that WTO Members behave in a manner that maximizes joint welfare. As noted above, Sykes and Schwartz understand welfare to mean political welfare rather than the aggregate welfare levels of citizens of WTO Member states. 197

Sykes and Schwartz argue that the Article 22.4 equivalence standard leads to efficient decisions by State V on whether to comply with or violate their WTO obligations. Sykes and Schwartz must assume that equivalent retaliation leads to a reduction of political welfare in State V equal to the reduction in political welfare experienced in State R as a result of the violation. 198 Faced with retaliation of this magnitude, State V will only violate WTO obligations where it gains more political welfare from the violation than the amount of political welfare that State R loses on account of the violation, and it will refrain from doing so when this is not the case, i.e., breach or opt out will only occur in situations when the result is an overall political welfare gain. 199

This theory requires that arbitrators ensure that the effects of retaliatory action by State R on officials in State V are precisely equal to the decline in political welfare experienced in State R as a result of the underlying violation of WTO law by State V. If the political welfare effects of retaliation by State R exceed this level then efficient breaches will be improperly deterred, and if they fall below this level then inefficient breaches will be improperly encouraged. Thus, the theory requires that the retaliatory response is finely calibrated to the political welfare decline in State R.

Under the DSU, however, it is impossible for an arbitral panel to ensure that this condition is enforced because arbitrators cannot, under Article 22.7 of the DSU, police the products selected for retaliation. 200 The level of decline in political welfare experienced as a result of retaliation will depend critically on the imported products that are affected. The political effects of an import ban that blocks imports worth one million dollars from a single low-margin, non-labor-intensive industry will be very different from an import ban that blocks imports worth one million dollars from fifteen labor-

197. See supra text accompanying note 175. It would be difficult to argue that WTO remedies are designed in a manner that invariably leads to outcomes that maximize the overall welfare of citizens in WTO Members states. Economic theory presumes that WTO remedies (which are usually protectionist in nature) will usually reduce the overall welfare of both State R and State V. A welfare-based defense of WTO remedies could only succeed if an account is provided of how this immediate welfare loss is compensated by welfare gains created from compliance over the longer term. No such account has been advanced in the literature.

198. Schwartz & Sykes, supra note 157, at S189 ("[The arbitrators] set a price for the EU’s persistence in its violation of WTO law equal to the harm caused to its trading partners.").

199. Id. at S184 ("When the political burden of performance to a promisor exceeds the political detriment of nonperformance to the promisee(s), evaluated at the proper weight or shadow price, nonperformance is jointly desirable.").

200. See supra text accompanying note 17.
intensive, high-margin industries in politically sensitive states. Nevertheless, arbitrators are explicitly barred from policing these choices and, as a consequence, it is impossible for arbitrators to ensure that WTO Members make efficient decisions about whether to perform or breach. Given its current design, the WTO remedial system cannot, as a practical matter, provide incentives for WTO Member states to conduct themselves in a manner that maximizes joint political welfare.

Moreover, this theory does not explain current practice in Article 22.6 arbitrations. For example, in the U.S.-FSC (Article 22.6) case, the Arbitral Panel used the amount-of-subsidy approach and ruled that the EC could retaliate up to the total amount of disbursements under the FSC scheme, which was approximately four billion dollars. However, this figure bears no discernable relationship to the political support lost, if any, by Commission officials or officials in EC Member States as a result of the United States' implementation of the FSC scheme, or to the level of any increase in their political welfare if they implemented this retaliation. Similarly, the equality-of-harm approach used in the EC-Hormones (Article 22.6) cases does not generate a figure for the amount of political welfare lost or gained in the United States as a result of the underlying violation or the authorized retaliatory action. Instead, it generates a figure for the amount of trade lost, which bears a very hazy relationship to measures of losses or gains in political welfare. Schwartz and Sykes are aware that measurement of political welfare is difficult, but fail to acknowledge the implication that arbitral panels do not and cannot reach decisions that provide incentives to maximize joint political welfare.

In a more recent contribution, Robert Howse and Robert W. Staiger develop their own variant of the efficient breach theory. They argue that a retaliatory rule would approximately allow for a “multilaterally stable system of remedies that provides for ‘expectation damages’ and facilitates a form of efficient breach” if certain conditions are met. The retaliatory rule they describe is a trade effects rule where retaliatory tariff changes by State R and the underlying illegal tariff changes by State V result in “the same trade volume changes in each (domestic and foreign) market,” with volumes being measured at original exporter prices.204

201. According to Bruess, the implementation of the FSC scheme resulted in an overall welfare gain to the EC. See Bruess, supra note 175, at 299–301.

202. See Schwartz & Sykes, supra note 157, at S187 (“[T]he harm done to political officials by a breach of promise in the WTO is no doubt difficult to measure precisely . . . .”).


204. Id. at 311. It is worth noting that Howse and Staiger conclude that although the retaliatory rule they propose is “efficient” and hence normatively desirable, it cannot be reconciled with the current design of the DSU. See id. at 313–16.
However, the model from which this conclusion is drawn does not generate meaningful conclusions about retaliation under the DSU. It assumes that retaliation occurs on a most favored nation (“MFN”) basis, i.e., the retaliatory action by State R applies to all WTO Members and not just State V.\textsuperscript{205} It also appears that the model is limited to cases involving non-discriminatory increases in tariff duties above the bound rate — but violations and retaliation take numerous other forms.\textsuperscript{206} As such, the model does not produce general conclusions about the system of WTO remedies. For these reasons, Howse and Staiger fail to establish that the WTO remedial system can deter inefficient breaches of WTO law while facilitating efficient breaches, even if it applied the retaliatory rule they propose.

E. Retribution

“[If compliance is not forthcoming domestic constituents] will . . . want . . . the satisfaction of imposing an equivalent harm on the other side.”

Robert Hudec\textsuperscript{207}

Faced with non-compliance, constituents in State R may wish to have the satisfaction of inflicting some harm on State V. This somewhat primitive urge brings us to a final possible aim of the WTO remedial regime: retaliation as a means of facilitating and controlling retribution.

If retaliation is conceived of in these terms, the arbitrator’s role is not to ensure that some instrumental goal, such as compliance or efficiency, is achieved; the arbitrator should strive for equivalence of harm as an end in itself. In practice, however, it is not always possible to ensure that the harm inflicted by the retaliatory action does not exceed the harm sustained by State R.

The bar in Article 22.7 on examining the nature of concessions — and hence one side of the balance — complicates the task of the arbitrator considerably. This provision in effect allows retaliation to inflict greater harm than the underlying violation — for instance, by targeting politically sensitive or high margin products. Moreover, the frequently used value-of-trade-blocked metric provides only a rough measure of harm,\textsuperscript{208} and it has proved difficult for a variety of reasons to ensure that the retaliation response and the underlying violation have equal trade effects.\textsuperscript{209} Nonetheless, there can

\textsuperscript{205.} Id. at 309 n.9.
\textsuperscript{206.} Howse and Staiger only model and discuss violations which take the form of increases in import protection by altering tariffs. The x- and y-axes of figures 2 and 4 of their text, which set out their model, refer solely to tariffs. Id. at 304–11.
\textsuperscript{207.} Hudec, supra note 46, at 389.
\textsuperscript{208.} See Anderson, supra note 157, at 127–29.
\textsuperscript{209.} See Spamann, supra note 73, at 50–71 (arguing that for a variety of reasons there is no reason to believe that arbitral awards under DSU Article 22.6 have resulted in the retaliatory response blocking the same amount of trade as the underlying violation).
be little doubt that this theory fits the legal regime better than other candidates. As we have seen, the dominant approach to assessing equivalence is the equality-of-harm approach, which precisely tracks the retributive theory.

However, other objections can be directed against this theory. If retaliation initiated by State R takes the form of an import prohibition, State R will usually undergo further damage in the form of increased prices for its imports and efficiency losses when it fulfils its wish of inflicting costs on State V. Retribution therefore comes at a high price for State R. Retributive retaliation appears irrational for this reason. It is difficult to argue that the purpose of the WTO remedial system is to facilitate a self-defeating outcome of this nature.

Retribution also appears misplaced in the context of trade relations between countries. The retributive principle is often applied in the context of crimes or torts that fundamentally deny the value of the victim, because retribution is thought to serve to reaffirm a victim’s worth and dignity. A breach of trade obligations is difficult to see in these terms. A WTO violation will almost never involve another WTO Member’s loss of dignity. In this context, it is worth noting that the International Law Commission’s Articles on State Responsibility appear to preclude any resort to countermeasures for purely retributive aims. At least in general international law, one wrong does not per se merit another wrong.

F. Summation: The Non-Escalation Function of Arbitral Review

The search for an instrumental rationale to guide arbitrators leads us to conclude that many theories cannot be reconciled with the structure of the remedial provisions of the DSU, are not achievable in practice, or are simply incoherent. The compliance rationale is difficult to reconcile with the equivalence limitation in Article 22.4 of the DSU, although it can play a role in assessments of proportionality in prohibited subsidies cases conducted under the Article 4.10 appropriateness standard. The compensation rationale is unlikely to be achievable in practice given the nature of WTO obligations. Similarly, the maintenance of the underlying bargain rationale appears all but impossible to achieve, and sits uneasily with the restraints on cross-retaliation. Finally, the Article 22.7 bar on examining the nature of retaliations...
tory measures prohibits arbitrators from ensuring that the WTO remedial system provides incentives for conduct by WTO Members that would maximize joint political welfare.

It is also clear that the two broad approaches adopted by arbitrators to date — the equality-of-harm approach and the amount-of-subsidy approach — cannot be justified by these theories. Neither approach generates a specific amount of retaliation that would necessarily (1) bring about compliance, (2) compensate State R in any meaningful way, (3) restore the underlying bargain, or (4) provide incentives for efficient behavior.

The retribution rationale fares somewhat better than the other theories. This rationale coheres with the structure of the DSU better than other theories and is not impossible to implement, albeit in an extremely rough manner. The retribution rationale can also be used to justify one of the two approaches used by arbitrators to date: the equality-of-harm approach.213 However, as noted above, doubts can be raised about whether this theory is a valid one.

It follows that, unless one endorses the retribution rationale, one must conclude that the bulk of the WTO remedial regime relating to the permissible intensity of retaliation is simply bereft of any valid rationale. Apart from the rare cases where intensity can be gauged in terms of the compliance214 or compensation215 rationales, the vast majority of arbitral awards concerning the permissible intensity of retaliation will be arbitrary to a certain degree.

The arbitrariness inherent in assessments of the permissible intensity of WTO retaliation, however, is only of secondary importance. The fact that the permissible intensity of retaliation is assessed by a neutral third party probably matters far more than the theoretical cogency of any individual arbitral award. To see how this is so, consider the situation that would prevail in the absence of binding arbitration. State V will often disagree with State R about the legitimacy of any proposed retaliation. Disagreement can arise about a wide variety of matters — such as the approaches to be used, the data, counterfactuals and the nature of the underlying bargain. The net result is that State V may threaten to counter-retaliate if it is subject to what it views as illegitimate retaliation from State R. This can lead to counter-counter retaliation by State R, and so on and so forth. The ultimate result is likely to be a costly spiral of retaliation and ultimately a breakdown of the

213. In contrast, the amount-of-subsidy approach cannot be justified by reference to this rationale. There is no reason to assume that the “harm” caused by a prohibited subsidy will be equal to the “harm” caused by a countermeasure that blocks trade of equal value to the financial contribution involved in the prohibited subsidy. It is important to note that the amount-of-subsidy approach, in addition to being bereft of any legal rationale, cannot be justified by reference to any normative theory of WTO retaliation.

214. An example could be a case brought under the Article 4.10 appropriateness standard, in which the arbitral panel adopts a compliance-based approach.

215. An example could be a case in which intellectual property rights have been suspended. This could lead to financial gains for citizens in State R.
entire cooperative arrangement. This scenario is not unthinkable; during the GATT era, threats of counter-retaliation did occur.\footnote{See Minutes of Meeting, Sept. 29-Oct. 1, 1992, at 27–31, GATT Doc. C/M/239 (Oct. 27, 1992), available at http://www.wto.org/english/docs_e/gatt94_e/gatt94_e.htm (discussing Canadian threats to counter-retaliate against the United States); Hosoda, supra note 186, at 101 (mentioning an EC threat to counter-retaliate against Austria, Czechoslovakia, Sweden and Switzerland under Article XXVIII).}

Authoritative third-party control can prevent this type of problem from arising. In this regard, the criterion used by the arbitrator is largely irrelevant — even an arbitrary or subjective decision will suffice. As long as the arbitrators’ decisions are accepted as final and binding, costly spirals of counter-retaliation will be avoided.\footnote{As Hudec has noted, “[T]he important thing is not the fact of equivalence itself, but rather having some credible mechanism which can certify equivalence in a politically persuasive way.” Hudec, supra note 46, at 390.} Thus, arbritral review is better understood as a means of preventing dispute escalation than as a means of bringing about results such as compliance and rebalancing.

VI. Implications

There are a number of implications to the claim that arbitrariness is likely to be present in assessments of permissible retaliation. First, there are the implications for the manner in which arbitral awards are evaluated. Arbitral awards are sometimes evaluated based on the extent to which they promote the theories we surveyed above, including compliance, efficient breach, or rebalancing.\footnote{See, e.g., Thomas Jürgensen, Crime and Punishment: Retaliation Under the World Trade Organization Dispute Settlement System, 39 J. WORLD TRADE 327, 328, 338-39 (2005) (criticizing two cases for failing to interpret equivalence in a manner that induces compliance); Palmeter & Alexandrov, supra note 164 (criticizing the ruling in Brazil-Aircraft (Article 22.6) for departing from the rebalancing paradigm).} As we have seen, many of these theories cannot be reconciled with the structure of the DSU, nor can the outcomes that these theories mandate be achieved because of practical considerations. It follows that it is inappropriate to use these theories as a basis for evaluating individual arbitral awards. To fault arbitrators for setting awards that are too low to induce compliance or that fail to facilitate efficient breach is to fault them for failing to achieve the impossible.

In the absence of a theoretical benchmark, arbitral awards can only be assessed according to fairly minimalist standards. These include whether an award respects process norms, whether the approach adopted is justified by the text, and whether the award is internally consistent. Beyond this, one must accept that arbitrators have a good deal of discretion. As we have seen, the treaty texts are ambiguous on crucial issues and effectively leave it to arbitrators to craft their own solutions.

All too often, WTO Members and commentators fail to acknowledge the inescapable discretion involved in the arbitrator’s task. Consider the reaction to the Arbitral Panel’s decision in the Canada-Aircraft (Article 22.6) case to
award a 20 percent premium in response to Canada’s declaration that it did not intend to withdraw the illegal export subsidies it had granted to its regional aircraft industry. This premium was subject to scathing criticism by Canada,219 the United States,220 and the academic community.221 However, Canada itself had requested the same Arbitral Panel to exercise discretion and lower its award, i.e., to award a discount rather than a premium.222 In light of its posture in the case, it was disingenuous for Canada to contend that an arbitral panel has no discretion to vary its award in light of broader circumstances. The further objection that the 20 percent figure was based on a subjective choice by the Arbitrator fails to acknowledge the reality that, given the gaps in the treaty text, arbitrators must invariably make subjective assessments regarding almost every aspect of an Article 22.6 award.

A second set of implications has to do with the renegotiation and safeguard provisions in the WTO Agreements. Article XXVIII of the GATT and Article XXI of the GATS allow WTO Members to alter their market access commitments and allow affected WTO Members to respond by withdrawing “substantially equivalent” concessions.223 The Safeguards Agreement allows WTO Members to temporarily raise tariffs on goods to prevent serious injury to a domestic industry. Here again, affected WTO Members can, in specific circumstances, respond by withdrawing “substantially equivalent” concessions.224 These mechanisms have never been understood as a means of forcing a WTO Member to terminate its safeguard action or desist from renegotiating the level of its concessions. Instead, they are understood as means of achieving some sort of “rebalancing.”225 However, the theoretical problems discussed above regarding the WTO remedial regime may also apply to these mechanisms. For instance, it appears difficult to understand the mechanisms as a means of ensuring compensation and it may be difficult to view them as a means of rebalancing the bargain, given that the baseline sought to be restored is unlikely to be clear. These matters may warrant further research.

CONCLUSION

WTO Members who resort to dispute settlement proceedings know that they will not be able to obtain compensation for the violations about which

220. See id. ¶ 49 (statement by the United States).
221. See, e.g., Lawrence, supra note 157, at 58.
222. Canada-Aircraft (Article 22.6), supra note 39, ¶¶ 3.91, 3.93.
223. GATS, supra note 25, art. XXI-(b); GATT 1947, supra note 35, art. XXVIII-3.
224. Agreement on Safeguards, art. 8, Apr. 15, 1994, reprinted in Legal Texts, supra note 5, at 275, 279.
225. See Jackson, supra note 157, at 121 (referring to the safeguards provisions in Article XIX of the GATT and the renegotiation provisions in Article XXVIII of the GATT as “clearly what was intended for the rebalancing process”).
they complain. They are also unlikely to be motivated by the prospect of inflicting retribution on the violating Member. Instead, their prime motivation will most likely be to force the violating Member to alter its conduct and comply with its treaty obligations. It may therefore appear to be somewhat ironic that the WTO remedial system was not designed to deliver a corresponding remedy. This Article has traced the divided interests during the Uruguay Round that led to this result.

The arbitral panels charged with the task of applying this system have resorted to two broad approaches to assess the permissible level of retaliation — the equality-of-harm approach and the amount-of-subsidy approach. Neither approach fixes the intensity of retaliation at a level that necessarily suffices to bring about the compliance that complainants seek. Indeed, the permissible level of retaliation is not set by reference to any instrumental rationale. Instead of means-ends assessments, the two approaches adopted by arbitrators are essentially comparative. This Article has argued that the amount-of-subsidy approach cannot be rationally justified, either legally or normatively. It has also argued that the equality-of-harm approach can only be justified if one accepts that retribution is a proper aim of the WTO remedial system — a position that is extremely difficult to defend. It follows then that the levels fixed in arbitral awards to date are, to a marked extent, arbitrary.

Nonetheless, despite these theoretical shortcomings, complainants continue to utilize the WTO dispute settlement system and its remedies. After all, the intensity of retaliation is only one of several factors that influence a WTO Member’s decision on whether to comply. The costs imposed by irrational “equivalent” retaliation alone may or may not be sufficient to induce compliance, but they can tip the balance of political forces faced by a WTO Member. Moreover, the criteria a third-party uses to determine equivalence may well be of secondary importance — the fact that a third-party, rather than the parties themselves, decides these issues is perhaps far more important in ensuring that costly spirals of counter-retaliation are avoided and that the WTO system continues to function.