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Why compensation cannot replace trade retaliation in the WTO Dispute Settlement Understanding

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Abstract: Throughout the course of the DSU Review, Members and commentators alike have proposed numerous modifications to the WTO DSU covering a wide range of areas. One area which has received quite a bit of attention is that of retaliatory measures in the implementation phase of the dispute settlement process. This article does not attempt to recap the debate over the appropriateness of trade retaliation or even to discuss all potential amendments targeting this issue. It does, however, identify some of the key criticisms of trade retaliation before analyzing and evaluating the worthiness of trade and/or financial compensation as an alternative. The article finds that neither trade nor financial compensation will do much to resolve the prominent criticisms of trade retaliation while also finding both options would add several uncertainties to the system and, far from increasing compliance with the rulings and recommendations of the DSB, could in fact increase the instances of non-compliance.

I. Introduction

More than a decade after its inception, the DSU remains one of the crown jewels of the Uruguay Round which created the World Trade Organization (WTO). The WTO Dispute Settlement Understanding (DSU) has served an integral role in increasing the legitimacy of the multilateral trading system by providing a rules-based, binding, and impartial forum for WTO Members to resolve their disputes.[1]

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1 While dispute settlement in the GATT increasingly became legalistic and formalized, an element of diplomacy remained. For instance, the adoption of panel reports could be blocked by either party to a dispute. See generally, Croome (1995), Barfield (2001).

Members have generally respected the process and the decisions of panels and the Appellate Body have, by and large, been carefully considered and reasoned.[2] Of course, every dispute settlement system has its flaws and the DSU remains an imperfect system. Throughout the course of the Review of the Dispute Settlement Understanding (DSU Review), several issues have been raised as potential impediments to the efficient and effective operation of the DSU, namely: the costs and technical capabilities associated with initiating and litigating a dispute,[3] transparency related issues,[4] security and predictability of the system,[5] the lack of meaningful special and differential treatment measures to developing countries,[6] and the implementation phase of the dispute settlement process.[7] Fortunately, Member proposals and a substantial majority of commentator proposals remain focused on improving the current system, and there are no credible calls for the DSU to be dismantled or even substantially rewritten.[8]

This article focuses on one area of the DSU – the implementation phase – and more specifically, the appropriateness of trade retaliation. Over the years, countless articles have been written on ways to amend the retaliation phase of dispute settlement so as to lessen the perceived problem of delayed compliance.[9] Most of the articles focus on increased and more targeted compensation, suspension of

2 Former Director-General Supachai Panitchpakdi noted: '[The dispute settlement system] has largely been successful because WTO member governments have been prepared to implement Panel and Appellate Body rulings and to bring their laws and regulations into conformity with WTO rules should a Panel decision go against them' (Panitchpakdi, 2005).

3 See, e.g., TN/DS/W/42, TN/DS/W/15, TN/DS/W/17, TN/DS/W/18, and TN/DS/W/19. See also Bown (2005: 287), Pauwelyn (2000: 338), Busch and Reinhardt (2003: 719), Hoekman and Mavroidis (2000: 527).

4 Issues under this heading include amicus submissions and public hearings. See Mercurio (2004: 795).

5 Issues under this heading include proposals for permanent panelists, granting the Appellate Body remand authority, amended timelines, interim reports, several housekeeping proposals (such as improved conditions for Members seeking to be joined in consultations), enhanced third party rights, and strengthened notification requirements for negotiated solutions. See Mercurio (2004: 810–820).

6 See, in particular, TN/DS/W/42, TN/DS/W/15, TN/DS/W/17, TN/DS/W/18, and TN/DS/W/19. The DSU contains several provisions which call for special treatment for developing-country Members, but these are largely minor or hortatory in nature. See DSU Articles 3.12, 4.10, 8.10, 12.10, 12.11, 21.2, 21.7, 21.8, 24, and 27.2.

7 See Mercurio (2004: 825–839).

8 See, e.g., Plasai (2007). Of course, it is important to recognize at the outset that a number of concerns cannot be addressed by any proposed amendments. For instance, numerous developing countries have stated they are hesitant to initiate a dispute against a larger developed country Member for fear of negative political consequences. As many developing countries rely on aid and trade preferences from the richer countries, these concerns seem entirely reasonable; unfortunately, no amendment to the DSU can placate these concerns. As long as the system allows for complainants and respondents the threat of reprisal (and vindictive) action on the part of the respondent country will exist.

9 As of January 2008, 369 formal complaints have been filed in the WTO DSB comprising 273 matters resulting in 246 panel requests. These claims have resulted in 219 panel and Appellate Body adopted reports and 39 arbitral awards. Of these, only eight disputes have reached the Article 22.6 arbitration stage (resulting in 17 arbitral decisions). Statistics have been compiled using the www.worldtradelaw.net database.

rights/concessions, and increased retaliatory rights.[10] Many of the articles are thought-provoking and contain several useful suggestions. What is astonishing, however, is the substantial majority of the existing literature fails to acknowledge that the DSU, as written and interpreted, does not have clear aims and objectives (beyond simply resolving the dispute). The question of whether the retaliatory phase of the process is designed to rebalance concessions, coerce compliance, or punish recalcitrant respondents is simply not clearly addressed in the text of the DSU. While every interested commentator holds an opinion on the subject, such diverse views leads to a situation where the DSU is being judged by various competing, and sometimes contradictory, standards. It is perhaps even more troublesome when Members and commentators recommend certain amendments to the system without apparent regard for the effect of the amendment on other important aspects of the system.

This article does not attempt to recap the debate over the appropriateness of trade retaliation or even to discuss all potential amendments targeting this issue.[11] Instead, this article will analyze one particular aspect of the implementation phase which some commentators feel could play a bigger role in improving the compliance rate of recalcitrant Members – compensation. Section 2 briefly summarizes some of the common criticisms directed towards the current system of relying on trade retaliation to combat non-compliance. Section 3 follows by first introducing the concept, textual support, and use of compensation in the DSU at present, before proceeding to evaluate proposals aimed at increasing the use of both mandatory trade compensation and financial compensation in the implantation phase of the DSU.[12] Section 4 concludes that neither trade nor financial compensation will do much to resolve or correct the prominent criticisms of trade retaliation. In addition, both options would add several uncertainties to the system and, far from increasing compliance with the rulings and recommendations of the DSB, could in fact increase the instances of non-compliance. Compensation cannot therefore replace trade retaliation in the WTO DSU.

2. Common criticisms of trade retaliation

Since the advent of the DSU, there have been countless criticisms leveled against the implementation phase of the system. This section does not attempt to provide a thorough review of these criticisms, but instead will merely provide a brief

10 For detailed discussion on several proposals, see Mercurio (2009).

11 Member proposals can be found at http://www.law.georgetown.edu/iiel/research/projects/dsureview/synopsis.html. See also, Trachtman (2007: 127, fn 3) (citing at least 20 such commentator proposals).

12 This article will discuss compensation only as it relates to violation disputes. Thus, the procedures used in and consequences of 'non-violation' disputes will not be discussed.

overview of some of the more credible criticisms directed towards trade retaliation.

One of the more frequently heard criticisms of the current system of trade retaliation is that the imposition of retaliatory trade measures is economically inefficient for both the country imposing the retaliatory measures as well as for the target nation. The reason for the inefficiency stems from the fact that trade retaliation causes consumers (or businesses in the case of inputs) in the nation imposing the trade retaliation – that is, the importing country – to pay more for the imported goods (whether they be goods subject to the additional tariff rate from the non-compliant country or higher priced substitute products from less efficient producers).[13] Moreover, it is also significant that any considerable rise in tariff levels to a segment of imports has the potential to increase political considerations, such as increased lobbying efforts and rent-seeking from a multitude of domestic interests.

The problem of increased tariff levels as retaliation is particularly troublesome for smaller developing country Members, who more often than not depend upon one (larger developed) country for a large percentage of their total trade and rely upon imports for both consumer goods and necessary imports. In such a circumstance, implementing traditional retaliatory measures is counterproductive as there may not be an alternative supplier or the additional costs associated with a new supplier may make the goods inaccessible to the local market.[14] Additionally, as both trading partners understand that retaliation will likely harm the smaller partner more than it harms the larger partner, the threat of retaliatory measures often lacks credibility.[15] Without credibility, a threat of retaliation loses any potential coercive effect. Without a credible threat of retaliation to perhaps persuade a non-complying Member to withdraw its offending practices, most developing-country Members are limited in their capacity to retaliate.[16] India summed up this position in a proposal to the DSU Review:

> [T]he tremendous imbalance in the trade relations between developed and developing countries places severe constraints on the ability of developing countries

13 Charnovitz considers the fact that the arbitrator in the first Article 22.6 arbitration in *EC–Bananas* encouraged the two parties to negotiate, 'as the suspension of concessions is not in the economic interest of either of them', 'a sober assessment of what some analysts consider the most impressive feature of the DSU'. See Charnovitz (undated: 11) (citing WT/DS27/ARB, para. 2.13). Robert Hudec, however, was of the view that even though trade retaliation may hurt the country imposing the measure, the very act of imposing retaliatory measures sends out a powerful message to recalcitrant governments. Hudec further argued that by selecting the appropriate sensitive industries of the non-compliant government a complaining Contracting Party could compel compliance. See Hudec (1990).

14 See, e.g., Bown and Hoekman (2005: 861).

15 In many cases, the threat of retaliation may be enough to coerce a Member to withdraw its inconsistent measures without the implementation of retaliatory measures. Although, as a threat has to be credible to be effective, a Member must be prepared to carry out its threat of retaliation. For example, the ECs threat of retaliatory tariffs is purported to have influenced the Bush administrations repeal of the US Steel safeguards in 2003. See Nzelibe (2005: 224–228), Breuss (2005: 14).

16 See Steinberg (2002: 347).

> to exercise their rights under Article 22. The economic cost of withdrawal of concessions in the goods sector would have a greater adverse impact on the complaining developing-country Member than on the defaulting developed-country Member and would only further deepen the imbalance in their trade relations already seriously injured by the nullification and impairment of benefits.[17]

Even if a small-sized Member does decide to implement retaliatory measures (regardless of whether it is economically inefficient), it will likely lack the economic strength to exercise any real pressure on the Member concerned. This problem is at its most severe when the complaining Member relies upon the responding Member for a substantial amount of its trade. In such a circumstance, the non-compliant measure not only might affect a large percentage of the complaining Member's exports, and thus a large number of industries and/or workers, but it is also very difficult for the complaining Member to select industries or goods to subject to retaliatory measures without harming its own industries (particularly necessary inputs) or consumers. This is true not only for smaller developing countries but is equally applicable to smaller developed country Members. In fact, the economic strength argument could even extend to trading relationships between larger, developed countries.[18]

Another criticism often made against trade retaliation is that it is incongruous to the aims and objectives of the WTO. More specifically, as an institution based on the principle that the expansion of trade through reduced barriers leads to growth, development, and poverty reduction, the sanctioning of the imposition of higher trade barriers in an attempt to remedy another Members transgression (or perhaps to punish the offending Member) seems contradictory as the higher trade barriers resulting from the retaliatory measures will inevitably lead to a reduction of trade between the parties concerned.[19] In this regard, reduced trade resulting from retaliatory measures could have the effect of contracting trade, limiting or reducing growth, and stymieing poverty reduction.[20]

An additional criticism is that retaliatory measures do not benefit the aggrieved party but instead damage the innocent.[21] Stated more clearly, the imposition of retaliatory measures does not necessarily offer any relief to the aggrieved industry and, in most instances, the suspended concessions (or retaliation targets) bear no relationship to the industry subject to the dispute. To illustrate, the banana

17 TN/DS/W/19 (2002), at 1.

18 See, e.g., *US–Foreign Sales Corporation* (DS 108), where the EU has not exercised its DSB sanctioned right to impose retaliatory measures to the amount of US$4 billion against US imports, at least in part because of the economic and competitive effect the increased tariff barriers will have on European industries.

19 See, e.g., Anderson (2002: 129) (stating, 'the idea of legitimizing retaliation is contrary to the objective of reducing impediments to trade').

20 The EC wrote in a submission to the DSU Review: 'the authorization to suspend concessions runs against a basic principle of the WTO, i.e., predictability of the trading system'. TN/DS/W/1, at 5.

21 See, e.g., Anderson (2002: 133).

industry in the US would not have been positively affected, or made whole, as a result of US retaliatory measures against European sweet biscuits and cheese resulting from European non-compliance in *EC–Bananas*. Instead, Europe continued to discriminate in favour of certain banana growing countries to the detriment of the US industry (or US owned industry located elsewhere), while US biscuit manufacturers and cheese makers benefited from the protection and those specific industries in Europe suffered. For most developing countries, the effect of the system could be even more detrimental as the non-compliant measures could harm one of the only competitive industries in the nation while the retaliatory measures could be structured to provide little to no benefit to the aggrieved industry and at the same time only nominally assisting other national industries due to their lack of international competitiveness.

Finally, many commentators assert that prospective remedies discourage immediate or timely compliance. Under the current system, Members are not punished for past discretions, but are only subject to the suspension of concessions (in the equivalent amount of harm caused) for continuing to apply the measure found to violate a covered agreement. Thus, remedies in the WTO are (almost) without exception only prospective in nature.[22] Such a system emphasizes that the intent, aim, and objective of the dispute settlement mechanism is to resolve the dispute, rather than 'punish' a Member for failing to abide by its WTO obligations;[23]

22 Although this was not entirely clearly spelled out in the GATT, the fact that an 'understanding' existed among Contracting Parties cannot be doubted. See Hudec (1993). The practice has been followed in the WTO. See *EC–Bananas*, WT/DS27/RW/ECU, at para. 6.105. See contra, the controversial decision in *Australia–Leather*, which held that Article 19.1 of the DSU does not limit remedies under Article 4.7 of the SCM Agreement to prospective action only. *Australia–Leather*, WT/DS126/RW, at para. 6.27ff. This decision was criticized by many Members, including the complainant in the dispute, the US. It should be noted, however, that the US nevertheless pressed for and received a repayment schedule mandating the recipient of Australian government subsidies to repay the grants and preferential loans. See WT/DSB/M/75. It should also be noted that throughout the GATT period panels did occasionally recommend that antidumping duties and countervailing duties found to violate the GATT be reimbursed. See, e.g., *United States–Measures Affecting Imports of Softwood Lumber from Canada*, 41 B.I.S.D. 413–15 (1993); *New Zealand–Imports of Electrical Transformers from Finland*, 32 B.I.S.D. 55 (1985). Most of these reports were not adopted. See Report of the Panel, *United States–Imposition of Anti-dumping Duties on Imports of Seamless Stainless Steel Hollow products from Sweden*, ADP/47, circulated 20 August 1990, unadopted; Report of the Panel, *United States–Anti-Dumping Duties on Gray Portland Cement and Cement Clinker from Mexico*, ADP/82, circulated 7 September 1992, unadopted. All other WTO dispute panels have rejected requests for restitution/repayment of duties, while not entirely dismissing the possibility of such repayments. See, e.g., *Guatemala–Cement I*, WT/DS60/R, at paras. 8.1–8.6; *Guatemala–Cement II*, WT/DS156/R, at para. 9.6; *US–Hot Rolled Steel*, WT/DS184/R, at paras. 8.9–8.14; and *EC–Tube or Pipefittings*, WT/DS219/R, at paras. 8.9–8.11.

23 The concept of 'punishment' does not generally appear in public international law. See, e.g., 'State Responsibility: Titles and Texts of the Draft Articles on Responsibility of States for Internationally Wrongful Acts Adopted by the Drafting Committee on Second Reading', U.N. GAOR Int'l L. Comm'n, 53d Sess., U.N. Doc. A/CN.4/L.602/Rev.1 (2001). For the ILC commentaries, see generally 'Text of the Draft Articles with Commentaries Thereto, in Report of the International Law Commission, Fifty-Third Session', U.N. GAOR, 56th Sess., Supp. No. 10, U.N. Doc. A/56/10 (2001). For more discussion on punishment, see generally, Duff and Garland (1995). For an analysis of punishment from an economics perspective, see Posner (1980: 71).

however, such a system also fails to discipline Members who fail to uphold their obligations and then delay compliance.[24]

With some or all of these criticisms in mind, Members and commentators have tabled a plethora of proposals aimed at amending the DSU. While there can be little doubt that all such proposals are genuine attempts to improve the workings of the system, the value of the proposal depends upon the standard by which we are to judge both the current DSU as well as the proposals. Is the aim of the system to effectively rebalance concessions until compliance is achieved, is it to coerce compliance as quickly as possible, is it to punish recalcitrant Members, or are there other important aims and objectives that should come into play?

The DSU does not explicitly provide the aim or objective of the suspension of concessions.[25] The DSU does, however, provide some guidance as to the aims and objectives of the dispute settlement mechanism. For instance, Articles 3.7 and 3.3 of the DSU, read together, state that the DSU should be used to 'secure a positive solution to a dispute' between Members as promptly as practicable. Article 3.7 also provides that, when disputing Members cannot reach a mutually acceptable solution, the first objective of the DSU is the removal of any measures that are found to be inconsistent measures with the covered agreements. The DSU also makes clear that compensation and the suspensions of concessions are 'temporary measures', and that neither is preferred 'to full implementation of a recommendation to bring a measure into conformity with the covered agreements'.[26] The DSU additionally states that 'prompt compliance with the recommendations and rulings of the DSB is essential'[27] and furthermore directs the DSB to 'continue to keep under surveillance the implementation of adopted recommendations or rulings, including those cases where compensation has been provided or concessions or other obligations have been suspended but the recommendations to bring a measure into conformity with the covered agreements have not been implemented'.[28] Most commentators therefore believe that Members are under an obligation to comply with the rulings and recommendations of adopted panel and Appellate Body reports.[29]

24 Regardless of the system, there will always be situations where a Member will refuse to comply with a panel/Appellate Body report. This has, of course, already happened in a few disputes and will no doubt happen again. The reality is that for political reasons, economic reasons, or no reason whatsoever, a 100% success rate cannot be achieved regardless of the retaliatory measures at the disposal of the complainants.

25 The Arbitrators in *US–Offset Act* called attention to the problems caused by a lack of stated purposes: 'it is not completely clear what role is to be played by the suspension of obligations in the DSU and a large part of the conceptual debate that took place in these proceedings could have been avoided if a clear "object and purpose" were identified'. *US–Offset Act*, WT/DS217/ARB/BRA, at para. 6.5.

26 DSU Article 22.1.

27 DSU Article 21.1.

28 DSU Article 22.8.

29 However, as Judith Hippler Bello stated in a provocative think-piece: '[T]he WTO has no jailhouse, no bail bondsmen, no blue helmets, no truncheons or tear gas' (Bello, 1996: 417). This piece sparked a series of retorts and rebuttals regarding the obligation to implement an adopted report, see Jackson (1997), Schwartz and Sykes (2002), Jackson (2004). See also, Hudec (2000), and Trachtman, who states:

With that in mind, some commentators argue that the objective of the ability to suspend concessions is to rebalance the tariff concessions and other obligations which Members have agreed to. Thus, if one Member is violating the rules and thereby nullifying or impairing benefits, the other Member can violate the rules as well in order to restore the original balance.[30] The rebalancing viewpoint thus allows the complaining Member to take action to remedy an injustice by removing concessions granted through negotiations to the non-compliant Member, thereby restoring the trade relationship balance.[31]

On the other hand, some commentators believe the purpose of the ability to suspend concessions is to induce the Member complained against to comply with its obligations under the covered agreements.[32] As evidence, advocates point to the fact that retaliatory measures often target powerful interest groups from the territory of the Member complained against in order to encourage them to lobby for compliance. For instance, in *EC–Bananas*, one of the complaining parties, the US, suspended the concessions on certain meat products, pecorino cheese, sweet biscuits, candles, bed linen, electrothermic coffee and tea makers, and handbags, even though the original matter concerned restrictions on the importation and distribution of bananas.[33] Under this view, the suspension of concessions or other

'Even assuming [WTO law is mandatory], a legal realist, and a legal economist, would ask not what the formal law specifies, but what it does in response to breach. Ubi ius ibi remedium. Here, the law in action clearly does not operate as a property rule. States that violate WTO law are neither subject to enforceable specific performance-type remedies, nor do they experience any penalty for their violation beyond the potential authorization of withdrawal of equivalent concessions (outside of the export subsidies context). So, as a matter of fact and practice, if not as a matter of legal doctrine, the WTO legal system is best characterized as employing a liability rule, rather than a property rule. As suggested above, it is a rather modest liability rule' (Trachtman, 2007: 146).

30 For the rebalancing view, see Palmeter (2001: 291), Palmeter and Alexandrov (2002: 647).

31 Several commentators, however, believe the current system does not provide a consistent model for calculating 'equivalence'. See, e.g., Spamann (2006: 31), Anderson (2002). Moreover, Anderson points out that 'ensuring equivalence between the damage and the retaliation in terms of the gross value of trade between the respondent and the complainant does not mean that retaliation has the same economic welfare effect on the respondent as the initial damage is having on the complainant. The bilateral trade value necessarily exaggerates the negative effect on both parties' economic welfare, but it does not do so equally (except by coincidence)' (ibid., at 7). For a discussion on 'equivalence' in the calculation of damages as well as to the inconsistency and flaws of 'rebalancing', see Trachtman (2007: 156–162). It is also worth noting that the Arbitrators in *EC–Bananas* found it difficult to establish the equivalent suspension of TRIPS concessions. See *EC–Bananas*, WT/DS27/ARB/ECU, at para. 159.

32 See, e.g., Charnovitz (undated: 21), Bronckers and van den Broek (2005: 112). Of course, if this is the case, the question must be asked why the system does not provide for punitive levels of retaliatory measures. That being said, some believe the system has evolved, post-Uruguay Round negotiations, in such a manner so that compliance is now the focus of retaliatory measures. For discussion on whether 'equivalent' retaliatory measures can induce compliance, see Pauwelyn (2004) (stating equivalent retaliation is 'a simple tit-for-tat or zero-sum game where, in principle, no more pressure is put on the violating country (by the trade sanction) than on the victim (by the original violation)'). See contra, Lawrence (2003).

33 See *EC–Certain EC Products*, WT/DS165/R, at 2.24.

obligations is designed to be a temporary measure pending full implementation of the DSB report. Thus, the ultimate goal is to have the offending measure brought into compliance, and suspension is designed to achieve this outcome. Under this view, equivalence between damage and retaliation is likely not to be seen as particularly relevant. Instead, the retaliatory measure should simply be sufficiently costly to the Member concerned so that it chooses to absorb the (lesser) cost of compliance instead of the (higher) cost of the retaliation.

The 'induce compliance' viewpoint has until recently been supported by the reports of several Article 22.6 arbitrations. For instance, the arbitrators in *EC–Bananas I* stated:

> [T]the authorization to suspend concessions or other obligations is a temporary measure pending full implementation by the Member concerned. … this *temporary* nature indicates that it is the purpose of countermeasures to *induce compliance*. But this purpose does not mean that the DSB should grant authorization to suspend concessions beyond what is *equivalent* to the level of nullification or impairment. In our view, there is nothing in Article 22.1 of the DSU, let alone in paragraphs 4 and 7 of Article 22, that could be read as a justification for counter-measures of a *punitive* nature.[34]

The arbitrators in *EC–Hormones* agreed with and quoted the above paragraph,[35] while the arbitrators in *EC–Bananas II* likewise found that in order to have 'effective' retaliatory measures, 'the party seeking suspension to ensure that the impact of that suspension is strong and has the desired result, namely to induce compliance by the Member which fails to bring WTO-inconsistent measures into compliance with DSB rulings within a reasonable period of time'.[36] However, the arbitrators in *US–Offset Act* recently cast doubt upon the theory when they stated:

> The concept of 'inducing compliance' … is not expressly referred to in any part of the DSU and we are not persuaded that the object and purpose of the DSU – or of the WTO Agreement – would support an approach where the purpose of suspension of concessions or other obligations pursuant to Article 22 would be exclusively to induce compliance. Having regard to Articles 3.7 and 22.1 and 22.2 of the DSU as part of the context of Articles 22.4 and 22.7, we cannot exclude that inducing compliance is part of the objectives behind suspension of concessions or other obligations, but at most it can be only one of a number of purposes in authorizing the suspension of concessions or other obligations. By relying on 'inducing compliance' as the benchmark for the selection of the most appropriate approach we also run the risk of losing sight of the requirement of

34 WT/DS27/ARB, at para. 6.3.

35 WT/DS26/ARB, at para. 40.

36 WT/DS27/ARB/ECU, at para. 72. See also, *Brazil–Aircraft*, WT/DS46/ARB, at para. 3.44; *US–Foreign Sales Corporation*, WT/DS108/ARB, at para. 5.52; *Canada–Aircraft*, WT/DS222/ARB, at para. 3.48.

> Article 22.4 that the level of suspension be *equivalent* to the level of nullification or impairment.[37]

Other commentators, however, have slightly differing views, such as that principles of contract law and the efficient allocation of resources are the driving force behind retaliation implementation.[38]

The importance of this debate cannot be overstated, as the present system cannot truly be judged, or any modifications be recommended, until clear aims and objectives of the DSU are set. It seems that this point is central to any discussion of reform, yet it has been virtually ignored by government officials, practitioners, and academics alike. Commentators have simply skipped over the issue and continued, without clear direction from the DSU, into why their favoured amendment would resolve one 'problem' or another. As a result, the DSU is being judged by competing, and sometimes contradictory, standards. Throughout this article, and indeed in any discussion regarding the success (or failure) of the DSU and any potential amendments, the important yet often ignored point regarding the lack of clarity of the aims and objectives of the DSU must be taken into consideration.

3. Compensation

As written, the DSU allows for 'voluntary compensation' as an alternative to retaliatory measures.[39] Article 22.1, however, places limits on the use of compensation:

> Compensation and the suspension of concessions or other obligations are temporary measures available in the event that the recommendations and rulings are not implemented within a reasonable period of time. However, neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity with the covered agreements. Compensation is voluntary and, if granted, shall be consistent with the covered agreements.

Trade compensation has only been utilized once since the formation of the WTO.[40] Even though trade compensation is an efficient form of rebalancing concessions in that it increases liberalization and economic welfare in the complaining country, for the respondent country, and even in third countries (due to the fact that trade

37 *US–Offset Act*, WT/DS217/ARB/BRA, at para 3.74.

38 See, e.g., Schwartz and Sykes (2002).

39 See, e.g., Report of the Panel, *EEC–Restrictions on the Imports of Dessert Apples*, BISD 36S/93 (L/6491), adopted 22 June 1989.

40 See *Japan–Taxes on Alcoholic Beverages* (WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R), where the Japan agreed to apply reduced tariff rates on specific items pending full implementation of the Appellate Body report.

compensation must be offered in accordance with the MFN principle),[41] it is not the preferred retaliatory method.

In contrast, the preferred retaliatory method – trade retaliation – almost always involves the complainant Member raising its import barriers on certain products exported by the respondent Member and thereby harming the economic welfare in *both* countries (and likely globally). While there may be numerous reasons for the preference toward retaliatory trade measures, two of the more persuasive reasons are as follows. First, a complaining Member does not prefer trade compensation as its exporters are not necessarily the exporters that benefit – exporters in third countries also benefit from responding Members' tariff reductions and, if they are more efficient exporters, they will take the majority of the benefit. The other reason that Members prefer trade retaliation over compensation is that while in the former the complaining Member retains control over both the level of the suspension of concessions as well as the targeted products, the latter hands over control to the responding Member, who can unilaterally end the trade compensation when it believes it has complied with the rulings of the DSB (or otherwise decides it no longer wants to offer trade compensation).[42] Thus, while the current system allows for compensation as an alternative to retaliatory measures, it has not proven to be an attractive option or viable alternative to Members. For this reason, there have been numerous proposals for the extension of compensation. The remaining part of this section will evaluate two such proposals, mandatory trade compensation and financial compensation.

Mandatory trade compensation

In contrast to the current voluntary regime, several developing and LDC countries have proposed the introduction of mandatory compensation as part of the DSU Review.[43] One immediate benefit mandatory trade compensation has over the suspension of concessions is that it would create, rather than contract trade. Trade compensation therefore neither aggravates injury to the complaining Member nor does it injure innocent industries in that state.[44] Under most of these proposals, a complaining Member who has prevailed in the dispute but is faced with non-compliance could nominate the sectors in which the offending Member should offer compensation. In the alternative, the DSB (through panel and Appellate Body reports) would be the party that indicates the sector in which the Member concerned should offer compensation. Another proposal suggests that Members nominate, or pre-establish, the sectors and forms of trade compensation to be triggered if and when the Member fails to comply with a ruling of the DSB (this has

41 See Anderson (2002: 5). This theory holds even though some third countries that import those or like products may lose from a terms of trade deterioration due to the fact that the world as a whole will be better off economically. See ibid.

42 See ibid., at 5–6.

43 See, e.g., TN/DS/W/15. Mandatory compensation is also discussed in Pauwelyn (2000: 344–346).

44 See Davies (2006: 31).

been referred to as 'contingent liberalization commitments').[45] In all proposals, compensation would continue until the Member concerned modifies its inconsistent measures and is deemed to be in compliance with its WTO obligations.

There are several hurdles to the introduction of mandatory compensation, with the most significant being the enforceability of mandatory compensation. The WTO is a member driven organization, with tariff schedules and all other commitments contained in the covered agreements being the product of countless hours of complicated negotiations. In most if not all countries, these decisions are taken after much consultation with business and other interests and made only after a careful balancing of all competing interests. Allowing another Member or the panel/Appellate Body to dictate the sector in which compensation must be offered raises a number of practical concerns, and does not appear to be politically viable in most Member countries (whether they be democratically elected or an authoritarian dictatorship). More generally, trade compensation, by its very nature, harms an innocent industry in the non-compliant Member. The decision to expose innocent industries to more foreign competition (by a reduction in tariff rates) is an important one that should be taken only after careful analysis of the trade policy aims, objectives, and an analysis of the economic positions of all affected innocent industries at issue. Placing such a decision in the hands of the complaining party or a panel/Appellate body may be seen as a too intrusive step which infringes upon the sovereignty and potentially the economic welfare of a nation. The pre-establishment of contingent liberalization commitments also raises a number of political issues, not least of which is the lobbying, horse-trading, and infighting that the process will inevitably foster.

Moreover, as any form of compensation is, by its nature, an act that must be performed by a non-complying Member, it will always essentially be a voluntary act. Neither a harmed Member, nor the WTO, can force another Member to provide compensation. The consequences of this being that 'mandatory' compensation depends upon the good faith compliance of the Member concerned. But of course, the fact that mandatory compensation is sought is solely due to the fact that the offending Member failed to abide by the rulings and recommendations of the DSB and remained in violation of its WTO obligations. The question must therefore be asked whether a non-compliant Member would feel any obligation to comply with this requirement.

Thus, regardless of whether there is an obligation to comply with the rulings and recommendations of the DSB, without an effective enforcement mechanism, all methods of compensation remain voluntary in nature in that they are dependent upon compliance by the non-compliant Member. Furthermore, in the longer term, as an international tribunal the legitimacy of the DSU depends upon the value Members place upon it. To date, both the usage of the system and a high compliance rate demonstrate that Members place a high value on the institution. DSB

45 See Lawrence (2003: chapter 5).

rulings regarding mandatory compensation, however, would likely face increased enforceability issues and decrease the overall rate of Member compliance. As such, mandatory compensation orders have the potential to threaten the long-term viability of an effective dispute settlement mechanism.

Moreover, requiring the DSB to recommend compensatory sectors would fundamentally alter the nature of WTO adjudicative tribunals. To date, panel and Appellate Body reports have been limited to making rulings as to the consistency of the measures at issue with the WTO agreements and, if applicable, making recommendations which 'may suggest ways [to] … implement the recommendations'.[46] In practice, this means that it is generally the responsibility of the Member concerned to choose whatever course of action will bring its measures into conformity with its WTO obligations. Under a system of mandatory compensation, however, both the panel and the Appellate Body report would need to prescribe remedies (which would become binding on the parties to the dispute after the reports were adopted by the DSB). Again, this intrusion into the trade policy determinations of a Member government may be an unwelcome step too far.

Another significant detraction to having panels or the Appellate Body recommending or selecting compensatory sectors is that such a system fails to remedy the perceived problem of retaliatory measures not aiding the aggrieved party while at the same time harming innocent parties. For that matter, even when the complaining Member nominates the sector subject to mandatory compensation there is no guarantee that the aggrieved industry will be assisted. As mentioned earlier, retaliatory measures and trade compensation almost always target a different sector to the subject of the dispute.

While mandatory trade compensation may be economically efficient and in line with the aims and objectives of the multilateral trading regime, it does little to remedy the other perceived problems of trade retaliation. There is nothing to suggest that mandatory trade compensation will assist the aggrieved industry or reduce the harm retaliatory measures cause to innocent parties any more than trade retaliation that does not allow either the complaining party or the panel/Appellate Body to recommend or prescribe which sectors should be offered compensation. Providing such a level of policy control to either another Member or to a panel/Appellate Body would be an unwelcome, undesirable, intrusive step into domestic trade policy. There is also nothing to suggest that mandatory trade compensation will encourage a greater level of compliance than trade retaliation. Remembering that compensation is by its very nature necessarily a voluntary act, the issuance of mandatory compensation orders would perhaps actually result in a decrease in the DSU's overall compliance rate. Therefore, the case for instituting mandatory trade compensation is unpersuasive as it fails to significantly improve upon trade retaliation and could potentially have several negative consequences.

46 DSU Article 19.1.

Financial compensation

As detailed above, the traditional form of compensation is 'trade compensation' whereby the non-compliant Member reduces tariff barriers equivalent to the amount of harm suffered through its measures. Some commentators, however, now view financial compensation as an alternative form of compensation which could more directly address the grievance and harm of complaining Members and/or increase both the speed and overall rate of compliance with panel/Appellate Body reports. Financial compensation, as the name suggests, entails the responding Member to provide a financial benefit (i.e. a direct payment) to either the complaining Member's government or to an industry, group or association within that Member's territory.

The concept of financial compensation is not a novel idea. In fact, despite having long been a part of public international law, the concept of financial compensation has often been raised and rejected throughout the history of the GATT/WTO. In fact, financial compensation was first raised and rejected as part of the original GATT 1947 negotiations.[47] The concept was again raised in 1964 when Brazil and Uruguay formally suggested its consideration.[48] The idea resurfaced and again failed to gain the support of Members during the course of the Uruguay Round.[49] Thus, the legality of financial compensation under the current DSU remains questionable as there is nothing in the text of the DSU or any other WTO agreement which provides a clear basis for its usage, and multiple attempts to include such a legal basis have failed. Despite this, financial compensation was used to resolve the *US–Copyright* dispute. In *US–Copyright*, a panel found that US laws exempting certain small businesses from paying music copyright licence fees contravened Article 9.1 of the TRIPS Agreement.[50] The case, initiated by the EC at the request of the Irish Music Rights Organisation (IMRO), did not involve a substantial amount of monetary damage to the IMRO or any other European collecting society or artist but the challenged measure did form an integral part of the overall US copyright laws. Thus, the dispute was ripe for a mutually agreed solution. Such a solution was reached when the US agreed to financially compensate the EC in exchange for allowing the continuation of the infringing practices. Both parties agreed the value of financial compensation would be based upon the determination of an arbitrator (under Article 25 of the DSU). The arbitrator determined the equivalent level of nullification and impairment to be $1.1 million

47 See Shadikhodjaev and Park (2007: 1252).

48 See GATT Document L/2195/Rev.1, Annex 4 (1964); COM.TD/F/W.1 (27 April 1965); COM.TD/F/W.4 (11 October 1965). See also, 'Report of the Ad Hoc Group on Legal Amendments to the General Agreement', COM.TD/F/4 (4 March 1966). See, generally, Hudec (2000).

49 See, e.g., 'Negotiating Group on Dispute Settlement: Communication from Nicaragua', MTN.GNG/NG13/W/15 (6 November 1987); MTN.GNG/NGl3/W/l9, at 6, para.3b; 'Negotiating Group on Dispute Settlement Differential and More Favourable Treatment of Developing Countries in the GATT Dispute Settlement System', MTN.GNG/NGl3/W/27 (30 June l988).

50 *US–Copyright*, WT/DS160/R.

per year.[51] Interestingly, the US did not provide financial compensation to the EC directly, but instead paid the money into a fund set up by the Groupment Europeen Des Societes D'Auteurs et Compositurs (GESAC).

Financial compensation as an alternative to traditional retaliatory measures has significant support among developing country Members and LDCs as well as from a handful of prominent scholars.[52] The most attractive feature of financial compensation is that, like trade compensation, it is not trade restrictive, and thus does not conflict with WTO principles. Moreover, financial compensation is also likely to have a compliance inducing effect. Faced with a large financial compensation claim (such as the $4 billion authorization in *US–FSC*), a Member may decide to expedite compliance in order to avoid financial compensation it may either not be able to afford or could not pay for political reasons (this compliance inducing effect would be even stronger if some form of retroactive compensation was also implemented). Moreover, financial compensation would likely be more attractive to developing countries and smaller developed country Members who may not be able to practically or effectively retaliate against the Member concerned. Finally, financial compensation imposes the burden – or costs – of compliance on the Member government, which seems 'fair' as it is the Member government and not industry (except in the case of dumping) who is failing to abide by its WTO obligations.[53]

There are numerous potential problems, however, with compensation as an alternative to retaliatory measures. First, whereas trade sanctions are a quasi form of self help, any form of financial compensation relies upon the willingness of the non-complying Member government. If that Member government refuses to financially compensate the complaining Member, there must be an additional enforcement mechanism which is not dependant upon the cooperation of the recalcitrant Member (likely trade retaliation).[54] Even proponents of financial compensation readily admit that financial compensation could not entirely replace trade compensation. For instance, Bronckers and van den state that:

> [F]inancial compensation (sh)ould be an additional choice for injured Members, not a replacement for trade compensation or retaliation. If worse comes to worst, and the violating Member does not live up to its obligation to pay monetary compensation, the aggrieved Member could still be given the option to go back to retaliation.[55]

51 *US–Copyright*, WT/DS160/ARB25/1. For more information and analysis of the dispute and compensation package, see Davies (2006).

52 See, e.g., WT/GC/W/162; TN/DS/W/17; TN/DS/W/33; Bronckers and van den Broek (2005: 109–126); Bronckers, (2001: 41); Pauwelyn (2000: 345–346). Other scholars have at times also supported financial compensation. See, e.g., Esserman and Howse (2003: 135).

53 Of course, in reality the industry, through its lobbying efforts, may have been partially responsible for the implementation of the offending activity.

54 See, e.g., Limao and Saggi (2006).

55 Bronckers and van den Broek (2005: 116).

Therefore and without a doubt, mandatory financial compensation could never replace trade compensation.[56] While some attempt to avoid this problem by recommending a system whereby each Member posts a bond (based on percentage of world trade, much like contribution fees) which remains in escrow and is used to pay the financial compensation (presumably if the Member refuses to pay the compensation),[57] this too appears to have limitations. For instance, what happens if the compensation is higher than the bond or if the amount in escrow is depleted? Eleso suggests adding the additional amount to the Member's contribution fees, but this recommendation is not without problems.[58] Of course, this is not to suggest that financial compensation could not form a part of other implementation procedures. In fact, recent US FTAs have increased the usage of financial compensation, such as by adopting a format whereby the non-compliant country can prevent the imposition of retaliatory trade measures by agreeing to pay the complaining government an annual 'monetary assessment' set at one-half of the level of trade suspension (or otherwise as set by agreement).[59] But again, the monetary assessment (financial compensation) is voluntary and cannot be demanded by the complaining party.

Another argument against compensation as an alternative to retaliatory measures is that it allows the continuation of the WTO inconsistent measure, and in doing so conflicts with Articles 3 and 22 of the DSU. To illustrate, the US and EC mutually agreed to resolve the *UC–Copyright* dispute with the US paying a set amount to GESAC year (which also raises the question of whether payments to a private entity are or should be legal). The agreement did not require the US to amend the act found to be a violation of US obligations under the relevant WTO agreement (the TRIPS Agreement). To the contrary, the relevant US legislation at issue remains unchanged, meaning the copyright infringements found to be violating WTO obligations continue to be permitted under US law. If the agreement between the US and EC is viewed as a permanent solution to the dispute, the requirement that mutually agreed solutions be consistent with covered agreements has not been met.[60] While Articles 3 and 22 could be amended to allow for an efficient breach, such a systemic change should be fully studied prior to its implementation for its effect not only on the system but also upon other Members.

This leads us to third potential problem with financial compensation, its consistency with the MFN principle. The fact that MFN applies to compensation has

56 This is true even if some form of penalty, such as suspension of WTO Rights or concessions, were imposed on the recalcitrant Member.

57 Eleso (2006: 35); Limao and Saggi (2006: 4, 14–16).

58 Eleso (2006: 35–36).

59 See, e.g., *United States–Singapore Free Trade Agreement*, Article 20.6.5-7; *United States–Chile Free Trade Agreement*, Article 22.15.5-7; *United States–Australia Free Trade Agreement*, Article 21.11.5-7.

60 DSU Article 3.7.

been confirmed by the Appellate Body in *EC–Poultry*.[61] In *EC–Poultry*, both the panel and Appellate Body rejected Brazil's argument that the MFN principle in Articles I and XIII of the GATT does not necessarily apply to tariff-rate quotas (TRQ) resulting from compensation negotiations under Article XXVIII of the GATT. In rejecting the argument, the Appellate Body referred to the adopted GATT panel report of *United States–Restrictions on Imports of Sugar*,[62] and the WTO Appellate Body report of *EC–Bananas*,[63] both of which confirmed that a Member may yield rights but not diminish its obligations under the GATT/WTO Agreement. More specifically, the Appellate Body rejected Brazil's argument that a country-specific TRQ was permissible because the frozen poultry TRQ was negotiated as compensation under GATT Article XXVIII. The Appellate Body stated:

> 100. Brazil argues that the Oilseeds Agreement was negotiated under Article XXVIII to compensate Brazil for the impairment of benefits from the oilseeds concession. According to Brazil, there is an element of specificity about compensation, which explains and justifies possible departure from the principle of non-discrimination. In support of this interpretation, Brazil refers to compensation under Article XXIV:6 of the GATT. In Brazil's view, no distinction should be made, either in procedure or in intention, between compensation negotiated under Articles XXIV:6 and XXVIII of the GATT. In practice, Brazil maintains, there are examples of both country-specific and non-discriminatory tariff-rate quotas offered and implemented by the European Communities as compensation under Article XXIV:6 of the GATT. There is no reason, Brazil argues, why the same principle should not apply to compensation under Article XXVIII of the GATT. We do not accept this argument. We see nothing in Article XXVIII to suggest that compensation negotiated within its framework may be exempt from compliance with the non-discrimination principle inscribed in Articles I and XIII of the GATT 1994. As the Panel observed, this interpretation is, furthermore, supported by the negotiating history of Article XXVIII. Regarding the provision which eventually became Article XXVIII:3, the Chairman of the Tariff Agreements Committee at Geneva in 1947, concluded:
>
> It was agreed that there was no intention to interfere in any way with the operation of the most-favoured-nation clause. This Article is headed 'Modification of Schedules'. It refers throughout to concessions negotiated under paragraph 1 of Article II, the Schedules, and there is no reference to Article I, which is the Most-Favoured-Nation Clause. Therefore, I think the intent is clear: that in no way should this Article interfere with the operation of the Most-Favoured-Nation Clause.

61 *EC–Poultry*, WT/DS69/AB/R, at paras. 96–102. For discussion, see O'Connor and Djordjevic (2005: 127).

62 *United States–Restrictions on Imports of Sugar*, BISD 36S/331, para. 5.2, adopted 22 June 1989.

63 *EC–Bananas*, WT/DS27/AB/R, at para. 154.

For these reasons, the Appellate Body agreed with the panel that: 'If a preferential treatment of a particular trading partner not elsewhere justified is permitted under the pretext of "compensatory adjustment" under Article XXVIII:2, it would create a serious loophole in the multilateral trading system. Such a result would fundamentally alter the overall balance of concessions Article XXVIII is designed to achieve.'[64]

Strict adherence to the MFN principle, however, creates a practical problem for financial compensation: while trade compensation can easily be extended to all Members (say, in the form of a reduced tariff rate), financial compensation offered on an MFN basis would be both extremely expensive and nearly impossible to administer. Therefore, and much to the consternation of some other WTO Members (most notably Australia),[65] the US in *US–Copyright* offered compensation only to the EU. While some commentators dismiss this issue by merely stating that other Members could have either joined in the original dispute or subsequently brought their own claim based upon the same facts, the issue warrants a more serious response. In dismissing interested WTO Members objections to the payment of financial compensation only to the complaining party commentators there is a failure to realize that the argument that a Member could simply join the original dispute has never been made in any other context – such as in the case of trade compensation (and that, being a major shift in the implementation of disputes, serious thought should be given to the wider ramifications of such an argument) – and that forcing a Member to instigate a claim based upon the exact factual scenario as a recently concluded dispute would result in a colossal waste of financial and human resources for all parties as well as the institution. Other commentators have summarily dismissed the MFN argument by merely stating that 'providing monetary compensation is not "an advantage, favour or immunity" [sic] which must be immediately and unconditionally granted to every Member … Therefore, [financial compensation] does not thereby imply that it is to be provided on an MFN basis.'[66] Shadikhodjaev and Park additionally conclude that since only one country (Australia) has consistently insisted that compensatory arrangements be applied on a non-discriminatory basis: 'It obviously shows that the overwhelming majority of WTO Members have not seen any problem with, or at least have not

64 *EC–Bananas*, WT/DS27/AB/R, at para. 101 (quoting panel report, at para. 215). This is not to suggest that a mutually agreed settlement to a dispute prior to the adoption of a panel/Appellate Body report would be inconsistent with the MFN principle or any other provision of a covered agreement. Such a settlement would not, of course, forestall any other Member from initiating a dispute based on the same fact pattern which caused the initial dispute.

65 A report of the 14 March 2002 meeting in which Australia tabled its submission can be found at http://www.twnside.org.sg/title/twe276b.htm.

66 Eleso (2006: 29). For slightly more analysis, see Davies (2006: 44–45); Bronckers and van den Broek (2005: 116). See contra, O'Connor and Djordjevic (2005: 131–136). Other scholars have proposed amending the DSU to make financial compensation explicitly preferential. See, e.g., Yang (2008: 449–458).

been opposed to, the allegedly discriminatory nature of the monetary payment provided.'[67] Such a position, enunciated by the authors without evidentiary support, seems immaterial to the debate. It is the text of the covered agreements, not the public or private statements of Members that should to lead any interpretive discussion. Likewise, Shadikhodjaev and Park question the feasibility of administering compensation on a non-discriminatory basis,[68] and while it may in fact be nearly impossible to administratively apply financial compensation on an MFN basis, mitigation of this difficulty by limiting the availability of the compensation to the complaining party or parties runs counter to the text of the relevant covered agreement.

The text of Article 22(1) of the DSU seems clear and unambiguous: 'Compensation is voluntary and, if granted, shall be consistent with the covered agreements.' The negotiating history of the Uruguay Round provides further support for the proposition that compensatory arrangements should be granted in a non-discriminatory manner. O'Connor and Djordjevic state:

> During the Uruguay Round negotiations, it was widely recognized that, in contrast to the right to suspend concessions, compensation, where applied, was to be offered on an MFN basis and was to be '*aimed at the restoration of the proper balance between the rights and obligations of all Contracting Parties*'.[69]

Thus, the relevant text, negotiating history and Appellate Body interpretation of the issue in *EC–Poultry* all suggest that compensation must be administered on a non-discriminatory basis.[70] Attempts to avoid the MFN principle are ill-advised and, at the very least, commentators asserting that compensation can be administered on a discriminatory basis should more seriously engage with and consider the text of the DSU, negotiating historymy and the ruling of the Appellate Body in *EC–Poultry*.

Another potential problem with financial compensation is that none of the proponents of financial compensation has seriously grappled with the issue of whether distribution (or redistribution) of the compensation to the affected industry would be an illegal subsidy under the Agreement on Subsidies and Countervailing Measures (SCM Agreement).[71] To illustrate, if a government provides compensation to another government, and the receiving government distributes the compensation to affected (harmed) industries, the receiving government's payout may be deemed to be an actionable subsidy under the

67 Shadikhodjaev and Park (2007: 1255).

68 Shadikhodjaev and Park (2007: 1255–1256).

69 O'Connor and Djordjevic (2005: 132) (emphasis in original). In support, the authors point to Negotiating Group on Dispute Settlement, Dispute Settlement Proposal, 10 October 1998, MTN.GNG/NG13/W/30; Negotiating Group on Dispute Settlement, Compensation in the context of GATT Dispute Settlement Rules and Procedures, Note by the Secretariat, 14 July 1989, MTN.GNG/NG13/W/32.

70 See O'Connor and Djordjevic (2005: 132).

71 For background, see *US–Foreign Ssales Corporation* (DS 108).

SCM Agreement. It is beyond the scope of this article to analyze the issue in detail, but it should be noted that if the payment of compensation from one government directly to a private entity in another country (rather than to the other government) would avoid the issue (the question would be if the receiving government provided a contribution and whether the affected industry received a benefit), several important implications arise, not least of which would be the asymmetrical treatment resulting from a direct payment to industry rather than government.

Next, while it has been argued that financial compensation can help redress injury on the part of the aggrieved industry, such a result only occurs when and if the Member government decides to distribute any of the compensation. While proponents of this purported benefit admit it is entirely up to the compensated Member government whether (and if so, how) to distribute the compensation,[72] they have as of yet failed to persuasively argue that the compensation would reach the injured industry. By contrast, when financial compensation is paid to the complaining Member government it seems likely that the aggrieved industry could be in the same position as with retaliatory measures.

Another problem with financial compensation is that it has the potential to create division within the institution as only the richer nations would be able to afford to pay financial compensation. If financial compensation is paid, but the measure found to be inconsistent with the WTO agreements is never modified or removed, financial compensation could merely be a proxy for allowing rich nations to 'buy-out' of their obligations. While, in theory at least, the non-compliant Member will still have an obligation to remove the offending measure, it may decide that paying financial compensation is a more attractive alternative (for reasons which include but are not limited to political and economic efficiency). Moreover, and perhaps more importantly, this could lead to a situation where traders can no longer rely on the WTO to provide predictable and secure market access. The Report by the Consultative Board to the Director-General, Supachai Panitchpakdi, released in 2004, expressed reservations regarding financial compensation for this reason, stating that: 'some experimentation in this regard could be useful, but great care must be exercised to be sure that monetary compensation is only a temporary fallback approach pending full compliance, otherwise the "buy-out" problems will occur'.[73]

Finally, questions remain as to which Members should be eligible to receive financial compensation, how it would be calculated and when it would become payable. On the first matter, most commentators suggest limiting those eligible to receive financial compensation to developing nations or LDCs. Others suggest a

72 For instance, Bronckers and van den Broek mention on at least four occasions that there is not any obligation (nor, in their minds, should there be any obligation) for distribution of financial compensation to an affected industry. Bronckers and van den Broek (2005). See also, Grané (2001).

73 WTO (2004: para. 243).

milder form of financial compensation whereby countries could opt-in, and thus be able to use the system as well as have the system used against them, or opt-out and not be able to receive or be liable for financial compensation. Such a splintered system raises questions about its long-term viability as well as memories of the problems of rampant 'code conditionality' under the GATT. Most proponents of financial compensation would calculate the sum on trade effects and also include a punitive element in that financial compensation would be retroactive to the date of the offending measure,[74] but both of these issues are, no doubt, subject to much debate. It is beyond the scope of this article to finalize a workable platform for financial compensation, but the point is that proponents of this system have yet to work out or agree upon all of the important details necessary to allow a full and complete evaluation of the proposal.

Financial compensation is attractive as it is not trade restrictive, it is in line with the liberalization aims and objectives of the WTO, and it has the ability to encourage compliance. However, the value of financial compensation is subject to several limitations. For instance, financial compensation will always rely upon the willingness of the non-compliant Member to provide the monetary compensation. The likelihood of compliance in every case is low, and the compliance statistics would surely decrease as the value of the mandated compensation increased. Suggestions to ensure compliance, such as the posting of a bond and the like, are perhaps useful but are by no means a complete solution to what surely would become a problem. Moreover, while financial compliance may resolve the dispute between the two parties, it does not necessarily address the problem of redressing the injury on the aggrieved industry. More worrying, financial compensation allows for the continuation of the inconsistent measure and, in doing so, contradicts Articles 3 and 22 of the DSU. Moreover, the consistency of financial compensation with the MFN principle so enshrined in the WTO is at the very least still subject to debate, while its consistency with the SCM Agreement has not to date been fully explored. Thus, while financial compensation is congruent with the liberalization aims and objectives of the WTO, its consistency with several other systemic parts of the WTO is questionable and uncertain. Perhaps most worrying is the fact that financial compensation could lead to a two-tiered system whereby richer Members could 'buy' themselves out of their obligations and commitments while poorer Members could not afford to pay compensation in order to continue flouting their obligations and commitments. When all of the potential negatives of financial compensation are taken into account, it becomes apparent that the negative and uncertain aspects of financial compensation outweigh any positives to be gained from its incorporation.

74 See, e.g., Eleso (2006: 19).

4. Concluding analysis

Over the past few years, many commentators have criticized the implementation phase of dispute settlement in the WTO for a variety of reasons. The appropriateness of retaliatory measures has been a particular favourite target, with commentators criticizing retaliatory measures for, inter alia, being economically inefficient, incongruous with the aims and objectives of the WTO, for being designed to harm innocent industries instead of the offending industries, and for not encouraging prompt compliance. While it is true that the system is far from perfect, no system is without its flaws. It is also important to remember that each amendment could potentially have unknown or unanticipated consequences. Finally, and most importantly, before recommendations can truly be considered a standard upon which to judge the current system, any possible alternatives must be developed. Before doing so, there must be consensus on some important questions. For instance: Is the point of retaliatory measures to rebalance concessions or to coerce compliance? Must Members comply with their obligations and implement panel/Appellate Body reports or is the concept of efficient breach present in the WTO? The answers to these and countless other questions will determine the shape of the DSU in the future. Without consensus on these issues, the present system can only be judged on an *ad hoc* basis and any conclusions will no doubt be driven by the commentator's particular opinions on the unanswered systemic questions.

With this in mind, this article evaluated the possibility of using trade or financial compensation to remedy the four most persuasive criticisms of trade retaliation – that it is economically inefficient, incongruous to the aims and objectives of the multilateral trading system, that it harms innocent industries while allowing offending industries to go unpunished, and that it fails to encourage compliance. Far from improving upon the system of retaliatory trade measures, both trade and financial compensation suffer from as many (if not more) drawbacks than trade retaliation. While trade and financial compensation may not be as economically inefficient as trade retaliation, and therefore may be more in line with the aims and objectives of the WTO, neither remedies the problem of the offending industry escaping 'punishment' while an innocent industry suffers. Moreover, it is doubtful whether trade or financial compensation would be more effective at encouraging compliance than are retaliatory measures; in fact, it could be argued that financial compensation could even result in decreasing Member's overall rate of compliance (given that all forms of compensation are essentially voluntary). In addition, as this article has demonstrated, both trade and financial compensation raise a host of other unknowns and uncertainties which not only could potentially run counter to existing obligations or are contrary to deeply embedded principles of the WTO but also could possibly destabilize the entire dispute settlement system. For these reasons, it does not appear that trade or financial compensation could either replace or substantially supplement trade

retaliation as a means for rebalancing/enforcing rights in the implementation phase of the dispute settlement process.

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