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Curtis S. Miller

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THE WTO: BITING THE HAND THAT FED IT

INTRODUCTION

Imagine that two countries (A & B) are involved in a trade dispute. The dispute arose because country B refused to accept shoes that country A's shoemakers produced. B's reason for refusal is that A's producers use a chemical to enhance the soles of the shoes, thereby allowing the wearer to run faster. Controversy has arisen, however, regarding the chemical's safety. B's scientists believe that this chemical causes detrimental side effects, such as flat-footedness. A's scientists, on the other hand, do not believe that there is any causal connection between the chemically enhanced shoe and its country's instances of flat-footedness.

Based on B's scientists' concerns, B refuses to accept any shoes A produces with this chemical, despite the shoes' apparent superiority. A, therefore, brings a nullification and impairment action¹ in the World Trade Organization (WTO) against B for B's refusal to accept A's shoes, and, after completely exhausting the WTO dispute resolution process without convincing B to accept its shoes,² A, acting completely within WTO rules, *retaliates* against B. A does this by raising tariffs on several different goods it imports from B, goods which A's domestic consumers previously purchased because of their physical and price superiority.

This hypothetical is loosely based on the *Beef Hormone* dispute between the United States and the European Union (EU).³ As in this hypothetical, the parties in the *Beef Hormone* dispute incurred the economic consequences of retaliatory tariffs because they could

1. General Agreement on Tariffs and Trade, Oct. 30, 1947, art. XXIII 61 Stat. A-11, T.I.A.S. 1700 55 U.N.T.S. 194 [hereinafter GATT]. Article XXIII sets out the general framework for a dispute settlement proceeding. Within this framework exists a cause of action for the breach of a complaining member's obligation by another party. *See id.* art. XXIII(1).

2. *See discussion infra* Part II.C.

3. *See infra* notes 85-89 and accompanying text.

not reach a satisfactory agreement⁴ pursuant to existing WTO dispute resolution process procedures.⁵

Although the measures introduced in the WTO are a vast improvement on previous dispute procedures,⁶ from a Ricardian economic perspective this outcome is entirely inefficient.⁷ WTO rules that allow a country to raise tariffs in order to "strike back" at uncooperative countries not only cause diplomatic strife but also prevent countries from attaining the benefits of international trade.

Instead of using this draconian approach to dispute settlement,⁸ this Note proposes that the WTO use pecuniary damages to resolve trade disputes.⁹ This would go much further in attaining the underlying objectives and benefits of international trade. This Note will begin with a historical description of free trade to illustrate why it remains an important subject. Following this overview, Part II will describe the current WTO Dispute Settlement Procedure, with particular focus on its inherent inefficiencies. Finally, in Part III, this Note will attempt to encourage debate on the efficacy and efficiency of the current system by proposing changes which

4. The two countries could not reach a settlement on an amount of compensation the losing party should pay in order to restore the overall balance of trade that existed prior to the conflict. See Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 2, 33 I.L.M. 1226 (1994) [hereinafter Dispute Understanding].

5. See Dispute Understanding, *supra* note 4, art. XXII, para. 2. Retaliation is the last resort for a country involved in a trade dispute over a violation of WTO law. The disputing countries must exhaust a number of mechanisms before they may legally use retaliation. For further explanation, see discussion *infra* Part II.D.

6. Prior to the Uruguay Round, the General Agreement on Tariffs and Trade (GATT) had no appeal procedures and no mechanism existed for authorizing retaliation short of obtaining the affirmative votes of all GATT members, including the losing party. Pierre Pescatore, *Drafting and Analyzing Decisions on Dispute Settlement*, in PIERRE PESCATORE ET AL., 1 HANDBOOK OF WTO/GATT DISPUTE SETTLEMENT pt. 2, at 14 (June 1997). This effectively gave each losing party the ability to veto completely "fair" settlements. See G. Richard Shell, *Trade Legalism and International Relations Theory: An Analysis of the World Trade Organization*, 44 DUKE L.J. 829, 840 (1995) (explaining the history of GATT dispute resolution system prior to creation of the WTO).

7. This is true because the WTO has intentionally rid itself of the gains that it acquired through comparative advantage and trade. See *infra* note 13 (discussing comparative advantage).

8. Some accurately analogize this to "shooting yourself in the foot." FRANK W. SWACKER ET AL., WORLD TRADE WITHOUT BARRIERS § 4-3(c)(3), at 310 (1995).

9. Dispute Understanding, *supra* note 4, art. XXII, para. 2.

illustrate that current trade enforcement is completely out of line with the underlying goals of free trade.

I. THE CASE FOR FREE TRADE

Adam Smith, in his seminal book, *The Wealth of Nations*, was one of the first to analyze the economic importance of international trade.¹⁰ Smith argued that the key to national wealth and power is economic growth. A country's growth, in turn, is primarily a function of the division of labor.¹¹

When Smith spoke of international trade, he did so in terms of absolute advantage.¹² It was David Ricardo, however, who built upon Smith's theories and established the concept upon which the WTO was founded: comparative advantage.¹³ He noted that although any one country may have an absolute advantage in the production of many goods,¹⁴ every country is likely to have a

10. ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS (Kathryn Sutherland ed., Oxford Univ. Press 1997) (1776).

11. As Smith so famously opined: "The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgment with which it is any where directed, or applied, seem to have been the effects of the division of labour." *Id.* at 1.

12. Absolute advantage, in light of production, means that any one country can produce a good more efficiently than others. This follows from the assumption that each country has a limited amount of raw inputs with which it can make certain products. Because each country is limited in its productive capabilities, the country that has a particular amount of inputs necessary for the production of a certain good will be able to produce that good more efficiently than other countries—i.e., it has an "absolute advantage." For an excellent graphical and numerical example of this theory, see HAL R. VARIAN, INTERMEDIATE MICROECONOMICS: A MODERN APPROACH 522-24 fig.29.8-29.9 (3d ed. 1993).

13. The law of comparative advantage reasons that because each country has only a limited amount of resources, each country has the ability to produce one good at a relative advantage to another. This notion builds on Adam Smith's theory of absolute advantage: though one country could hypothetically have the ability to produce all goods more efficiently than smaller countries, it still has limited resources. Therefore, the larger country should apply its resources to the goods which it can produce most efficiently and allow for other countries to produce the goods for which they have a relative advantage. If each country can produce one good cheaper, relative to how another country can produce it, each will have an advantage in the production of one commodity and a disadvantage in the production of others. Each country will then be anxious to export the commodity in which it has an advantage and import the commodities in which it has a disadvantage. If this is done, international trade can increase the total wealth of society. J.R. MCCULLOCH, THE WORKS OF DAVID RICARDO 72-86 (Lawbook Exchange 2000) (1846).

14. See *supra* note 12.

comparative advantage in the production of at least some goods.¹⁵ All countries theoretically have something to contribute, and, through the process of multilateral exchange, benefit from trade. It is "[through] exploiting [this] comparative advantage [that] liberal trade policies permit the unrestricted flow of the best goods and services at the lowest prices, thereby increasing total world wealth."¹⁶

One can easily trace the importance of international trade throughout world history.¹⁷ An excellent example of the benefits realizable through trade is the initial growth¹⁸ and development of the high performance Asian economies (HPAEs).¹⁹

Academics have viewed the HPAEs as an illustration of how modernization and increased economic well-being are encouraged by free exportation of goods.²⁰ The HPAEs have achieved very high growth rates at an average of eight to nine percent since the mid-1960s. Such growth is incredible when compared with the two to three percent growth the United States and Western Europe realized during this same period.²¹

15. See *supra* note 13.

16. RAJ BHALA & KEVIN KENNEDY, *WORLD TRADE LAW* § 1(b) (1998); see also PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, *ECONOMICS* 691 (16th ed. 1998) ("When countries concentrate on their areas of comparative advantage under free trade, each country is better off."). For a good graphical illustration of the benefits of international trade brings to world markets, see *id.* at 697 fig.35-7.

17. For a good illustration of the importance countries place on the free trade principle, one need look no further than the beginnings of American history. The Founders realized that many problems occurred when the Articles of Confederation gave the states virtual *carte blanche* to impose customs duties and trade barriers. See generally CHARLES A. BEARD, *AN ECONOMIC INTERPRETATION OF THE CONSTITUTION OF THE UNITED STATES* 52-63 (1913) (discussing how economic factors led to the adoption of the Constitution).

18. "Initial growth" because of the economic problems these countries now face. This, however, appears to be more of the consequence of poor banking and fiscal management than a failure of trade growth. See, e.g., *The Non-Performing Country*, *ECONOMIST*, Feb. 16, 2002, at 24-26 (discussing Japan's now long-standing recession).

19. See generally PAUL R. KRUGMAN & MAURICE OBSTFELD, *INTERNATIONAL ECONOMICS: THEORY AND POLICY* 265-70 (4th ed. 1997) (discussing different explanations for the HPAEs' success, including theories crediting free trade and theories crediting government intervention). The HPAEs are Japan, Hong Kong, Taiwan, South Korea, Singapore, Malaysia, Thailand, Indonesia, and China. *Id.* at 267.

20. For a useful survey of the growth of the HPAE's, see generally WORLD BANK, *THE EAST ASIAN MIRACLE: ECONOMIC GROWTH AND PUBLIC POLICY* (1993).

21. KRUGMAN & OBSTFELD, *supra* note 19, at 266.

The HPAEs all have one identical feature: They are open to international trade.²² Following from this and other examples of trade-induced growth, experts have noted that in today's world, international trade, dependent on growing adherence to free trade principles, should be even more of a priority than it has been in the past.²³ Both the GATT and the WTO are based on the underlying benefits of liberal trade policies.²⁴ Accordingly, it is from this perspective that this Note addresses international trade disputes.²⁵

22. There has been significant dispute, however, over how "open" these markets truly are. On this debate, see generally *id.* at 265-70.

23. This argument is even stronger when one recognizes the trend toward lower information costs and increased transportation capacity that we see in today's world. See Louis De Alessi, *Form, Substance, and Welfare Comparisons in the Analysis of Institutions*, 146 J. INST. & THEORETICAL ECON. 5, 14 (1990).

24. Martin Wolf writes:

In a liberal economic system, government does not thwart private parties in their attempt to enter voluntary transactions, and taxes are stable, predictable, and nonprohibitive. The General Agreement on Tariffs and Trade (GATT) is liberal in this sense....

....

... Interventions in liberal exchange [by governments] across frontiers to make trade fair may be the political price of liberalism, but such interventions are themselves its antithesis.

Martin Wolf, *Why Trade Liberalization is a Good Idea*, in *THE URUGUAY ROUND, A HANDBOOK FOR THE MULTILATERAL TRADE NEGOTIATIONS* 14 (J. Michael Finger & Andrzej Olechowski eds., 1987).

25. Free trade principles have, however, encountered much less than universal embrace. Opponents point out that free trade proponents argue from an idealized model that does not reflect the problems of reality. Some of these problems include the destructive nature of competition and unemployment. See generally 2 JOHN MAYNARD KEYNES, *A TREATISE ON MONEY* 374-87 (1930). Other potential dangers include the threat to Member countries' sovereignty. See *Results of the Uruguay Round Trade Negotiations: Hearings Before the S. Comm. on Finance*, 103d Cong. 240 (1994) (statement of Ralph Nader); Shell, *supra* note 6, at 896 n.319 (noting that free trade "sometimes involve[s] a loss of domestic control over economic and social priorities"). A good illustration of this concern over loss of control is the EU's rationale for refusing to comply with the WTO rulings on the beef hormone disputes. The EU argued that compliance would prevent Member nations from exercising the "fundamental right of governments to choose the level of health protection they consider necessary for their citizens." Neil Buckley, *EU Defends Ban on Hormone-Treated Beef*, FIN. TIMES, Nov. 4, 1997, at 3. For an argument to the contrary, see JOHN H. JACKSON, *THE JURISPRUDENCE OF GATT & THE WTO: INSIGHTS ON TREATY LAW AND ECONOMIC RELATIONS* 181 (2000) (describing how the WTO "Appellate Body is [taking] a more deferential attitude ... towards national government decisions (or in other words more deference to national 'sovereignty')"). An example of this deference is seen in Report of the Appellate Body, United States—Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R (Apr. 29, 1996), available at 1996 WL 227476 ("WTO members have a large measure of autonomy to determine their own policies on the environment (including its relationship with trade), their

II. DISPUTE SETTLEMENT IN THE WTO

Enforcement procedures are a necessity within any legal framework. They provide the way in which societies encourage compliance with existing rules, thereby giving certainty to those operating within it.²⁶ The goal of enforcement should be to implement efficient administration devices because rules based on efficiency considerations will lead to the correct incentive and risk allocations for those operating within the system.²⁷ From an economic perspective, upon which the Members constructed the WTO,²⁸ the WTO dispute resolution process falls far short of this objective.

A. WTO's Beginnings

To fully explain this failure to achieve efficiency, it is necessary to give both a brief introduction to the history of the GATT's original dispute resolution process and a description of its transformation, following the Uruguay Round, into the present process.

GATT did not authorize retaliation by an injured country unless a party obtained the consent of all GATT contracting parties.²⁹ This unanimity rule shockingly required the affirmative vote of the country that had lost its case.³⁰ The not too surprising result was that retaliation presented no more than an idle threat. GATT's

environmental objectives and the environmental legislation they enact and implement.").

26. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 101-03 (5th ed. 1998) (discussing how opportunism is one of the dangers inherent in the process of voluntary exchange, and thus society must rely on enforcement procedures); see also Azar M. Khansari, *Searching for the Perfect Solution: International Dispute Resolution and the New World Trade Organization*, 20 HASTINGS INT'L & COMP. L. REV. 183, 189 (1996) (describing GATT's (pre-WTO) dispute resolution process as one of a lack of confidence and uncertainty ultimately leading to the search for a more "rule-oriented regime").

27. A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW & ECONOMICS* 129-134 (1989) (arguing that efficiency should be "the sole criterion used to evaluate legal rules").

28. Wolf, *supra* note 24, at 19-20 (discussing economic efficiency objective of WTO).

29. The term "contracting parties" describes membership to the original GATT agreement. Following the Uruguay Round, and creation of the WTO, these same contracting parties are now called Members.

30. Pierre Pescatore, *Drafting and Analyzing Decisions on Dispute Settlement*, in PESCATORE ET AL., *supra* note 6, pt. 2, at 14 (1997).

inability to deter improper behavior, despite a functioning legal framework, led to huge losses in efficiency.

To illustrate, in the years between 1948 and 1990, many disputes never lasted long enough to warrant retaliation. More than seventy-seven percent of the rulings found that the complaint was justified, but the disputes were either partially or completely settled through means other than retaliation.³¹ At first glance, this would appear to demonstrate that the system was working efficiently despite the disquieting veto power GATT gave to each contracting party. The failure of countries who violated GATT rules to follow GATT rulings, however, is more illustrative of the problems inherent in a system without a sufficient deterrence mechanism. For example, in a dispute between the United States and Nicaragua, GATT declared a United States discriminatory sugar quota illegal.³² Despite this ruling, the United States refused to alter its trade stance until Nicaragua met United States political demands. Even though the United States eventually removed the discriminatory sugar quotas, the case was a clear-cut illustration of legalistic inefficiency.

The failure of GATT's ruling to compel the United States to remove its sugar quotas led to substantial losses. These injuries included not only the lost sugar sales for Nicaragua,³³ but also the disputing parties' wasted expenditures in arriving at an alternative outcome.³⁴ These "inefficiencies" became apparent to countries operating within the GATT framework and pushed some nations to revert to self-help procedures.³⁵

31. ROBERT E. HUDEC, *ENFORCING INTERNATIONAL TRADE LAW* 273-355 (1993) (providing a statistical profile of GATT dispute settlement cases).

32. *United States—Imports of Sugar from Nicaragua*, Mar. 13, 1984, GATT B.I.S.D. (31st Supp.) at 67, 74 (1985).

33. Sales which would have netted a surplus to United States consumers and Nicaraguan producers.

34. There were, however, alternative benefits that the United States derived from its failure to comply with GATT's ruling. The United States was able to achieve its desired result of inducing democratic elections. This political and philosophical achievement's benefit could, in the eyes of some, outweigh any economic losses that resulted from the United States' failure to comply; this behavior, however, remains economically unjustified.

35. For the United States, this "self-help" need led to the development of Section 301 of the Trade Act of 1974, Pub. L. 93-618, § 301, 88 Stat. 1978, 2041 (1974) (codified as amended at 19 U.S.C. § 2411(a) (2000)). Various business interests lobbied Congress for stronger enforcement procedures, resulting in Congress authorizing "unilateral" trade sanctions in Section 301. Jagdish Bhagwati, *Aggressive Unilateralism: An Overview*, in *AGGRESSIVE*

B. From GATT to WTO

As the GATT contracting parties became aware of GATT's enforcement shortcomings, compliance with its rulings began to suffer.³⁶ During the first twenty years of GATT's existence, contracting parties implemented its rulings about eighty percent of the time. In the following years, however, party compliance fell to less than sixty percent.³⁷ The contracting parties recognized that there were serious problems with GATT mechanisms and attempted to remedy them in the Uruguay Round of Multilateral Trade Negotiations. The Uruguay Round of negotiations began in 1986 and continued through 1994. These negotiations resulted in the creation of the WTO.³⁸

The WTO was not, however, a replacement of previous GATT substantive law; instead, the WTO agreement consisted of "institutional" changes.³⁹ Though the WTO changed little of GATT substantive law, it created a vast amount of new law.⁴⁰ This was accomplished through a series of detailed annexes.

The *Dispute Understanding* was included in one of these annexes.⁴¹ The *Dispute Understanding* made several important changes to GATT dispute rules and procedures.⁴² One of the most important new rules for the purposes of this Note is that disputing

UNILATERALISM: AMERICA'S 301 TRADE POLICY AND THE WORLD TRADING SYSTEM 1-2 (Jagdish Bhagwati & Hugh T. Patrick eds., 1990). Section 301 endowed the President with the power to unilaterally retaliate against foreign protectionist devices through various means, including trade sanctions. BHALA & KENNEDY, *supra* note 16, § 10-2.

36. See Khansari, *supra* note 26, at 189.

37. Kendall W. Stiles, *The New WTO Regime: The Victory of Pragmatism*, 4 J. INT'L L. & PRAC. 3, 9 (1995).

38. See JOHN H. JACKSON ET AL., *LEGAL PROBLEMS OF INTERNATIONAL ECONOMIC RELATIONS: CASES, MATERIALS, AND TEXT* 218-19 (4th ed. 2002).

39. *Id.* at 219 (describing the WTO agreement as a "mini charter").

40. *Id.* at 220. This included new agreements and understandings covering agriculture, sanitary and phytosanitary measures, textiles and clothing, technical barriers to trade, trade-related investment measures, dumping and countervailing duties, rules of origin, pre-shipment inspection, import licensing procedures, safeguards, intellectual property, trade policy review mechanisms, optional agreements, and dispute settlement rules.

41. *Dispute Understanding*, *supra* note 4.

42. *Id.*

parties *must* adopt a WTO panel report⁴³ unless a party notifies the Dispute Settlement Body (DSB) that it plans to appeal or unless the DSB decides by consensus not to adopt the report.⁴⁴ This drastically modifies GATT's earlier practice of giving any losing country the ability to veto an unfavorable panel holding.⁴⁵ A second important change is that the *Dispute Understanding* now provides for appeals from DSB decisions.⁴⁶ Third, the *Dispute Understanding* prohibits unilateral action by its Members intended to redress what they see as violations of obligations, requiring instead that winning parties use WTO settlement procedures.⁴⁷ Finally, the WTO presents an injured country with strengthened means with which to enforce trade sanctions for noncompliance—specifically, the power to retaliate.⁴⁸ Although these changes are a dramatic improvement from the impoverished GATT dispute resolution process,⁴⁹ the underlying goals of economic efficiency remain unrealized.

C. Steps Of Dispute Resolution Pursuant to the Dispute Understanding

In order to fully discuss the failings of the current WTO dispute resolution process, it is necessary to briefly explain its basic procedures. The objective of the dispute resolution process is to help disputing countries reach a mutually agreeable settlement or, if

43. A WTO panel report is the decision of the trial level judges of the Dispute Settlement Body (DSB). An Appellate Body report is the decision of appellate level judges of the DSB and is final absent consensus by the DSB to overturn the decision.

44. Dispute Understanding, *supra* note 4, art. XVI; *see also* Shell, *supra* note 6, at 848-53.

45. *See* Shell, *supra* note 6, at 848-53.

46. Dispute Understanding, *supra* note 4, art. XVI; *see also* Shell, *supra* note 6, at 849.

47. Dispute Understanding, *supra* note 4, art. XVII; *see also* JOHN CROOME, GUIDETO THE URUGUAY ROUND AGREEMENTS 20 (1999) ("Members ... may not determine that violations, nullifications or impairment have taken place, except in accordance with approved panel or appellate findings, and must follow other rules in the Understanding that give a reasonable time for panel recommendations to be followed and govern resort to retaliation.") (footnote omitted).

48. *See* Dispute Understanding, *supra* note 4, art. XXII; *see also* CROOME, *supra* note 47, at 23-24 (discussing retaliation under the WTO).

49. The WTO also produced positive externalities missing from its predecessor's regime. The improved system (1) reduces transaction costs for its Members; (2) provides Members with valuable information; and (3) makes the overall operation of the regime more predictable. ROBERT O. KEOHANE, AFTER HEGEMONY 89-95 (1984).

that is not possible, to remove the measures inconsistent with the WTO agreement.⁵⁰ Articles III and IV simply allow a complaining Member to call for removal of the alleged offending measure⁵¹ and provide the respondent ten days with which to reply to the complaint.⁵² The countries then must enter into consultation within thirty days.⁵³

If consultations are unsuccessful, the aggrieved Member can request that the DSB set a panel.⁵⁴ The complainant and respondent submit the facts and their arguments to the panel and the panel submits a report to the parties.⁵⁵ If the panel finds the challenged measure to be inconsistent with WTO rules, it recommends a remedy in a panel report. After the panel presents its report, the DSB adopts the report within sixty days unless a party appeals the decision.⁵⁶ If the defendant appeals, there are further proceedings within sixty days, or, at maximum, within ninety days. The Appellate Body then issues a report that the DSB adopts, absent consensus not to adopt it, within thirty days.⁵⁷

Once the Appellate Body issues its report and the DSB adopts it, the losing party must state whether it intends to implement the recommendations.⁵⁸ If immediate compliance is not possible, DSB procedures allow a party a "reasonable period of time" to act in accordance with the report.⁵⁹ If the defendant Member does not comply within this time period, the complaining Member may request negotiations to determine mutually acceptable compensation.⁶⁰ If after twenty days the parties cannot agree on satisfactory compensation, the complainant may request authorization

50. CROOME, *supra* note 47, at 23.

51. Dispute Understanding, *supra* note 4, art. III, para. 7.

52. *Id.* art. IV, para. 3.

53. *Id.*

54. *Id.* art. VI.

55. *Id.* arts. XXII-XIV (prescribing the rules and procedures for panel review).

56. *Id.* art. XVI, para. 4 (both parties may appeal the report for legal error).

57. *Id.* art. XVII, para. 14.

58. *Id.* art. XXI.

59. *Id.* art. XXI, para. 3. A reasonable period of time is a flexible concept. First, the party implementing the decision will propose a period for implementation. If the DSB accepts this as reasonable, that is the end of the matter. If the DSB disagrees, the next step is for the parties to the dispute to agree on a reasonable period. If this is unsuccessful, binding arbitration will set the appropriate period for implementation. *Id.* art. XXI, para. 3(a)-(c).

60. *Id.* art. XXII, para. 6.

from the DSB to retaliate.⁶¹ This generally will involve the complainant's suspension of concessions or obligations it previously granted the other party.⁶²

D. Retaliation in Action

Member countries generally reach mutually agreeable outcomes without ever resorting to removing concessions or other retaliatory measures. This does not mean, however, that when a country imposes retaliatory tariffs, small losses are the result. The effect on the economies of both parties can be enormous: A tariff on any industry has the initial effect of raising the targeted product's price to domestic consumers, thereby causing rational consumers to substitute less desirable alternatives. The losses do not derive from the producer's lost sale alone, but also from the consumer who likely valued the imported product more than the alternative (otherwise, he would not have initially been predisposed to purchase that imported good)—instead, he now receives an inferior product. This result cumulates throughout the economy, resulting in huge losses.⁶³ When disputing parties reach the final stage of the dispute resolution process, compliance with WTO rules is rarely the outcome. Rather, the parties take on avoidable inefficiencies.

The problems inherent in the WTO's retaliation scheme are the economic effects which inevitably accompany trade barriers. As this Note previously observed, free trade is very beneficial to trading nations.⁶⁴ At the most basic level, tariffs have three costly effects on the free flow of trade: (1) domestic producers, operating under a tariff-induced price umbrella, can expand production; (2) consumers are faced with higher prices and therefore reduce their consumption

61. *Id.* art. XXII (compensation and suspension of concessions).

62. This is the reinstatement of tariffs or other nontariff barriers eliminated by previous trade regulations. *Id.* art. 24.

63. There is an argument that the gain to domestic producers counters this loss, but this is an inefficient gain. It provides a disincentive to the domestic producer to more efficiently produce his product, either through innovations or cost reductions. He no longer has to compete with companies abroad that produce superior products—instead, the tariffs force customers to purchase his more costly product.

64. *See supra* Part I.

of the imported good, resulting in the loss of an unrecoverable surplus; and (3) the retaliating government gains tariff revenues.⁶⁵

Even though academics recognize these losses, many still feel that Ricardian efficiencies are never attainable.⁶⁶ The primary argument is that although a world of free trade would be ideal, this world is not an ideal place. The reasoning is, "[a]s long as other countries impose import restrictions or otherwise discriminate against our products, we have no choice but to play the protection game in self-defense. We'll go along with free trade only as long as it is fair trade. But we insist on a level playing field."⁶⁷

Though this perspective appears both sensible and equitable, it is not founded in either good economic analysis or an understanding of world history.⁶⁸ Consider the extreme examples that Professors Samuelson and Nordhaus provide of how this logic might play out: "If [a discriminating country] decided to slow down trade by putting mines in its harbors, should we mine ours?"⁶⁹ Although this example is intentionally outrageous, consider their next example: "[I]f China violated trade agreements by pirating American CDs, how would the United States gain by putting 100 percent tariffs on Chinese silks and other textiles?"⁷⁰ With these examples, the professors are demonstrating the potentially self-destructive nature of retaliatory tariffs. By reciprocating for injurious trade policies, a country will likely cross the line between convincing other nations

65. SAMUELSON & NORDHAUS, *supra* note 16, at 700. It may appear to some that a tariff may actually generate extra profits for domestic producers and government revenues that outweigh consumer losses; however, economists have historically disfavored them. "[T]he economic loss to consumers exceeds the revenue gained by the government plus the extra profits earned by producers." *Id.* Economists refer to these shortfalls as deadweight social losses. JACKSON ET AL., *supra* note 38, at 41-43 (giving graphical explanations demonstrating the "deadweight loss" effects of tariffs and quotas on consumer surplus).

66. "Ricardian efficiencies" occur when nations capture surpluses from international trade because of comparative advantage. *See supra* notes 13-16 and accompanying text (discussing the writings of David Ricardo, for whom the efficiencies are named).

67. SAMUELSON & NORDHAUS, *supra* note 16, at 704 (discussing this perspective).

68. *See id.*

69. *Id.*

70. *Id.*

to reduce their trade violations⁷¹ from harming their own consumers and escalating international disputes.

Another problem with retaliation is that even when the offending nation responds to retaliation by removing concessions, this has been accomplished by a drawn-out battle of diplomacy.⁷² This "shortcoming[] reflect[s] the fundamentally *political* nature of the implementation process—in contrast to the earlier stages of the dispute resolution process under the [*Dispute Understanding*], which are at least somewhat more insulated from political pressures."⁷³

Political "foot-dragging" is inherent in the current WTO retaliatory scheme. Examples include:

Mobilization of other Members to support a losing defendant; sowing the seeds of opposition to full implementation in one or more of the winning complainant Members (such as the EC has attempted to do by arguing that by pressing for full implementation [in the *Bananas* dispute], the United States would be responsible for the death of the Caribbean banana industry and attendant economic, political and social consequences); and seeking to divide and conquer winning complainant countries.⁷⁴

Additional political problems may include smaller countries refraining from using available remedies for fear of an adverse reaction from a larger—and therefore economically significant—trading partner. This appears to have been exactly the reason

71. The Reagan Administration reported:

Intervention in international trade ... even though costly to the U.S. economy in the short run, may, however, be justified if it serves the strategic purpose of increasing the cost of interventionist policies by foreign governments. Thus, there is a potential role for carefully targeted measures ... aimed at convincing other countries to reduce their trade distortions.

Id. (quoting the 1982 ECONOMIC REPORT OF THE PRESIDENT).

72. One can categorize such delays as transaction costs. For an example of these costs in action, see Frances Williams, *EU 'Needs 8 Months' to End Banana Crisis*, FIN. TIMES, Apr. 20, 1999, at 9 (discussing the delays and inefficiencies that occur while countries wait to implement retaliatory measures because of diplomatic concerns).

73. Timothy M. Reif & Marjorie Florestal, *Revenge of the Push-Me, Pull-You: The Implementation Process Under the WTO Dispute Settlement Understanding*, 32 INT'L LAW. 755, 756 (1998).

74. *Id.* at 781.

Mexico "soft-pedaled" their *Tuna-Dolphin* dispute with the United States.⁷⁵ With NAFTA negotiations proceeding during litigation, Mexico had strong incentive to avoid antagonizing one of its most important trading partners and therefore decided not to pursue the case though some "intermediary" countries pressed them to do so.⁷⁶ Repeated successful attempts of powerful countries in preventing both immediate and effective implementation of DSB, rulings such as the *Tuna-Dolphin* and *Banana*⁷⁷ disputes, will inevitably lead to a loss of confidence in the ability of the dispute resolution process to provide consistent and reliable outcomes.

A related problem with the current system is the WTO's inability to attain the compliance of superpower nations.⁷⁸ Glaring examples of this problem are the *Beef Hormone* and *Banana* disputes. The *Banana* dispute involved a conflict between the EU, the United States, and several Central American countries.⁷⁹ EU Members had been granting their ex-colonies preferential access to their banana markets in Europe.⁸⁰ The United States and the Central American countries complained that these preferential import regimes violated WTO rules.⁸¹ The United States and the Central American countries successfully challenged the EU's practices before the WTO.⁸²

75. JOHN WHALLEY & COLLEEN HAMILTON, *THE TRADING SYSTEM AFTER THE URUGUAY ROUND* 130 (1996).

76. See WTO BEYOND THE AGREEMENTS: THE TUNA-DOLPHIN DISPUTE, at http://www.wto.org/thewto_e/whatis_e/tif_e/bey5_e.htm (last visited Mar. 23, 2003).

77. See *infra* notes 78-89 and accompanying text.

78. These are WTO Members such as the United States and the European Union, whose relative size and corresponding economic power allow them to control trade relations with smaller countries.

79. See James M. Cooper, *Spirits in the Material World: A Post-Modern Approach to United States Trade Policy*, 14 AM. U. INT'L L. REV. 957, 970-71 (1999).

80. *Id.* at 970.

81. *Id.* at 970-71.

82. Report of the Panel, European Communities—Regime for the Importation, Sale and Distribution of Bananas, Complaint by Ecuador, WT/DS27/R/ECU (May 22, 1997), available at 1997 WL 490487; Report of the Panel, European Communities—Regime for the Importation, Sale and Distribution of Bananas, Complaint by Guatemala and Honduras, WT/DS27/R/GTM, WT/DS27/R/HND (May 22, 1997), available at 1997 WL 409148; Report of the Panel, European Communities—Regime for the Importation, Sale and Distribution of Bananas, Complaint by Mexico, WT/DS27/R/MEX (May 22, 1997), available at 1997 WL 533133; Report of the Panel, European Communities—Regime for the Importation, Sale and Distribution of Bananas, Complaint by the United States, WT/DS27/R/USA (May 22, 1997), available at 1997 WL 461900.

The EU, undeterred by the DSB's panel report, then instituted an appeal and followed up with numerous delay tactics.⁸³ It took almost three years from the time the United States' instituted the complaint to its resolution and the institution of WTO-approved sanctions.⁸⁴

The *Beef Hormone* dispute presented similar difficulties. The problems began when the EU objected to the United States' usage of growth hormones in U.S. beef production. Faced with public outcry over the effects of hormone beef when consumed by humans, the EU instituted an import ban on hormone beef.⁸⁵ The United States filed a complaint against the EU in 1996.⁸⁶ In 1997, the WTO issued a panel report stating that the EU ban constituted an unfair trade barrier.⁸⁷ Despite this report and a subsequent Appellate Body ruling,⁸⁸ the EU continued to refuse to lift its ban on beef imports.⁸⁹ These two cases—the *Banana* and *Beef Hormone* disputes—are just two examples of some difficulties that emerge when parties attempt to enforce WTO rules on powerful countries.

83. These "delay tactics" included not implementing the WTO panel reports to the satisfaction of the complaining countries. This led to repetitive litigation and arbitration to attain compliance. See Williams, *supra* note 72.

84. Report of the Appellate Body, European Communities-Regime for the Importation, Sale and Distribution of Bananas, WT/DS27/AB/R (Sept. 9, 1997) [hereinafter Report of the Appellate Body, Bananas], available at 1997 WL 577784. It must be noted, however, that the approval of United States retaliation still did not lead to an effective resolution of the banana controversy. The EU, in an attempt to avoid the retaliatory tariffs, continued to find ways to avoid meaningful compliance with the DSB rulings. It was not until 2001 that the EU and the United States finally resolved the *Banana* Dispute. See Press Release, Office of the United States Trade Representative, U.S. Government and European Commission Reach Agreement to Resolve Long-Standing Banana Dispute (Apr. 11, 2001), available at <http://www.ustr.gov/releases/2001/04/01-23.html> (last visited Apr. 9, 2003).

85. See Report of the Appellate Body, EC Measures Concerning Meat and Meat Products (Hormones) WT/DS26/AB/R, paras. 2-5 (Jan. 16, 1998) [hereinafter Report of the Appellate Body, Hormones], available at 1998 WL 25520 (holding that the scientific evidence did not support the EU's ban on U.S. beef).

86. Request for Consultations by the United States, European Communities—Measures Concerning Meat and Meat Products, G/TBT/D/5 (Jan. 3, 1996), available at http://docsonline.wto.org/gen_search.asp.

87. Report of the Appellate Body, Hormones, *supra* note 85, para. 6.

88. *Id.*

89. For a discussion of the conflicting interpretations of the Appellate Body Report by both the EU and the United States, which led to further delays in dispute resolution, see Benjamin L. Brimeyer, Note, *Bananas, Beef, and Compliance in the World Trade Organization: The Inability of the WTO Dispute Settlement Process to Achieve Compliance from Superpower Nations*, 10 MINN. J. GLOBAL TRADE 133, 156-61 (2001).

Another practical reality belying the argument for retaliation is that in many instances the withdrawal of concessions is either a virtual impossibility or an idle threat. This is the dilemma for many export-dependent countries, and it is magnified by the "already extensive tariff reductions made during successive GATT rounds of multilateral tariff negotiations."⁹⁰

The problems of export-dependent countries may appear, at first glance, to actually support the use of retaliatory tariffs from an economic point of view. It could be argued that retaliation, at least with export-dependent countries, is not a substantial economic concern.⁹¹ This statement, however, undervalues the original intent behind the retaliation scheme—to deter nations from infringing on free trade. Deterrence is conspicuously absent when a country lacks any real power to stop another country's noncompliant behavior. The combination of these two factors, export dependence and the nonexistence of tariffs,⁹² often leaves a country with very little with which it can retaliate.⁹³ With all of the problems, why should we use procedures that contradict the very principles underlying our world trade system, especially if the end result of compensating injured countries can be attained through more efficient procedures?⁹⁴

III. PROPOSAL

Although many of the procedures in place today are a significant improvement upon past GATT practices,⁹⁵ even more efficiency is possible through a relatively straightforward change: simply removing the modus operandi of retaliating countries and eliminating Member countries' ability to reciprocate injuries by removing concessions. Instead, the WTO should modify the first step under

90. JACKSON, *supra* note 25, at 83.

91. This is because the smaller countries cannot exacerbate the economic losses through the imposition of tariffs. The small amount of imports they receive prevents any substantial economic loss to the small country's consumers or the exporting country's producers.

92. An export-dependent country may have few tariffs because it does not import many goods and thus has little with which to threaten another country.

93. JACKSON, *supra* note 25, at 83.

94. See generally Wolf, *supra* note 24 (discussing the underlying liberal economic principles of world trade).

95. See *supra* Part II.B (discussing changes to GATT implemented through the WTO).

the *Dispute Understanding*⁹⁶ and make compensation not just a goal, but *compulsory*.

A. Efficacy and Problems with a New System

As a threshold matter, this Note recognizes that the primary policy underlying the dispute resolution process is deterrence, not compensation.⁹⁷ Current procedures, however, do not advance this to a further extent than would a process purged of deadweight-producing measures. The goal, therefore, should be for the WTO to continue to maintain a strong system of enforcement that leaves economic inefficiencies behind.

Proceeding with this objective in mind, the first question is whether countries comply with the current WTO dispute procedures. Unless there is regular fulfillment of WTO obligations, the change that this Note proposes will have little effect and simply be a waste of administrative resources. In other words, there would be no point in changing the rules of a system that no one follows. Professor Jackson, however, has concluded that nations generally *do* adhere to the dispute resolution process.⁹⁸

A pattern of decreased "removal of concession retaliations" (RCRs) has recently emerged.⁹⁹ This is in line with the original intent of the *Dispute Understanding*, which makes clear that suspension of concessions is meant to be only "temporary"¹⁰⁰ because of its disastrous effects.

Given general compliance, an elimination of RCRs could further effectuate the *Dispute Understanding's* objective. The practical

96. The first step in a dispute is to negotiate "with a view to developing mutually acceptable compensation." *Dispute Understanding*, *supra* note 4, art. XXII, para. 2.

97. See *supra* notes 91-92 and accompanying text.

98. JACKSON, *supra* note 25, at 179, 189 (indicating the "general spirit of compliance" with which Member countries, even the largest of them, act in the face of negative reports). There are, however, differing opinions as to what level of compliance there has actually been. This is not surprising when one considers that DSB demands are subject to numerous interpretations. The implementation of DSB's report in the *Banana* dispute suffered from this problem. See Brimeyer, *supra* note 89, at 161-64 (discussing the EU and United States' conflicting interpretations of the Appellate Body report and consequent delays in reaching a final solution).

99. See WHALLEY & HAMILTON, *supra* note 75, at 133 (noting that the number of instances where a dispute has reached retaliation is "surprisingly small").

100. *Dispute Understanding*, *supra* note 4, art. XXII, para. 8.

effect of perpetual RCRs, remaining in place for as long as the offending country has failed to come into compliance and as long as diplomatic measures are unsuccessful,¹⁰¹ so far has had little effect in persuading countries determined to follow independent goals and policies. Supporters of the current regime cannot, therefore, justify RCRs on superior deterrence grounds.¹⁰²

B. Gains from a System Without Retaliatory Tariffs

The benefits of a system free of retaliatory tariffs are obvious. Tariffs are inefficiency-producing mechanisms that result in deadweight losses to society overall.¹⁰³ In the hypothetical proposed at the beginning of this Note, country B refused to accept country A's shoes, and as a result A retaliated. Country A would impose a retaliatory tariff, if practical, against the same sector that B's noncompliance injured. This would raise prices for the targeted goods, as well as their complementary goods,¹⁰⁴ and affect both domestic buyers and foreign sellers. Domestic buyers would reduce the quantity they demanded of the affected imports, and foreign sellers would suffer losses. The result would be a reduction in the welfare of domestic consumers, a reduction in the welfare of foreign producers, and an introduction of deadweight losses.¹⁰⁵

Eliminating RCRs that cause deadweight loss could have a major impact on the welfare of countries that reach the final stage of the dispute resolution process. Returning to the hypothetical of countries A and B, if the DSB did not condone A's retaliation in the form of tariffs, but instead awarded pecuniary damages to offset their industry losses, A would recover the revenue from the lost sales and provide B incentive to bring its conduct into compliance with WTO rules. Moreover, society would not experience the unnecessary residual harm that RCRs produce.

101. SWACKER ET AL., *supra* note 8, § 4-3(b)(3).

102. See *infra* notes 108-13 and accompanying text.

103. See *supra* note 62 and accompanying text.

104. Complementary goods are "[g]oods that 'go together'; a decrease in the price of one results in an increase in demand for the other, and vice versa." KARL E. CASE & RAY C. FAIR, *PRINCIPLES OF MACROECONOMICS* 52 (6th ed. 2002).

105. N. GREGORY MANKIW, *PRINCIPLES OF ECONOMICS* 184 (1998). Professor Mankiw also notes that any gains domestic producers make, along with the gains of their factory employees, are outweighed by the losses for the nation as a whole. *Id.* at 178.

C. Improvements on the Current Retaliatory Scheme

1. Diplomacy

Political concerns have historically been inseparable from international law.¹⁰⁶ This intermingling of politics with the implementation of DSB reports has led to many problems in the current system. The WTO framework is the international trading community's latest attempt to deal with some of these problems; accordingly, it is inherently legalistic in nature.¹⁰⁷ The character of such a code theoretically should encourage a complete withdrawal from "Power Oriented" diplomacy.¹⁰⁸ Sadly, this has not been the real world effect of the WTO. As the *Tuna-Dolphin* dispute demonstrates,¹⁰⁹ these "power" movements still exist. Political "foot-dragging"¹¹⁰ causes even more delays in implementing what could be efficient solutions. Because of the institutional intermingling of both politics and international dealings, the current system does not present any viable solution. This Note's proposed changes would not completely resolve this recurring problem because it is unlikely that the international field will ever exist as a completely egalitarian system. The changes, however, would be a vast improvement on the current system.

106. ASIF H. QURESHI, *THE WORLD TRADE ORGANIZATION: IMPLEMENTING INTERNATIONAL TRADE NORMS* 50 (1996).

107. *Id.* at 10 (noting that "[t]he substantive law of the WTO partakes more of the nature of a code than of a detailed regulatory system") (footnote omitted).

108. JOHN H. JACKSON, *PERSPECTIVES ON THE JURISPRUDENCE OF INTERNATIONAL TRADE: COSTS AND BENEFITS OF LEGAL PROCEDURES IN THE UNITED STATES* 1570-71 (1984). Jackson categorizes diplomatic techniques into two groups: power-oriented and rule-oriented. Power-oriented diplomacy consists of a diplomat asserting the clout of the nation that they represent to gain an advantage in negotiations. Alternatively, rule-oriented diplomacy revolves around pre-defined rules that all players must follow, regardless of their relative size and strength. Commentators have also described this technique as a legalistic approach to diplomacy. *Id.*

109. *See supra* Part II.D (discussing the problems inherent in WTO retaliation policy/schemes).

110. *Id.*

2. *Inability to Attain the Compliance of Superpower Nations*

The DSB's inability to deter the world's most powerful countries' inappropriate trade behavior is another visible blemish on the WTO's generally favorable performance. The statements of Ambassador Mickey Kantor, U.S. Trade Representative, clearly illustrate this failure: "No ruling by any dispute panel, under this new dispute settlement mechanism ... can force us to change any Federal, State, or local law or regulation. Not the city council of Los Angeles, nor the Senate of the United States, can be bound by these dispute settlement rulings"¹¹¹

Would this Note's proposed approach remedy the problem of noncompliance of superpower nations? The answer is unclear, but at the very least, the suggested change would be a substantial improvement to existing mechanisms.

The most obvious benefit is the recurring theme of this Note—the reduction in deadweight losses to the world as a whole.¹¹² The fact that the current system is unable to ensure compliance belies any argument that such a change would worsen the existing deficiencies in the DSB's deterrence function. Are there, however, other potential detriments which would accompany such a change?

A strong argument against removing retaliation as an option is that we should not displace mechanisms designed to give relatively small or developing countries the ability to ensure proper behavior with more powerful trading partners. As Professor Jackson has noted, the participation of developing countries in the current dispute settlement system has increased and led to generally positive results.¹¹³

This optimistic pattern, however, does not appear to be the result of the threat of retaliatory tariffs; instead, countries' threat of *any challenge*,¹¹⁴ and the superpower countries' voluntary compliance with Appellate Body reports are what enable developing or smaller

111. *GATT Implementing Legislation: Hearings on S.2467 Before the S. Comm. on Commerce, Sci. and Transp.*, 103d Cong. 33, 37 (1994) (statement of Ambassador Mickey Kantor). This common response to the threat of losing control over one's own domestic affairs likely prevents any international legal system's attainment of complete control.

112. See *supra* Part III.B (discussing gains in a system without retaliatory tariffs).

113. JACKSON, *supra* note 25, at 180.

114. See, e.g., *US Threatens Canada with WTO Case, Hints at Mexico Challenge*, INSIDE U.S. TRADE, Apr. 3, 1998, at 1.

countries to enforce proper trade relationships.¹¹⁵ If a larger country such as the United States or the EU *decides* to disregard an Appellate Body report, imposing retaliatory tariffs will not ensure a change in behavior. Retaliation simply imposes unnecessary costs on the global economy.

If we instead used a system that simply imposed pecuniary damages, smaller countries would have the same protection. The injuring country would be faced with the prospect of paying for the harm it caused, which in and of itself would be an improved deterrent factor.

The next question is whether WTO imposed damages would remove what little incentive countries currently have to change noncompliant behavior. In the current system, retaliation continues until the offending Member withdraws its violative measures. This promotes compliance because the loss of export revenues continues to grow until the offending country makes the necessary changes. This Note's proposed changes could follow either the current framework by imposing recurring damages, or institute one-time penalties.

A new WTO policy of one-time damages would more closely follow the intent of Article XXII of the *Dispute Understanding* (Compensation and the Suspension of Concessions), which requires that "[t]he suspension of concessions or other obligations shall be temporary"¹¹⁶ Recurring penalties, however, as opposed to one-time penalties, would constitute more of a deterrent. Countries would be less willing to continue noncompliant behavior if the prospect of losses continued to accumulate. Under the current retaliatory scheme such a result is far from evident. In both the *Beef Hormone* and *Banana* disputes, the offending country refused to comply with Appellate Body rulings,¹¹⁷ despite the eventual imposition of retaliatory tariffs.¹¹⁸ The complaining Member's

115. See Report of the Appellate Body, United States Restrictions on Imports of Cotton and Man-Made Fibre Underwear WT/DS24/AB/R, (Feb. 10, 1997), available at 1997 WL 426484.

116. Dispute Understanding, *supra* note 4, art. XXII, para. 8 (emphasis added).

117. See Report of the Appellate Body, Hormones, *supra* note 85; Report of the Appellate Body, Bananas, *supra* note 84.

118. Some argued that the European Community (EC) tried, albeit half-heartedly, to comply with WTO rulings in the *Banana* case. See generally Reif & Florestal, *supra* note 73, at 776-82 (discussing the EU's opinion over what constituted compliance with the Appellate

maintenance of RCRs merely led to the cumulation of economic losses. Instituting recurring damages may not completely change this pattern, but at the minimum would greatly reduce economic costs.

The above paragraph illustrates that a system contemplating one-time penalties would not be much of a deterrent. An additional problem with changing to a single-sanction system is that its success would be a practical impossibility. If the WTO allowed nations to simply decide to pay an initial penalty and then disregard WTO declarations on required compliance, the system's validity would fall into disrepute. Cooperation and compliance within the system would be replaced by a situation in which wealthy nations could simply reach into their pockets to follow their own agenda, regardless of the deleterious effect on the trade system as a whole. A system that continues to impose penalties on a noncompliant Member thus emerges as the most viable option.

The WTO could also avoid any serious loss in deterrence by increasing estimates as to what damages are appropriate. It is unlikely that a country will view damages designed to compensate for injuries it imposed on an entire industrial sector (including complementary industries) as insignificant. Moreover, the reader must not forget that countries would have deterrents in addition to WTO-imposed fiscal penalties. A particularly important disincentive is that a country choosing to ignore DSB reports would, as under the current regime, gain an injurious reputation. Such a standing in the international community impairs future negotiation over trade, and can force the uncooperative country to answer for these failures in other areas subject to negotiation.¹¹⁹

Another improvement that would likely accrue if the WTO were to employ pecuniary damages is that the remedy would be universally available. This is important because, as discussed above, under the current scheme, it is practically impossible for some smaller export-dependent countries to deter noncomplaint behavior with retaliatory mechanisms.¹²⁰ If the WTO imposed

Body ruling).

119. William J. Davey, *Dispute Settlement in GATT*, 11 *FORDHAM INT'L L.J.* 51, 76-78 (1987).

120. See *supra* Part II.D (discussing problems inherent in WTO retaliation policy/schemes).

damages, however, a country's relative trade strength would have much less impact on a larger trading partner's incentive to comply with WTO standards.

Although the preceding sections of this Note have illustrated the benefits of a system free of retaliatory tariffs, they have perhaps not fully answered the question of whether such a change would do anything to improve the compliance with unfavorable rulings of superpowers such as the EU and United States. It is important to note, however, that even the United States, which has been a subject of controversy on the system's ability to generate compliance, has at least as much of an interest in maintaining an international trading system as any other country. The United States and other large trade-heavy countries are active participants in international trade. They thus have everything to gain from a predictable and dependable system that has the fewest unfavorable secondary effects.¹²¹

D. Objections to a New System

1. Administration and Information Costs

The prohibitive cost of imposing any rule that requires a large degree of information to determine appropriate action is an objection to any change in a system that involves parties as large as entire nations. In many cases, ideal procedures can become so expensive that they become practically impossible.

Fortunately, assessing appropriate damages for a breach of WTO rules need not incur any additional costs—the WTO would follow current procedures. Compensation should remain “equivalent to the level of nullification or impairment.”¹²² This evaluation would require knowledge of not only the offended sector, but also of the damage the violations inflicted on the victim country's overall economy.

121. SWACKER ET AL., *supra* note 8, § 4-3(c)(3), at 310-11 (discussing net benefits to the United States of an effective dispute settlement program).

122. Dispute Understanding, *supra* note 4, art. XXII, para. 4.

There is no question that these appraisals would be difficult and very costly to obtain¹²³ in a system of limited resources, but it would be no different than the current system. The current system already limits retaliation by principles of proportionality.¹²⁴ The WTO makes assessments of the limits of appropriate retaliation under the system in place today. This Note's proposed amendment to the current system would thus not impose costs more onerous than those currently in place.

2. Sovereignty Concerns

Large countries would likely oppose the introduction of a system that would grant an independent international body the power to "punish" noncompliant Members with pecuniary damages. They would see this independent authority as a threat to their sovereignty. Does this mean that the WTO, as imagined by this Note can never exist except in theory? The history of the world, and continuing international consolidation points to a resounding: "No!"

One thing that can be said with certainty is that international cohesion will continue to flourish. The WTO recently added China

123. An example of how the WTO acquires these measurements is found in the Decision by Arbitrators, EC Measures Concerning Meat and Meat Products (Hormones), WT/DS26/ARB (July 12, 1999), available at 1999 WL 512321. The decision discusses the WTO's use of the American system of evaluating damages:

(1) it examined relevant actual US exports during a recent period in which the EC was, in the US view, failing to comply with its WTO obligations; and (2) it estimated the relevant exports that would have existed during the same period if: (a) the EC were acting in compliance with its WTO obligations; (b) the long-term economic adjustments resulting from compliance were reflected; and (c) all other factors were held constant. The US refers to the estimate in (2) as "the counterfactual." Harm to US exports is estimated as the difference between the actual value of exports in (1) and the estimated value in the counterfactual (2).

Id. at *7. This process is further complicated when the complainant is a developing country. The *Dispute Understanding* directs the DSB to "take into account not only the trade coverage of measures complained of, but also their impact on the economy of developing country Members concerned." *Dispute Understanding*, *supra* note 4, art. XXI, para. 8.

124. Proportionality imposes a "general limitation on the exercise by ... national authorities of the powers conferred upon them by ... law by requiring the measures they adopt to be in proportion to their ultimate objectives." ANTHONY ARNULL, *THE EUROPEAN UNION AND ITS COURT OF JUSTICE* 199 (1999). A good example of this current practice is the *Beef Hormone* case. There, the retaliatory measures the WTO allowed the United States to use were set at an amount equal to the amount of harm the EU's refusal to accept American meat products inflicted on American industry.

to its membership, and in the not too distant future, will likely add Russia to the WTO's enlistment of more than 130 Members. China's entry integrates the world's most populous country into the equation,¹²⁵ making any country's continued refusal to concede some sovereignty to the WTO, in exchange for greatly expanded economic opportunities, a very unwise move.

Consider, for example, the United States. A withdrawal from the international scene would be extremely unwise as billions of dollars in investment and trade—not to mention in foreign policy goals—would be lost. Nevertheless, many Americans would still oppose a push for increased international integration. The United States is not even close to being free of protectionist thinking,¹²⁶ and much of the world shares American concerns.¹²⁷

In contrast to this pessimism, however, is the United Kingdom. It provides a perfect example of a country that once was, and still is, pervaded by isolationist feelings; it continues, however, to acquiesce to increased supranational governance. This has occurred even though the United Kingdom originally was opposed to the idea of *any* supranational guidance.¹²⁸ The United Kingdom has subsequently pushed aside such concerns in order to benefit from a Europe with "economic conditions similar to those on the market of a single state,"¹²⁹ and become a member of the European

125. Geoff Winestock & Karby Leggett, *China to Enter WTO; Dispute on Insurance To Be First Test*, WALL ST. J., Sept. 17, 2001, at A14.

126. *See Tariffs on Steel: George Bush, protectionist*, ECONOMIST, Mar. 9, 2002, at 13 (discussing the President's recently announced "plans to protect the American steel industry" through "temporary high tariffs (ranging up to [thirty-percent])").

127. *See Turkey and the EU: A general speaks his mind*, ECONOMIST, Mar. 16, 2002, at 53 (discussing Turkey's reluctance to accede to the EU's conditions on membership). Some of Turkey's concerns include converting to a democratic government and the settlement of territorial disputes. *Id.* These required concessions have prompted at least one leading traditionalist to call for "alternatives" to EU membership. *Id.* (citing statements by Gen. Turner Kiline, Secretary General of Turkey's National Security Council).

128. The "Schuman plan," a framework the French Foreign Minister designed to unite Europe following World War II, met with enthusiastic approval from France, Germany, Italy, and the Benelux countries. The United Kingdom, however, rejected the idea of subjugating itself to a supranational institution. *See* A.M. ARNULL ET AL., EUROPEAN UNION LAW 3 (4th ed. 2000).

129. *Id.* at 8. Three years after Britain initially rejected the "Schuman Plan," negotiations for membership began anew. This resulted in Britain's eventual membership into the European Economic Community. These successive efforts by the United Kingdom exhibit the willingness of even traditionally isolated countries to give away sovereignty in order to reap the rewards of a greatly enlarged trading union.

Economic Community. This trend of increased integration has continued, and may even lead to British abandonment of its traditional pound in favor of the Euro. Britain's new found attention to the Euro is especially telling of how Britain's isolationist sentiments have given way to a powerful push for greater international integration; it also serves as a prognosis of future action by the United States. Though the British have long been Europe's most reluctant citizens,¹³⁰ their growing interest in a uniform international currency has taken root and continues to grow.¹³¹

Like Britain, the EU as a whole serves as a perfect illustration of how a trading union will continue to develop into a supranational institution with the ability to affect all aspects of its member's domestic concerns. The EU's founders envisioned it as a supranational institution that would lead to major advances in economic growth.¹³² Economic reform, however, is only one of the remarkable changes that have developed through the EU.¹³³ Social reform,

130. *See id.* at 3-12.

131. The British adoption of the Euro was very unlikely at one point. This reluctance was first evident in 1997, when Gordon Brown, the United Kingdom's Chancellor of the Exchequer, took the financial community by surprise and declared an independent monetary policy. Instead of aligning itself with the European Central Bank, the chancellor announced that the Bank of England would establish operational independence. *See Let Pounds & Euros Compete: Contrary to General Opinion, the Issue of Economic and Monetary Union has become Less Important to Britain*, FIN. TIMES, Jan. 17, 2002, at 17. The decision to isolate Britain's economic governance from the rest of the EU was to many a sure sign of a British refusal to tie its economy to the fate of the rest of the Union.

Recent polls by the "Yes" campaign, however, show that this sentiment has taken a dramatic turn. *See Kevin Brown & Robert Shrimley, Top Business Support for Membership of Euro Soars*, FIN. TIMES, Jan. 14, 2002, at 3. The campaign promotes adoption of the Euro in Britain.

Bob Worcester, chairman of MORI (a British research company), said the results were highly encouraging for the government, which supports entry in principle; subject to a referendum and five economic tests set by Gordon Brown, the U.K. chancellor. "This is very good news for them because the steady decline (in support) since 1998 has been reversed. Our figures for typical voters in a referendum show that economists, bankers and business leaders are the people they would be most influenced by."

Id.

132. Brown & Shrimley, *supra* note 131, at 3.

133. The EU has recently admitted ten new countries to its membership and began working on a European Constitution that will possibly bring even greater cohesion to its members. *See The European Union Summit: From the Sublime to the Cantankerous*, ECONOMIST, Dec. 22, 2001, at 57-58.

including the reduction of discrimination against different races, nationalities, and gender are but some of the far-reaching effects EU trade regulation has encouraged.¹³⁴ These changes are not the result of legislation aimed *directly* at social policies, as these issues are not part of what is essentially a trading union.¹³⁵ Instead, these results are a part of the EU's intent to further trade and thus eliminate any impediments to that goal.¹³⁶

These are just a few examples of the changing face of international relations and the power and draw of increasing economic opportunities. Countries all over the world, including the United States, will soon be unable to resist the temptation of an ever-increasing market; they will be forced to concede on some issues of domestic control. Viewing sovereignty issues through the lense of the emerging marketplace is likely to transform current political impossibilities into tomorrow's reality.

3. *Refusal to Pay*

Even with the consent of all WTO Members to switch to a damages system, there exists the possibility that a superpower country would not comply with a DSB decision. This could occur, for example, if the United States decided that the damages panel assessed against it were excessive. Although this is a possibility in any legal system that requires a losing party to compensate through pecuniary remedies, it would be unlikely that the United States or any other superpower country would do so in the WTO.

First, the United States and the EU already belong to other international trade organizations that provide damages as a remedy

134. See ARNULL, *supra* note 124, at 144-48.

135. *Id.*

136. This is evident when one considers a law that would prohibit impediments to the free movement of goods, workers, services, payments, and capital—the four tenets of the EU. Uwe Blaurock, *Steps Toward a Uniform Corporate Law in the European Union*, 31 CORNELL INT'L L.J. 377, 379 (1998). To illustrate, if a country were to discriminate against women, and thus prohibit them from working, it would impede the "free movement" of women workers from other countries. See Case C-197/96 Commission v. French Republic, 1997 E.C.R. I-1489 (invalidating French legislation that prohibited night work by women in plants, factories, and workshops).

for aggrieved parties,¹³⁷ therefore, such a system would not be unprecedented nor incomprehensible for either Member. Moreover, assuming the United States or any other superpower country committed itself to this proposed system, it is unlikely that they would remove themselves from the most expansive international trading system simply because of an unfavorable decision. The more likely result is the status quo: Responding nations will not eliminate trade barriers but will continually compensate the complaining country for their noncompliant behavior.¹³⁸

4. *Rapid Recovery*

One welcome benefit to a system that utilizes damages would be a shortened period between the complaining Member's injury and its eventual compensation. Under current procedures, reparation is made through market channels. Any compensation the injured party receives is only by way of gains from essentially "protectionist" measures.¹³⁹

This system leaves a significant time lag between a country's imposition of tariffs¹⁴⁰ and its eventual compensation. If the system were instead one of pecuniary damages, there would be nearly instantaneous remuneration. Once the DSB made a decision to

137. See North American Free Trade Agreement Between the Government of the United States of America, The Government of Canada and the Government of the United Mexican States, Dec. 17, 1992, art. 1135(1), 107 Stat. 2057, 32 I.L.M. 289 (providing damages for violations of investor's rights); Cases C-6/90 & C-9/90, *Francovich v. Italian Republic*, 1991 E.C.R. I-5357, paras. 31-33 (noting that it is inherent in the system of the EU Treaty that a member state must be liable for loss and damages inflicted on individuals as a result of the member state's breaches of Community law).

138. Obviously, the aggrieved Member would get the benefit of receiving pecuniary damages (and all the additional economic benefits) rather than be left with a possibly unattractive opportunity to retaliate. See *supra* Part III.B.

139. See SAMUELSON & NORDHAUS, *supra* note 16, at 704 (noting that in "the United States and other countries, firms and workers who are injured by foreign competition attempt to get protection in the form of tariffs or quotas"). The injured industry then gets the benefit of now facing more expensive imports; this logically pushes domestic consumers into substituting away from those products. The injured sector, therefore, recovers damages through indirect channels.

140. Not to mention the practical time difficulties that seemingly accompany many attempts at attaining retaliation. See *supra* Part II.D.

impose penalties, the payment would ideally go directly to those injured by the offending measures.¹⁴¹

5. Ambiguity

One problem under the current system is that it is unclear whether a WTO Member that the dispute panel directs to become consistent with treaty rules is obligated, as a matter of international law, to comply or whether that nation has the option merely to compensate by other trade measures and not follow WTO directions. The question, then, is whether this Note's proposed changes would resolve this ambiguity. Unfortunately, the changes in the retaliatory scheme would not likely do so. This does not mean, however, that changes in the current scheme of retaliation would be inconsequential. Efficient compensation remains an attainable goal that the WTO should pursue to increase world-wide gains from trade.

CONCLUSION

The political economy of trade policy encompasses many concerns. The most prominent trade system, the WTO, makes economic efficiency its primary objective, yet employs procedures inconsistent with this goal.¹⁴² Why should the WTO utilize procedures contrary to its fundamental purpose? Looking at current procedures and their consequences, any compelling rationale for their continual use is lacking.

Although the system undoubtedly requires strong enforcement mechanisms, retaliatory tariffs are destructive and inefficient. They cause the unnecessary loss of global welfare and encourage diplomatic strife. Returning again to the hypothetical dispute involving countries A and B in the beginning of this Note, if we use

141. These benefits are based on the assumption that the proposed procedure would require that any damages go directly to the harmed sectors, essentially following current practice. See CROOME, *supra* note 47, at 24. The motive for this could be the same as that underlying the practice of retaliation. Admittedly focused on deterrence, these measures have the additional benefit of providing injured industries with the opportunity to regain lost sales, albeit indirectly. If the damages were diverted to other sectors, perhaps even hugely beneficial social programs, the opportunity for compensation would be lost.

142. Wolf, *supra* note 24, at 14-21.

the damages alternative, A, the complaining country, would be able to acquire its lost sales and the benefits flowing from them without injuring its own citizens.

A simple modification, moving from retaliatory tariffs to pecuniary damages, would avoid these costs and, as this Note demonstrates, not impose significant additional burdens on the world economy.

*Curtis Miller**

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