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Institute for Agriculture and Trade Policy
Trade and Global Governance Program

Strengthening Compliance at the WTO

Cross-retaliation in WTO disputes

Summary

The WTO dispute resolution body (DSB) is coming under increasing strain because some member states that lose cases, often the WTO's wealthiest members, fail to fully implement the dispute panel rulings. On August 21, Brazil formally requested a WTO dispute panel because the U.S. has not made all the changes to its cotton programs that the dispute ruling of June 2004 on U.S. Upland Cotton required. The case is not unique. Non-compliance undermines the credibility and viability of the WTO's rules-based multilateral trading system. In the wake of the July 2006 collapse of the Doha Round negotiations, many experts believe there will be a significant rise in WTO legal disputes. IATP proposes developing countries consider using a new strategy to ensure compliance: cross-retaliation within the WTO system. Under this approach, winners would be able to force implementation by suspending commitments to WTO agreements not named in the dispute. The approach is allowed in theory, but has not yet been tested in practice.*

Compliance with WTO Dispute Rulings

There have been a number of studies conducted on the extent of compliance within the WTO dispute settlement system. An analysis of 181 WTO disputes prior to July 1, 2002, found an 83 percent compliance rate.[1]

Despite the high percentage of full or partial compliance, many of the disputes that led to formal non-compliance action include some of the best known: EC-Bananas III, EC-Hormones, Australia-Salmon, Australia-Automotive Leather II, Brazil-Aircraft, Canada-Aircraft, U.S.-Shrimp, Canada-Dairy, U.S.-Tax Treatment for Foreign Sales Corporations (U.S.-FSC), and U.S.-Copyright Act. Of these, a further subset resulted in arbitrators awarding the complainant the right to apply economic retaliation (raising tariffs against exports originating from the non-compliant member) pursuant to article XXVIII of the General Agreement on Tariffs and Trade (GATT): EC-bananas, EC-Hormones, Brazil-Aircraft, Canada-Aircraft, and U.S.-FSC.

Once authorized by the DSB, WTO members may apply punitive tariffs as a form of economic retaliation. The objective of economic retaliation is to pressure the non-compliant member enough that the non-compliant member will comply with the DSB ruling. Unfortunately, poor countries are economically too vulnerable and otherwise not well positioned to retaliate through the conventional method of raising tariffs applicable to the goods imported from the non-compliant member (usually a wealthier country). Any tariff increase on a small-sized market of a poor country would likely not be enough to force compliance. For example, U.S. imports matter far more to the Peruvian economy than exports to Peru matter to the U.S. The proposed punishment risks hurting the wronged party more than the offender.

Three Examples of Non-Compliance

Three cases demonstrate the challenges of securing compliance with DSB rulings for developing countries. The EC-Bananas case involved complaints from Ecuador, Honduras, Mexico, Guatemala and the U.S. against the EC's banana import licensing scheme. The DSB ruled that the EC Bananas import regime was discriminatory and in violation of WTO obligations under the General Agreement on Tariffs and Trade (GATT) and the General Agreement on Trade in Services (GATS). The DSB granted Ecuador the authority to suspend trade concessions with the EC of $201.6 million, but for the first time the WTO also authorized cross-retaliation under other WTO agreements. The DSB allowed Ecuador to suspend trade-liberalizing commitments it had made to the EC first under the GATT, then GATS and finally the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs). While Ecuador has yet to exercise its right to these sanctions, the precedent of the DSB authorization to cross retaliate is important.[2]

In a second case, Antigua and Barbuda challenged U.S. gambling laws. In April 2005, the DSB ruled that three U.S. federal laws and the provisions of four U.S. state laws were inconsistent with U.S. obligations under GATS. The DSBs "reasonable period" of time allowed for U.S. compliance expired on April 3, 2006.[3] The U.S. has failed to comply. Antigua and Barbuda now face the dilemma of how to secure compliance from a significantly more powerful trading partner.

A third example is the U.S.-Upland Cotton case. In June 2004, the DSB ruled against the U.S. on several key issues, finding that the amount of U.S. subsidies were too high for two types of U.S. payments, that the U.S. Step 2 payments were prohibited export subsidies, and that U.S. support programs directly contingent on market price levels, i.e. marketing loan provisions and counter-cyclical payments, caused harm to Brazil's interests through price suppression in the world market between 1999 and 2002.

The Panel recommended the U.S. comply with the ruling by July 1, 2005. The U.S. said it would rather reach a new political agreement through the Doha round of negotiations than comply with the DSB ruling on its violations of Uruguay Round agreements.[4] Brazil rejected this proposal, insisting the U.S. comply in full with the ruling and not wait until the completion of the Doha Round.

Brazil then requested authorization from the WTO to suspend TRIPs and GATS concessions as well as to raise tariffs on some U.S. goods.[5] These proceedings were suspended when the U.S. Congress took steps to repeal the Step 2 program, which was eventually completed in August 2006. Brazil remained dissatisfied, however, with the partial U.S. response to the WTO ruling, as its August 2006 request for a new WTO panel shows. The U.S. blocked that request. But if Brazil makes a second request for a panel, the U.S. cannot block it.[6]

Using cross-retaliation to ensure compliance

The DSB offers two options for dealing with non-compliance. The first is compensation, usually in the form of a tariff increase against the offending WTO member. Secondly, the DSB may impose discriminatory countermeasures against the offending member country under other WTO Agreements that have nothing to do with the dispute so long as the monetary value of cross-retaliation is not greater than the harm caused by the offending member's WTO violation.

In light of the limited effectiveness of conventional economic retaliation, the suspension of WTO member commitments under GATS and TRIPs may prove more effective in securing implementation of the DSB rulings. Why? In part because large, multinational corporations based in wealthy countries stand to benefit enormously from the commitments made by poor countries under both GATS and TRIPs and so have a strong interest in these obligations being respected. These companies exert considerable political influence in the countries where they are based.

The TRIPs agreement primarily benefits commercial pharmaceutical, software and entertainment industries located in the U.S., Japan, Switzerland, Germany and the UK. Under GATS, banks, insurance firms, telecommunications companies, tour operators, hotel chains and transport companies all benefit from rules that require WTO members to open markets to transnational service providers and to ensure that government regulation is "necessary" and not "burdensome" to trade.

Given the overwhelming advantages conferred to transnational corporations under GATS and TRIPs, much greater economic pressure could be brought to bear through non-compliance with GATS and TRIPs than through punitive tariffs on goods. Where heavily invested firms from rich countries are facing the prospect of revenue losses, they will lobby for compliance rather than risk being the subject of cross-retaliation. For example, if Brazil threatened to suspend royalty payments to Pfizer in retaliation for U.S. non-compliance with the Upland Cotton ruling, then Pfizer would likely use their considerable political clout to lobby to change U.S. law to conform to the DSB ruling.

Limitations of cross-retaliation

A cross retaliation strategy does have drawbacks. Many poor countries are dependent on wealthier countries for foreign aid and other assistance. Many poor countries receive tariff preferences from wealthier countries under voluntary schemes that can be unilaterally withdrawn by the developed country granting the preference. For example, Brazil has about $2.5 billion in trade to the U.S. under the Generalized System of Preferences (GSP). The U.S. has been pushing Brazil to step up protection of intellectual property rights (IPRs) if it wants to keep these benefits. The U.S. can withdraw trade preferences such as the GSP with no legal consequences to itself, since the system is entirely voluntary and is conferred by the U.S. on those it chooses; it is a unilateral obligation.

One challenge to withdrawing commitments under TRIPs arises when these commitments are codified in domestic legislation. If TRIPs commitments were withdrawn without first modifying that legislation, the result could be many civil suits in domestic courts for illegal expropriation of intellectual property. In countries where constitutions have been amended to accommodate TRIPs obligations, the domestic legislation needed to withdraw from TRIPs is more complicated still. A solution is to rewrite domestic legislation to expressly reserve the right of the country's executive authorities to revoke or suspend certain IPRs in the event such retaliation is needed.

As a form of cross retaliation under GATS, a poor country complainant may order a service supplier of the defendant country to suspend business or impose a supplementary tax on each unit of its service input. However, the diversity and disjointed levels of services regulation, as well as the incomplete state of GATS negotiations, makes cross-retaliation under GATS difficult to implement as a general compliance strategy.

Conclusion

A future with cross-retaliation under TRIPs and GATS promises to place poor countries in a better strategic position to secure compliance by rich countries.

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*This fact sheet is based on "Strengthening a Culture of Compliance: The potential use of cross-retaliation by WTO developing member countries" by IATP intern Nneka Morrison, a paper submitted to fulfill a Master of Laws degree requirement at the University of Melbourne.

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