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Doctoral Thesis

**A Legal and Economic Analysis of the
Remedy System for Prohibited Subsidies in the WTO**

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ABSTRACT

The remedy system in the WTO for prompt dispute settlement has attracted a lot of attention by international trade scholars due to its unique enforcement mechanism which is not available in other areas of international law. In particular, the remedy system for prohibited subsidies deserves more focused attention due to a contradiction: Despite the tight regulations and rules to ensure compliance with WTO subsidy rules, the actual implementation rate of the WTO DSB rulings to remove violating prohibited subsidy measures fares the poorest. This leads to the question of whether the current remedy system for prohibited subsidies is indeed effective, or at least desirable from the perspective of WTO Members.

During the process of this study, several proposals have been made to ‘remedy’ the current inefficiency in the remedy system for prohibited subsidies by examining the following issues: (1) Whether retrospective remedies should be allowed for the effective ‘withdrawal’ of subsidies; (2) What the ‘appropriate’ level of retaliation for prohibited subsidies should be; (3) Whether monetary compensation could be allowed as an alternative remedy for inducing compliance in prohibited subsidy disputes; and (4) How the current mechanism for inducing compliance through the ‘fast track’ procedure for prohibited subsidies could be strengthened.

In order to address these questions, this research has relied on both legal and economic analyses to provide an economic justification for the legal arguments that are made in this study. In particular, existing research using economic models have been

applied to this work in order to provide interesting perspectives that help to suggest a renewed approach for the remedy system, at least for the case of prohibited subsidies. In conclusion, the results of this study suggest that when it comes to the remedy rules on prohibited subsidies, a stronger incentive for prompt compliance is needed through the retrospective application of the retaliation remedy, especially for dealing with non-recurring prohibited subsidies. This study further suggests that the possibility of using monetary compensation as an alternative remedy for prohibited subsidies is not viable, mainly due to the purpose of remedies in prohibited subsidy rules that is served by the 'property rule'. For determining the level of retrospective retaliation, proportionality and the multilateral nature of remedies should be considered, under which the trade effects of the subsidy measure on individual WTO Members should be the basis for calculation.

The problem of delayed implementation involving recurring prohibited subsidies may be a more intricate matter that mainly derives from the fundamental nature of subsidies as a strategic national policy. However, the loophole that is created, which undermines the stability and predictability of the WTO remedy system should not go unaddressed. In this regard, the existing fast track procedures that are in place as the remedy system for prohibited subsidies may be made more effective by addressing the problems that incur from the narrow jurisdiction of WTO compliance panels and the arbitrary 'sequencing' arrangements in compliance and authorization proceedings. Ultimately, it will be the role of the WTO adjudicating bodies and the Members to apply the rules in a sensible and practical manner that gives meaning and effectiveness to the

WTO rules in accordance with the purpose and objectives of the respective WTO Agreements.

Key words: WTO Remedy System, Prohibited Subsidies, Dispute Settlement Procedures, Retrospective Remedies, Level of Retaliation

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LIST OF ACRONYMS AND ABBREVIATIONS

AD	Anti-Dumping
AG	Agriculture
ATC	Agreement on Textiles and Clothing
BIT	Bilateral Investment Treaty
CVD	Countervailing Duty
DSB	Dispute Settlement Body
DSU	Dispute Settlement Understanding
ETI	Extraterritorial Income Exclusion
FSC	Foreign Sales Corporation
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
ICJ	International Court of Justice
ICSID	International Center for Settlement of Investment Disputes
IIA	International Investment Agreements
ILC	International Law Commission
IP	Intellectual Property
IPR	Intellectual Property Right
ISD	Investor-State Dispute
ITO	International Trade Organization

MFN	Most Favored Nation
NAFTA	North American Free Trade Agreement
PCIJ	Permanent Court of International Justice
RPT	Reasonable Period of Time
SCM	Subsidies and Countervailing Measures
SG	Safeguards
SPS	Sanitary and Phytosanitary Measures
TBT	Technical Barriers to Trade
TRIPS	Trade-Related Aspects of Intellectual Property Rights
VCLT	Vienna Convention on the Law of Treaties
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

1.1 THE IMPLEMENTATION PROBLEM IN PROHIBITED SUBSIDY DISPUTES

The WTO dispute settlement system has in place a remedial mechanism that enables the enforcement of the rulings and recommendations made by the Dispute Settlement Body (DSB) on the violations of the WTO law and obligations contained therein. Due to its unique enforcement mechanism which has not been available in other areas of international law, the remedy system for dealing with non-compliant actions in the WTO dispute settlement system has attracted a lot of attention by international trade scholars. As compared to the international legal regime in general, the WTO has dispute settlement procedures specified by law that are comparable to domestic legal proceedings, and the rulings made by the WTO DSB has binding authority on its Members and remedies available to enforce the rulings if Members do not comply with the rulings promptly enough.

Within the subject matter of remedies, however, the narrower field of the remedy system for prohibited export subsidies deserves more focused attention, due to a contradiction: Under the WTO, the regulation on subsidies and dispute settlement procedures for subsidy disputes, especially prohibited subsidies, are the most severe and tightly disciplined. However, surprisingly, the rate of actual implementation of DSB recommendations in subsidy disputes is one of the lowest in the WTO. In other words,

despite tight regulations and rules to ensure compliance with WTO subsidy rules, the implementation of the recommendations by the WTO DSB to terminate the violating subsidy measures is faring the poorest. Therefore, this leads to the question of whether the current WTO remedy system, especially for prohibited subsidies, is indeed effective, or at least, desirable from the perspective of WTO members.¹

The evidence of stringency regarding the discipline on prohibited subsidies is shown from the provisions in the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) which contains the following rules: the outright prohibition of export subsidies (and import substitution subsidies)²; the corresponding obligation for immediate withdrawal when ruled to be a violation of WTO rules³; higher retaliation levels authorized by the Dispute Settlement Body (DSB); and ‘fast track’ dispute

¹ Many prominent scholars have discussed this specific issue of remedies to WTO subsidy disputes, from both legal and economic perspectives: R. Lawrence and N. Stankard, ‘Should Export Subsidies be Treated Differently?’, Conference paper at University of Wisconsin (2005); A. Green and M. Trebilcock, ‘Enforcing WTO Obligations: What Can We Learn from Export Subsidies?’, 10 *Journal of International Economic Law* 653 (2007); T. Lin, ‘Remedies for Export Subsidies in the Context of Article 4 of the SCM Agreement: Rethinking Some Persistent Issues’, 3 *Asian Journal of WTO & International Health Law and Policy* 21 (2008); K. Bagwell and R. Staiger, ‘Will International Rules on Subsidies Disrupt the World Trading System?’, 96 *American Economic Review* 877 (2006); K. Bagwell, ‘Remedies in the WTO: An Economic Perspective’, Columbia University Discussion Paper No. 0607-09 (2007); G. Grossman and A. Sykes, ‘Optimal’ Retaliation in the WTO – A Commentary on the *Upland Cotton* Arbitration’, 10 *World Trade Review* 133 (2011); K. Bagwell and R. Staiger, ‘The Economics of Trade Agreements in the Linear Cournot Delocation Model’, 88 *Journal of International Economics* 32 (2012).

² While the category of prohibited subsidies in the SCM Agreement (Article 3) includes both subsidies contingent upon export performance (export subsidies) and subsidies contingent upon the use of domestic over imported goods (local content subsidies), the focus of this article is on export subsidies for which all dispute cases involving prohibited subsidies have been raised against.

³ SCM Agreement Article 4.7 provides that, “If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member *withdraw the subsidy without delay*. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn.” (emphasis added).

settlement procedures as compared to the general DSU process.⁴ Despite the evidently tight regulations regarding prohibited subsidies, subsidy disputes have resulted in the highest number of Article 22.6 arbitrations, which authorize retaliatory measures against the infringing member retaining its non-compliant measure, the highest amount of countermeasures to enforce compliance with the DSB recommendations, and some of the lengthiest dispute processes due to delayed implementation actions.⁵

While there may be many problems involving subsidies in general, some of the most prominent dispute cases involve prohibited subsidies, and most of the disputes involving subsidies are concerned with prohibited subsidies. More specifically, while in terms of scope of coverage, actionable subsidies may be the largest, in terms of legal disputes (of which legal scholars are most interested in), prohibited subsidies are by far the most problematic. Therefore, more focus may be warranted for prohibited subsidies with a more rigorous legalistic, in addition to an economic approach for analysis.

1.2 PURPOSE AND SCOPE OF STUDY

This study focuses on the problematic area regarding the remedy system for

⁴ Article 4 of the SCM Agreement provides for shorter periods for establishment of a panel after consultation request (30 days), circulation of panel report (90 days), adoption of panel report (30 days), and adoption of Appellate Body report (20 days). In contrast, the general rules on dispute settlement contained in the Dispute Settlement Understanding (DSU) provides for 60 days for establishment of a panel after consultation request (Article 4.7), 9 months for circulation of panel report (Article 12.9), 60 days for adoption of panel report (Article 16.4), and 30 days for adoption of Appellate Body report (Article 17.14).

⁵ Out of a total of 9 Article 22.6 disputes that have authorized retaliation amounts to date, 5 cases are subsidy-related disputes, among which 4 cases involve prohibited subsidies.

prohibited subsidies under the WTO dispute settlement system. There has been quite a large amount of legal research on the purpose or the role of remedies in the WTO dispute settlement system,⁶ and many economic analyses on the optimal level of retaliation as a form of remedy in the WTO system.⁷ However, there still lacks sufficient research that provides a more comprehensive approach from both the legal and the economic perspectives, which may provide a more ‘balanced’ view for understanding the discipline on prohibited subsidies in terms of its rules and remedies. Furthermore, the focus and analysis results of the legal and economic research on this subject tends to be quite the opposite: the former arguing for tighter restrictions on prohibited subsidies and stronger remedies for inducing compliance, while the latter calling for a more welfare and

⁶ See, for example, J. Pauwelyn, ‘The Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?’, in C. Bown and J. Pauwelyn eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010); D. Palmeter and S. Alexandrov, ‘Inducing Compliance’ in WTO Dispute Settlement’, in D. Kenney and J. Southwick eds., *The Political Economy of International Trade Law* (2002); P. Mavroidis, ‘Remedies in the WTO Legal System: Between a Rock and a Hard Place’, 11 *European Journal of International Law* 763 (2000); S. Charnovitz, ‘Rethinking WTO Trade Sanctions’, 95 *American Journal of International Law* 792 (2001); C. Carmody, ‘Remedies and Conformity under the WTO Agreement’, 5 *Journal of International Economic Law* 307 (2002); J. Jackson, ‘International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or to “Buy Out”?’’, 98 *American Journal of International Law* 109 (2004); J. Bellow, ‘The WTO Dispute Settlement Understanding: Less is More’, 90 *American Journal of International Law* 415 (1996); R. Lawrence, *Crimes and Punishments? Retaliation Under the WTO*, Institute for International Economics (2003), at 13-47.

⁷ See, for example, C. Bown and M. Ruta, ‘The Economics of Permissible WTO Retaliation’, in C. Bown and J. Pauwelyn eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010); G. Maggi and R. Staiger, ‘Breach, Remedies and Dispute Settlement in Trade Agreements’, NBER Working Paper No. 15460 (2009); M. Beshkar, ‘Optimal Remedies in International Trade Agreements’, 54 *European Economic Review* 455 (2010); K. Bagwell, P. Mavroidis, R. Staiger, ‘The Case for Tradable Remedies in WTO Dispute Settlement’, World Bank Policy Research Working Paper 3314 (2004); W. Schwartz and A. Sykes, ‘The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization’, 31 *Journal of Legal Studies* 179 (2002); A. Sykes, ‘The Remedy for Breach of Obligations under the WTO Dispute Settlement Understanding: Damages or Specific Performance?’, in M. Bronckers and R. Quick eds., *New Directions in International Economic Law: Essays in Honour of John H. Jackson* (2000).

efficiency-based view of the issue, arguing for a more lenient treatment of prohibited (export) subsidies. In this light, the goal of this study is to build on the existing studies to provide economic justification for the legal remedy system on prohibited subsidies, which further provides important implications for remedies in the WTO dispute settlement system as a whole.

This paper is organized as follows. Chapter II gives an overview of the legal remedies in general, from those in domestic contract law, public international law, international investment treaties, and intellectual property law. The purpose is to provide the context for examining the remedy system for breach of obligations in other legal regimes so as to better understand the remedy system in the WTO. A key element for understanding remedies is a discussion on the purpose of remedies, which is traditionally distinguished as the property rule and liability rule, which are concepts derived from the theory of entitlements. The principle of proportionality will also be discussed, as another important principle regarding remedies in international law.

Chapter III deals with the remedy system for prohibited subsidies in the WTO, beginning with an overview of the current status of the remedial mechanism for prohibited subsidies in the WTO. The compliance problem in prohibited subsidy disputes will be examined in more detail, going over the type of remedies in place for enforcing rulings regarding prohibited subsidies, and how they are applied in prohibited subsidy disputes. A substantial part of this chapter will be devoted to the distinctive treatment of prohibited subsidies in the WTO, starting from how the rules on prohibited subsidies have evolved throughout the trade regulations history. The application of the rules is examined

in more detail to identify some of the most persistent issues that remain unresolved in WTO jurisprudence on prohibited subsidies.

Chapter IV gives an overview of the existing literature that provides important economic evidence on the WTO remedy system in general, and the remedy system for prohibited subsidies. The purpose of this chapter is to examine the approaches of trade economists in assessing the remedy system in the WTO dispute settlement system using technical methods based on economic principles in order to provide some more rigorous framework of analysis for the discussion on remedies.

Based on the above legal and economic analyses of the remedies as applied in the WTO dispute settlement system, Chapter V proposes several alternative remedy systems for 'remedying' the current remedy system for prohibited subsidies in the WTO. The main arguments are focused on devising more effective and practical remedial means that pertain to the objective and purpose of the WTO dispute settlement system. Finally, Chapter VI discusses the implications of the results of this paper, the remaining agenda for further research, and concludes.

1.3 RESEARCH METHODS AND SOURCES

Several methods of research have been used for this study, including literature review, case analysis, and treaty interpretation, based on legal and economic analysis methods. Primary sources for literature review include academic literature written by legal and economic scholars related to the subject of WTO remedies and export subsidy

disciplines, books written by prominent trade law specialists and trade economists on subjects related to subsidies, remedies, and WTO dispute cases, and GATT/WTO documents, including adopted reports by WTO adjudicating bodies, submitted proposals by WTO Members, and other communication and notifications by WTO members to the DSB.

First of all, statistical data provided by the WTO website and international trade law-related portals, in addition to information from existing academic literature on the related subject, were gathered to examine the current status of implementation of WTO disputes. To examine the remedy system in action and how they are applied with regard to prohibited subsidies, GATT and WTO documents, particularly the decisions made by the WTO adjudicating bodies for relevant dispute cases, and WTO Agreement texts for the related provisions were referred to. For the review of economic perspectives on the discipline on prohibited subsidies and their remedy system, academic literature provided in relevant journals and books was the main source of information. The economic principles and models contained therein were applied to this study for assessing the approach by WTO adjudicating bodies in their interpretation and application of the relevant WTO text. Law-and-economic theories as explained by trade economists were applied as well to understand the purpose of the remedy system for prohibited subsidies, such as the property rule and liability rule from the theory of contract law.

As for the case analysis, primary sources of information are GATT/WTO documents, consisting of adopted DSB reports on the decision of WTO adjudicating bodies on the relevant dispute cases. In addition, existing academic literature assessing

the decision process and results from both legal and economic perspectives served as reference points as well. Trade-related journal articles, such as from Inside U.S. Trade, were referred to gather up-to-date information on the status of relevant disputes regarding implementation by WTO Members as parties to the dispute. Analysis of relevant WTO dispute cases also contributed to identifying the issues that are persistent and remain unresolved in the area of remedies for dealing with non-complaint actions against prohibited subsidy rules.

The examination of remedy rules in other legal regimes was conducted based on a comparative analysis, with focus on the type of remedies that are available for different legal regimes that are disciplined with distinct purposes of protecting rights. The primary source of analysis are books explaining the basic concepts and principles of respective laws, such as contract law, public international law, investment law, and intellectual property law.

Analysis of economic theories based on trade economists' literature published in academic journals or edited books on international economic law were mainly used to understand the economic principles enshrined in the SCM Agreement and the remedies used to enforce the obligations contained therein. Some economic theories were also used to substantiate the arguments made in this study regarding the alternative remedies that may be considered for 'remedying' the current remedy system for prohibited subsidy disputes. This study does not provide new economic models for explaining an alternative system of remedies for prohibited subsidies in the WTO; rather, it applies the existing economic research relevant to this study in order to provide more substantiated grounds

for suggesting a reformed legal path for dealing with remedies in the WTO prohibited subsidies regime.

CHAPTER II

LEGAL REMEDIES IN GENERAL

2.1 RULES ON REMEDIES

The discussion on rules on remedies needs to begin with an observation of the different rules on remedies that are established in different legal systems. Prior to an in-depth examination of the remedy rules of the world trading system, an observation of the remedy rules in other legal regimes deserves attention, since it may reveal some common or distinct features that explain the design of remedies in their respective legal regimes. While there have been a few studies comparing the WTO remedial system with domestic contract law or public international law,⁸ there does not seem to be any comprehensive work comparing the various remedial systems. In consideration of the distinct goals and structures of the respective legal regimes, this section will summarize some of the key features of the remedial systems in domestic contract law, international public law, international investment treaties, and laws governing intellectual property rights, in order

⁸ For example, see Carmody (2002), comparing private law, domestic public law, international public law, and WTO law, *supra* note 6; Lawrence (2003), discussing the difference between remedies in domestic law and international trade law, *supra* note 6; E. Posner and A. Sykes, 'Efficient Breach of International Law: Optimal Remedies, "Legalized Noncompliance", and Related Issues', 110 *Michigan Law Review* 243 (2011), discussing remedies in international law, international trade law, and investment law; J. Pauwelyn, 'The Role of Public International Law in the WTO: How Far Can We Go?', 95 *American Journal of International Law* 535 (2001), and S. Shadikhodjaev and N. Park, 'Cessation and Reparation in the GATT/WTO Legal System: A View from the Law of State Responsibility', 41 *Journal of World Trade* 1237 (2007), both discussing the role of public international law in WTO law; J. Trachtman, 'The WTO Cathedral', 43 *Stanford Journal of International Law* 127 (2007), for a more general observation of different remedies for different legal rules.

to understand the logic behind the design of remedies that are established against acts of non-compliance in the respective legal systems. This exercise will provide the context for understanding the rules on remedies in international trade law.

2.1.1 REMEDIES IN DOMESTIC CONTRACT LAW

In the context of tort or breach of contract, remedies refer to the relief that a court provides to a prevailing party in litigation.⁹ In a more strict sense, remedies used to denote the relief that a person can seek from the court are referred to as ‘judicial remedies’, distinguishable from ‘self-help’ remedies, which are available without coming to court, such as out-of-court settlements, termination of contract, or resorting to reputation as a non-legal market force.¹⁰ Remedies can be further distinguished between so-called ‘legal’ remedies and ‘equitable’ remedies. In general, ‘equitable’ remedies refer to ‘specific performance’ as the remedy for breach of contract, normally in the form of a judicial order requiring the defendant (or promisor) to perform his or her contractual promise. On the other hand, ‘legal’ remedies for contract breach refer to damage payments, mostly in the form of monetary compensation.¹¹

The traditional remedies against breach of contract usually fall into one of the three major categories under domestic contract law. First, a complainant may recover ‘damages’, which provides compensation to the victim of the breach. There are several

⁹ R. Weaver, E. Shoben, M. Kelly, *Principles of Remedies Law* (2007), at 1.

¹⁰ A. Burrows, *Remedies for Torts and Breach of Contract* (2004), at 1.

¹¹ *Supra* note 9, at 1; T. Ulen, ‘Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies’, 83 *Michigan Law Review* (1984), 364.

different kinds of damages as the remedy for breach, depending on their primary functions and goals served. Second, the complainant may recover ‘restitution’, which is aimed at depriving the defendant of the unjust enrichment or improper gains resulting from the breach. Third, the complainant may recover ‘specific performance’, or the very performance promised in the contract.¹²

2.1.1.1 Damages

Damages for breach of contract aim at compensation of the complainant as the victim of the breach. Generally, the objective of compensatory damages is to place the complainant in as good a position as he would have been in had the contract been performed.¹³ This concept is also referred to as ‘expectation damages’, or the damages remedy that attempts to give the complainant the kind of gains he would have made if the contract had been performed. The goal is to avoid either over-compensation or under-compensation, but the practical difficulties of measurement due to costs and uncertainties of proof, make pure compensation often not feasible. Therefore, it would be fair to understand that while the law of contractual remedies do not aim to provide the complainant a perfect substitute for full performance, the overall aim is to find an ‘approximately right and reasonably usable’ legal rule of damages.¹⁴

There is a general rule against ‘punitive’ damages for breach of contract. Firmly

¹² D. Dobbs, *Law of Remedies: Damages, Equity, Restitution* (1993), 750.

¹³ *Ibid.*, 763.

¹⁴ *Ibid.*, 765.

established common law holds that punitive damages are not to be awarded for simple breach of contract.¹⁵ The rule against punitive damages prevails even if the breach is willful or malicious, so long as the breach does not amount to an independent tort, and there is almost no stated dissent in the courts regarding these rules. There are exceptions to these rules if a breach of contract also constitutes a violation of fiduciary duties or other tort, or fraud in inducing the contract in the first place. In practice, however, punitive damages have been awarded in cases involving arbitrary actions by government officials, and willful conduct resulting in profits that may well exceed the compensation payable to the complainant.¹⁶ In such cases, the assessment of punitive damages has traditionally been almost total discretion to award whatever sum deemed necessary to punish the defendant and to set an example to others.

2.1.1.2 Restitution

Restitutionary remedies for breach of contract are remedies for reversing unjust enrichments, such as through the claimant's payment of money or services to the defendant by mistake, under duress, or other conditions which trigger restitution. The precondition of resorting to restitution as the remedy is when the defendant has made a profit or saved an expense due to the breach of contract.¹⁷ However, while the restitution remedy may be preferred to compensatory damages when the complainant may obtain

¹⁵ *Ibid.*, 790.

¹⁶ Burrows (2004), *supra* note 10, 410-411.

¹⁷ *Ibid.*, 371.

more profits by restitution than compensation, the remedy of restitution does not seem to be widely used against breach of contract. This is in part derived from the 'efficient breach' theory that it is more economically efficient to allow breach of contract than to deter it, as restitution would *prima facie* do.¹⁸

2.1.1.3 Specific Performance

Specific performance, or injunctive relief, is an 'equitable' remedy which enforces a defendant's positive contractual obligations, or simply put, orders the defendant to do what he or she promised to do. Therefore, it is referred to as a remedy that protects the claimant's expectation interest based on the morality of promise-keeping. In contrast to damages, the remedy of specific performance is not available for every breach of contract, but is invoked by the court only when the damages remedy is deemed to offer inadequate relief.¹⁹ Specific performance may be the appropriate remedy as compared to damages, when it is difficult to assess damages, and where the defendant may be unable to pay damages. As a consequence, the granting of such equitable relief is at the discretion of the court, when it is demonstrated by the complainant that damages are not adequately compensatory or that there is difficulty in assessing the damages.²⁰

According to Carmody, the remedies for private law are mainly concerned with

¹⁸ *Ibid.*, 400.

¹⁹ There are other bars to specific performance, such as 'constant supervision' (too much judicial time and effort in seeking compliance with the order), personal service (i.e. contract of employment), want of mutuality, and uncertainty. Burrows (2004), *supra* note 10, 458-504.

²⁰ Ulen (1984), *supra* note 11, 364.

‘corrective justice’, since the remedies of specific performance or damages are largely about correcting the claimant’s injury or punishing the wrongdoer’s behavior. Accordingly, such remedies can be considered to be specific and usually retrospective in nature.²¹

In sum, the remedies in contract law, generally understood to be consisting of damages and specific performance, award the party at loss the ‘benefit of the bargain’, or in more legal terminology, ‘expectation damages’. Also, in certain situations, both the legal and equitable remedies are perceived to perform the same or similar functions, such as in the case of restitutionary damages that result in monetary compensation for restitution, or specific performance accompanied with the award of an agreed sum to induce performance of contractual obligations. However, due to a number of restrictions in using the equitable remedy of specific performance, the legal remedy of damages seems to be more widely-used. The damages remedy is intended to provide compensation, and normally does not serve a punitive goal. More fundamentally, such a rule represents the ‘efficient breach’ principle in the law-and-economics theory, that one should be permitted to breach the contract so long as he pays the damages required to put the non-breaching party in his rightful position.

2.1.2 REMEDIES IN PUBLIC INTERNATIONAL LAW

International law consists of rules and principles of general application dealing

²¹ Carmody (2002), *supra* note 6, 310.

with the conduct of states, on the basis of either customary international law or multilateral treaties. Unlike national legal systems, international law is primarily concerned with the legal regulation of the international interplay between the states, which are organized as territorial entities, and are considered as ‘sovereign’ and ‘equal’.²² Thus, international law is a horizontal legal system, lacking supreme authority and the centralized use of force. According to Pauwelyn, international law is ‘decentralized’ in that it has no central legislator creating its rules. Neither is there any third-party enforcer which compels the performance of legal obligations by the parties. Such absence of third-party enforcement in international law implies that enforcement relies on the states as parties subject to international law.²³ However, this does not suggest that international law has no legal force, since the rules of general international law, in principle, are binding on all states.²⁴ Furthermore, while the law enforcement capacity of international organizations, such as the United Nations, is both legally and politically limited, a state which violates an international obligation is responsible for the wrongful act incurred to the injured state, or, under certain circumstances, to the international community as a whole. By international norms, injured states can raise international claims which can be pursued on the basis of available remedies, or rely on third-party mediation or arbitration proceedings. In practice, however, states predominantly resort to ‘self-help’ when their rights have been violated, which is comparable with the restricted use of self-help by

²² P. Malanczuk, *Akehurst's Modern Introduction to International Law* (1997), at 2-3.

²³ Pauwelyn (2001), *supra* note 8, 535.

²⁴ According to Article 26 of the Vienna Convention on the Law of Treaties (VCLT), “every treaty in force is binding upon the parties to it and must be performed by them in good faith”.

individuals in the domestic legal systems.²⁵

The fundamental difference between remedies in national private law and public international law is that while the former is concerned with corrective justice for the individual as a victim of the breach of contract, the latter is more acutely concerned about the sovereignty of states, and international responsibility that arises in the context of negotiated diplomatic settlements.²⁶ Therefore, as Pauwelyn has observed, even though there may be rules on remedies for breach of internationally negotiated agreements among states and their actors, the enforcement of such obligations may not be compelled as with domestic contracts.

The effort to deal with the problem of effectiveness and enforcement of international law has resulted in the codification of the International Law Commission (ILC)'s Draft Articles on Responsibility of States for Internationally Wrongful Acts (hereinafter ILC Draft Articles).²⁷ After nearly four decades of attempts to codify and develop the rules on state responsibility, the final text of the Draft Articles were adopted by the ILC in 2001. They have been cited by the International Court of Justice (ICJ) numerous, and have generally been well received. Since there is no other authoritative international legal source on the international law of remedies, most of the existing studies, including this one, rely on the ILC Draft Articles. They are customary international law rules, and they are applied to breaches of both customary international

²⁵ Malanczuk (1997), *supra* note 22, 3.

²⁶ I. Brownlie, *Principles of Public International Law* (2008), 433.

²⁷ Draft Articles on the Responsibility of States for Internationally Wrongful Acts, in Report of the International Law Commission on the Work of its Fifty-Third Session, *UN Official Records of the General Assembly (GAOR)*, 56th Session, Supplement No. 10, UN Doc. A/56/10 (2001).

law and treaty law, except as otherwise provided in the treaties. They provide guidance for determining when an obligation has been breached, and the legal consequences of that violation.

2.1.2.1 Cessation

Part Two of the ILC Draft Articles deals with the legal consequences for the responsible state arising upon an internationally wrongful act.²⁸ The primary obligation in case of breach of an international obligation is ‘cessation’ of the wrongful conduct. There is also an obligation to offer appropriate ‘assurances’ and ‘guarantees’ of non-repetition if circumstances so require.²⁹ While cessation can be said to be a negative aspect of future performance, since it is concerned with securing an end to continuing wrongful conduct, assurances and guarantees serve as a preventive function and can be described as a positive reinforcement of future performance.³⁰ The latter remedy involves somewhat more flexibility than cessation, and is most commonly sought when the injured state considers that the mere restoration of the *status quo ante* is not satisfactory. On the other hand, in order to apply the primary obligation of cessation, two essential conditions are required: “namely that the wrongful act has a continuing character and that the

²⁸ Part Two of the Draft Articles consists of three chapters. Chapter I sets out the general principles and scope; Chapter II provides for the forms of reparation (restitution, compensation, satisfaction); and Chapter III deals with cases of breach of obligations under general international law and the legal consequences of such breaches.

²⁹ ILC Draft Articles, *supra* note 27, Article 30.

³⁰ Commentaries to ILC Draft Articles, in J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (2002), at 196, para.1.

violated rule is still in force at the time in which the order is issued”.³¹ This implies that if the obligation has ceased following its breach, the remedy of cessation no longer applies (prospective function). The purpose of cessation is to put an end to a violation of international law, and to protect the interests of the international community as a whole for the preservation of the rule of law.

2.1.2.2 Reparation

The secondary obligation upon the commission of an internationally wrongful act is the obligation to make ‘full reparation’.³² According to the statement by the Permanent Court in the *Factory at Chorzów* case, full reparation refers to “wip[ing] out all the consequences of the illegal act and reestablish the situation which would, in all probability, have existed if that act had not been committed”.³³ There are three forms of reparation: restitution, compensation, and satisfaction.³⁴ Restitution involves the “reestablishment as far as possible of the situation which existed prior to the commission of the internationally wrongful act”, for example, such conduct as the release of persons wrongly detained or the return of property wrongly seized.³⁵ However, due to situations where restitution is not available or where it is not effective, there are difficulties in applying restitution in practice. Despite these difficulties, there have been certain cases

³¹ *Rainbow Warrior (New Zealand/France)*, RIAA, vol. XX (1990), at 270, para. 113.

³² ILC Draft Articles, *supra* note 27, Article 31.

³³ *Factory at Chorzów*, PCIJ Series A, No. 17 (1928), 47.

³⁴ ILC Draft Articles, *supra* note 27, Article 34.

³⁵ ILC Commentaries, *supra* note 30, 213, para. 1.

where restitution has been required as an aspect of compliance with the primary obligation. There are also limitations to using restitution as a form of reparation as set out in the ILC Draft Articles, under which restitution is not required if it is “materially impossible”, and if it would “involve a burden out of all proportion to the benefit deriving from restitution instead of compensation”.³⁶ In other words, if the injury caused by the internationally wrongful act cannot be fully repaired with restitution, such as due to material impossibility, other forms of reparation will be required, and consideration should be taken to ensure that reparation by restitution be ‘equitable’ and ‘reasonable’ to either the injured state or the victim of the breach.³⁷

In international practice, compensation is perhaps the most commonly sought of the various forms of reparation. Since restitution is frequently unavailable or inadequate, the role of compensation is to fill in any gaps so as to ensure full reparation for damages suffered.³⁸ Compensation generally consists of monetary payment, and it is not concerned to punish the responsible state, nor does it have an expressive or exemplary character.³⁹ Monetary compensation is intended for a purely compensatory function, and to offset the damage suffered by the injured state as a result of the breach.

Lastly, as the third form of reparation, satisfaction is provided for “insofar as [the injury] cannot be made good by restitution or compensation”.⁴⁰ Although not a standard form of reparation, in that it may be required only in those cases where

³⁶ ILC Draft Articles, *supra* note 27, Article 35.

³⁷ ILC Commentaries, *supra* note 30, 216-217, para. 11.

³⁸ *Ibid.*, 218, para. 2.

³⁹ *Ibid.*, 219, para. 4.

⁴⁰ ILC Draft Articles, *supra* note 27, Article 37.

restitution or compensation has provided full reparation, this kind of remedy for ‘non-material injury’ is well-established in international law. According to a tribunal in an international arbitration: “There is a long established practice of States and international courts and tribunals of using satisfaction as a remedy or form of reparation (in the wide sense) for the breach of an international obligation. This practice relates particularly to the case of moral or legal damage done directly to the State, especially as opposed to the case of damage to persons involving international responsibilities”.⁴¹ The most common modalities of satisfaction would be a declaration of wrongfulness of the act by a competent court or tribunal, or an apology either in verbal or written form by an appropriate official or head of State. Furthermore, satisfaction is not intended to be punitive in character. Such limitation is set out in the related articles. First, they require proportionality to the injury, and second, the satisfaction should not be ‘humiliating’ to the responsible State.

In sum, the remedies against breach of an international obligation set out in the ILC Draft Articles provide for the importance of ‘full reparation’, which seemingly allow for ‘retrospective’ remedies in the form of monetary compensation when restitution of the injury incurred is not possible. However, the compensation remedy is not designed to be punitive, but merely compensatory, or to ‘fill in gaps so as to ensure full reparation for damage suffered’.⁴² Despite the adopted codifications of the remedy rules for application to the international law regime, however, international law lacks important enforcement

⁴¹ *Rainbow Warrior* arbitration, *supra* note 31, at 272-273, para. 122.

⁴² *Factory at Chorzów*, *supra* note 33, 47-48.

capability to ensure that the rulings of the international tribunal are implemented. Instead, a noticeable feature in public international law remedies is the well-established use of the ‘satisfaction’ remedy, which seemingly reflects the ‘equality’ of nation states in terms of their sovereignty and thus, the difficulty in administering remedies in the absence of any third-party enforcement authority.

2.1.3 REMEDIES IN INTERNATIONAL INVESTMENT TREATIES

Investment treaties, often referred to as ‘international investment agreements’ (IIA), are essentially instruments of international law through which states make commitments to other states with respect to the treatment accorded to the investors and investment from those other states, and establish mechanisms for enforcement of those commitments. Countries establish investment agreements for the purpose of protection and promotion of investment.⁴³ International investment agreements are generally understood as to incorporate bilateral investment treaties (BITs), bilateral economic agreements with investment provisions, and other investment-related agreements among states (i.e. taxation agreements). Such investment agreements have been increasing in number, especially since the 1950s when World War II ended, as nations wished to create effective investment protection regimes that facilitate and protect investments of their nationals and companies abroad as international transactions grew. While bilateral efforts under such objectives led to significant growth in the number of bilateral treaties,

⁴³ J. Salacuse, *The Law of Investment Treaties* (2010), at 1.

multilateral efforts to create an international legal framework to govern investments resulted in the creation of the International Center for Settlement of Investment Disputes (ICSID) as an important institutional support for the enforcement of BIT provisions.⁴⁴

Accordingly, the key difference between the investment regime and the trade regime is that while the latter has been developed on a multilateral basis through a succession of multilateral negotiating rounds leading to multilateral agreements, the former has been built largely on a bilateral basis, as a large number of countries have bilaterally negotiated rules and enforcement mechanisms that apply to their nationals and investments in the territory of the other country. Another important nature of the investment regime that makes it unique is the broad scope of private decision-making, as non-state actors are delegated the authority to decide and act independently in the process of decision-making on the rules of the regime. This is in stark contrast to other regimes, such as the WTO, where decision-making is only entrusted to states and their representatives.⁴⁵

2.1.3.1 Dispute Settlement Methods in Investment Arbitrations

Investment treaties contain enforcement mechanisms which function as a means for resolving disputes and securing compensation payment to the injured investors, and

⁴⁴ *Ibid.*, 88-95. ICSID was created on the basis of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (575 UNTS159; 4 ILM 524 (1965)), which was drafted in the framework of the World Bank and entered into force on 14 October 1966. ICSID provides a system of dispute settlement that is specialized in investor-state disputes. R. Dolzer and C. Schreuer, *Principles of International Investment Law* (2008), 222-223.

⁴⁵ Salacuse (2010), *supra* note 43, 11-14.

deter states from neglecting their treaty commitments to other investors. The dispute settlement methods that are contained in most investment treaties take the following four forms: (1) consultation and negotiations between contracting states; (2) arbitration between contracting states; (3) consultation and negotiations between investors and host governments; and (4) investor-state arbitration.⁴⁶

Interstate consultations and negotiations serve as a useful function in preserving the investment relationships under the treaty, since conflicts over, for example, the interpretation and application of treaty provisions can be settled by discussions and negotiations diplomatically between representatives of the contracting states. Interstate arbitration is a traditional method for the peaceful resolution of state disputes, as the disputing parties agree to resort to a third party to resolve their dispute according to agreed-upon norms and procedures. Even for disputes between investors and host countries, consultations and negotiations substantially help toward their resolution, as parties increasingly recognize the disadvantages of arbitration in terms of time and cost.⁴⁷

On the other hand, investor-state arbitration is a unique feature of the dispute resolution system in the international investment regime. While arbitration is a traditional dispute settlement method whereby disputants agree to refer their dispute to a third-party arbitrator, the fact that private investors can initiate a dispute against a state has significant implications. First of all, while such investor-state disputes (ISD) are subject to the host country's domestic law, they are also governed by the public international law

⁴⁶ *Ibid.*, 359.

⁴⁷ *Ibid.*, 360-363.

in the form of treaties, making unilateral attempts by a host country unsuccessful. However, since public policy measures are often at the center of the investor-state conflicts, the result of dispute resolution may require corrective measures on the part of the host country government, and the controversy may become highly political in nature.⁴⁸ Another feature of the investment remedy regime is the creation of ICSID, as mentioned previously, which provides the institutional support for establishing a jurisdictional system for the settlement of investor-state disputes.⁴⁹

2.1.3.2 Primary Remedy of Compensation

The primary purpose of remedies provided by investment law is to compensate an investor for the losses caused by an act of a state. This is based on the understanding that the purpose of investment treaties is to protect foreign investment by granting investors guarantee against expropriation or discriminatory treatment by the host government.⁵⁰ While under the international law of state responsibility, reparation for the wrongful act takes the forms of restitution, compensation, or satisfaction, the remedy in investment arbitration nearly always consists of monetary compensation. This is because

⁴⁸ *Ibid.*, 354.

⁴⁹ On the other hand, arbitration for international investment disputes that is not supported by a particular arbitration institution is referred to as ad-hoc arbitration, which requires an arbitration agreement regulating a number of issues, including the selection of arbitrators, applicable law, and procedural matters. Dolzer and Schreuer (2008), *supra* note 44, at 222.

⁵⁰ G. Kaufmann-Kohler, 'Compensation Assessments: Perspectives from Investment Arbitration', in C. Bown and J. Pauwelyn eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010), at 624. According to the author, the clear compensatory purpose of remedies in investment arbitration contrasts with the somewhat unclear purpose of remedies in international trade, which seeks to achieve compliance or compensation, or both.

satisfaction as a remedy for violation of investment-related commitments does not play a practical role, and restitution in kind is rarely ordered by arbitration courts. While this is not due to any inherent limitation upon investment arbitration tribunals, it is due to the consequence of situations in which most disputes arise and the way the claims are put forward.⁵¹

Most modern BITs and multilateral investment treaties (i.e. NAFTA) expressly require the ‘prompt, adequate, and effective’ compensation for the damages incurred to the injured investor.⁵² The overriding principle is that the investor must be made whole for the deprivation of his assets. Such an approach is in line with the well-established principle in customary international law.⁵³ The World Bank Guidelines on the Treatment of Foreign Direct Investment state that: “Compensation will be deemed ‘adequate’ if it is based on the fair market value of the taken asset as such value is determined immediately before the time at which the taking occurred or the decision to take the asset became publicly known”.⁵⁴ Tribunals have frequently relied on the ‘fair market value’ as the appropriate standard for compensation, being considered as an objective standard that compares the amount that a willing buyer would normally pay to a willing seller in a free transaction.⁵⁵ In calculating the compensation remedy for enforcement in international

⁵¹ Dolzer and Schreuer (2008), *supra* note 44, 271.

⁵² North American Free Trade Agreement (NAFTA), Article 1110.

⁵³ Dolzer and Schreuer (2008), *supra* note 44, 626. The guiding principles for reparation are provided in Article 31 and 36 of the ILC Draft Articles (2001), which specify that ‘reparation must, as far as possible, restore the situation that would have existed had the illegal act not been committed’.

⁵⁴ World Bank Guidelines on the Treatment of Foreign Investment, Guideline IV (3), 31 ILM 1379, at 1382.

⁵⁵ NAFTA Article 1110(2) provides for compensation at the expropriated investment’s fair market

investment arbitrations, the valuation date is the ‘date immediately before the fact of the expropriation became publicly known’. This is designed to avoid an influence of the impending expropriation on the investment’s market value. Furthermore, the award of compensation normally includes interest, normally a sum paid or payable as compensation for the temporary withholding of money. This is designed to cover the costs of the loan, or if there is no loan, may reflect the lost earning capacity of the money in question.⁵⁶

Also notable regarding the review of investment arbitration decisions is that the awards granted by ICSID are final and not subject to any appeals procedures. This may be based on the existence of conflicting principles that are at work with regard to the process of review of a judicial decision in general, namely the principle of ‘finality’ and the principle of ‘correctness’. While finality serves to provide more efficiency in terms of an expeditious and economical settlement of disputes, correctness is a more elusive goal that consumes time and effort, and may involve several layers of control. In international arbitrations, the prevailing view is that the principal of finality is typically given more weight than the principle of correctness.⁵⁷ As a result, the arbitral award of monetary compensation as the remedy for enforcing commitments is binding upon the parties and creates an obligation to comply with them.⁵⁸

value, while US-Argentina BIT Article IV (1) provides for compensation to be “equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known”.

⁵⁶ Dolzer and Schreuer (2008), *supra* note 44, 274.

⁵⁷ *Ibid.*, 277-278.

⁵⁸ Article 53(1) of the ICSID Convention specifically provides for the ‘finality’ of awards: “The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy

In sum, the unique features of the remedy rules in international investment agreements seems to provide a stronger enforcement mechanism for the settlement of disputes involving international investment commitments as compared to the dispute settlement systems in other international legal regimes. In particular, the creation of an international arbitration tribunal to rule on international investment disputes provide not only the institutional support for more efficient dispute settlement in investment-related disputes, but the power to enforce the awards through binding authority. More importantly, unlike most international arbitrations where state-to-state disputes are more common, foreign private investors are allowed to initiate a dispute against a host state, due to the purpose of investment arbitrations being designed to protect foreign investors. This has the effect of broadening the scope of participation in investment arbitration disputes, while also opening up the possibility for more challenges against a state's public policy choice that has commercial implications. Lastly, monetary compensation as the primary remedy for enforcing international investment commitments, rather than the alternative requirement of specific performance against acts of violation, contrasts with the remedial mechanisms in place for the enforcement of commitments in other legal regimes.

2.1.4 REMEDIES IN INTELLECTUAL PROPERTY LAW

except those provided for in this Convention. Each party shall abide by and comply with the terms of the award except to the extent that enforcement shall have been stayed pursuant to the relevant provisions of this Convention.”

Intellectual property law comprises a wide range of forms of protection for intellectual property (IP). The definition of IP by the World Intellectual Property Organization (WIPO) refers to the “rights relating to: literary, artistic and scientific works; performance of performing artists, phonograms and broadcasts; inventions in all fields of human endeavor; scientific discoveries; industrial designs; trademarks, service marks, and commercial names and designations; protection against unfair competition, and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields”.⁵⁹ The WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement), which covers all the main areas of IP, provides rules for copyright, trademarks, geographical indications, designs, patents, topographies of integrated circuits, undisclosed information, and anticompetitive practices involving contracts.⁶⁰

While there are important differences between the various forms of intellectual property, one factor that they share in common is the protection of ‘intangible’ subject matters. This gives rise to problems over the control of property and its protection, such as the interference with intellectual property without the exhaustion of the property itself. For this reason, the rights and remedies for intellectual products are specific and not abstract. Furthermore, since IP protection is concerned with identifying and policing permissible and impermissible dealings with intellectual products, it is usually referred to the consent of the right holder. In a similar vein, intellectual property rights (IPR) eventually expire, leaving the subject matter without an owner and thus free to be used or

⁵⁹ WIPO Convention (1967), Article 2 (viii).

⁶⁰ WTO TRIPs Agreement, Part II.

exploited. On the other hand, all forms of IP must qualify for protection according to stringent criteria which vary depending on the kind of property right it is being sought.⁶¹

Another defining characteristic of IPR is that it is national or territorial in nature, meaning that they do not operate outside the national territory where they are granted. Accordingly, considering that the works of intellectual property are subject to transnational trade, it has long been a problem to right holders. Therefore, as a way of protection, countries have first engaged in bilateral treaties, under which parties to the treaties agreed to allow the nationals of the other country to claim protection by their respective laws, and later developed several multilateral agreements which were eventually supervised by WIPO.⁶² Under these agreements, the central criterion for protection was the principle of national treatment. However, national treatment being only a partial solution to the protection of IPR, international efforts to provide more effective protection culminated in the TRIPS Agreement, as it became part of the WTO Agreement in 1994. The main advantage of the TRIPS rules was that it brought IPR into a broader framework, persuading countries to accept stronger IPR standards in exchange for other advantages elsewhere. Since not all countries had incorporated minimum standards of enforcement regarding IPR protection in their domestic laws, the WTO TRIPS Agreement has become significant as the first international treaty on intellectual property to place obligations on member states regarding enforcement of IPR at the domestic level. Through the WTO Dispute Settlement Body and the enforcement

⁶¹ H. MacQueen, C. Waelde and G. Laurie, *Contemporary Intellectual Property: Law and Property* (2008), 7-8.

⁶² These include the Paris Convention for the Protection of Industrial Property of 1883, and the Berne Convention for the Protection of Library and Artistic Works of 1886.

procedures contained in therein, the TRIPS Agreement provides expedited dispute settlement for states at international levels. Prior to TRIPS, matters of procedure, remedies and criminal sanctions had largely been left to national law.⁶³

The majority of enforcement procedures for dealing with IP infringements at the domestic level are, in fact, civil, and dealt as torts (illegal acts) committed against property.⁶⁴ However, the growing incidence of counterfeiting and piracy has also led to the introduction and development of criminal procedures over the past years. Especially in the area of copyright, performers' rights and trademarks, civil actions are assisted by criminal sanctions in cases where the infringement has been committed on a commercial scale.⁶⁵ The civil and criminal remedies that claimants may obtain for a violation of IPR are: interim and final injunction; delivery-up; damages; account of profits; and criminal enforcement.⁶⁶

2.1.4.1 Interim and Final Injunctions

Many civil intellectual property cases are subject to interim relief, as it is important for the injured party to halt the damages from the allegedly infringing act as soon as possible. After a claimant establishes a legal standing, the court considers whether it would be fair to grant interim relief, with the aim to reduce the changes of the provisional decision providing an unjust result.

⁶³ L. Bently and B. Sherman, *Intellectual Property Law* (2009), 7.

⁶⁴ P. Torremans, *Holyoak & Torremans Intellectual Property Law* (2008), 578.

⁶⁵ MacQueen, Waelde and Laurie (2008), *supra* note 61, 891.

⁶⁶ *Ibid.*, 899-906; Bently and Sherman (2009), *supra* note 63, 1100-1130.

A final injunction is usually granted to a claimant who proves at trial that their rights have been infringed by the defendant. As an order of the court, a final injunction will order the defendant to specific performance or to refrain from doing a certain act. Injunctions are normally highly effective, particularly since willful non-compliance will amount to contempt of court which is punishable by fine, imprisonment or confiscation of assets.⁶⁷

2.1.4.2 Delivery-up

A court may order ‘delivery-up’, or destruction, of the infringing articles, for the purpose of effectively removing the infringing goods from circulation. When the infringement has been committed ‘in the course of a business’, the court may order delivery-up to the right owner pending a further order for destruction or forfeiture. It also applies to where a person has in their possession anything specifically designed or adapted to making infringing goods.⁶⁸

2.1.4.3 Damages

Damages are the most common form of remedy used in intellectual property cases. As with other actions in tort or breach of contract, the purpose of awarding

⁶⁷ *Supra* note 61, 899-901; *supra* note 63, 1100-1115; *supra* note 64, 582.

⁶⁸ *Supra* note 61, 904; *supra* note 63, 1115-1116.

damages is to put the claimant back in the position he would have been had the infringement not occurred. Although there is no standard rule for the assessment of damages in IP cases, the amount of damage is normally calculated on the basis of lost profits, where the right owner has not granted a license. A secondary measurement method, applied when there is a license granted, is on a royalty basis, and other costs payable under the license. Although rarely awarded, exemplary damages may also be awarded, limited to cases where infringement by the defendant is based on the calculation that profits would exceed the compensation payable to the claimant.⁶⁹

2.1.4.4 Account for Profits

Instead of claiming damages, a claimant may opt for an ‘account of profits’, through which the right owner may reclaim the amount earned by the defendant by way of unjust enrichment through infringement of the IPR. Once liability is established, the owner can opt for either damages or an account of profits, but not both, in order to avoid double liability. The net profits, after deducting the profit attributable to the infringer’s efforts, is the measure of the award.⁷⁰

2.1.4.5 Criminal Remedies

⁶⁹ *Supra* note 61, 903; *supra* note 63, 1117-1121.

⁷⁰ *Supra* note 61, 905; *supra* note 63, 1122-1123.

Criminal sanctions do not play an important role in the IP area in general, but some exist in the areas of copyright, performers' rights and trade mark infringement, where acts of piracy and counterfeiting occur. The publicity that a criminal trial can attract and the deterrent effect that it entails make the criminal remedy an attractive option. On the other hand, there is no criminal sanction for the infringement of patents or designs. Due to the prevalence of such offences and difficulties of detection, the courts have emphasized that criminal copyright infringement is to be regarded as a very serious matter. Liability of criminal offenses regarding performers' rights depends on proof of knowledge or reason to believe that the recordings are 'illicit', and the penalties awarded are equivalent to those for infringement of copyrights. The criminal penalties for infringement of trademarks are similar to those for copyright infringement, where the punishment will depend largely on the gravity and the scale of the infringement and the persistence of the defendant. The courts also have the authority to order delivery-up of infringing copies of goods and to make certain compensation and confiscation orders.⁷¹

In sum, due to the national and transnational implications of intellectual property rights and laws governing them, the remedy rules for IPR protection makes available all civil and criminal proceedings at both national and international levels. Furthermore, while the remedy of damages is the most common remedy against the infringement of IPR, this is provided in addition to the primary remedy of injunction (since IPR is essentially a property right). This also implies that the remedies available against IPR infringement are both prospective and retrospective, as they include both the forward-

⁷¹ *Supra* note 61, 906; *supra* note 63, 1124-1129.

looking injunctions and damages for past injury. In short, compared to other legal regimes, remedies available in intellectual property law are most comprehensive and inclusive in terms of the availability of remedies against infringement.

Table 1 below summarizes some of the key features of the remedy rules in each respective legal regime as examined above. The most common form of remedy available in all legal regimes is the legal remedy of damages, which are mostly purely compensatory in nature. While the equitable remedy of specific performance is available in most cases, investment treaties seemed to be an exception, at least as a formal remedy. The primary remedy in each legal regime differs depending on their purpose, object of protection, and features. Though it may be difficult to generalize, when property rights are involved, as in the case of public international law and intellectual property law, the primary remedy seems to be the equitable remedy of specific performance. On the other hand, for legal regimes in which the object of protection is related to monetary transactions, the primary remedy is the remedy of compensation. In conclusion, the rules on remedies in the respective legal regimes aptly reflect the purposes of protection that their regimes are trying to provide to their main object of protection, with the appropriate mechanisms to provide adequate forms of relief against any violation of obligations or entitled rights under their legal systems.

<Table 1> Remedies in Legal Regimes

	Domestic Contract Law	Public International Law	International Investment Treaties	Intellectual Property Law
Purpose of protection	Corrective justice	Sovereignty of states	Protection and promotion of foreign investment	Balance between intellectual property rights and public interest
Object of protection	Contracts & contract holders	State & individuals	Investment & investors	Intellectual property & right holders
Features	- General rule against punitive damages - Based on notion of 'expectation damages' and 'efficient breach'	- Absence of third-party enforcement mechanism - Remedies with both prospective and retrospective functions	- Broad private party involvement - Institutional support for enforcement (strong enforcement mechanism)	- Violations primarily dealt in national courts - Multilateral remedy for transnational IPR trade (TRIPS) - Remedies with both prospective and retrospective functions
Primary remedy	Compensatory damages (retrospective function)	Cessation (prospective function)	Monetary compensation (retrospective function)	Civil remedies (injunction; damages)
Secondary remedy	Specific performance (invoked only when damages offer inadequate remedy)	Reparation (mostly compensation; retrospective function)	-	Criminal remedies (only for copyright, performers' rights, trademark)

2.2 PURPOSE OF REMEDIES

As observed in the previous section, the primary forms of remedy in various legal regimes seem to be generally divided into the remedy requiring specific performance (i.e. injunctive relief or cessation) and the remedy of compensatory payment

(i.e. monetary compensation). While a common fundamental role of remedies may be enforcement of the rights and obligations, the purpose these remedies serve may be dissimilar, as different situations require different means to enforce the obligations and commitments. Accordingly, when it comes to the discussion on the purpose of remedies, there are two main schools of thought: (1) remedies that serve to protect rights under the ‘property rule’; and (2) remedies that protect rights under the ‘liability rule’.

The distinction between the property rule and the liability rule in the theory of entitlements (property rights) was first introduced by Calabresi and Melamed, who believed that a complete description of property and tort law required not only the specification of the entitlements to be protected, but also specification of the manner in which the entitlements are protected.⁷² Their framework led to a voluminous literature on remedies by following up or improving on their work, but their classification of the rules on remedies for protecting entitlements remains valid and provides the basis for understanding the choice of remedies for the enforcement of rights.

Where entitlements are protected by the ‘property rule’, infringement of a person’s entitlement is strictly prohibited, with the prohibition enforced by injunctive relief, or if necessary, by criminal sanctions. This rule is generally applied when the purpose is to protect individuals or right holders from having their possessions taken from them, and to ensure the fundamental right of ownership. Anyone who wishes to remove the entitlement from its holder must buy it from the owner in a voluntary transaction in

⁷² G. Calabresi and D. Melamed, ‘Property Rules, Liability Rules, and Inalienability: One View of the Cathedral’, 85 *Harvard Law Review* 1089 (1972).

which the value of the entitlement is agreed upon by the owner. Hence, this form of entitlement gives rise to the least amount of state intervention, since once the initial entitlement is decided upon, state intervention is needed only for enforcing the initial entitlement, and not for determining the value of the entitlement (i.e. calculation of the amount of damages).⁷³ Therefore, property rules are deemed to be the most appropriate when ‘transaction costs’ are low,⁷⁴ since low obstacles to bargaining will enable parties to bargain and reach desirable outcomes at the initial stage when determining the value of the entitlement.

On the other hand, whenever someone may destroy the initial entitlement if the infringer is willing to pay an objectively determined value for it, entitlements are protected by the ‘liability rule’. Hence, under the liability rule, violations are merely discouraged by requiring infringers to pay the victims for harms suffered.⁷⁵ This rule is often employed to protect individuals against ‘harmful externalities’, such as in the case of environmental pollution or automobile accidents. This is because with the existence of harmful externalities, involved parties cannot practically bargain with one another, so that the resolution of difficulties may have to be determined by the courts which can objectively determine the extent of the harm done.⁷⁶ Therefore, according to Calabresi and Melamed, this form of entitlement involves an additional stage of state intervention, since the transfer or destruction of entitlements is allowed on the basis of a value

⁷³ *Ibid.*, 1092.

⁷⁴ ‘Transaction costs’ refer to any bargaining barriers, or the cost of negotiating, and asymmetry of knowledge.

⁷⁵ L. Kaplow and S. Shavell, ‘Property Rules versus Liability Rules: An Economic Analysis’, 109 *Harvard Law Review* 713 (1996), 715.

⁷⁶ *Ibid.*, 719.

determined by the state (i.e. determination of the amount of damages by the courts).⁷⁷ As a result, it is believed that liability rules are more appropriate when the transaction costs of bargaining are high and bargaining on the initial entitlement is difficult, so that the resolution of difficulties would have to be determined directly by the legal rules as applied by the courts. In this context, the commonly held view is that liability rules are preferred to property rules, assuming that courts can accurately determine the magnitude of the harm caused by the violation. However, if courts have difficulty ascertaining the actual level of harm, the liability rule may be inferior to the property rule.⁷⁸ Table 2 below summarizes the purpose of remedies as explained so far.

<Table 2> Purpose of Remedies

	Property Rule	Liability Rule
Purpose	To ensure fundamental right of ownership (protect individuals from having possessions taken)	To protect individuals against ‘harmful externalities’ for which bargaining is difficult
Means of protection	Strict prohibition of infringement of another person’s entitlement	Infringement is merely discouraged by requiring infringers to pay damages
Means of enforcement (Remedy)	Enforcement by injunctive relief (i.e. criminal sanctions)	‘Expectation damages’ serve as criteria for enforcement when efficient, and breach when inefficient (‘efficient breach’)
Preference of rule	Appropriate when transaction costs are low (state intervention needed only for enforcement of initial right)	Preferred when transaction costs (i.e. bargaining costs) are high (state intervention by courts needed to determine value of entitlement)
Transfer of entitlement	Voluntary transaction for removing entitlement from right holder, based on initial determination of value of the entitlement	Initial entitlement may be removed if infringer is willing to pay the determined value of the entitlement

⁷⁷ Calabresi and Melamed (1972), *supra* note 72, 1092.

⁷⁸ Kaplow and Shavell (1996), *supra* note 75, 719.

In contract law, it has often been recognized that the remedies for breach of contract can be classified as either property rules or liability rules. In fact, the ordinary remedy of expectation damages against breach of contract resembles the remedy under the liability rule, for it allows one party to break the contract whenever he is willing to pay the court's estimate of the value of his performance to the other party. By contrast, the remedy of specific performance protects the contract with a property rule, barring the promisor from breaking the contract unless he negotiates his release from the promisee.⁷⁹

Transaction costs, or the costs of overcoming barriers to bargaining, play an important role in the distinction between the property rule and the liability rule in the choice of remedies. If barriers can be easily overcome (i.e. transaction costs are low), protecting the owner with a property rule will usually be appropriate, but if the barrier cannot be overcome, or can only be overcome at great expense (i.e. transaction costs are high), it will usually be better to adopt a liability rule.⁸⁰ Put differently, a liability rule reduces transaction costs by not forcing parties to negotiate on the initial entitlement, so long as the parties are willing to enforce only what the court has reasonably determined to be the value of the entitlement as a payment for damages ('expectation damages'). If the transaction costs saved by this method are large enough, it may be better to relieve the parties from the burden of bargaining by protecting promisors with a liability rule rather than a property rule.⁸¹ This reasoning also forms the basis for the notion of 'efficient breach' in the theory of contracts, where allowing the promisor to breach a contract and

⁷⁹ R. Craswell, 'Property Rules and Liability Rules in Unconscionability and Related Doctrines', 60 *University of Chicago Law Review* 1 (1993), at 4.

⁸⁰ *Ibid.*, 65.

⁸¹ *Ibid.*, 12.

not perform its commitments may be more efficient when the costs of performance is higher for the promisor than the benefits of compliance for the promisee.

There are also arguments challenging the belief that property rules are more appropriate when transaction costs are low, while liability rules are more appropriate when transaction costs are high. While existing literature suggests that liability rules may be inferior to property rules if courts have difficulty determining the actual level of injury,⁸² liability rules may be superior to property rules even when courts are uncertain about the magnitude of injury, especially if a court is able to set damages at a level equal to its best estimate of injury done, since the outcome will be superior to the outcome under property rules.⁸³ Furthermore, even when transaction costs are low, there exists the possibility that bargaining might not always be successful, since parties sometimes misgauge what each other is willing to pay or accept. Hence, in such cases, either property rules or liability rules could be better, though depending on the different circumstances.⁸⁴

As can be observed, the discussion on the choice of remedy as a means of protecting rights and obligations remains unresolved. In fact, both of the rules seem to coexist in respective legal regimes and their remedy systems, in an attempt to provide sufficient relief for the injury suffered by the violation of obligations that are of different natures. As will be examined in the following chapters, this situation is also evident in the

⁸² Since if courts underestimate the level of injury by the violation, a liable firm may violate obligations even though its cost of prevention is less than the actual level of injury.

⁸³ Kaplow and Shavell (1996), *supra* note 75, 719.

⁸⁴ *Ibid.*, 720.

context of trade law as stipulated and applied in the GATT/WTO rules.⁸⁵ While this may not be a problem *per se*, there may be some significance in discussing which rules are more appropriate, or at least more effective, for enforcing the rights and obligations of the Members of the WTO, especially in the area of prohibited subsidies, which contain some of the most stringent disciplines for rules enforcement. This subject matter will be covered in chapter III.

2.3 THE PRINCIPLE OF PROPORTIONALITY

While there is no uniform standard for determining the level of remedies against the breach of rights and obligations in various legal regimes, the ILC codifications as a part of public international law establishes the principle of ‘proportionality’ which serves as the basis for determining the amount of countermeasures that are used to enforce obligations. Proportionality as a principle in customary international law is used to assess the lawfulness of countermeasures, mainly intended to place a ceiling on potential escalating cycles of transactional violence that can occur from the imposition of retaliatory countermeasures among disputing parties.⁸⁶

While the ILC Draft Articles on state responsibility specifically provides for

⁸⁵ There may be some disagreement on whether the rules are ‘coexisting’, rather than ‘conflicting’. While Pauwelyn views that both property and liability rules coexist throughout the GATT and WTO systems, law-and-economics scholars such as Sykes and Posner are of the view that the liability rule prevails in the GATT/WTO remedy system, whereas Jackson is strongly supportive of the property rules-based system of remedies in GATT/WTO.

⁸⁶ T. Franck, ‘On Proportionality of Countermeasures in International Law’, 102 *American Journal of International Law* 715 (2008), 715.

‘full reparation’ against injury caused by an internationally wrongful act, the principle of proportionality serves as a limitation to each form of reparation as the remedy against the injury caused. In the case of restitution, as the first form of reparation, it shall “not involve a burden out of all proportion to the benefit deriving from restitution”,⁸⁷ otherwise compensation should be the remedy for repairing the injury caused. The commentaries to this provision further explain that the requirement of proportionality implies considerations of ‘equity and reasonableness’ in balancing the burden between restitution which is imposed on the responsible state and the benefit which would be gained by the injured state.⁸⁸

Despite there being no specific mentioning of proportionality with regard to the second form of reparation, commentaries explain that compensation is “not concerned to punish the responsible State, nor... have an expressive or exemplary character”.⁸⁹ In other words, the remedy of compensation should be proportionate to the actual injury caused, and not serve to have any deterrent or punitive impact.⁹⁰ As for satisfaction, as the third form of reparation to be resorted to when the injury caused cannot be fully addressed by restitution or compensation, the related provision specifies that it “shall not be out of proportion to the injury and may not take a form humiliating to the responsible State”.⁹¹

Many commentators have observed that the textual language of the ILC

⁸⁷ ILC Draft Articles, *supra* note 27, Article 35 (b).

⁸⁸ Commentaries to ILC Draft Articles, *supra* note 30, Article 35, para. 11.

⁸⁹ *Ibid.*, Article 36, para. 4.

⁹⁰ Franck (2008), *supra* note 86, 740.

⁹¹ ILC Draft Articles, *supra* note 27, Article 37.3.

provisions indicate that the focus of the proportionality requirement is on the actual harm caused, rather than the culpability of the actor or the need to induce compliance which could weigh in favor of a lower or higher penalty than the actual level of injury.⁹² However, there also seems to be some confusion due to the reference in the same ILC provisions which state that “countermeasures must be commensurate with the injury suffered, taking into account the gravity of the internationally wrongful act and the rights in question”.⁹³ Furthermore, the objective of imposing countermeasures is to “induce that [responsible] State to comply with its obligations”.⁹⁴ Consideration of the ‘gravity’ of the act and the ‘rights’ infringed separately from the injury suffered seem to have led several WTO Arbitrators to interpret the provisions as suggesting that countermeasures may serve some ‘fairness’ or ‘retributive’ purpose.⁹⁵ However, a careful reading of the commentaries to the relevant provision explains that proportionality is a limitation even on measures which may be justified as required for the purpose of inducing compliance with the responsible state’s obligations, and clearly states that: “In every case a countermeasure must be commensurate with the injury suffered”, and has a function that is partly “independent of the question whether the countermeasure was necessary to achieve the result of ensuring compliance”.⁹⁶ This may be understood to imply that despite the importance of the purpose of countermeasures in inducing responsible states to comply with their obligations in the first place, countermeasures need be ensured to

⁹² A. Mitchell, ‘Proportionality and Remedies in WTO Disputes’, 17 *European Journal of International Law* 985 (2007), 995.

⁹³ ILC Draft Articles, *supra* note 27, Article 51.

⁹⁴ *Ibid.*, Article 49.

⁹⁵ Mitchell (2007), *supra* note 92, 992.

⁹⁶ Commentaries to ILC Draft Articles, *supra* note 30, Article 51, para. 7.

provide full reparation, but imposed at a level that is closely linked to the actual injury suffered. In other words, full reparation from an injury caused by an act of infringement must be equal to the actual injury suffered. In essence, the principle of proportionality as provided in international law requires that for assessing the lawfulness of any proposed countermeasures, the actual injury suffered and the proposed countermeasure need always be 'proportionate'.

2.4 SUMMARY

This chapter has examined the various rules on different legal systems in order to understand the logic behind the design and form of remedies in respective legal regimes. As a result, in addition to the fact that different legal regimes have different remedies for enforcement, all regimes seem to have in place remedies that provide protection for their rights and obligations based on either the property rule or the liability rule. Furthermore, the remedies are mostly in the form of some specific performance of compliance (or injunctive relief to enforce compliance) or payment of compensatory damages. As will be examined in the following chapters, this situation is not much different in the WTO regime.

Despite these commonalities, there also exist particular features of the legal regimes which are unique in nature, considering the different purposes and the object of protection. With these features of the legal systems in mind, we will be able to understand the rules on remedies in the WTO regime for prohibited subsidies in a better context. This will be dealt in the following chapter.

CHAPTER III

THE REMEDY SYSTEM FOR PROHIBITED SUBSIDIES IN THE WTO

3.1 OVERVIEW OF THE REMEDY SYSTEM IN THE WTO

The dispute settlement mechanism that has been established with the launch of the WTO mainly refers to the Dispute Settlement Body (DSB) and the juridical proceedings that are governed by the Dispute Settlement Understanding (DSU). The DSU is viewed as the most significant achievement of the Uruguay Round negotiations, and unique in public international law, since it confers compulsory jurisdiction on the DSB for the purpose of resolving disputes.⁹⁷ According to Article 3.2 of the DSU, the dispute settlement system of the WTO is a “central element in providing security and predictability to the multilateral trading system”. In comparison to early GATT dispute settlement, which has very much been a diplomatic process, the WTO dispute settlement process provides for a far more legalized system. The WTO dispute settlement system has established a unified and integrated framework, where disputes involving most of the WTO Agreements are resolved by a single dispute settlement system, thereby providing consistency and coherence to the rulings and determinations by the DSB. Decisions made by the panel and the standing Appellate Body are quasi-automatically adopted, due to the consensus rule by which panel and Appellate Body reports are adopted unless there is a

⁹⁷ DSB operates on a ‘negative’ consensus principle, under which panel and Appellate Body reports are adopted unless there is a consensus not to, and with adoption, their decisions have legal binding power to be enforced.

negative consensus not to.

This section aims to examine the remedy system that is established under the WTO, also looking into the purpose WTO remedies are trying to serve, and the limitations these remedies have under the current WTO system. This will be based on the voluminous existing literature on the dispute settlement mechanism of the WTO, with particular attention to the merits and shortcomings of the WTO remedy system. Based on this context, this study will further examine the specific area of prohibited subsidies, going over the historical evolution of the legal rules disciplining subsidies and the features of the remedy system that are in place and active for dealing with prohibited subsidy disputes in the following sections.

3.1.1 REMEDIES IN THE WTO DISPUTE SETTLEMENT SYSTEM

The WTO regime deals with three different types of legal actions that are available to WTO Members when their rights are infringed upon: violation complaints; non-violation complaints; and situation complaints. However, since the latter two categories do not pertain to internationally wrongful acts, the discussion of WTO remedies provided in this study shall be focused on the former type of remedy that addresses acts of violation against international obligations.⁹⁸

Remedies are, in fact, a part of the enforcement mechanism that, in a broader

⁹⁸ For a review of all three types of complaints addressed by the WTO dispute settlement system, see, for example, P. Van den Bossche, *The Law and Policy of the World Trade Organization: Text, Cases and Materials* (2008), at 183-186.

sense, includes both the subject of enforcement and the means for achieving enforcement.⁹⁹ In this light, WTO remedies should be understood to include both: as a primary means to redress actions that have been determined to be illegal under the WTO system, and as a secondary means that is used to enforce WTO law.

The remedies that are available under the WTO are set out in the provisions of the Dispute Settlement Understanding (DSU).¹⁰⁰ Under the aim to secure a positive solution to disputes, parties are first recommended to engage in consultations to reach a mutually satisfactory agreement which is acceptable to the parties and consistent with the WTO agreements. However, if a mutually agreed solution cannot be attained, the parties may request to establish a panel, after which a decision issued by the panel is adopted by the Members in the form of a recommendation or suggestion for the removal of the infringing measure if determined to be a violation of WTO obligations.¹⁰¹ If the respondent party, however, appeals, a standing Appellate Body reviews the case, after which it may uphold, modify or reverse the legal findings and conclusions of the panel.¹⁰²

The primary remedy in the case of a DSB ruling that determines that the respondent party has violated its obligations under the WTO is to ‘bring its measure into conformity’ with the WTO agreements, normally referring to the removal or ‘withdrawal’ of the violating measure.¹⁰³ Article 21.1 of the DSU requires ‘prompt compliance’ to

⁹⁹ P. Mavroidis, ‘Remedies in the WTO Legal System: Between a Rock and a Hard Place’, 11 *European Journal of International Law* 763, 766.

¹⁰⁰ WTO, Dispute Settlement Understanding (DSU), Article 3.7.

¹⁰¹ *Ibid.*, Articles 4.7, 12 and 16.

¹⁰² *Ibid.*, Article 17.13.

¹⁰³ *Ibid.*, Article 19.1. Strictly speaking, while the DSU recommends to ‘bring the measure into conformity’ for most WTO covered agreements, the Agreement on Subsidies and Countervailing

ensure the effective resolution of disputes. Withdrawal of the infringing measure is the primary obligation of the WTO Members when determined by the WTO adjudicating bodies to have acted inconsistently with WTO rules. However, when such act of compliance is not promptly implemented, usually within a ‘reasonable period of time’ for implementation,¹⁰⁴ the WTO dispute settlement mechanism provides for secondary remedies to enforce the rulings.

There are two types of secondary remedies, which consists of ‘compensation’ and ‘suspension of concessions or other obligations’. These are remedies available by the DSU when a Member fails to bring a non-conforming measure into compliance with the DSB ruling within the given time for implementation. They are ‘secondary’, in the sense that they are temporary measures that are only available when the DSB rulings cannot be promptly implemented, and to be used only until the primary remedy of ‘withdrawal’ is possible.¹⁰⁵ Compensation typically takes the form of reduction of tariff or other bound trade barriers, and should be granted on a most-favored-nation (MFN) basis.¹⁰⁶ If an agreement on compensation is not reached within 20 days after the implementation period expires, the second and last remedy available under the WTO is the ‘suspension of

Measures (SCM Agreement) recommends the ‘withdrawal’ of the inconsistent subsidy measure, or ‘withdrawal without delay’ of prohibited subsidy measures.

¹⁰⁴ *Ibid.*, Article 21.3.

¹⁰⁵ *Ibid.*, Articles 22.1 and 22.8.

¹⁰⁶ D. Palmeter and P. Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure* (2004), 265. Also, DSU Article 22.1 provides that compensation “shall be consistent with the covered agreements”, meaning that this would include the MFN requirement of Article I of GATT 1994. Compensation, which takes the form of ‘lifting’ of trade barriers, therefore, is generally understood as supporting free trade principles. However, due to the requirement for the complainant party to agree on compensation and the amount thereof (DSU Articles 22.1 and 22.1), the remedy of compensation is rarely used in the WTO.

concessions’, more commonly referred to as ‘retaliation’ or ‘countermeasures’, of which WTO Members may request for authorization from the DSB in case of continued non-compliance.¹⁰⁷ The level and type of retaliation are set out in the DSU provisions, under which the level should be “equivalent to the level of nullification or impairment” caused by the measure found to be in violation,¹⁰⁸ and shall be applied to the same sector of the violating measure or otherwise, depending on the circumstances of the case.¹⁰⁹ Countermeasures in the WTO are bilateral in nature, meaning that they can only be taken by Members that have initiated the dispute. Furthermore, as opposed to compensation, countermeasures imply the ‘raising’ of trade barriers, which is perceived to be against free trade principles. Table 3 below summarizes the remedies in the WTO dispute settlement system as explained so far.

<Table 3> Remedies in the WTO Dispute Settlement System

	Pre-litigation	Primary remedy	Secondary remedies	
Type of Remedy	Consultations	‘Bring measure into conformity’ or ‘withdrawal’	Compensation	Suspension of concessions (retaliation)
Purpose	To secure positive resolution of disputes	Primary obligation of DSB determination of non-compliance	For enforcing DSB rulings when responding party fails to bring WTO-inconsistent measure into compliance	

¹⁰⁷ DSU, *supra* note 100, Article 22.2.

¹⁰⁸ *Ibid.*, Articles 22.4 and 22.7.

¹⁰⁹ *Ibid.*, Article 22.3. The general principle is to retaliate on the same sector of the measure found to be in violation (parallel retaliation); or, if “not practicable or effective”, other sector under the same agreement (cross-sector retaliation); or, if “not practicable or effective” and “circumstances are serious enough”, other sector under other agreements (cross-agreement retaliation).

<p style="text-align: center;">Legal Requirements</p>	<p>If a 'mutually agreed solution' cannot be attained within 60 days after request for consultation, complaining party may request for panel establishment</p>	<ul style="list-style-type: none"> - 'Prompt compliance' (DSU Art. 21.1) - Implementation within a 'reasonable period of time' (DSU Art. 21.3) 	<ul style="list-style-type: none"> - Reduction of tariffs - Temporary remedy - Voluntary remedy - MFN application - If agreement on compensation is not reached within 20 days after RPT expires, retaliation can be requested 	<ul style="list-style-type: none"> - Final remedy for enforcement - Temporary - Bilateral application - Level of retaliation should be 'equivalent to the level of nullification or impairment' (DSU Art. 22.4) - Three types of retaliation allowed (parallel, cross-sector, cross-agreement)
<p style="text-align: center;">Other Features</p>	<p style="text-align: center;">-</p>	<p style="text-align: center;">-</p>	<p style="text-align: center;">Trade 'liberalizing' effect</p>	<p style="text-align: center;">Trade 'restrictive' effect</p>

The key objective of the dispute settlement mechanism of the WTO is to enable effective functioning of the WTO as a facilitator of world trade and to maintain the proper balance between the rights and obligations of the WTO member countries. Under this aim, the role of remedies in the WTO is to facilitate the prompt settlement of situations where any benefits accruing to a Member has been impaired by measures imposed by other Members.¹¹⁰ The WTO dispute settlement system and its remedies are central to providing security and predictability to the multilateral trading system by preserving the rights and obligations of the Members.¹¹¹

3.1.2 PURPOSE OF REMEDIES IN THE WTO

¹¹⁰ *Ibid.*, Article 3.3.

¹¹¹ *Ibid.*, Article 3.2.

The question of remedies in the WTO has attracted considerable attention and academic research from scholars of international trade law, demonstrating the significance, but at the same time, the perplexities concerning the issue.¹¹² The purpose of remedies in the WTO is important in that it has direct implications on the level and the design of countermeasures that would be allowed in response to continued non-compliance of the WTO rulings for enforcement of the obligations. However, the text and practices in the WTO lead to different interpretations as to the purpose of WTO remedies as conceived by the drafters of the system.

The two main strands of argument regarding the debate over the purpose of WTO remedies are that of ‘inducing compliance’ and ‘rebalancing concessions’. The argument that the goal of WTO suspensions is to induce compliance may well be represented by John Jackson, who argues that in the current system, WTO rulings are legally binding and must be complied with. In his view, the DSU text expresses a strong

¹¹² See, for example, P. Mavroidis, ‘Remedies in the WTO Legal System: Between a Rock and a Hard Place’, 11 *European Journal of International Law* 763 (2000); S. Charnovitz, ‘Rethinking WTO Trade Sanctions’, 95 *American Journal of International Law* 792 (2001); C. Carmody, ‘Remedies and Conformity under the WTO Agreement’, 5 *Journal of International Economic Law* 307 (2002); D. Palmeter and S. Alexandrov, ‘“Inducing Compliance” in WTO Dispute Settlement’, in D. Kenney and J. Southwick eds., *The Political Economy of International Trade Law* (2002); S. Cho, ‘The Nature of Remedies in International Trade Law’, 65 *University of Pittsburgh Law Review* 763 (2004); J. Jackson, ‘International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to “Buy Out”?’’, 98 *American Journal of International Law* 109 (2004); H. Spamann, ‘The Myth of ‘Rebalancing’ Retaliation in WTO Dispute Settlement Practice’, 9 *Journal of International Economic Law* 31 (2006); J. Trachtman, ‘The WTO Cathedral’, 43 *Stanford Journal of International Law* 127 (2007); W. Davey, ‘Compliance Problems in WTO Dispute Settlement’, 42 *Cornell International Law Journal* 119 (2009); J. Pauwelyn, ‘The Calculation and Design of Trade Retaliation in Context: What is the Goal of Suspending WTO Obligations?’, in C. Bown and J. Pauwelyn eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010).

preference for the immediate withdrawal of the measure found inconsistent, and that compensation and suspension are only fallback measures, with either alternatives being only temporary.¹¹³ Such a view is also referred to as the ‘absolutist view’, supporting the position that strict compliance with all obligations at all points in time should be the preferred outcome for the WTO membership in order to serve the important goal of ‘security and predictability’. It is also consistent with the view that WTO obligations are protected by the ‘property rule’, from the contract theory of entitlements, under which the infringement of a person’s entitlement is strictly prohibited, with enforcement by specific performance.

On the other hand, the argument that the purpose of WTO remedies is to rebalance concessions is based on the view that international trade agreements are basically ‘contracts’ among politically-motivated governments, and that the current WTO system does not impose a legal obligation to comply with WTO rulings. Therefore, suffering WTO suspension or paying compensation are equally valid alternatives to compliance. Most notably, Schwartz and Sykes claim that the concept of ‘efficient breach’ is a central feature of the WTO dispute settlement system, especially where WTO provisions respecting renegotiation and settlement of disputes over breach of obligations are designed to facilitate efficient adjustments to unanticipated circumstances.¹¹⁴ In other words, the objective of WTO dispute settlement is compliance only when the gains of compliance outweigh its costs. However, when compliance incurs net cost, breach is the

¹¹³ J. Jackson (2004), *supra* note 112, at 115.

¹¹⁴ W. Schwartz and A. Sykes, ‘The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization’, 31 *Journal of Legal Studies* 179 (2002), 181.

preferred efficient outcome. Under this view, WTO obligations are protected by the ‘liability rule’, where entitlements can be removed through the payment of compensatory damages that are legally determined by courts.

However, rather than this black-or-white perspective, there are also arguments that the system of trade remedies consists of both objectives. Such a view is led by Pauwelyn, who claims that when viewed historically, the goal of GATT/WTO suspensions and dispute settlement in general is multiple, and even sometimes overlapping. More specifically, there seems to have been a gradual evolution from ‘rebalancing’ to ‘compliance’ throughout the GATT and WTO systems.¹¹⁵ In other words, the focus of dispute settlement in GATT has been the negotiated balance of benefits that has been harmed by ‘nullification or impairment’ from the violating measure, which provides justification for using remedies to ‘rebalance’ the upset negotiated balance of benefits. However, the changing character of WTO rules and the parties they affect seems to provide reason to move toward treating WTO obligations more as international legal obligations.¹¹⁶ This flexibility in the goals pursued by trade remedies is arguably more desirable, when carefully calibrated, based on the view that different types of legal entitlements should be matched with different types of protection and enforcement goals.¹¹⁷

In practice, the approaches employed by the WTO Arbitrators in DSU Article 22.6 proceedings for measuring the level of countermeasures to be authorized to the

¹¹⁵ J. Pauwelyn (2010), *supra* note 112, 62.

¹¹⁶ J. Pauwelyn, ‘Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach’, 94 *American Journal of International Law* 335 (2000), 337.

¹¹⁷ J. Pauwelyn (2010), *supra* note 112, 62.

violating WTO Member can be divided into the property rule and the liability rule as well. While there have been only less than a dozen of these arbitration rulings to date,¹¹⁸ a certain trend can be identified. According to Pauwelyn, the goal of WTO suspensions as identified by the Arbitrators' statements can be classified into three categories: (1) rulings with unequivocal statements that the goal of WTO suspensions is 'inducing compliance'; (2) rulings where close to punitive suspension was authorized in response to prohibited subsidies; and (3) rulings in regular cases with statements that the goal of WTO suspensions is not clear, and it might not be compliance.¹¹⁹ Pauwelyn mentions that a 'cyclical evolution of WTO case law' may be identified, that moves through phase (1) to phase (3), and back to phase (1), as shown in Table 4.¹²⁰ However, in addition to the classification proposed by Pauwelyn, there seems to be a recent additional trend regarding the view of Arbitrators in determining the award in terms of the permissible level of countermeasures, with the recent Article 22.6 Arbitration in *US-Upland Cotton*. As a result, there seems to be an evident departure from the previous Arbitrators' positions regarding the purpose of WTO remedies, particularly with respect to violations of

¹¹⁸ *EC-Bananas* (US), WT/DS27/ARB, 9 April 1999; *EC-Bananas* (Ecuador), WT/DS27/ARB/ECU, 24 March 2000; *EC-Hormones* (US), WT/DS26/ARB, 12 July 1999; *EC-Hormones* (Canada), WT/DS48/ARB, 12 July 1999; *Brazil-Aircraft* (Canada), WT/DS46/ARB, 28 August 2000; *US-FSC* (EC), WT/DS108/ARB, 30 August 2002; *Canada-Aircraft II* (Brazil), WT/DS222/ARB, 17 February 2003; *US-1916 Act* (EC), WT/DS136/ARB, 24 February 2004; *US-Offset Act (Byrd Amendment)* (Brazil, Canada, Chile, EC, India, Japan, Korea, Mexico), WT/DS217/ARB, 31 August 2004; *US-Gambling* (Antigua), WT/DS285/ARB, 21 December 2007; *US-Upland Cotton* (Brazil), WT/DS267/ARB, 31 August 2009.

¹¹⁹ J. Pauwelyn (2010), *supra* note 112, 50.

¹²⁰ For example, the Arbitrator in *US-Gambling* noted that while the purpose of suspension of concessions is to "induce compliance", it does not mean that countermeasures can be imposed beyond what is "equivalent" to the level of nullification or impairment. Article 22.6 Arbitration Decision, *US – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/ARB, 21 December 2007, para. 2.7.

prohibited subsidy obligations. This will be discussed in more detail in section 3.3.2 of this chapter.

<Table 4> Purpose of Countermeasures in DSU Article 22.6 Rulings

Purpose of WTO Countermeasures	Arbitration Cases
Goal of 'inducing compliance' (Phase 1)	<i>EC-Bananas</i> (DS27)
	<i>EC-Hormones</i> (DS26,48)
	<i>US-Gambling</i> (DS285)
Punitive countermeasures in response to prohibited subsidies (Phase 2)	<i>Brazil-Aircraft</i> (DS46)
	<i>US-FSC</i> (DS108)
	<i>Canada-Aircraft II</i> (DS222)
Goal of suspension is not clear (Phase 3)	<i>US-1916 Act</i> (DS136)
	<i>US-Offset Act</i> (DS217)
'Equivalent' countermeasures in response to prohibited subsidies (New trend)	<i>US-Upland Cotton</i> (DS267)

Source: Author's compilation, based on Pauwelyn (2010) classification of DSU Article 22.6 Arbitration disputes

3.1.3 LIMITATIONS OF THE WTO REMEDY SYSTEM

The WTO remedies of withdrawal, compensation or suspension of concessions are essentially forward-looking remedies that offer only prospective relief. In the case of withdrawal, the best circumstances may offer an immediate withdrawal of the inconsistent measure upon the adoption of DSB recommendations and rulings. However, in most cases, the inconsistent measure will be recommended to be withdrawn within a 'reasonable period of time', which, in many cases, may result in delayed

implementation.¹²¹ If not so withdrawn, compensation may be provided in the form of reduced trade barriers, but the level of compensation is counted only from the date of expiration of the reasonable period of time, thus offering only prospective relief for the injury caused. Similarly, the level of suspension of concessions to be authorized by the DSB is also calculated from the date of expiry of the implementation period.

As previously mentioned, the remedy of trade compensation is considered to be ‘trade-liberalizing’ as compared to the remedy of retaliation which is considered to be ‘trade-restrictive’. However, due to the requirement of MFN application when using the remedy of compensation, which necessarily imposes a burden on the respondent party since it has to provide compensation to all the WTO Members, the remedy of compensation is rarely used. Instead, complainant parties more frequently resort to the remedy of retaliation which results in raising trade barriers, albeit on a bilateral basis.

The remedy of suspension of concessions is essentially bilateral in nature, which has many implications. In short, this feature of WTO countermeasure, as the last resort for the Members to induce compliance, has resulted in a weak enforcement mechanism for the WTO dispute settlement system. Particularly when politically sensitive disputes are involved, and weaker Members have to face negotiations with stronger Members in

¹²¹ For example, the DSU allows parties to extend the reasonable period of time (RPT) upon mutual consent (DSU Article 21.4), but imposes no restraint on the parties’ discretion, which results in possible excessive extensions of the RPT beyond the normal period of 15 months. In other cases, parties may make use of the RPT as a mere tactic to delay its implementation, by continuously doing ‘something’ as a measure to implement the DSB rulings which is deemed insufficient from the complaining party. The lack of supervision over implementation within the RPT by the DSB results in delayed performance by the defying party. M. Qian, ‘Reasonable Period of Time’ in the WTO Dispute Settlement System’, 15 *Journal of International Economic Law* 257 (2012), 265-271.

terms of economic and political power, the likely result is that WTO remedies will not be effective enough to induce compliance from the defying Members. According to Pauwelyn, the “legalization of disputes under the WTO stops, in effect, roughly where noncompliance starts”.¹²²

Furthermore, an inherent problem of counterproductive countermeasures renders the WTO remedies impractical and ineffective not only for the weaker Members but also for all Members of the WTO. Especially for the developing countries, suspending concessions towards the respondent country’s exports may effectively block the much needed imports from the developed countries, resulting in ‘shooting oneself in the foot’ by using retaliatory countermeasures and actually harming the complainant’s economy. Therefore, while from a legal perspective, the remedy of countermeasures in the form of raising tariff barriers against the defying member may seem a reasonable enough remedy, in effect, the results are not desirable and thus not usable for the weaker members of the WTO. In addition, the use of countermeasures results in discrepancy between the losing export sectors (which are harmed from the initial infringing measure) and the benefiting import-competing sectors (which benefit from the blocked imports due to the retaliatory measure) for the complainant party. Therefore, retaliation does not necessarily help the export industry that has been denied market access by the respondent in the first place. Rather, it is the complainant’s competing industries that benefit from the temporarily raised tariff barriers against imports. A similar situation also exists for the respondent party, where the injured sectors from the retaliatory measure are not the same as the

¹²² Pauwelyn (2000), *supra* note 116, 338.

benefiting sectors from the initial infringing measure. Rather, the benefiting industries are chosen by the complainant, typically with a view to having the largest negative impact on the respondent country's government.¹²³

There also exists a problem related to the level of authorized countermeasures when using the remedy of retaliation. Article 22.7 of the DSU provides that when determining the level of suspension of concessions, it shall be 'equivalent to the level of nullification or impairment'. Typically, the gross value of imports which have been wrongfully blocked due to the initial infringing measure has been used as the basis of calculation for ensuring 'equivalence' to the amount of harm done by the violating measure. However, from an economic perspective, it is doubtful whether such gross values of trade may accurately represent the actual economic welfare effects of government policy measures. In fact, Anderson (2002) posits that the effects of retaliation calculated on the basis of 'trade loss' equivalence will never translate into equivalent 'damage to economic welfare', except by coincidence. In addition, the complainant will lose economically during the retaliation period from the import restrictions it imposes on the respondent's trade.¹²⁴

The ineffectiveness of the WTO enforcement mechanism due to its prospective

¹²³ K. Anderson, 'Peculiarities of Retaliation in WTO Dispute Settlement', 1 *World Trade Review* 123 (2002), 129-130.

¹²⁴ *Ibid.*, 127-128. This is because economic welfare loss to the respondent by the retaliatory measure cannot be equal to the gross value of imports prohibited by the retaliatory measure, except by coincidence, especially when economic welfare loss is relative to the respondent's excess export supply curve. In other words, economic welfare loss to the respondent is larger when the respondent's export supply for the relevant product is lower (i.e. less price elastic).

nature has been quite controversial among legal scholars.¹²⁵ Compared to public international law, WTO remedies are perceived as perhaps offering less.¹²⁶ This is because the ILC Draft Articles, that provide codification for situations regarding international disputes and remedies, explicitly require ‘full reparation’ for any damages incurred, which include retrospective compensation for past damages. On the other hand, WTO remedies do not include monetary compensation for damages in the past.¹²⁷ Instead, the level of countermeasures (either in the form of compensation or suspension of concessions) is required to be equivalent to the damages done which are measured prospectively, or after the date of expiry of the reasonable period of time. Consequently, WTO Members might not have an incentive to comply promptly or comply at all, especially when a Member considers that the profit of retaining its inconsistent measure is higher than the cost of compensating for the damage done.

According to Mavroidis, remedies are an ‘institutional guarantee’ that a contract will always be served.¹²⁸ Therefore, remedies must be effective. However, as observed so far, the WTO countermeasures as the *ultima ratio* of its enforcement mechanism seems to

¹²⁵ See, for example, Mavroidis (2000), *supra* note 112, 806-812. The issue of ineffective remedies has also been an important subject of discussions in the Doha negotiations on DSU reform. Various issues, grouped under the title of ‘effective compliance’, have been proposed and discussed, including collective retaliation, facilitated cross-retaliation for developing countries, relationship between monetary compensation and suspension of concessions, and whether calculation of the level of nullification or impairment should cover the period of RPT. WTO, Special Session of the Dispute Settlement Body, Report by the Chairman to the Trade Negotiations Committee, TN/DS/25, 21 April 2011.

¹²⁶ Pauwelyn (2000), *supra* note 116, 339.

¹²⁷ There may be one exception to this rule, as in the *US-Section 110(5) Copyright Act* case (WT/DS160/ARB25/1, 9 November 2001), where the Article 25 Arbitrators ruled that the benefits nullified or impaired as a result of the US Copyright Act is € 1,219,900 per year, to be paid as compensation to European musicians until such time as the US Copyright Act is amended.

¹²⁸ Mavroidis (2000), *supra* note 112, 811.

be failing both in terms of effectiveness and impartiality. This situation is not an exception in the case of prohibited subsidies, where the rules are most stringent, but the performance of the WTO enforcement mechanism seems to be the weakest. The following section will examine the current problems regarding the effectiveness of remedies for prohibited subsidies.

3.2 CURRENT STATUS OF REMEDIES FOR PROHIBITED SUBSIDIES IN THE WTO

As mentioned in the introductory section (section 1.1), WTO disputes involving prohibited subsidies are challenged with the problem of delayed compliance with the rulings and recommendations of the Dispute Settlement Body (DSB). With a view to understanding the current situation regarding prohibited subsidy disputes in the WTO, this section will examine several numerical illustrations that indicate the status of compliance in WTO subsidy disputes. In addition, the types and forms of remedies that are available for non-compliant prohibited subsidy disputes in the WTO will be examined with an overview of how these remedies have been applied in prohibited subsidy disputes.

3.2.1 THE COMPLIANCE PROBLEM IN WTO PROHIBITED SUBSIDY DISPUTES

The figures showing the current status of disputes which have been brought to the WTO and the record of non-compliance in WTO disputes are shown in Tables 5 and 6

below. As of March 2013, out of a total of 313 disputes that were brought to the WTO for which panels have been established,¹²⁹ 18 disputes are categorized as non-compliance cases (Table 5).¹³⁰ Non-compliance cases include cases in which the implementing action taken by the respondent party has been deemed inadequate and thus referred to compliance proceedings which are either ongoing, completed without any finding of non-compliance, or completed with a finding of non-compliance, and to arbitration proceedings for authorization of retaliation which have been requested or granted. While this figure is not a significant number, a closer look at the dispute cases shows that the problem of non-compliance is concentrated in a few areas (Table 6). It should be noted that, while the last row in Table 6, representing the cases for which a mutually acceptable solution on implementation has been notified to the WTO, has not been counted in as dispute cases with problems of non-compliance, the category has been included in this list in order to show the frequency of disputes involving subsidies among dispute cases for which implementation has been an issue as raised by the complaining party.

¹²⁹ As of March 2013, a total of 456 disputes have been brought to the WTO, including 143 disputes which are currently in the stage of consultation.

¹³⁰ Disputes categorized as non-compliance cases include cases which are in the process of: ongoing compliance procedures (3 cases); compliance proceedings completed without finding of non-compliance (2 cases); compliance proceedings completed with finding of non-compliance (5 cases); request for authorization to retaliate (3 cases); and granted authorization to retaliate (5 cases).

<Table 5> Current Status of Disputes in the WTO (as of March 2013)

Status	No. of disputes	Note
In consultation	143	Including dispute cases still in consultation stage since 1995
Panel established, but not yet composed	22	-
Panel composed	11	-
Panel report circulated	1	-
Panel report under appeal	2	-
Appellate Body report circulated	0	-
Report(s) adopted, no further action required	27	No further action required due to no finding of violation
Report(s) adopted, with recommendation to bring measure into conformity	28	-
Implementation notified by respondent	83	Implementation notified by respondent after RPT determination through Article 21.3(c) arbitration proceeding
Mutually acceptable solution on implementation notified	21	After initial disagreement on RPT (Article 21.3(c) arbitration), parties reach mutual agreement on RPT
Compliance proceedings ongoing	3	Article 21.5 arbitration proceedings <i>[(preliminary) Inadequate implementation case]</i>
Compliance proceedings completed without finding of non-compliance	2	Article 21.5 arbitration proceedings <i>[(preliminary) Inadequate implementation case]</i>
Compliance proceedings completed with finding of non-compliance	5	Article 21.5 arbitration proceedings <i>[Inadequate implementation case]</i>
Authorization to retaliate requested	3	Article 22.6 arbitration proceedings <i>[(preliminary) Authorization of retaliation case]</i>
Authorization to retaliate granted	5	Article 22.6 arbitration proceedings <i>[Authorization of retaliation case]</i>
Authority for panel lapsed	7	-
Settled or terminated (withdrawn, mutually agreed solution)	93	-
Total	456	-

Source: Compiled by the author, based on the information provided by the WTO website, http://www.wto.org/english/tratop_e/dispu_e/dispu_current_status_e.htm

<Table 6> Record of Non-Compliance in WTO Disputes

Non-compliance cases	No. of disputes	Dispute cases	Subject area
Authorization to retaliate granted ¹³¹	5	US-Offset Act (DS217) US-Offset Act (DS234) Canada- Aircraft II (DS222) US-Upland Cotton (DS267) US-Gambling (DS285)	AD/SCM(CVD) AD/SCM(CVD) SCM(Subsidies) AG/SCM(Subsidies) GATS
Authorization to retaliate requested ¹³²	3	US-Copyright Act (DS160) US-Sunset Reviews (DS268) EC-Biotech Products (DS291)	TRIPS AD AG/SPS/TBT
Compliance proceedings completed with finding of non-compliance	5	Canada-Aircraft (DS70) Mexico-HFCS (DS132) EC-Bed Linen (DS141) Chile-Price Band System (DS207) Korea-Paper (DS312)	SCM(Subsidies) AD AD AG/SG AD
Compliance proceedings ongoing	3	EC-Civil Aircraft (DS316) US-Stainless Steel (DS344) US-Civil Aircraft (DS353)	SCM(Subsidies) AD SCM(Subsidies)
Compliance proceedings completed without finding of non-compliance	2	Brazil-Aircraft (DS46) US-Shrimp (DS58)	SCM(Subsidies) GATT (Art. I, XI, XIII, XX)
Mutually acceptable solution on implementation notified	21	Japan-Alcoholic Beverages (DS8) Japan-Alcoholic Beverages II (Canada) (DS10) Japan-Alcoholic Beverages II (US) (DS11) Australia-Salmon (DS18) EC-Hormones (US) (DS26) EC-Hormones (Canada) (DS48) US-Wool Shirts (DS33) Turkey-Textiles (DS34) Japan-Agricultural Products II (DS76) US-DRAMS (DS99) Canada-Dairy (US) (DS103)	GATT (Art.III) GATT (Art. III) GATT (Art. III) SPS AG/SPS/TBT AG/SPS/TBT ATC ATC AG/SPS AD AG/SCM(Subsidies)

¹³¹ It must be noted that the 5 dispute cases listed in this category have different status of implementation. Disputes in *US-Offset Act* and *US-Gambling* remain unresolved; Brazil did not impose the authorized countermeasures in *Canada-Aircraft II* dispute; Brazil and US agreed to maintain the Mutually Agreed Solution (agreed in August 2010) under which Brazil agreed not to retaliate in *US-Upland Cotton* dispute.

¹³² It must be noted that while authorization to retaliate has been requested, all 3 disputes falling under this category have resulted in arbitration proceedings, but suspended upon parties' requests.

		US-FSC (DS108)	AG/SCM(Subsidies)
		Canada-Dairy (New Zealand) (DS113)	AG
		Australia-Automotive Leather II (DS126)	SCM(Subsidies)
		EC-Sardines (DS231)	TBT
		US-Softwood Lumber III (DS236)	SCM(Subsidies)
		Japan-Apples (DS245)	AG/SPS
		US-Softwood Lumber IV (DS257)	SCM(Subsidies)
		US-Softwood Lumber V (DS264)	AD
		US-Softwood Lumber VI (DS277)	AD/SCM(CVD)
		EC-Commercial Vessels (DS301)	SCM(Subsidies)

Source: Compiled by the author based on information provided by the WTO website, http://www.wto.org/english/tratop_e/dispu_e/dispu_current_status_e.htm

Table 7 below shows the amount of countermeasures that have been awarded by the WTO adjudicating bodies in Article 22.6 arbitrations to date. Two points are notable in this table: First, a majority of the Article 22.6 arbitrations involve dispute cases on subsidies, reflecting the importance of the subsidy measure as a national policy to WTO member countries, and difficulties in achieving compliance on subsidy policies. Despite high litigation costs involved in going through the multilateral track for dispute resolution with respect to subsidies, WTO members seem keen to obtain a ‘verdict’ on the other party’s subsidy measure that they perceive to be a violation of WTO law. Furthermore, the strategic characteristic of national subsidy policies seem to pose structural difficulties in removing the violating measure to a satisfactory level for the complaining party, resulting in delayed dispute settlement procedures involving arbitrations on compliance and authorization of retaliation. Secondly, some of the highest amounts of retaliation granted as a result of the Article 22.6 arbitrations are from subsidy disputes, such as in the *US-FSC* case where the amount requested by EC was granted in full by arbitrators. This is due to the difference in text in the SCM Agreement that allows “appropriate

countermeasures” in lieu of a retaliation level that is “equivalent to the level of nullification or impairment” as enshrined in DSU. Most of the arbitrators in relevant Article 22.6 disputes have interpreted the term “appropriate” to be a level allowing more than the level that addresses the trade-distorting effect on the injured party.

<Table 7> WTO Disputes with Authorized Retaliation

Dispute	Parties (Complainant/ Respondent)	Date of circulation	Requested retaliation amount	Authorized retaliation amount	Related Agreement
<i>US-Upland Cotton</i> (DS267)	Brazil / US	Aug. 31, 2009	US\$1.12 billion (SCM 4.11) US\$1.037 billion (SCM 7.10)	US\$147.4 million (SCM 4.11) US\$147.3 million (SCM 7.10)	SCM (subsidies)
<i>US-Gambling</i> (DS285)	Antigua / US	Dec. 21, 2007	US\$3.443 billion	US\$21 million	GATS
<i>US-Offset Act</i> (DS217, 234)	Brazil, Canada, Chile, EC, India, Japan, Korea, Mexico / US	Aug. 31, 2004	Amount of offset duties collected on product by respective complainants	Disbursements multiplied by trade effect coefficient	Antidumping/ SCM(CVD)
<i>Canada- Aircraft II</i> (DS222)	Brazil / Canada	Feb. 17, 2003	US\$3.36 billion	US\$247,797,000	SCM (subsidies)
<i>US-FSC</i> ¹³³ (DS108)	EC / US	Aug. 30, 2002	US\$4,043 million	US\$4,043 million	SCM (subsidies)

¹³³ *US-FSC* (DS108) dispute has been settled with notification of a mutually acceptable solution on implementation (17 May 2006) after being referred to second recourse to Article 21.5 compliance proceedings (adopted 14 March 2006) following authorization for imposing countermeasures (7 May 2003).

<i>Brazil-Aircraft</i> ¹³⁴ (DS46)	Canada / Brazil	Aug. 28, 2000	C\$700 million	C\$344.2 million	SCM (subsidies)
<i>EC-Bananas</i> ¹³⁵ (Ecuador) (DS27)	Ecuador / EC	Mar. 24, 2000	US\$450 million	US\$201.6 million	Agriculture/ GATS
<i>EC-Hormones</i> ¹³⁶ (US, Canada) (DS26, 48)	Canada, US / EC	July 12, 1999	C\$75 million (Canada) US\$202 million (US)	C\$11.3 million (Canada) US\$116.8 million (US)	Agriculture/ SPS/TBT
<i>EC-Bananas</i> (US) (DS27)	US / EC	April 9, 1999	US\$520 million	US\$191.4 million	Agriculture/ GATS

As observed thus far, the current status of compliance with respect to prohibited subsidy disputes may not be as satisfactory as the drafters of the rules on subsidies might have anticipated at the onset of their negotiations on subsidy matters. The next section will examine the remedies that are in place and how they are applied for addressing continued non-compliance with WTO rulings and recommendations in prohibited subsidy disputes.

3.2.2 THE REMEDY SYSTEM IN ACTION FOR PROHIBITED SUBSIDIES IN THE WTO

¹³⁴ *Brazil-Aircraft* (DS46) dispute has been categorized as a case with “compliance proceedings without finding of non-compliance” since the case was referred again to Article 21.5 compliance proceedings after authorization for retaliation was granted as a result of Article 22.6 arbitration. Brazil took revised measures to conform to the DSB ruling, but was not accepted by Canada, which requested for second recourse to an Article 21.5 compliance panel.

¹³⁵ *EC-Bananas* (DS27) dispute was settled with a mutually agreed solution on November 8, 2012 after recourse to Article 22.6 arbitration and second recourse to Article 21.5 Appellate Body proceedings. WTO, Notification of a Mutually Agreed Solution, WT/DS27/98, 12 November 2012.

¹³⁶ *EC-Hormones* (DS26, 48) dispute was settled with implementation of adopted reports.

The WTO dispute settlement system provides for two types of ‘tracks’ for resolving disputes with respect to illegal subsidy measures. The ‘multilateral track’ allows WTO Members to bring a subsidy-related case directly to the WTO with the goal of obtaining a multilateral adjudication on whether the measure concerned is consistent with WTO rules and consequent recommendation for bringing the infringing measure into conformity.¹³⁷ The ‘bilateral track’, on the other hand, allows WTO Members to unilaterally impose countervailing duties against the subsidizing country after going through due processes of investigation, determination, and imposition in accordance with the relevant provisions of the SCM Agreement.¹³⁸

3.2.2.1 Type of Remedies for Prohibited Subsidies

As previously mentioned, the dispute settlement procedure for disputes involving prohibited subsidies is different from the general provisions for dispute resolution that apply to the rest of the WTO covered agreements, mainly in terms of the expedited procedures that are in place for addressing illegal subsidies.¹³⁹ However, prior to initiating formal litigation procedures, all potential disputing parties are first recommended to engage in consultations so as to reach a mutually satisfactory agreement which is acceptable to both parties, and which is consistent with the WTO agreements. However, if a mutually agreed solution cannot be reached at the pre-litigation stage, the

¹³⁷ Parts II through IV of the SCM Agreement.

¹³⁸ Part V of the SCM Agreement.

¹³⁹ Refer to *supra* note 4 for difference in time-lines in the dispute settlement procedures contained in the SCM Agreement and the DSU.

parties may initiate panel proceeding (and Appellate Body proceeding, if the decision has been appealed), which provide rulings that recommend the infringing party to comply with the recommendation to ‘bring the measure into conformity’ with the related agreement.¹⁴⁰

There are two types of remedies that are available in the WTO dispute settlement system for prohibited subsidies against breach of the SCM Agreement. There is one final and primary remedy of ‘withdrawal’ (removal of the adverse effects of the subsidy or amendment by law so that the measure no longer provides benefits to the recipient in the subsidizing country), under which any measure found to be a prohibited subsidy must be ‘withdrawn without delay’.¹⁴¹ In all cases, a specific time-period for implementation (“reasonable period of time”) is specified by the panel within which the measure must be withdrawn. In prohibited subsidy disputes, the ‘reasonable period of time’ is, in most cases, considered to be 90 days. However, when such act of compliance is not achieved within the given implementation period, the WTO provides for a secondary, temporary remedy for prohibited subsidies: ‘suspension of concessions’ or retaliation.

Unlike other agreements covered by the DSU, the remedy of compensation is not available as a secondary remedy for prohibited subsidies. There is no legal basis for the use of compensation as a remedy for prohibited subsidy cases.¹⁴² In general,

¹⁴⁰ DSU, Article 19.1.

¹⁴¹ SCM Agreement, Article 4.7.

¹⁴² The provisions concerning remedies for prohibited subsidies in the SCM Agreement do not mention any remedy of “compensation”. Article 4.7 stipulates that if a measure is found to be a prohibited subsidy, the violating party shall “withdraw the subsidy without delay”, while Article 4.10 provides that in case the DSB recommendation is not followed within the period of implementation, the complaining party shall be granted authorization to take “appropriate

compensation as a form of remedy under the WTO consists of additional trade concessions on the part of the losing party, usually in related economic areas to the dispute. Such trade compensation is voluntary in nature, meaning that the losing respondent party needs to agree to compensation by self-imposing the terms of the arrangement. Therefore, the need for cooperation from the subsidizing country may lead to problems in enforcement. Furthermore, unlike the retaliation remedy which can be applied on a bilateral basis, the compensation remedy is subject to the requirement of MFN application. As a result, the remedy of trade compensation necessarily imposes a burden on the losing party (respondent) having to provide compensation to all the WTO Members, as a consequence of which, this remedy is rarely used. Also, as a secondary remedy to the preferred final remedy of withdrawal, the compensation remedy should be temporarily used, only until compliance is achieved, and applied prospectively, with compensation allowed only up to the level of damages that will be suffered in the future.

The authorization to retaliate against the offending party, as a ‘last resort’ remedy in WTO countermeasures, is mainly in the form of suspension of concessions, or of raising tariff barriers to the pre-negotiation level, on strategically selected products of export that are of interest to the infringing party so as to induce compliance by the infringing party. The remedy of retaliation consists of three types, under which the winning party may suspend concessions on the same economic sector in which the violation has occurred, or on different sectors in the same agreement, or on sectors in a

countermeasures”.

different agreement.¹⁴³ The retaliation remedy should also be applied only temporarily until the infringing measure has been withdrawn. On the other hand, due to its inherent nature, the retaliation remedy is generally understood to be trade-restrictive (‘shooting oneself in its own foot’), especially for smaller developing countries for which lifting their import barriers against products from developed countries may not be a valid option.

The level of retaliation which is authorized to the requesting party is based on a standard that is termed differently for prohibited subsidy cases. Unlike the standard of “equivalence” which is prescribed for the general countermeasures in the DSU,¹⁴⁴ retaliation for prohibited subsidies is granted on the basis of “appropriate countermeasures”, meaning that they are “not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited”.¹⁴⁵ The interpretation and application of these terms are discussed in the next section.

3.2.2.2 Application of Remedies in Prohibited Subsidy Disputes

As explained in section 3.2.1, the remedy of retaliation has been most frequently used in prohibited subsidy disputes. The aircraft disputes between Brazil and Canada (*Brazil-Aircraft* and *Canada-Aircraft II*), *US-FSC*, and *US-Upland Cotton* disputes are all cases involving prohibited subsidy measures that have gone through the entire dispute

¹⁴³ DSU, Article 22.3. The three types of retaliation are referred to as ‘parallel retaliation’, ‘cross-sector retaliation’, and ‘cross-agreement retaliation’.

¹⁴⁴ DSU, Articles 22.4 and 22.7.

¹⁴⁵ SCM Agreement, Articles 4.10 and 4.11, and footnotes 9 and 10.

settlement process to reach the final stage of authorizing retaliatory measures against continuing acts of non-compliance.

A. Application of the primary remedy of “withdrawal”

In two of the four dispute cases (*Brazil-Aircraft*¹⁴⁶ and *Canada-Aircraft II*¹⁴⁷), the DSB recommended the respondent countries to withdraw the export subsidies found to be inconsistent with relevant provisions in the SCM Agreement, within the implementation period of 90 days. The time-period for implementation is normally specified by the panel in its recommendation, and in most cases that are brought to the WTO, the implementation period provided to prohibited subsidy cases has been 90 days. Panels seem to have considered the nature of the measures and issues regarding implementation to be relevant in determining the period for withdrawal.¹⁴⁸ In contrast, under the general provisions of the DSU, the reasonable period of time (RPT) for implementing the DSB recommendations should not exceed 15 months,¹⁴⁹ but in most cases the RPT provided is less than such the maximum allowed period, which can be determined by proposal from the complainant party, mutual agreement by the parties, or determination from arbitrators.¹⁵⁰ On the other hand, the implementation period for

¹⁴⁶ Panel Report, *Brazil - Export Financing Programme for Aircraft*, WT/DS46/R, 14 April 1999.

¹⁴⁷ Panel Report, *Canada - Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, 28 Jan. 2002.

¹⁴⁸ P. C. Mavroidis, P. A. Messerlin, and J. M. Wauters, *The Law and Economics of Contingent Protection in the WTO* (2008), 421.

¹⁴⁹ DSU, Article 21.4.

¹⁵⁰ DSU, Article 21.3.

withdrawal in *US-FSC* and *US-Upland Cotton* were 12 months and 6 months, respectively.¹⁵¹ In both cases, ample consideration seems to have been given for the legislative process for amending related legislations on the part of the defending parties.

While all four cases aforementioned (and all other WTO disputes) have applied the meaning of “withdrawal” to be forward-looking, there has been one distinct case in the WTO in which the term was interpreted differently. Arbitrators in *Australia-Leather (Article 21.5)* dispute,¹⁵² which involved non-recurring prohibited subsidies that had been granted in the past, found that the term “withdraw the subsidy” provided for in Article 4.7 of the SCM Agreement is “not limited to prospective action only but may encompass repayment of the prohibited subsidy”.¹⁵³ As a result, the Arbitrators viewed that “withdrawal” should mean retrospective, full reimbursement of the subsidy payment received for cases involving non-recurrent subsidies.¹⁵⁴ This was based on their understanding that a mere termination of the subsidy program would have no impact as a remedy and no deterrent effect against other attempts to use one-time subsidy payments. However, this WTO ruling was subject to criticism from both parties to the dispute and prompted several proposals with regard to the interpretation of “withdrawal of the

¹⁵¹ Panel Report, *United States – Tax Treatment for ‘Foreign Sales Corporations’*, WT/DS108/R, 8 October 1999, para. 8.8; Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, 8 September 2004, para. 8.3.

¹⁵² Article 21.5 Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, 21 January 2000.

¹⁵³ *Ibid.*, paras. 6.39 and 6.42.

¹⁵⁴ *Ibid.*, para. 6.48. The exact wording of the determination was: “Thus, we conclude that, in the circumstances of this case [*one-time subsidies*], repayment is necessary in order to “withdraw” the prohibited subsidies found to exist. As discussed above, we do not find any basis for repayment of anything less than the full subsidy. We therefore conclude that *repayment in full of the prohibited subsidy* is necessary in order to “withdraw the subsidy” in this case.” (emphasis added).

subsidy”,¹⁵⁵ and ended in a mutual agreement on partial repayment of the subsidy and termination of the subsidy measure at issue.¹⁵⁶

B. Application of the retaliation remedy

So far under the WTO, the remedy of retaliation was authorized in four dispute cases involving prohibited subsidies. *Brazil-Aircraft (Article 22.6)*¹⁵⁷ was the first arbitration proceeding pursuant to Article 22.6 of the DSU and Article 4.11 of the SCM Agreement in which the remedy of retaliation for prohibited subsidies was requested and granted. In this case, the DSB had recommended Brazil to withdraw the prohibited export subsidies that had been found to exist, and in response, Brazil had to modify the subsidy program (PROEX) at issue. However, Canada challenged the revised program under DSU Article 21.5, where the measure was found to be inconsistent with the WTO obligations. Canada consequently requested authorization to take “appropriate countermeasures” against Brazil in the amount of C\$700 million per year. The Arbitrators in this case looked into the meaning of the term “appropriate” to determine whether the proposed countermeasures were “appropriate”, taking note of the issues of what would constitute the subsidy to be withdrawn, and whether the level of countermeasures should correspond

¹⁵⁵ WTO, Negotiating Group on Rules, Communication from Australia, Subsidies: Withdrawal of a Subsidy, TN/RL/GEN/35 (23 March 2005), TN/RL/GEN/97 (20 January 2006), and TN/RL/GEN/115 (21 April 2006); WTO, DSB Minutes of Meeting on 11 February 2000, WT/DS/M/75 (7 March 2000).

¹⁵⁶ WTO, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, Notification of Mutually Agreed Solution, WT/DS126/11, 31 July 2000.

¹⁵⁷ Article 22.6 Arbitration Decision, *Brazil-Export Financing Programme for Aircraft*, WT/DS46/ARB, 28 August 2000.

to the amount of the subsidy or to the level of nullification or impairment suffered by Canada. In conclusion, the Arbitrators reasoned that the subsidy to be withdrawn would be the “full amount” of the subsidy payments on exports of the regional aircraft, and that when dealing with a prohibited export subsidy, an amount of countermeasures that corresponds to the *total amount of the subsidy* is “appropriate”.¹⁵⁸ Based on this analysis, the Arbitrators calculated the total amount of the subsidy as the appropriate amount of countermeasures on the basis of: (1) average sale price of the aircraft models for which sales were subsidized; (2) projected annual production of each aircraft model during a set period; (3) calculated present value of the subsidy per aircraft model over the same period. Based on this methodology, the Arbitrators concluded that the amount of the subsidy is C\$344.2 million per year.¹⁵⁹

In *US-FSC*, the DSB recommended that the US shall withdraw the prohibited export subsidies provided through the Foreign Sales Corporation (FSC) measure within the granted period of implementation. In response to the recommendation, the US modified its measure, but was challenged by the EC under DSU Article 21.5. At the same time, the EC requested authorization to take “appropriate countermeasures” pursuant to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU, and suspend concessions against the US in the amount of US\$4,043 million per year, in the form of an additional duty of 100 percent ad valorem above the bound duty rate on various US products. In examination of whether the proposed countermeasures are “appropriate”, the

¹⁵⁸ *Ibid.*, paras. 3.30-3.60.

¹⁵⁹ *Ibid.*, paras. 3.67-3.93.

Arbitrator considered the fact that the subsidy measure concerned “creates systemic uncertainty and instability of expectations as to trading conditions, as opposed to security and stability of such conditions based on the understanding... that export subsidies are prohibited”.¹⁶⁰ Notably, the Arbitrator in this case also considered that the US’ breach of obligation is “an *erga omnes* obligation owed in its entirety to each and every Member” and cannot be considered to be “allocatable” across the Membership. In conclusion, the Arbitrator viewed that the countermeasures proposed are “not disproportionate to the initial wrongful act to which they are intended to respond”,¹⁶¹ and found that the proposed countermeasures in the amount of US\$4,043 million per year constitute “appropriate countermeasures”.¹⁶²

Canada-Aircraft II is closely tied to the earlier *Brazil-Aircraft* and the original *Canada-Aircraft* disputes. In both cases, panel found that illegal export subsidies had been provided, and the programs at issue were revised by Brazil and Canada respectively. While Brazil challenged the consistency of Canada’s revised subsidy program to implement the ruling, Article 21.5 compliance proceedings in the original *Canada-Aircraft* dispute found that Brazil had failed to prove that the revised program is inconsistent with the SCM Agreement.¹⁶³ As a result, Brazil challenged the revised programs again in a renewed dispute, under which some of the subsidy programs found to

¹⁶⁰ Article 22.6 Arbitration Decision, *United States – Tax Treatment for ‘Foreign Sales Corporations’*, WT/DS108/ARB, 30 August 2002, para. 6.9.

¹⁶¹ *Ibid.*, para. 6.24.

¹⁶² *Ibid.*, para. 8.1.

¹⁶³ Article 21.5 Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/RW, 9 May 2000.

be prohibited export subsidies were ordered to be withdrawn within 90 days.¹⁶⁴ Claiming that Canada failed to follow the recommendations of the DSB within the required time-period, Brazil requested for authorization to take “appropriate countermeasures” in the amount of US\$3.36 billion, which corresponded to the value of the aircraft contracts not delivered as of the date that the subsidies at issue should have been withdrawn.¹⁶⁵ Examining Brazil’s “lost sales/competitive harm” methodology, the Arbitrator found that it does not justify the level of countermeasures proposed, and therefore the level is not “appropriate” under SCM Agreement Article 4.10.¹⁶⁶ Instead, the Arbitrator calculated its own amount of appropriate countermeasures starting from using a methodology based on the amount of subsidy, which resulted in a net present value of the total amount of the subsidy of US\$206,497,305.¹⁶⁷ However, in addition, the Arbitrator considered it appropriate to adjust the result of the calculations “to take into account the fact that Canada, until now,...does not intend to withdraw the subsidy at issue and the need to reach a level of countermeasures which can reasonably contribute to induce compliance”. As a result, the Arbitrator adjusted the level of countermeasures by an amount corresponding to 20 percent of the amount of the subsidy, to grant US\$247,797,766 in “appropriate countermeasures”.¹⁶⁸

Most recently, in *US-Upland Cotton (Article 22.6)*, Brazil requested

¹⁶⁴ Panel Report, *Canada- Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, 28 Jan. 2002, para. 8.4.

¹⁶⁵ Article 22.6 Arbitration Decision, *Canada- Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/ARB, 17 Feb. 2003, para. 1.2.

¹⁶⁶ *Ibid.*, paras. 3.20-3.49.

¹⁶⁷ *Ibid.*, para. 3.90.

¹⁶⁸ *Ibid.*, paras. 3.119-122.

authorization to take countermeasures with regard to US subsidy programs found to be prohibited export subsidies in the annual amount of US\$3 billion.¹⁶⁹ First, Brazil sought one-time countermeasures in relation to payments made by the US (Step 2 payments) during the period when it should have withdrawn the subsidies at issue (period after expiry of its implementation period until the period when the measure was repealed) in the amount of US\$350 million. However, the Arbitrator found that the absence of any finding of non-compliance by an Article 21.5 panel regarding the repealed measure provided no legal basis for Brazil to seek countermeasures.¹⁷⁰ In turn, Brazil's proposed countermeasure in relation to the US subsidy program used for export transactions (GSM 102 export credit program) was taken into consideration. In examining the "appropriateness" of the proposed countermeasures by Brazil, the Arbitrator determined that Brazil's methodology, which consisted of "interest rate subsidies" and "additional sales resulting from the subsidy payments", was "more than the amount of the subsidy, because it considers 'benefits' which extend outside the meaning of Article 1.1 of the SCM Agreement".¹⁷¹ Accordingly, in determining the proper basis of calculation of "appropriate countermeasures", the Arbitrator considered Brazil's methodology in relation to the interest rate subsidy, full additionality and marginal additionality, and

¹⁶⁹ Brazil's proposed countermeasures in *US-Upland Cotton (Article 22.6)* dispute constituted of countermeasures against prohibited subsidies (US\$3 billion) and actionable subsidies (US\$1.037 billion) as both were found to be WTO-inconsistent subsidies in the original panel and found by the Article 21.5 panel that the US modifications had not brought its measures into compliance. In both cases, Brazil proposed to take countermeasures on not only goods, but also to take cross-sector suspension of obligations under the TRIPS Agreement and GATS. Article 22.6 Arbitration Decision, *United States – Subsidies on Upland Cotton*, WT/DS267/ARB/1, 31 August 2009, para. 1.13.

¹⁷⁰ *Ibid.*, para. 3.64.

¹⁷¹ *Ibid.*, paras. 4.139-4.151.

found that the appropriate level of countermeasures is US\$147.4 million.¹⁷² However, rather than resorting to the calculation methods used by the previous Arbitrators that were based on the total amount of the subsidy, the Arbitrator in this case apportioned the subsidy amount to the “trade-distorting impact to Brazilian producers and exporters”. This was based on the understanding that the requirement that countermeasures be “appropriate” and not “disproportionate” suggests that “there should be a degree of relationship between the level of countermeasures and the trade-distorting impact of the measure” on the complaining member.¹⁷³ Table 8 below summarizes the amounts of the retaliation remedy that has been requested and awarded and the calculation standards used in each case.

<Table 8> Retaliation Remedies as Applied in Prohibited Subsidy Disputes

Article 22.6 Arbitration	Requested Award	Granted Award	Calculation Method
<i>Brazil-Aircraft</i> (DS46)	C\$700 million	C\$344.2 million	Amount-of-subsidy approach
<i>US-FSC</i> (DS108)	US\$4,043 million	US\$4,043 million	Amount-of-subsidy approach
<i>Canada-Aircraft II</i> (DS222)	US\$3.36 billion	US\$247,797,000	Amount-of-subsidy approach + Adjustment (20%)
<i>US-Upland Cotton</i> (DS267)	US\$3 billion (SCM 4.11) US\$1.037 billion (SCM 7.10)	US\$147.4 million (SCM 4.11) US\$147.3 million (SCM 7.10)	Trade-effects approach

¹⁷² *Ibid.*, paras. 4.208-4.278.

¹⁷³ *Ibid.*, para. 4.135.

C. The compensation remedy

In contrast to the retaliation remedy, there has been no request or application of the trade compensation as a form of remedy in subsidy disputes that have been brought to the WTO. As noted previously, the voluntary nature of trade compensations by which the losing party agrees to lower its tariff barriers further against competing imports, and the obligation of MFN application attached to the compensation remedy, do not make the remedy necessarily attractive for the disputing parties to agree upon.

Although it does not involve prohibited subsidies, there has been one single WTO dispute case under which compensation in the form of monetary payment has been awarded by the WTO arbitrators to the complaining party. In *US – Copyright Act (Article 25)*¹⁷⁴, the arbitrators awarded the US to pay EC copyright holders an amount of €1,219,900 per year. The compensation amount was determined on the basis of the amount of royalty payments that would have been distributed by related organizations in the US to EC right holders had the offending US legislation not taken effect.

3.3 THE DISTINCTIVE TREATMENT OF PROHIBITED SUBSIDIES IN THE WTO

In this section, the treatment of prohibited subsidies that are quite distinctive in terms of its stringency and expedited rules for WTO Members are examined in more

¹⁷⁴ Article 25 Arbitration Award, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/ARB25/1, 9 November 2001.

detail. In order to understand the *sui generis* treatment of prohibited subsidies in the WTO, the historical evolution of the rules will be first reviewed, followed by an examination of how these rules have been interpreted and applied in practice by the WTO. During the process of this exercise, issues in WTO jurisprudence regarding prohibited subsidies will be identified for more detailed discussion in the subsequent chapters.

3.3.1 EVOLUTION OF RULES ON PROHIBITIVE SUBSIDIES

In order to place the current WTO remedial regime on prohibited subsidies in context, it is useful to examine the historical background of the remedial regimes that are associated with the rules on subsidies: beginning from the preparatory work of the Havana Charter to establish the International Trade Organization (ITO); the original GATT Agreement in 1947; the 1955 amendments to the GATT subsidy rules; the 1979 Subsidies Code of the Tokyo Round; to the current SCM Agreement as a result of the Uruguay Round negotiations.

3.3.1.1 Rules on Subsidies in the Draft ITO Charter

From its inception, GATT perceived subsidies as increasingly significant barriers to the free flow of trade, but there were critical difficulties in achieving a consensus on the problem of the international regulation of subsidies. Therefore, until the 1955 Review Session of the GATT, where major amendments were made to fill in the gap of a failed

ITO, subsidy rules in GATT consisted of only one paragraph which contained simply a requirement that any contracting party maintaining a subsidy must notify GATT.¹⁷⁵

The draft ITO Charter,¹⁷⁶ which contains explicit clauses corresponding to particular obligations contained in the GATT, consists of a more elaborate pattern of subsidy regulation that was not carried over into the GATT draft.¹⁷⁷ Rules on subsidies in the ITO Charter were contained in Section C, Articles 25 to 28, under which general obligations of notification with regard to the maintenance of any subsidy and consultations where any party considers that subsidization has caused or threatened to cause serious prejudice to its interests were provided for. Unlike GATT 1947, the ITO draft also specified a prohibition on export subsidies, and an additional distinction between primary and non-primary products, providing for a special (more lenient) treatment for primary products with regard to subsidization. With respect to export subsidies, however, primary products were subject to limitations as well, as subsidies that would have the effect of maintaining or acquiring trade volumes that are “more than an equitable share of world trade” are not allowed.¹⁷⁸ The provisions also provide that if an agreement cannot be reached within a “reasonable period of time”, the ITO would be

¹⁷⁵ Article XVI:1 of the present GATT.

¹⁷⁶ For the history on preparations for the ITO and the parallel preparatory work on GATT, see J. Jackson, *The World Trading System: Law and Policy of International Economic Relations*, MIT Press (1997), 36-38.

¹⁷⁷ It should be noted that the preparatory work of GATT and ITO reflects the drafters' consideration of GATT as more of an international “contract” with specific limited choices, while considering ITO and the explicit clauses contained therein, as providing a more expansive framework for interpretation for the contracting parties. J. Jackson, *World Trade and the Law of GATT: A Legal Analysis of the General Agreement on Tariffs and Trade* (1969), 49.

¹⁷⁸ Havana Charter for an International Trade Organization (hereinafter Draft ITO Charter), Article 28 (1).

given the authority to determine what constitutes an “equitable share of world trade”, with the relevant Member required to conform to the determination.¹⁷⁹

While there are no specific rules for remedies with respect to export subsidies, the general rules on dispute settlement in the ITO draft are provided in Chapter VIII (Settlement of Differences), in Articles 92 through 97. It contains provisions on consultation and arbitration, which can be referred to where any member considers that “any benefits accruing to it directly or indirectly, implicitly or explicitly... is being nullified or impaired” with a view to a “satisfactory adjustment” of the matter.¹⁸⁰ However, the provision limits the authority of the arbitration, as decisions by an arbitrator would not be binding on any party to the dispute.¹⁸¹ If a satisfactory settlement is not reached, the matter may be referred to the Executive Board which investigates the matter and renders a decision on whether nullification or impairment exists.¹⁸² More specifically, if the Executive Board considers that the recommended actions are “not likely to be effective in time to prevent serious injury”, it may release the parties concerned from obligations or the grant of concessions “to the extent and upon such conditions as it considers *appropriate* and *compensatory*, having regard to the benefit which has been nullified or impaired” (emphasis added).¹⁸³ It is notable that the explicit term of “compensatory” was not carried into GATT 1947. Jackson explains that since the ITO

¹⁷⁹ *Ibid.*, Article 28 (3).

¹⁸⁰ *Ibid.*, Article 93(1).

¹⁸¹ *Ibid.*, Article 93(2).

¹⁸² *Ibid.*, Article 94(2). As a result of the investigation, the Executive Board may decide on: (a) no call for action; (b) recommend further consultation; (c) refer matter to arbitration; (d) request to take actions necessary to conform to the provisions of the Charter; (d) make recommendations to contribute to a satisfactory adjustment.

¹⁸³ *Ibid.*, Article 94(3).

Charter was made applicable to a broader set of obligations than those of the GATT, there may be reason for distinguishing between the GATT and the ITO with regard to the nullification clause.¹⁸⁴

3.3.1.2 Subsidy Rules in GATT 1947 and the 1955 Amendments

Due to the prospects of establishing the ITO as a separate organization to deal with trade regulations, the original General Agreement on Tariffs and Trade (GATT) Agreement in 1947 provided very little discipline on the matter of subsidies. The first multilateral discipline on subsidies was contained in Article XVI:1 of GATT, which was drawn from Article 25 of the draft ITO Charter, and addressed subsidies that operate “directly or indirectly to increase exports”, which were subject only to general reporting and consultation requirements with regard to subsidization if determined that serious prejudice is caused or threatened by the subsidization.

As mentioned previously, the more elaborate forms of subsidy regulation in the draft ITO, in terms of the prohibition of export subsidies and different treatment of subsidies for primary and non-primary products, have not been carried over to the original text of the GATT. Jackson (1969) observes that the argument for more stringent regulation of subsidies was ‘blunted’ by the prospect that the temporary GATT general provisions were to be superseded by the ITO Charter provisions, in addition to the US

¹⁸⁴ Jackson (1969), *supra* note 177, at 170.

position not to make any undertakings with regard to the matter of export subsidies.¹⁸⁵

During the GATT Review Session in 1955, Article XVI was amended extensively and some of the original form of the subsidy regulations in the ITO draft was reintroduced into the GATT text.¹⁸⁶ Section B, entitled “Additional Provisions on Export Subsidies” was added to Article XVI, with new focus on export subsidies with increased disparity of treatment in subsidy rules with respect to primary and non-primary products. In the case of primary products, GATT parties were to “seek to avoid” using export subsidies that resulted in obtaining a “more than equitable share of world export trade”.¹⁸⁷ On the other hand, subsidies for exports of non-primary products that “resulted in the sale at a price lower than the comparable price charged for the like product to buyers in the domestic market” were to be prohibited from January 1, 1958 or shortly thereafter.¹⁸⁸ Since most GATT parties did not comply promptly with this prohibition, this led to the establishment of a “Working Party on Provisions of Article XVI:4” in 1960, which led to the development a non-exhaustive list of measures considered to be prohibited export subsidies pursuant to Article VI:4.¹⁸⁹

The rules on dispute settlement related to subsidies are contained in several articles in GATT. As the first and most significant countermeasure against the use of subsidies under GATT rules, Article VI on antidumping and countervailing duties

¹⁸⁵ *Ibid.*, 370.

¹⁸⁶ WTO, World Trade Report 2006: Exploring the Links between Subsidies, Trade and the WTO (2007), 189.

¹⁸⁷ General Agreement on Tariffs and Trade (GATT 1947), Article XVI:3.

¹⁸⁸ *Ibid.*, Article XVI:4.

¹⁸⁹ This later became the Illustrative List of Export Subsidies contained in Annex I to the WTO SCM Agreement. World Trade Report (2006), *supra* note 186, 190.

provides a self-help remedy to counter subsidies, by allowing the use of countervailing duties that may be levied “for the purpose of offsetting any bounty or subsidy bestowed, directly or indirectly, upon the manufacture, production, or export of any merchandise”.¹⁹⁰ Article XIX, related to the increase of imports that cause or threaten serious injury, provides for another possible remedy for foreign subsidies, by allowing the importing country to “suspend” GATT obligations or “withdraw or modify” GATT concessions related to imports.¹⁹¹ A third remedy to counter foreign subsidies can be found in Article XXIII, which provides for rights for consultation, and in extreme cases, suspension of GATT concessions or obligations in the event of “nullification or impairment” of a “benefit accruing...directly or indirectly” under GATT.¹⁹²

As can be compared from the original text of GATT 1947, there has been quite a development in the provisions regarding the rules and remedies on subsidies leading up to the 1960 amendments of the original GATT text. Rules on subsidies have been more elaborated with increased distinction between primary and non-primary products regarding subsidies for exports, albeit with more leniency for subsidies for primary export products, but more available remedy provisions to counteract acts of subsidization by foreign governments.

3.3.1.3 Subsidy Rules in the 1979 Subsidies Code

¹⁹⁰ GATT 1947, *supra* note 187, Article VI:3.

¹⁹¹ *Ibid.*, Article XIX:1.

¹⁹² *Ibid.*, Article XXIII:1.

The next stage in the evolution of subsidy rule-making resulted from the Tokyo Round, in the “Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of GATT”, known as the “Subsidies Code”. One of the most principal achievements in the 1979 Subsidies Code was the ‘two-track’ approach for disciplining subsidies. The first track instituted disciplines for imposing countervailing duties with detailed requirements for injury finding (Part I of the Subsidies Code). More detailed rules pertaining to countervailing measures were established, notably in respect of procedures associated with countervailing duty investigations and standards for determining whether subsidies were a cause or threat of material injury. The second track contained disciplines on the use of subsidies, but with different treatment of export subsidies between primary and non-primary products (Part II of the Subsidies Code). The prohibition on the use of export subsidies on non-primary products are strengthened, with addition of an “Illustrative List” of export subsidies in the Annex that explicitly provided a non-exhaustive definition of what falls under the category of export subsidies. With regard to domestic subsidies, Article 2 provided first statements on the use of domestic subsidies, but in a quite ambiguous manner, reflecting the division of views among GATT contracting parties.

As observed, the subject of dispute settlement had not received any sustained attention prior to the Tokyo Round negotiations, when a variety of dispute settlement reforms were discussed, mainly in the various code groups as the issue was related to the enforcement of particular agreements, and the Framework Group that dealt with GATT Article XXIII procedures that were applicable to the obligations of the main GATT

agreement.¹⁹³ However, despite the renewed attention on the rules on dispute settlement in the 1979 Subsidies Code, the outcome may be judged as providing little effective discipline as regards the enforcement of subsidy rules in GATT. The remedies provided for prohibited export subsidies were mainly consultations or conciliation for reaching a mutually acceptable solution, or “appropriate” countermeasures, with no exact meaning of the term, when recommendations to resolve the issue had not been followed.¹⁹⁴ On the other hand, a significant development in subsidy remedy rules was the establishment of dispute settlement procedures provided in Part VI of the Subsidies Code, consisting of Article 17 and 18. There is considerable resemblance with the current rules providing for countermeasures against prohibited subsidies, especially in Article 18(9) which stipulates that “if the Committee’s recommendations are not followed within a reasonable period, the Committee may authorize appropriate countermeasures (including withdrawal of GATT concessions or obligations) taking into account the nature and degree of the adverse effect found to exist”. However, a fundamental problem with regard to the enforcement of the new codes negotiated in the Tokyo Round was the principle of consensus decision-making, particularly the possibility of panel findings being blocked by the losing party. Furthermore, since subsidies were an area of considerable controversy, few countries ultimately signed onto the 1979 Subsidies Code, which only applied to the signatories among the GATT contracting parties, consequently limiting the scope of

¹⁹³ R. Hudec, *Enforcing International Trade Law: The Evolution of the Modern GATT Legal System*, Butterworth Legal Publishers (1993), 40-42.

¹⁹⁴ Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade (“Subsidies Code”), GATT, BISD26 Supp. 56 (1980); 31UST513; T.I.A.S. No. 9619, Articles 12 and 13.

application of the renewed enforcement measures that had been put in place.

3.3.1.4 Subsidy Rules in the SCM Agreement

The Uruguay Round negotiations were launched with a mandate to improve GATT disciplines regarding all subsidies and countervailing measures affecting international trade. According to the 1985 Report by the GATT Secretariat,¹⁹⁵ the 1979 Subsidies Code had proven inadequate to resolve the problem of subsidies and countervailing measures. Thus, the resulting Agreement on Subsidies and Countervailing Measures (SCM Agreement) contained substantive modifications to subsidy disciplines. First, while GATT 1947 and the Subsidies Code contained no definition of the term “subsidy”, Part I of the SCM Agreement defines “subsidy” in more detail through requirement of “financial contribution by a government” and “benefit” conferred. Furthermore, the concept of “specificity” has been introduced in the SCM Agreement, under which both *de jure* and *de facto* specificity need be taken into account to determine which measures are subject to the multilateral subsidy disciplines.¹⁹⁶

A major change in the SCM Agreement is the classification of subsidies into three categories: “red light” (prohibited subsidies), “yellow light” (actionable subsidies), and “green light” (non-actionable) subsidies. There are two types of “red light” subsidies which are completely prohibited: export subsidies, which are contingent, in law or in fact,

¹⁹⁵ GATT, Report of Eminent Persons on Problems Facing the International Trade System, reprinted in 24 I.L.M. 716 (1985).

¹⁹⁶ Agreement on Subsidies and Countervailing Measures (SCM Agreement), Article 2.

on export performance, including all subsidies listed in the Illustrative List (attached as Annex I); and import substitution subsidies, which are contingent on the use of domestic over imported goods.¹⁹⁷ Prohibited subsidies are irrebuttably presumed to distort trade and deemed to be specific. The rest of the subsidies that are determined to cause “adverse effects to the interests of other Members” are considered to be actionable subsidies,¹⁹⁸ and, along with prohibited subsidies, can be challenged either through the multilateral dispute settlement procedures or through the imposition of countervailing duties. The provisions on “green light” subsidies lapsed as of January 1, 2000, leaving only two categories of prohibited and actionable subsidies being covered by the SCM Agreement.

Articles 4 of the SCM Agreement specifies procedural rules for multilateral remedies regarding prohibited subsidies, providing for an expedited dispute resolution procedure in cases involving prohibited subsidies. Disputes brought to the WTO pursuant to Article 4 of the SCM Agreement are subject to much shorter time limits than normal disputes, including for the phases of panel establishment, and adoption of panel and Appellate Body reports.¹⁹⁹ Furthermore, in the case of prohibited subsidies, withdrawal of the subsidy should be done “without delay”, and the arbitrators should specify a time-period within which the measure must be withdrawn.²⁰⁰ In case the recommendation by the DSB is not implemented within the specified time-period, “appropriate

¹⁹⁷ *Ibid.*, Part II (Prohibited Subsidies), Article 3.

¹⁹⁸ *Ibid.*, Part III (Actionable Subsidies), Article 5. “Adverse effects” include: (a) injury to the domestic industry of another Member; (b) nullification or impairment of benefits accruing directly or indirectly to other Members; (c) serious prejudice to the interests of another Member.

¹⁹⁹ *Ibid.*, Article 4.

²⁰⁰ *Ibid.*, Article 4.7.

countermeasures” may be authorized to the complaining Member.²⁰¹ Prohibited subsidies may also be challenged through the imposition of countervailing duties under the SCM Agreement (two-track approach). Under this unilateral remedy against prohibited subsidies, the importing Member must conduct an investigation which demonstrates that the subsidized imports are causing injury to its domestic industry.²⁰² The remedy procedures for actionable subsidies are provided in Article 7, which also provide for shorter time limits for dispute settlement proceedings than the general DSU procedures.²⁰³ As a result, where there is determination that the subsidy has resulted in adverse effects to the interests of another Member, the subsidizing member shall “remove the adverse effects or shall withdraw the subsidy”.²⁰⁴ With regard to the level of the countermeasures that may be imposed, Articles 7.9 and 7.10 provide that countermeasures shall be “commensurate with the degree and nature of the adverse effects determined to exist”.

Another important feature of the SCM Agreement is that by virtue of the ‘single undertaking’, the disciplines in the new Agreement apply to the entire WTO membership. This is a significant achievement for the dispute settlement rules, since more stringent subsidy disciplines can be enforced on all WTO Members and without the possibility of being blocked, due to the ‘positive’ consensus decision-making principle. While this implies an automatic, and thus binding nature of the DSB rulings, it also implies

²⁰¹ *Ibid.*, Article 4.10. Footnote 9 explains that “appropriate” does “not mean to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited”.

²⁰² *Ibid.*, Part V (Countervailing Measures), Article 15.

²⁰³ For actionable subsidies, SCM Agreement Article 7 provides for establishment of a panel after consultation request (60 days), circulation of panel report (120 days), adoption of panel report (30 days), and adoption of Appellate Body report (20 days).

²⁰⁴ SCM Agreement, Article 7.8.

considerable additional obligations for the developing countries. As a means to modulate this impact, the SCM Agreement also contains extensive special and differential treatment provisions.²⁰⁵

In sum, an observation of the evolution of the rules on prohibited subsidies and remedies show that the initial drafters of international trade regulations had intentions to strongly discipline subsidy measures with quite elaborate rules. However, due to the failure of ITO, the GATT discipline on subsidies seemed to have begun with quite ineffective rules for enforcement, further compounded by the ‘birth defect’ problem of GATT. However, as a result of negotiations and reforms, which culminated in the current WTO rules on prohibited subsidies, we have now in place a set of the most stringent rules for dealing with enforcement of prohibited subsidy related obligations. In the following subsection, we will examine how the current WTO rules on prohibited subsidies have been interpreted by the WTO Arbitrators to enforce non-compliant acts against prohibited subsidy rules.

3.3.2 INTERPRETATION AND APPLICATION OF THE REMEDY RULES ON PROHIBITED SUBSIDIES

As the rules disciplining prohibited subsidies and remedies to enforce the rules have evolved so far, the application and interpretation of those rules under the GATT and WTO have also evolved somewhat. Disputes brought to the WTO dispute settlement

²⁰⁵ World Trade Report 2006, *supra* note 186, 192.

system involving remedies for prohibited subsidies have been already introduced in section 3.2.2.2, albeit with focus on the amount of authorized retaliation and the approach used by Arbitrators in prohibited subsidy disputes. This section looks into how the rules on prohibited subsidies have been interpreted and applied in practice by the WTO adjudicating bodies, in order to identify some major issues that remain unresolved.

WTO disputes involving remedies for prohibited subsidy involve cases where the measures taken to comply by the respondent party in accordance with the rulings and recommendations of the WTO adjudicating bodies have been challenged by the complainant party pursuant to DSU Article 21.5, and those for which authorization for countermeasures have been requested pursuant to SCM Article 4.10 and DSU Article 22.6 in order to enforce the rulings of the DSB. These cases are listed in chronological order in Table 9 below.

<Table 9> WTO Disputes involving Prohibited Subsidy Remedies

Prohibited Subsidy Dispute	Request for Panel	Adoption of Panel/AB Report	Adoption of Article 21.5 Arbitration Report	Adoption of Article 21.5 II Arbitration Report	Authorization of Retaliation	Length of dispute
<i>Brazil-Aircraft</i> (DS46)	10 Jul. 1998	20 Aug. 1999 (AB)	4 Aug. 2000 (21.5 AB)	23 Aug. 2001 (21.5II P)	12 Dec. 2000	2Y 5M*
<i>Canada-Aircraft</i> (DS70)	10 Jul. 1998	20 Aug. 1999 (AB)	4 Aug. 2000 (21.5 AB)	-	-	
<i>US-FSC</i> (DS108)	1 Jul. 1998	20 Mar. 2000 (AB)	29 Jan. 2002 (21.5 AB)	14 Mar. 2006 (21.5II AB)	7 May 2003	7Y 10M
<i>Australia-Leather</i> (DS126)	11 Jun. 1998	16 Jun. 1999 (P)	11 Feb. 2000 (21.5 P)	-	-	1Y 8M

<i>Canada-Aircraft II</i> (DS222)	1 Mar. 2001	19 Feb. 2002 (P)	-	-	18 Mar. 2003	2Y (4Y 8M)**
<i>US-Upland Cotton</i> (DS267)	26 Feb. 2003	21 Mar. 2005 (AB)	20 June 2008 (21.5 AB)	-	19 Nov. 2009	6Y 7M

* Y: years, M: months

** Length of *Canada-Aircraft II* taking into account the original *Canada-Aircraft* (DS70) dispute.

As shown in Table 9, there are four prohibited subsidy disputes that have resulted in the authorization of countermeasures against continued non-compliant actions by the respondent party (*Brazil-Aircraft*, *US-FSC*, *Canada-Aircraft II*, *US-Upland Cotton*), and two dispute cases where dispute settlement procedures have been prolonged due to continued non-compliance of the implementing measure taken by the respondent party (*Brazil-Aircraft*, *US-FSC*). More notably, an examination of the total length of the disputes on the prohibited subsidy cases (shown in the last column) illuminates that quite a long period of time is spent before a complaining Member can finally be granted the authorization to impose retaliatory countermeasures against non-compliant Members. Included in the table is *Australia-Leather* dispute, for which the Article 21.5 compliance ruling has raised an important issue with regard to the effective remedial measure for prohibited subsidies, and the original *Canada-Aircraft* dispute, as it is closely related to the *Canada-Aircraft II* dispute.

3.3.2.1 Interpretation and Application of “appropriate countermeasures”

In the first three Article 22.6 arbitration cases involving prohibited subsidies -

Brazil-Aircraft, *US-FSC*, and *Canada-Aircraft II* – the basis for calculating the level of retaliation, based on the interpretation of the term “appropriate countermeasures”, has been quite different from the most recent arbitration proceeding involving prohibited subsidies in *US-Upland Cotton*. In the former disputes, the remedies were set at a level deemed sufficient to compel compliance, with the basis of calculation of the level of countermeasures set at the ‘amount of the subsidy’. The arbitrators in these cases determined that the ‘amount of subsidy’, as opposed to the amount calculated on the basis of the ‘trade effect’ caused by the subsidy, is the proper basis upon which “appropriate countermeasures” should be calculated.²⁰⁶

More specifically, the Arbitrators in *Brazil-Aircraft (Article 22.6)* held the view that it was appropriate to authorize Canada to take countermeasures up to the level of the subsidy paid by Brazil to its aircraft producers and not only up to the amount of injury suffered by Canadian producers operating in the same competing market. In interpreting the meaning of the word “appropriate”, the Arbitrators first looked into what constitutes the subsidy to be withdrawn, concluding that the subsidy payments (PROEX) “as a whole” are prohibited and must be withdrawn, not just a portion of the payments.²⁰⁷ Regarding the second question of whether the level of countermeasures should correspond to the ‘amount of the subsidy’ or to the ‘level of nullification or impairment’, the Arbitrators concluded that a countermeasure is “appropriate” if it “effectively induces compliance”,

²⁰⁶ In a more detailed analysis, Shadikhodjaev (2009) provides that a ‘violation value’ approach based on benefits was used in *Brazil-Aircraft (Article 22.6)* and *Canada-Aircraft II (Article 22.6)*, and a ‘violation value’ based on financial contribution was used in *US-FSC (Article 22.6)*. S. Shadikhodjaev, *Retaliation in the WTO Dispute Settlement System* (Kluwer, 2009), 140-149.

²⁰⁷ *Brazil-Aircraft (Article 22.6)*, *supra* note 157, paras. 3.33-3.40.

which means inducing the withdrawal of the subsidy.²⁰⁸ The Arbitrators in this case further noted that since a different term (“commensurate with the degree and nature of the adverse effects determined to exist”) exists when the intention is to limit countermeasures to the trade-distorting effects of a subsidy, the term “appropriate countermeasures” does not have similar constraints.²⁰⁹ They also noted that footnotes 9 and 10, which explain that “appropriate” should not mean “disproportionate”, at least confirm that the term “appropriate” should not be given the same meaning as the term “equivalent” in Article 22 of the DSU.²¹⁰

In *US-FSC (Article 22.6)*, the Arbitrators did consider the relevance of using the ‘trade effects’ of the subsidy as the appropriate benchmark. In examining the meaning of the term “appropriate countermeasures”, the Arbitrators noted that, based on the text of the provision (SCM Article 4.10), the prohibition on export subsidies is a “*per se* obligation, not itself conditioned on a trade effects test”.²¹¹ Therefore, the Arbitrators considered that the text cannot be interpreted as “to confine the appropriateness test to the element of countering the injurious effects on a party”, and more importantly, that countermeasures for prohibited subsidies need to take into account “the legal status of the wrongful act and the manner in which the breach of that obligation has upset the balance

²⁰⁸ *Ibid.*, paras. 3.44-3.45. In reaching this conclusion, the Arbitrators referred to the ILC Draft Articles on State Responsibility, which address the notion of countermeasures.

²⁰⁹ *Ibid.*, para. 3.49.

²¹⁰ *Ibid.*, para. 3.51. The Arbitrators further explain that the term “appropriate” may allow for more ‘leeway’ than the term “equivalent”, and that a countermeasure remains “appropriate” as long as it is “not disproportionate”, since the fact that the measure at issue is a prohibited subsidy need to be taken into account (Footnote 51).

²¹¹ *US-FSC (Article 22.6)*, *supra* note 160, 30 August 2002, para. 5.23.

of rights and obligations between Members”.²¹² Furthermore, the Arbitrators considered that the distinction in the terminology relating to countermeasures for export subsidies shows a “clear and unambiguous intent to apply different and more exacting disciplines when it comes to export subsidies”.²¹³ Finally, considering the object and purpose of the DSB’s mandate to authorize countermeasures pursuant to Article 4.10 of the SCM Agreement, the Arbitrator noted that, since in the case of prohibited subsidies, a panel can only recommend a subsidy found to be prohibited to be withdrawn without delay, a countermeasure should contribute to the ultimate objective of withdrawal of the prohibited subsidy without delay.²¹⁴ In conclusion, the Arbitrator reasoned that, in the case of prohibited subsidies, where countermeasures are to “take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question”, it cannot be reduced to a requirement that constrains countermeasures to trade effects.²¹⁵

The Arbitrators in *Canada-Aircraft II (Article 22.6)* went further to consider it appropriate to adjust the results of the calculations based on the subsidy amount to take into account Canada’s lack of intention to withdraw the illegal subsidy, by imposing countermeasures that “can reasonably contribute to induce compliance”.²¹⁶ As a result, the Arbitrators in this case awarded a level of retaliation that constituted of the amount of subsidy, plus an amount tantamount to 20 percent of the subsidy amount so as to induce

²¹² *Ibid.*, para. 5.24.

²¹³ *Ibid.*, para. 5.37.

²¹⁴ *Ibid.*, para. 5.56-57.

²¹⁵ *Ibid.*, para. 5.61.

²¹⁶ *Canada-Aircraft II (Article 22.6)*, *supra* note 165, para. 3.119.

compliance.²¹⁷ In reaching this determination, the Arbitrator in this case referred to the interpretation of “appropriate countermeasures” in the two prior arbitrations, but also noted that the provisions in SCM Agreement do not *a priori* exclude methodologies for calculating appropriate countermeasures as suggested by the parties, and thus they need to ensure that the proposed countermeasures are not disproportionate.²¹⁸ During the process of examining Brazil’s proposed countermeasures, the Arbitrator noted that it agreed that the need to induce compliance is a factor that should be considered in evaluating the appropriateness of the level of proposed countermeasures.²¹⁹ However, it rejected Brazil’s arguments that the characteristics of a particular subsidy might sometimes justify the application of particularly high level of countermeasures and that any level of countermeasures that is not “manifestly excessive” should be considered appropriate. Rather, the Arbitrator considered that “some congruence must remain between the countermeasure and the measure to which it responds”.²²⁰ However, in the end, the Arbitrator referred to the prior arbitrations under Article 4.10 and found it “proper as a starting-point to calculate the level of countermeasures in this case based on the amount of the subsidy methodology, subject to adjustments if necessary to ensure that the level of countermeasures is appropriate”.²²¹ As for ‘adjustments’, the Arbitrator in this case considered that the “specificities of this case” need to be taken into account that may justify an adjustment of the level of countermeasures. In particular, the lack of intention

²¹⁷ *Ibid.*, paras. 3.119-3.122.

²¹⁸ *Ibid.*, para. 3.14.

²¹⁹ *Ibid.*, para. 3.48.

²²⁰ *Ibid.*, para. 3.49.

²²¹ *Ibid.*, para. 3.51.

by the respondent party (Canada) to withdraw the subsidy at issue led the Arbitrator to view that “a higher level of countermeasures than that based on Canada’s methodology would be necessary and appropriate” to induce compliance from the non-compliant party.²²² As a result, the Arbitrator ‘adjusted’ the level of countermeasures “by an amount corresponding to 20 per cent of the amount of the subsidy”.²²³

In a departure from the previous Article 22.6 arbitration cases involving prohibited subsidies, the Arbitrators in *US-Upland Cotton (Article 22.6)* adopted a method of calculation that is based on the ‘trade effects’ of the WTO-inconsistent measures for authorizing the level of retaliation. The interpretation of the term “appropriate countermeasures” by the Arbitrators in this case had taken account of “not only the prohibited nature of the subsidy at issue as such, but also the manner in which that illegal measure adversely affects the interests of the complaining Member”.²²⁴ They deemed that the ‘amount of the subsidy’ was not necessarily the only basis for calculation to be consistent with the legal standard embodied in Article 4.10 of the SCM Agreement, but rather, that the requirements that countermeasures be “appropriate” and “not disproportionate” suggest that “there should be a degree of relationship between the level of countermeasures and the trade-distorting impact of the measure on the complaining Member”.²²⁵ In the process, the Arbitrator acknowledged that while the arbitrators in these cases took into account the fact that the legal standard embodied in Article 4.10 of the SCM Agreement may allow ‘greater flexibility’ than those under Article 22.4 of the

²²² *Ibid.*, paras. 3.106-3.107.

²²³ *Ibid.*, para. 3.121.

²²⁴ *US-Upland Cotton (Article 22.6)*, *supra* note 169, para. 4.115.

²²⁵ *Ibid.*, para. 4.315.

DSU, the provisions do not exclude trade effects as a relevant consideration. In fact, the Arbitrator noted that, in the prior arbitration decisions, consideration was given to the trade effects of the measure on the complaining Member.²²⁶ As a result, the Arbitrators concluded that the “trade-distorting impact” of the subsidy is the proper approach to calculating the relation level, and awarded countermeasures that incorporated the subsidy amount and ‘additionalities’, that were further apportioned based on the amount of the complaining party (Brazil)’s share of world trade in the pertinent product.²²⁷

3.3.2.2 Interpretation and Application of “withdraw the subsidy”

The panel’s interpretation of “withdraw the subsidy” in *Australia-Leather* (Article 21.5) has brought to the fore the question of whether “withdrawal” involves a ‘retrospective’ repayment of subsidies received. The subsidy measure at issue in this case was ‘one-time’ subsidy payments made under a grant contract by the Australian

²²⁶ *Ibid.*, para. 4.133. The Arbitrator in *US-FSC* (Article 22.6) considered that the proposed countermeasures on the basis of the trade effects of the subsidy would entitle the complaining Member to a countermeasure which would at least counter the injurious effect of the persisting illegal measure (para. 6.33), while the Arbitrator in *Canada-Aircraft II* (Article 22.6) noted that a calculation based on the trade effects is not *a priori* excluded from the basis for “appropriate countermeasures”, and that it was only because it was not convinced that the actual calculation of trade effects proposed by the requesting Member accurately reflected these trade effects, that it rejected the approach based on trade effects as proposed by the requesting Member (paras. 3.20-26).

²²⁷ The total amount of US\$147.4 million granted as countermeasure under Article 4.11 of the SCM Agreement consisted of: (1) the interest rate subsidy, or the “trade-distorting impact of the subsidy measure to Brazilian producers and exporters” (US\$25.27 million); (2) full additionality, or the “displacement effect on Brazilian production and exports of export credit guarantees issued to uncreditworthy obligors” (US\$80.8 million); and (3) marginal additionality, or the “displacement effect on Brazilian production and exports of export credit guarantees issued to creditworthy obligors (US\$41.3 million). This total amount was apportioned to Brazil’s share of the world market (11.7%). *US-Upland Cotton* (Article 22.6), paras. 4.199-277.

government to an Australian leather company. Due to the current WTO remedy system which provides for only prospective remedies, WTO Members could, in theory, evade obligations in SCM Agreement Article 3 by making one-time payment under a subsidy program and then later terminating the program. The solution found by the panel in this case was to require that the subsidies be *repaid in full*. The panel concluded that “repayment in full of the prohibited subsidy is necessary in order to “withdraw the subsidy” in this case”.²²⁸ In their view, “if the term “withdraw the subsidy” can properly be understood to encompass repayment of any portion of a prohibited subsidy, ‘retroactive effect’ exists”.²²⁹ In reaching this conclusion, the panel referred to Article 31 of the Vienna Convention on the Law of Treaties, according to which treaties should be interpreted in good faith on the basis of the ordinary meaning of the terms in their context and in light of the object and purpose of the treaty. In terms of the ordinary meaning of “withdraw the subsidy”, the panel viewed the term as referring to the “taking away” or “removing” the financial contribution, and thus encompassing “repayment” of the prohibited subsidy.²³⁰ With regard to the object and purpose, the panel viewed that the architecture of the SCM Agreement, particularly the special and additional rules for expedited dispute settlement in cases involving prohibited subsidies, implies that terminating a program found to be a prohibited subsidy on a prospective basis may “have no impact, and consequently no enforcement effect, in the case of prohibited subsidies

²²⁸ *Australia - Automotive Leather (Article 21.5)*, *supra* note 152, para. 6.48.

²²⁹ *Ibid.*, para. 6.22.

²³⁰ *Ibid.*, para. 6.27.

granted in the past”,²³¹ and thus interpretation of “withdraw the subsidy” which encompasses repayment is consistent with the overall structure of the SCM Agreement. Finally, in terms of effectiveness of the remedy, the panel explained that for “withdraw the subsidy” to be a meaningful remedy, it must “be effective regardless of the form in which a prohibited subsidy is found to exist”. In effect, the panel considered that a finding that the term “withdraw the subsidy” does not encompass repayment would have the effect of “granting full absolution to Members who grant export subsidies that are fully disbursed to the recipient...for which the export contingency is entirely in the past”.²³²

The statements by the *Australia-Leather (Article 21.5)* panel on the issue of retrospective remedies were quite controversial among WTO Members,²³³ and the findings of this case were not adopted by any of the later panels. However, the possibility of considering retrospective remedies for prohibited subsidy cases was also mentioned by the panel in *Canada-Aircraft II*. The panel stated that “it is not entirely clear that the WTO dispute settlement system only provides for prospective remedies in cases involving prohibited export subsidies. In this regard, we recall that the *Australia-Leather-21.5* panel found that remedies in cases involving prohibited export subsidies may encompass (retrospective) repayment in certain instances”.²³⁴

²³¹ *Ibid.*, para. 6.34.

²³² *Ibid.*, paras. 6.36-6.38.

²³³ Australia strongly criticized the panel’s findings, while Canada, Brazil, Japan, EC, and Malaysia also expressed similar concerns. WTO Dispute Settlement Body, Minutes of Meeting on 11 February 2000, WT/DSB/M/75 (7 March 2000), at 5-8. See also G. Goh and A. Ziegler, “Retrospective Remedies in the WTO after Automotive Leather”, 6 *Journal of International Economic Law* 545 (2003) for views against retrospective remedies in the WTO and judicial activism by WTO panels.

²³⁴ *Canada-Aircraft II (Panel)*, *supra* note 147, para. 7.170. However, it must be noted that the

In a similar vein, the issue of ‘one-time’ countermeasures to address a non-recurrent subsidy program that had been repealed prior to the establishment of an Article 21.5 panel had been raised in *US-Upland Cotton (Article 22.6)*. The subsidy measure at issue was payments made by the US after the expiry of the time-period for implementation when the measure should have been withdrawn, until when the US repealed the subsidy program. However, since the measure did not exist at the time the compliance panel was established, there had been no multilateral finding on whether the measure at issue was in compliance by an Article 21.5 panel. In this case, due to the absence of a multilateral determination of non-compliance, the Arbitrator refused to consider the proposed countermeasures for the repealed subsidy measure that had been granted in the past. The Arbitrator reasoned that there is no “legitimate basis to such countermeasures as requested by Brazil in relation to past payments made until the repeal...in the absence of a multilateral determination of non-compliance in relation to such payments and independently of any continuing situation of non-compliance”.²³⁵

On a different note, the dispute settlement proceedings in the *US-FSC* dispute illustrate another problematic area regarding the application of “withdraw the subsidy” in Article 4.7 of the SCM Agreement. In all the prohibited subsidy disputes that have been referred to the Article 21.5 compliance panel, the panel has not provided any recommendations other than the statement that the implementing Member has failed to withdraw the subsidies and/or had failed to implement the rulings of the original panel.²³⁶

final rulings in this case did not endorse the notion of retrospective remedies.

²³⁵ *US-Upland Cotton (Article 22.6)*, *supra* note 169, para. 3.50.

²³⁶ *Canada-Aircraft (Article 21.5)*, *supra* note 163, para. 6.2; *Australia-Leather (Article 21.5)*,

As a consequence, the US as the responding party in the US-FSC (*Article 21.5*) panel proceeding claimed that there was no recommendation made by the DSB under Article 4.7 of the SCM Agreement that the compliance measure (ETI Act tax exclusion) be withdrawn, and that a new recommendation by a compliance panel would be necessary for the responding party to withdraw the prohibited subsidy measure.²³⁷ Regarding this issue, the panel was of the view that a new recommendation by Article 21.5 panel is not required, since “if an Article 21.5 panel made a new recommendation...which...required an additional time period for implementation, this would give an *additional* period of time for the Member concerned to bring itself into conformity with the covered agreements”, which “might lead to a potentially never-ending cycle, whereby a Member continues to adopt non-compliant measures in order to win more time to comply with adopted DSB recommendations and rulings”.²³⁸ In conclusion, the compliance panel ruled that the US “continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations”, and that the original panel’s recommendations and rulings “remain operative through the results of the compliance proceedings in 2002”.²³⁹

3.3.2.3 Interpretation and Application of “withdraw without delay”

supra note 152, para. 7.1; *Brazil-Aircraft (Article 21.5)*, para. 7.1. Article 21.5 Panel Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/RW, 21 July 2000.

²³⁷ Article 21.5 II Panel Report, *US – Tax Treatment for ‘Foreign Sales Corporations’ (US-FSC (Article 21.5 II))*, WT/DS108/RW2, adopted 14 March 2006, paras. 7.37-7.39.

²³⁸ *Ibid.*, paras. 7.40-7.46.

²³⁹ *Ibid.*, paras. 7.37-7.39.

In most of the prohibited subsidy disputes where the DSB recommended the WTO-inconsistent measure to be “withdrawn without delay”,²⁴⁰ the specified time-period for withdrawal for prohibited subsidy cases was 90 days. This was the case in *Australia-Leather*,²⁴¹ *Brazil-Aircraft*,²⁴² *Canada-Aircraft II*²⁴³. However, in the case of *US-FSC*, the implementation period specified by the panel was nearly one year, since the FSC subsidies were recommended to be withdrawn by 1 October 2000.²⁴⁴ The panel had given ample consideration of the facts that it would require legislative action for the panel’s recommendation to be implemented, and that the US would only be able to implement the recommendation only after the following fiscal year which commences on 1 October 2000. This due date was later extended further to 1 November 2000 by the request of the US.²⁴⁵ In *US-Upland Cotton*, the panel recommended that the prohibited subsidy measures be withdrawn “at the latest within six months of the date of adoption of

²⁴⁰ For general DSU procedures, Article 21.3 of the DSU proscribes that “if it is impracticable to comply immediately with the recommendations and rulings, the Member concerned shall have a *reasonable period of time* in which to do so” (emphasis added). In the case of prohibited subsidies, Article 4.7 of the SCM Agreement specifies that “If a measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy *without delay*. In this regard, the panel shall *specify in its recommendation the time-period* within which the measure must be withdrawn” (emphasis added).

²⁴¹ Panel Report, *Australia-Leather*, WT/DS126/R, adopted 16 June 1999, para. 10.7.

²⁴² *Brazil-Aircraft (Panel)*, *supra* note 146, para. 8.5.

²⁴³ *Canada-Aircraft II (Panel)*, *supra* note 147, para. 8.4.

²⁴⁴ *US-FSC (Panel)*, *supra* note 151, para. 8.8. Since the *US-FSC* panel report was circulated on 8 October 1999, US was given almost one year for withdrawal of the FSC subsidies by 1 October 2000.

²⁴⁵ Request for Modification of the Time-Period for Compliance, *US-Tax Treatment for “Foreign Sales Corporations”*, WT/DS108/11, 2 October 2000; Minutes of the DSB Meeting, WT/DSB/M/90, 12 October 2000, paras. 6-7.

the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier)”²⁴⁶. However, no specific reason was provided by the panel for the longer period of implementation.

3.3.3 ISSUES IN WTO JURISPRUDENCE REGARDING PROHIBITED SUBSIDIES

The series of WTO dispute cases involving remedies for prohibited subsidies have revealed some of the most prominent and persisting problems in the WTO dispute settlement system. These issues can be categorized into: (1) the level of retaliation for addressing continued acts of non-compliance in prohibited subsidy cases; (2) the retrospective application of remedies for addressing non-recurrent payments found to be prohibited subsidies; (3) prolonged dispute settlement proceedings due to various loopholes in the remedy system for prohibited subsidies. These issues are discussed respectively in this section.

3.3.3.1 Level of Retaliation: “appropriate countermeasures”

As previously explained in sections 3.2.2.2 and 3.3.2.1, the standard of calculation for the level of “appropriate countermeasures” that has been applied by the WTO adjudicating bodies has changed over the years. While in the first three cases (*Brazil-Aircraft*, *US-FSC*, *Canada-Aircraft II*), the standard of calculation was the

²⁴⁶ *US-Upland Cotton (Panel)*, *supra* note 151, para. 8.3(b)-(c).

‘amount of subsidy’, the standard applied in the later dispute (*US-Upland Cotton*) was the ‘trade effects’ of the subsidy for measuring the amount of “appropriate countermeasures” in Article 4.10 of the SCM Agreement.

As observed in the literature regarding the ‘appropriate’ or ‘optimal’ level of countermeasures for prohibited subsidies, legal and economic commentators seem to be satisfied with the departure shown by the WTO adjudicating bodies in applying the remedy rules on prohibited subsidies. In particular, the *US-FSC* arbitration has been criticized on the grounds that complaining nations could each retaliate based on the effect of the subsidy on all nations, and the resulting cumulative retaliation might ultimately prove to be ‘disproportionate’. Therefore, the decision of the arbitrator in *US-Upland Cotton* (Article 22.6) to apportion retaliation rights based on market share was viewed as a more a ‘reasonable’ response with respect to the concern of optimal retaliation.²⁴⁷

Many legal scholars have referred to the ILC Draft Articles on State Responsibility and the concept of ‘proportionality’ contained therein to provide a reasonable method for applying a standard for measuring “appropriate countermeasures”.²⁴⁸ The concept of proportionality has been a prominent feature in

²⁴⁷ G. Grossman and A. Sykes, “‘Optimal’ Retaliation in the WTO – a Commentary on the *Upland Cotton* Arbitration”, in H. Horn and P. Mavroidis, eds., *The WTO Case Law of 2009: The American Law Institute Reporters’ Studies* (2011), 141. See also, R. Howse and D. Neven, “United States – Tax Treatment for ‘Foreign Sales Corporations’, Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS108/ARB), A Comment”, in H. Horn and P. Mavroidis, eds., *The WTO Case Law of 2002: The American Law Institute Reporters’ Studies* (2005), 53.

²⁴⁸ With regard to the matter of international remedies, the ILC Draft Articles have been considered to be the most authoritative reference, as it provides codification of situations regarding international disputes and countermeasures. Arbitrators in *US-Upland Cotton* (Article 22.6) have also referred to the ILC Draft Articles (footnote 126, page 26).

dispute settlement since the term appears explicitly in the two footnotes of the SCM Agreement for providing an explanation of the term “appropriate”. Proportionality as defined in Article 51 of the ILC Draft Articles specify that “countermeasures must be *commensurate with the injury suffered*, taking into account the *gravity of the internationally wrongful act and the rights in question*” (emphasis added). While this provision needs to be read together with Article 49 of the ILC Draft Articles, which specify that “an injured State may only take countermeasures...in order to induce that State to comply with its obligations”, the Commentaries further explain that the imposition of countermeasures are subject to an “essential limit”, according to which in every case a countermeasure “must be commensurate with the injury suffered”, and “partly independent of the question of whether the countermeasure was necessary to achieve the result of ensuring compliance”.²⁴⁹ According to Mitchell (2007), this concept of proportionality seems to have been applied inappropriately in the series of Arbitrations involving prohibited subsidy countermeasures. In particular, the Arbitrators seem to have put too much emphasis on the purpose of inducing compliance, viewing the prohibited nature of subsidies as an aggravating factor, serving as justification for considering both harm and culpability of the inconsistent subsidy measure. The author cautions that the notion of proportionality should not be applied in an interpretative manner to change the intention of drafters that Members should not be entitled to countermeasures that go beyond the level of harm caused by the WTO-inconsistent measure.²⁵⁰

²⁴⁹ Commentaries to ILC Draft Articles, *supra* note 30, at 296.

²⁵⁰ A. Mitchell, ‘Proportionality and Remedies in WTO Disputes’, 17 *European Journal of International Law* 985 (2007).

There have also been many economic scholars criticizing the application of the ‘amount-of-subsidy’ standard in interpreting “appropriate countermeasures”. Grossman and Sykes (2011) looked into whether the use of lost trade volume as a metric for retaliation or an approach that ties retaliation to the amount of the subsidy is better supported by economic principles. Their analysis was based on the approach of Howse and Staiger (2005),²⁵¹ which showed that retaliation at a level equal to the lost volume of trade (valued at pre-violation prices) can enable a complaining nation to restore its welfare to what it was before the tariff violation. First, they characterized the effect of the export subsidy on the injured country, which could be decomposed into a loss of producer surplus, gain in consumer surplus, and savings in government revenue. They observed that the welfare effect on the injured country would depend on the magnitude of the induced effect on the world price.²⁵² However, they also noted that the overall effect on the injured country depends on the relative weights that the country’s government attaches to producer surplus, consumer surplus, and tax revenue, and the extent of the country’s support for its own import-competing industry. Next, in analyzing what level of retaliation would restore the injured country’s welfare, the authors concluded that the trade effects of the retaliatory measure would match those of the initial infringing measure, but only if the elasticity of export supply for the product in the retaliated

²⁵¹ R. Howse and R. Staiger, ‘United States – Anti-Dumping Act of 1916 (Original Complaint by the European Communities) – Recourse to Arbitration by the United States under 22.6 of the DSU, WT/DS136/ARB, 24 February 2004: A Legal and Economic Analysis’, 4 *World Trade Review* 295 (2005).

²⁵² This is due to the consideration of the welfare effect as a terms-of-trade effect, in that the harm to the injured country is transmitted entirely through the reduction in the world price of the product of which the injured country exports. G. Grossman and A. Sykes, ‘“Optimal” Retaliation in the WTO – A Commentary on the Upland Cotton Arbitration’, 10 *World Trade Review* 133 (2011).

industry of the violating country is equal to the elasticity of the injured country's export supply for the subsidized product.²⁵³ However, since such a situation may not necessarily always be the case, especially if the sector for retaliation is often chosen arbitrarily, the authors conclude that the approach to retaliation that balances trade effects is not likely to achieve its purpose in the real world.²⁵⁴ Therefore, while their analysis provides some support for an approach to retaliation that allows the retaliator to reduce the value of its imports by an amount equal to the value of its lost exports due to the violation, this approach can approximately restore lost welfare only if it is assumed that all components of welfare receive equal weight, and that trade in other goods is not affected significantly following the violation and subsequent countermeasure. But since these assumptions are unrealistic in general, the analysis provides support for the trade-volume-effects calculation, but only on a weak basis.

Bown and Ruta (2010) provide a graphical representation of the different effects of retaliation for which the basis of calculation is the trade effects of the subsidy versus the amount of the subsidy. Using a framework that extends the model based on the theory of reciprocity by Bagwell and Staiger (2001),²⁵⁵ the authors show in a simple graphical

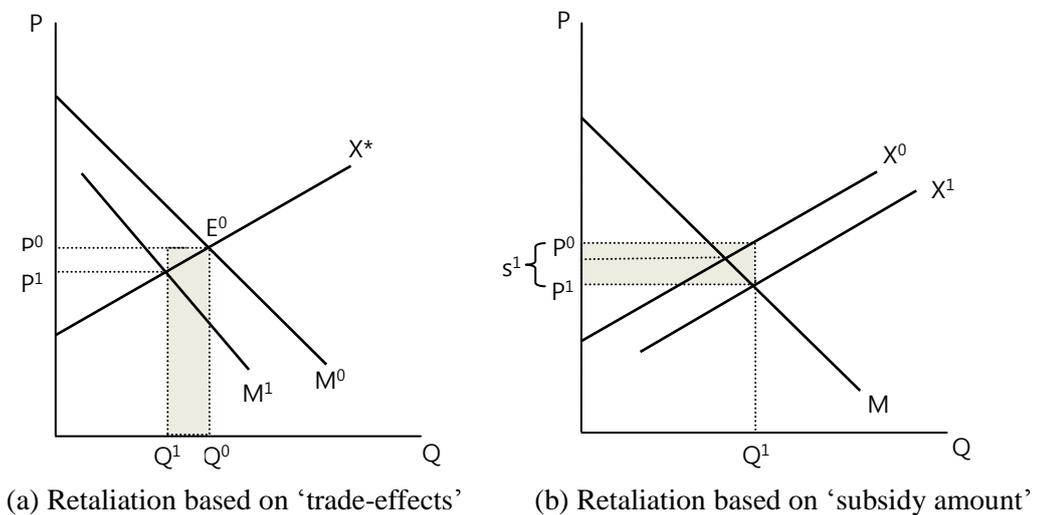
²⁵³ Authors explain that this means that a retaliatory tariff set to be equivalent to the trade effects of the subsidy would restore the injured country's welfare if and only if the violating country's supply of exports of the retaliated product responds to changes in the price of the pertinent product by the same amount as the injured country's exporters hurt by subsidization respond to change in their domestic price of the pertinent product.

²⁵⁴ Grossman and Sykes (2011), *supra* note 252, 151-159.

²⁵⁵ K. Bagwell and R. Staiger, "Reciprocity, Nondiscrimination and Preferential Agreements in the Multilateral Trading System", 17 *European Journal of Political Economy* 281 (2001). Bagwell and Staiger show that a subsidy agreement that limits government subsidy payments and avoids subsidy escalation can be of value to exporting countries. Without such an agreement, each government would be tempted to subsidize its exporters with the aim of creating a competitive

model that the retaliation based on the value of lost trade volumes under the reciprocity approach does not correspond to retaliation based on the value of the subsidy. Furthermore, the relationship between the two approaches is shown to be dependent on the elasticity of the world's import demand and the subsidizing country's export supply (Figure 1).²⁵⁶

<Figure 1> Level of Retaliation based on 'Trade Effects' and 'Amount of Subsidy'



Source: Bown and Ruta (2010)

Figure 1 depicts the international markets from the perspective of: (a) the complainant country, and the (b) respondent country. Figure 1(a) shows the international market's net import demand for exports from the complainant country (M^0) and the

advantage in a third market, leading to a prisoner's dilemma problem.

²⁵⁶ C. Bown and M. Ruta, "The Economics of Permissible WTO Retaliation", in C. Bown and J. Pauwelyn, eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010), 177-180.

export supply from the complainant country (X^*). Before the respondent country provides an export subsidy, the equilibrium is at point E^0 , at which the export price is P^0 and the corresponding trade volume is Q^0 . After an export subsidy is provided by the respondent country, the net import demand curve in the international market shifts downward (M^1). Intuitively, this is because the export subsidy in the respondent country allows its exporters to supply products in the international market at a lower price, which reduces the demand for exports from the complainant country. At the new equilibrium (E^1), the price received by exporters in the complainant country is lower (P^1) and the quantity exported is reduced as well (Q^1). Thus, the policy change in the respondent country hurts the exporting sector in the complainant country by lowering its market access in the international market and worsening its terms of trade. Since the shaded area represents the amount of trade lost by the complainant country due to the subsidy policy of the respondent country, it also corresponds to the amount of retaliation entitled to the complainant calculated based on the ‘trade effects’ approach.

Figure 1(b) presents an illustration of the international market from the perspective of the respondent country which implements a subsidization policy. After the export subsidy policy (s^1), the respondent country’s export supply curve shifts out (from X^0 to X^1), and the shaded area represents the value of the respondent country’s export subsidy, corresponding to the amount of retaliation that is calculated based on the ‘amount of subsidy’ approach. As can be seen from the graphs, while the sizes of the shaded areas in both figures do not seem to be equivalent at a glance, the sizes would ultimately depend on the elasticity of the import demand for the complainant country’s

export products in the international market and of the export supply of the respondent country.

Other legal scholars have suggested an approach that neither supports the ‘amount-of-subsidy’ or the ‘trade-effects’ approach as standards for assessing the permissible level of retaliation. Sebastian (2007) has observed that the amount-of-subsidy approach as applied by the previous Arbitrators disingenuously ignores the practical possibility of multiple complainants, in which case the retaliation awarded may result in disproportionate countermeasures. However, more problematic is the observation that the various theories on the purpose of remedies in the WTO cannot explain the structure of the remedial provisions of the DSU, or the SCM Agreement when it pertains to prohibited subsidies. While the ‘compliance’ rationale cannot explain the limitation of requiring countermeasures to be “equivalent” to the amount of injury done, neither can the ‘compensation’ rationale be achieved in practice due to the nature of WTO obligations which requires ultimate compliance with its treaty obligations. Therefore, in such an absence of any valid theoretical benchmark in awarding retaliation against acts of non-compliance, Sebastian suggests ‘minimalist standards’, such as due process, justification of any applied approach by text, and internally consistent award levels, with the rest of the gap in WTO treaty texts to be filled by Arbitrators’ discretion. Rather, the existence of a third-party arbitral review *per se* plays the most important role in bringing about a stable and predictable environment that can prevent costly spirals of counter-retaliation.²⁵⁷

²⁵⁷ T. Sebastian, ‘World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness’, 15 *Journal of International Economic Law* 257 (2012), 380-382.

In sum, the prevailing view regarding the level of “appropriate” countermeasures, even for the allegedly ‘more flexible’ standard perceived for prohibited subsidy remedies, seems to be pointing towards allowing countermeasures that are closely related to the trade-distorting impact of the subsidy measure at issue. Principles of proportionality, the multilateral nature of the remedy system and economic principles based on welfare effects similarly point to the view that the more “appropriate” standard for measuring the level of countermeasures would be based on the ‘trade effects’ of a prohibited subsidy measure.

3.3.3.2 Remedies for Past Injury: “withdraw the subsidy”

The issue of retrospective remedies is an important aspect in the discussion on the remedy system for prohibited subsidies in the WTO as shown in the *Australia-Leather* compliance case. As the panel argues, without retrospective payment of subsidies granted, there would be no effective way to deal with prohibited subsidies that have incurred injury to the domestic industry of the other Member which no longer exist to be addressed by the current prospective remedy system in the WTO. Such use of non-recurrent subsidies is evidently a persistent problem in subsidy disputes as explained previously (section 3.3.2.2).

Problems exist when the notion of retrospective remedies is seriously considered as a possibility for the WTO remedy system. The ruling by the panel in *Australia-Leather* (*Article 21.5*) that withdrawal of a prohibited subsidy encompasses retrospective

remedies in the form of full repayment was met by strong criticism by many WTO Members. Australia naturally objected to the finding in that it was a ‘punitive’ remedy for which there was no basis in the WTO. It argued that WTO did not endorse any “notion of deterrence through retrospective punishment”, and that “retrospectivity without any statute of limitations” would be “a risky path” for the WTO. Furthermore, it argued that the nature of the panel’s findings are “at odds with democratic governance and economic reality”, and if the findings were to be accepted, it would have serious consequences for other Members as well in the future.²⁵⁸ Canada was also critical of the panel’s approach, and was of the view that panel’s interpretation of the operative phrase “withdraw the subsidy” was contrary to GATT/WTO custom and practice. It emphasized its understanding that the special and additional rules in Article 4.7 of the SCM agreement was with regard to ‘timing’. Furthermore, the ruling was in conflict with the principles of customary international law where the language of a treaty should clearly indicate whether retroactivity was to be inferred. Brazil and Japan also shared this concern that the retroactive remedy was inconsistent with GATT and WTO practice.²⁵⁹

On the other hand, there were also views in favor of a retrospective system as a stronger means to induce compliance with WTO obligations. Hong Kong was appreciative of the need for effective remedies even if it represented a cost to violating members, but cautioned that the cost should be “measured against the damage inflicted on other Members through illegal actions” based on the *pacta sunt servanda* principle. The

²⁵⁸ WTO, Dispute Settlement Body, Minutes of the Meeting on 11 February 2000, WT/DSB/M/75, 7 March 2000, at 5-6.

²⁵⁹ *Ibid.*, 7-8.

US, as the complaining party in this case, was supportive of the panel's finding, although it stated it did not agree with every wording of the panel report, particularly since the panel's remedy went beyond that sought by itself.²⁶⁰

Commentators of this case have shown mixed responses. Several scholars were strongly against the notion of retrospective remedies, arguing that retrospective remedies have no basis either in past GATT practices or under the WTO Agreements. In particular, they were critical of the fact that the Panel exceeded its mandate under the DSU by making a case for a complaining party, as well as infringing the fundamental due process principles that a responding party should not be subject to legal claims of which it had not been given sufficient notice for response. While acknowledging that customary international law provided for both prospective and retrospective remedies, such practice cannot be imported into WTO law since it would be against the basic principles and objectives of the multilateral trading system where Members bound themselves for specific reasons. They claimed that GATT practice did not provide for retrospective remedies.²⁶¹ Furthermore, they were concerned about the consequences of implementing the retrospective repayment of monies granted, which could give rise to constitutional and democratic issues on the part of Member governments since there would be

²⁶⁰ *Ibid.*, at 8-9.

²⁶¹ G. Goh and A. Ziegler, 'Retrospective Remedies in the WTO after Automotive Leather', 6 *Journal of International Economic Law* 545 (2003), at 551-552. The issue of retrospective remedies was considered by the panel in *Norway – Procurement of Toll Collection Equipment for the City of Trondheim* (GPR/DS2/R, adopted 13 May 1992), but ruled that the "recommendations of this nature had not been within customary practice in dispute settlement under the GATT system". There were five other GATT cases where panels have recommended a retrospective remedy, but being all exclusively anti-dumping and countervailing duty cases, the authors viewed that GATT practice did not provide for retrospective remedies as subsidy remedies.

significant legal constraints on expropriating private property for public purposes. Most importantly, they argued that the role of compensation and retaliation under Article 22 of the DSU is as “temporary” measures pending the full implementation of obligations under the WTO.²⁶²

However, while it is true that the GATT cases were related exclusively to anti-dumping and countervailing measures under the Tokyo Round codes, the fact that the possibility of retrospective remedies was considered in the early years of GATT dispute settlement raises an important point. In fact, two of the three GATT subsidy cases were adopted, which contained recommendations of retrospective repayment of the countervailing duties and subsidy payments respectively.²⁶³ In *United States – Countervailing Duties on Fresh, Chilled and Frozen Pork from Canada*, the panel recommended that US reimburse the countervailing duties corresponding to the amount of the subsidy, or make a subsidy determination consistent with GATT rules and reimburse the duties to the extent that they exceeded the amount of the subsidy determined to have been granted.²⁶⁴ In *United States – Measures Affecting Imports of Softwood Lumber from Canada*, the panel recommended that the US terminate the subsidy program and refund the cash deposits that were made during the period of application of the inconsistent measure.²⁶⁵ Therefore, the notion of retrospective remedies does not seem to be a totally new concept raised for the remedy system for

²⁶² *Ibid.*, 553-560.

²⁶³ Out of the 3 GATT cases, *Canada-Imposition of Countervailing Duties on Imports or Manufacturing Beef from the EEC* (SCM/85, dated 13 October 1987) was not adopted.

²⁶⁴ DS7/R-38S/30 (adopted), 11 July 1991, para. 5.2.

²⁶⁵ SCM/162 (adopted), 27 October 1993, para. 415.

prohibited subsidies.

It is notable that there were several views on the ‘prospective portion’ of a remedy as proposed by the parties to the dispute in *Australia-Leather (Article 21.5)*. While the compliance panel viewed that the retrospective remedy should constitute ‘full repayment’ of the subsidy, US had proposed that Australia withdraw the ‘prospective portion’ of the prohibited subsidies found to have been provided, since that portion of the fund “continues to confer a benefit to Howe *after the adoption of the Report* in this dispute” (emphasis added). In order to calculate this amount, the US proposed to calculate the amount of the grant payments over the useful life of the production assets of the beneficiary company, and allocate the amount to the period following adoption of the panel report.²⁶⁶ In other words, the US seems to be of the view that the period that distinguishes the ‘retrospective portion’ and ‘prospective portion’ of a subsidy would be the period of adoption of the panel report in which a determination of whether a measure is consistent with the obligations is made. On the other hand, Australia proposed that the point of distinction exists where the implementation period ends.²⁶⁷ These proposals provide some valid suggestions as to how the current remedy system could be ‘remedied’ to apply retrospective remedies that would be feasible within the current framework of the WTO rules on remedies in the context of prohibited subsidies.

Other problems exist due to the lack of retrospectivity in compliance proceedings as well. As the case in *US-Upland Cotton* shows, WTO Members can delay

²⁶⁶ *Australia-Leather (Article 21.5)*, *supra* note 152, paras. 6.9-6.10.

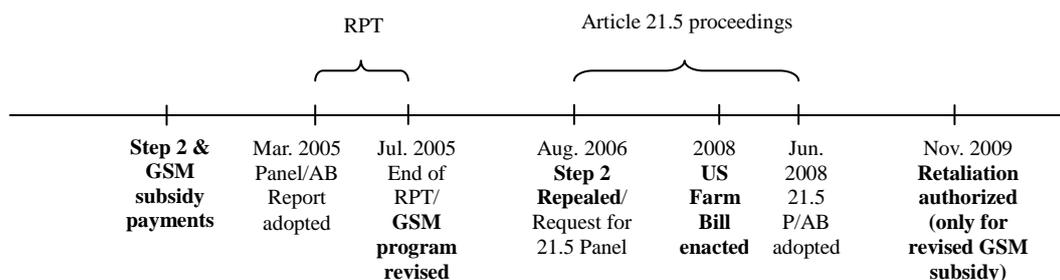
²⁶⁷ *Ibid.*, paras. 6.20-6.21.

compliance until immediately before a compliance panel reviews the compliance record of the revised measure taken to comply, and then ‘uncomply’.²⁶⁸ Figure 2 below illustrates the chronology of events in the *US-Upland Cotton* dispute. As shown, the US had repealed certain cotton subsidies (Step 2 payments) that were ruled to be prohibited subsidies before the compliance panel was established, gained acknowledgement of the withdrawal of the measure, and then reinstated similar payments under the 2008 Farm Bill. When Brazil requested countermeasures against the reinstated measures, it was declined due to lack of a multilateral determination of non-compliance regarding the measure. This is possible due to the current dispute settlement rules which do not provide remedies for past violations, according to which, the jurisdiction of Arbitrators in Article 21.5 proceedings is limited to on-going measures that are existent at the time of the compliance proceeding. Additionally, the limited jurisdiction of Article 22.6 Arbitrators relative to Article 21.5 Panels in being only able to authorize countermeasures on matters that have been subject to a compliance determination also compounds the problem. Consequently, Members can commit repeated violations without having to face any economic consequences of retaliation, especially for parties which are not concerned about reputational damages.²⁶⁹

²⁶⁸ The term ‘uncompliance’ was used by Townsend and Charnovitz (2011), to explain the practice of WTO Members which deliberately reinstate WTO-inconsistent measures after obtaining a positive ruling of compliance due to repeal of the original inconsistent measure prior to a compliance panel proceeding. D. Townsend and S. Charnovitz, ‘Preventing Opportunistic Uncompliance by WTO Members’, 14 *Journal of International Economic Law* 437 (2011).

²⁶⁹ *Ibid.*, at 438.

<Figure 2> Chronology of Events in *US-Upland Cotton Dispute*



In sum, the ineffective remedy mechanism for dealing with non-recurring subsidies due to the lack of a retrospective remedy system is a persistent, unresolved issue in the current system of remedies for prohibited subsidies. Arguments and positions are still varied and undecided over this issue. But, overall, despite the criticisms over the practical problems that can arise from implementing such a retrospective remedy, there seems to be a larger voice that recognizes the existence and persistency of this problem. This issue will be dealt in more detail in the chapter V.

3.3.3.3 Prolonged Dispute Proceedings: “withdraw without delay”

While the time-period for implementation *per se* may not be a matter of issue in prohibited subsidy disputes, there have been several disputes under the general DSU procedures where the problems have been identified relevant to the determination of the

‘reasonable period of time (RPT)’ for implementation of the DSB rulings.²⁷⁰ With regard to prohibited subsidy disputes, a more serious problem lies in the length of the disputes, as already shown in Table 7. One of the reasons for this delay in the dispute settlement procedure, especially for subsidy disputes, is the fact that the inconsistent subsidy measure is usually retained until the end of the implementation period, and some times, even repealed shortly after the expiry of the RPT.²⁷¹ There has even been a case where the original subsidy measure determined to be inconsistent had been revised, albeit only partially, leading to a series of compliance proceedings even after reaching the final stage of authorizing countermeasures to enforce the DSB recommendation.²⁷²

Such significant delays in the dispute settlement procedure may also be attributable to the lack of retrospective application of remedies in prohibited subsidy cases. Due to the current system under which the retaliation remedy is applied only after the implementation period has expired for the respondent Member, there is no incentive for the respondent party to comply promptly within the given time-period for compliance (RPT). In fact, as shown in many dispute cases, respondent parties seem to be enacting their revised measures at the near-end or shortly after the time-period for implementation

²⁷⁰ See M. Qian, ‘Reasonable Period of Time’ in the WTO Dispute Settlement System’, 15 *Journal of International Economic Law* 257 (2012) for various problems related to RPT determination in general.

²⁷¹ For example, in *US-FSC*, the US enacted its revised measure (the ETI Act) on 15 November 2000, after the implementation period expired on 1 November 2000.

²⁷² In *US-FSC*, second recourse to the Article 21.5 panel was made with regard to the “Jobs Act” (13 January 2005) after receiving authorization to impose countermeasures on the formerly revised subsidy measures (the “ETI Act”). After going through an appeal proceeding for the compliance panel ruling, the revised measure was finally determined to be a prohibited subsidy and was recommended its withdrawal (Appellate Body Report, *US-FSC (Article 21.5 II)*, WT/DS108/AB/RW2, adopted 14 March 2006).

has lapsed. This may not be a problem *per se*, since the purpose of granting a “reasonable period of time” is to take into account the need for member countries to take shorter administrative or longer legislative procedures for revising their measures. However, there is possibility that this system may be abused, especially when there is opportunity for the parties to the dispute to extend the RPT through Article 21.3(c) arbitrations or mutual agreement between the parties. In *US-FSC* and *US-Upland Cotton*, we have seen how the panels discretionally grant ‘reasonable period of time’ to the respondent parties, sometimes not even providing any explicit reason for a time-period that exceeds the normal recommendation of 90 days.²⁷³ With regard to the determination of the ‘reasonable period of time’, Article 21.3 of the DSU provides that the time-period may be proposed by the respondent party, or mutually agreed by the disputing parties, or determined through binding arbitration, while for prohibited subsidies, Article 4.7 of the SCM Agreement only provides that the subsidy shall be withdrawn “without delay”. Most of the practice by WTO panels seems to have recognized this clear textual difference and have requested implementation within a period of 90 days for prohibited subsidy cases. However, this does not seem to have been always the case as previously mentioned.

However, a more serious problem regarding prolonged dispute proceedings seems to be due to the nature of the subsidy measure. In fact, the opportunistic practice of some WTO Members to comply with the DSB rulings and later ‘uncomply’, or to comply only partially to the effect that it does not completely remove the effect of the

²⁷³ In *US-FSC*, the respondent party was given 6 months or a specific date of 1 October 2000 (whichever was earlier), but was later extended to 1 November 2000 upon the request of the respondent.

subsidization are all problems that derive from the lack of willingness on the part of the subsidizing country to terminate the prohibited subsidy measure in the first place. While this problem may not be fundamentally addressed merely by remedy measures, at least the remedy system that is in place to enforce DSB rulings against non-compliant acts of subsidization may need to be tightened so as to fill in the loopholes that evidently exist in the current prospective remedy system for prohibited subsidies.

3.4 SUMMARY

This chapter has observed the remedy system for prohibited subsidies in the WTO to understand the current problems and issues that remain unresolved despite the stronger rules for enforcement against prohibited subsidy measures. In this light, the evolution of rules on prohibited subsidies have shown that the drafters of the text were very much aware of the need to strongly discipline subsidy measures categorized as prohibited subsidies, through substantive rules and remedy procedures. The rules as applied by the WTO adjudicating bodies suggest that, while as a whole, Arbitrators have tried to provide meaningful rulings to make effective use of the WTO dispute settlement system, there are still many controversies over several determinations, that have revealed some critical loopholes in the current remedy system for dealing with prohibited subsidies.

In the next chapter, the current WTO remedy system will be examined further from an economic perspective to shed some light on the issue from a new standpoint, for the purpose of finding more substantiated grounds for the treatment of prohibited subsidies with more stringent remedies.

CHAPTER IV

ECONOMIC PERSPECTIVES ON THE WTO REMEDY SYSTEM

4.1 ECONOMIC PERSPECTIVES ON THE RETALIATION REMEDY IN GENERAL

Economists have traditionally viewed remedies as a necessary feature of achieving an efficient equilibrium. Under the economic theory of contract remedies, the key objective of an enforcement system is to deter inefficient breaches, but to encourage efficient ones (“efficient breach”). In other words, a party would be induced to comply with its obligations whenever compliance yields greater benefits to the promisee than costs to the promisor, while allowing the promisor to depart from its obligations whenever the costs of compliance to the promisor exceed the benefits to the promisee.²⁷⁴

Applying this principle of ‘efficient breach’ to understanding the dispute settlement system in GATT/WTO, scholars such as Schwartz and Sykes (2002) perceived the WTO provisions that respect renegotiation and settlement of disputes over breach of obligations as carefully designed to facilitate efficient adjustments to unanticipated circumstances. In particular, while the GATT system can be understood as having relied on unilateral retaliation and reputation to police the bargain, which eventually became

²⁷⁴ For the literature on contract remedies and efficient breach, *see*, R. Birmingham, “Breach of Contract, Damage Measures, and Economic Efficiency”, 24 *Rutgers Law Review* 273 (1970); J. Barton, “The Economic Basis of Damages for Breach of Contract”, 1 *Journal of Legal Studies* 277 (1972); T. Ulen, “The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies”, 83 *Michigan Law Review* 341 (1984); R. Craswell, “Contract Remedies, Renegotiation, and the Theory of Efficient Breach”, 61 *Southern California Law Review* 629 (1987).

excessive and interfered with opportunities for efficient breach, the WTO mechanism for arbitrating the level of proposed sanctions has assured that retaliation levels are not set too high. Furthermore, retaliation is limited to measures that are substantially equivalent to the harm caused by the violation, which is incurred only after a ‘reasonable period of time’ for implementation has lapsed. Therefore, by limiting the retaliation remedy to equivalent-to-harm levels, the WTO remedy system may be understood as incorporating the ‘efficient breach’ principle for achieving more efficient outcomes.²⁷⁵

According to Bagwell and Staiger (2002), the role of retaliation comes as part of the discussion on the enforcement of trade agreements. Trade agreements are needed to internalize the negative externality of terms-of-trade driven unilateral trade policy choices (i.e. restrictions in trade volumes that arise when governments set tariffs unilaterally), thus offering governments a means to escape from a terms-of-trade driven prisoner’s dilemma. Enforcement of such trade agreements, in the form of retaliatory measures that are imposed against continuing acts of non-compliance with the negotiated trade agreements, are important in the sense that they can restrain governments which have a short-term incentive to deviate to a higher-than-is-efficient tariff in order to obtain consequent terms-of-trade gains. Thus, governments are dissuaded from such opportunistic behavior only if the pursuit of short-term gains results in long-term losses,

²⁷⁵ For literature on the application of “efficient breach” in WTO dispute settlement, *see also*, A. Sykes, “Optimal Sanctions in the WTO: The Case for Decoupling (and the Uneasy Case for the Status Quo)”, in C. Bown and J. Pauwelyn, eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2008); M. Beshkar, “Optimal Remedies in International Trade Agreements”, *54 European Economic Review* 455 (2010); E. Posner and A. Sykes, “Efficient Breach of International Law: Optimal Remedies, “Legalized Noncompliance”, and Related Issues”, *110 Michigan Law Review* 243 (2011).

such as retaliation by other governments. In this sense, the GATT/WTO principles of reciprocity and nondiscrimination have been viewed by these scholars as complementary principles that assist governments in bilateral negotiations to achieve more efficient trade-policy outcomes and ensure that welfare of third country governments are not altered.²⁷⁶

Bown has produced several empirical research on the GATT/WTO dispute settlement mechanism to understand the role of retaliation in the world trading system. Using GATT/WTO trade dispute data between 1973 and 1998, Bown (2004) has shown that the economic threat of retaliation has influence on determining a respondent country's ability to credibly commit to trade liberalization (i.e. compliance with WTO rules). In other words, the so-far successful resolution of disputes has been positively influenced by the economic concern for retaliation, rather than the procedural or institutional features of the GATT/WTO dispute settlement system.²⁷⁷

Maggi and Staiger (2009) contribute to understanding the remedy system in GATT/WTO based on the principles of the liability and property rules regarding the purpose of remedies.²⁷⁸ They observed that the GATT/WTO remedy system has seen a gradual shift from liability rules to property rules as the accuracy of DSB rulings has

²⁷⁶ Sykes (2008), *supra* note 275, 339-354. Sykes further examines the discussion of trade agreements as incomplete contracts and the analogy between the reciprocity approach to calculate appropriate trade sanctions and concept of "expectation damages" in private contract law.

²⁷⁷ C. Bown, 'On the Economic Success of GATT/WTO Dispute Settlement', 86 *The Review of Economics and Statistics* 811 (2004).

²⁷⁸ The 'property rule' and 'liability rule' are principles used to explain the purpose of remedies in an enforcement system. Where obligations are protected by the 'property rule', under which the infringement of a person's entitlement is strictly prohibited, rights are enforced by injunctive relief (i.e. specific performance). On the other hand, where obligations are disciplined by the 'liability rule', under which entitlements can be removed through the payment of legally determined damages (i.e. monetary compensation).

increased with the accumulation of dispute settlement reports adopted by GATT/WTO adjudicating bodies. Based on their models, the liability rule should be more prevalent in issue areas that are characterized by a higher degree of uncertainty over the joint benefits of free trade. Furthermore, where the liability rule is optimal, it is never optimal to set damages at a level high enough to make the exporter 'whole', so as to enable a party to breach when it is optimal to 'buy out' the injured party. On the other hand, if there is less ex-ante uncertainty about the joint benefits of free trade, the property rule is a more optimal institutional arrangement. Therefore, they suggest that the optimal institutional arrangement for the WTO dispute settlement system, as the accuracy of DSB increases over time, tends to move away from the liability rule to the property rule.²⁷⁹

There is not much economic literature with respect to the remedy of compensation as compared to the legal literature on the subject. Though not dealing with the compensation remedy directly, Beshkar (2010) suggests that if monetary compensation is not available as a form of remedy in addition to the retaliation remedy, trade agreements cannot ensure efficient breach. In other words, a system that is structured by the 'liability rule' cannot ensure efficient performance unless cash payments (i.e. monetary compensation) or other efficiency-neutral methods of compensation are available and enforceable. Beshkar further argues that if there is no remedy of financial compensation available in a system (which is the case of the WTO dispute settlement system), an optimal remedy system would constitute a less-than-proportional retaliation

²⁷⁹ G. Maggi and R. Staiger, 'Breach, Remedies and Dispute Settlement in Trade Agreements', NBER Working Paper 15460 (2009).

scheme against an offending country. This is because if there are no ‘efficiency-neutral’ side payments available as a method of compensation, it would be in the best interest of all parties to agree on a remedy system that awards the smallest possible damages to victims.²⁸⁰

4.2 ECONOMIC PERSPECTIVES ON THE REMEDY SYSTEM FOR PROHIBITED SUBSIDIES

As compared to the positive discussions on the role of retaliation in enforcing the world trade rules in general, the economic discussions on the narrower subject of remedies for prohibited subsidies seem to be puzzled with the distinct *sui generis* rules regarding prohibited subsidies (as compared to the general remedy rules in the DSU) and their application in practice.

Sykes (2005) provides economic support for the distinctive treatment for export subsidies in the WTO. While acknowledging that economic theory offers no general objection to the use of subsidies since subsidies may be used constructively by governments to remedy ‘market failures’, Sykes suggests that some subsidies may be deemed undesirable by economists, such as protective subsidies and subsidies for export promotion.²⁸¹ From an economic standpoint, export subsidies are generally undesirable,

²⁸⁰ Beshkar (2010), *supra* note 275.

²⁸¹ A. Sykes, ‘Subsidies and Countervailing Measures’, in P. Macroy, A. Appleton, M. Plummer eds., *The World Trade Organization: Legal, Economic and Political Analysis* (2005), 88-93. Sykes (2005) further explains that protective subsidies upset the expectations associated with market access commitments in the GATT/WTO system, and distorts resource allocation as subsidies allow

since they diminish market access opportunities for competing exporters and upset expectations pursuant to negotiated trade agreements. This may result in fewer trade agreements and a battle of competing subsidy programs which may in turn dissipate resources on a broader scale for no useful economic purpose. Furthermore, even if an export subsidy does not frustrate market access expectations of other trading nations, it can be a source of economic distortion. Therefore, even though subsidies may be economically needed to correct market failures, they should be made contingent on the activity that is undersupplied due to the market failure. But, in political reality, it may be quite difficult to imagine a market failure that is best addressed with an export subsidy.²⁸²

In contrast, Lawrence (2003) views that when it comes to export subsidies, the WTO has moved away from the paradigm of reciprocity which guides the rest of the agreement. This is based on the observation that there is no reference to their ‘trade effects’ in the SCM Agreement, and infringers do not have any mechanism for ‘legal breach’ as violations of the SCM Agreement are rather treated as ‘crimes’. The author notices that in the case of export subsidies, the basis of retaliation in the WTO to deal with violations has shifted from ‘rebalancing concessions’ to ‘inducing compliance’, which fundamentally changes the character of WTO retaliation.²⁸³

In a more developed view on export subsidies, Lawrence and Stankard (2005)

domestic firms to expand output at the expense of imports, thus diverting productive resources into domestic production away from foreign production, and goods and services are no longer produced at the lowest possible cost.

²⁸² This is because export subsidies may not necessarily be the solution that directly addresses the market failure problem at issue.

²⁸³ R. Lawrence, *Crimes and Punishments? Retaliation under the WTO* (Cambridge, 2003), at 58-59.

argue that economic theory suggests greater leniency, rather than stringency for export subsidies. More specifically, the authors hold that there lacks economic reasoning not only for the unique status for export subsidies in terms of its outright prohibition in the WTO, but also for greater or more stringent retaliation for violation of export subsidy rules. Other than the strategic and political reasons for restricting export subsidies,²⁸⁴ the treatment of export subsidies in the WTO reflects a theoretical and practical orientation which is inconsistent with the objective of rebalancing of rights and obligations in the WTO. In particular, the WTO practice which shows an absence of injury or adverse effect as a prerequisite for challenging export subsidies may be a dangerous shift for any legal system, since it may invite larger countries to abuse this power against smaller economies.²⁸⁵

Bagwell (2008) uses a terms-of-trade-based welfare approach to understand the purpose and design of the WTO retaliation mechanism. In considering the SCM Agreements and the associated remedy system, he argues that the terms-of-trade approach does not support the use of disproportionate retaliation in response to export subsidies as a means of facilitating efficient breach, but rather, that export subsidies should be used

²⁸⁴ Strategically, prohibition of export subsidies may provide help for governments, particularly for developed economies, to resist rent-seeking producers (since export subsidy reduces national welfare). Moreover, when exporters are forced to compete with foreign firms receiving export subsidies, governments are often pressured to 'level the playing field'.

²⁸⁵ This refers to the lack of requirement for a legal standing for challenging an export subsidy. Under the SCM Agreement (Article 4.1), a member needs only "reason to believe that a prohibited subsidy is being granted or maintained by another member". This is in contrast to the general WTO framework under which the standing right is generally based on the notion injury. R. Lawrence and N. Stankard, 'Should Export Subsidies be Treated Differently?', paper prepared for Conference on the WTO Dispute Settlement and Developing Countries: Use, Implications, Strategies, Reforms (2005).

with greater leniency. Governments would achieve mutual gains through trade agreements that facilitate reciprocal increase in export subsidies. Also, while restrictions on the use of export subsidies may be favorable to exporting governments, they may come at the expense of importing countries and world welfare. Furthermore, Bagwell notes that the SCM Agreement provides for countervailing duties (CVDs) as another form of remedy against consequences that result in welfare loss for the importing country competing against subsidizing exporters, and that the importing government must gain when it imposes a CVD that offsets the effect of the export subsidy.²⁸⁶ Therefore, implying that disproportionate retaliation in response to export subsidies may constitute redundant or excessive response to violations of export subsidy rules.

With regard to the method of calculating the level of countermeasures in prohibited subsidy cases, Grossman and Sykes (2011) stress the need to understand the objectives of the SCM Agreement and what behaviors it is meant to discourage.²⁸⁷ They conclude that there is no economic support for the ‘amount of subsidy’ approach in

²⁸⁶ This is because the countervailing duty (raising tariff barriers) restores the original local price in the importing country, and through increased tariff revenue, resulting in a terms-of-trade gain for the importing country .

²⁸⁷ In a more detailed analysis on the objective of the SCM Agreement from an economic perspective, Grossman and Mavroidis (2003a) observed that the main objective of the SCM Agreement is to discourage subsidies that might harm producers in importing countries. If the drafters had intended the SCM Agreement to discourage actions that would inflict welfare losses on others, they would have required the identification of conditions where aggregate loss is most likely to occur. Instead, the SCM Agreement does not confine the use of countervailing duties to situations in which an importing country has established the presumption of a welfare loss. Rather, CVDs are permitted only when there has been, or threatens to be, injury to a domestic industry in an importing country. G. Grossman and P. Mavroidis, ‘United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom: Here Today, Gone Tomorrow? Privatization and the Injury Caused by Non-Recurring Subsidies’, in H. Horn and P. Mavroidis eds., *The WTO Case Law of 2001* (2003a), 185.

previous arbitrations, and a more rational approach to retaliation would employ non-prohibitive tariffs that would enhance the terms-of-trade of the importing country. Prohibitive tariffs would be an odd instrument of retaliation since they generally reduce welfare in the complainant country, while non-prohibitive tariffs could impose the same harm on the violator while generating a gain for the complainant. Therefore, the authors conclude that if the concern is about the effect of welfare of other nations when using the retaliation remedy, it is the magnitude of the terms-of-trade effect that matters, rather than the formal structure of the subsidy program.

Bown and Ruta (2010) have examined how arbitrators authorizing the retaliation remedy use economic analysis to determine the awards. In particular, they observed that in disputes involving prohibited export subsidies, the arbitrators clearly deviate from the ‘reciprocity approach’, based on the trade-effects approach from Bagwell and Staiger (2002), for determining the level of countermeasures, as compared to most dispute cases not involving prohibited subsidies. As already shown in Figure 1 (section 3.3.3.1), the size of the subsidy’s value does not necessarily correspond to the size of the trade effect of the subsidy, and the sizes ultimately depend on the elasticity of the world market’s import demand and the respondent country’s export supply. In conclusion, the authors contend that in the disputes in which the ‘reciprocity approach’ has not been used, the procedural difficulties confronted by the arbitrators and other political constraints may hinder the use of economic analysis in practice.²⁸⁸

In an assessment of the economic perspectives on prohibited subsidy rules and

²⁸⁸ Bown and Ruta (2010), *supra* note 256.

retaliation to enforce the rules so far, the economic approach on calculating the level of countermeasures in prohibited subsidy cases seems to be more rational and readily acceptable, as demonstrated by the departure of the WTO Arbitrators in their approach to determining the level of countermeasures in the actual cases (as observed in Section 3.3.2.1). However, the understanding of the purpose and design of the remedy mechanism for enforcing prohibited subsidy rules seems to be based on inaccurate assumptions regarding the remedy system for prohibited subsidies. First of all, the arguments by Lawrence (2003, 2005) that the treatment of export subsidies should be in such a manner that brings it into conformity with the overall WTO paradigm of reciprocity, and accordingly, that export subsidies should be treated under the objective of ‘rebalancing concessions’, do not accurately take into account the purpose of the WTO rules on prohibited subsidies. Furthermore, Bagwell (2008)’s argument that the level of authorized retaliation in the case of export subsidies does not “facilitate efficient breach” seems to be based on a different understanding of the purpose of the SCM Agreement disciplining prohibited subsidies. In fact, the purpose of rules on prohibited subsidies in the WTO does not pertain to the objective of rebalancing WTO rights and obligations. As observed in the discussion so far on the purpose of remedies (Section 2.2) and the remedies in place and in action for prohibited subsidies in the WTO (Section 3.2.2), the rights and obligations in prohibited subsidy rules are not of a nature that can be ‘rebalanced’ through tariff renegotiations. Rather, the purpose lies in inducing the specific performance of ‘withdrawal’ in accordance with the property rule. In other words, the purpose of remedies for enforcing prohibited subsidy rules is not served by the liability rule, under

which the main purpose of remedies would be to allow ‘efficient breach’. The purpose of remedies in the SCM Agreement for all kinds of subsidies should be to ensure a ‘proportional’ level of countermeasures to the amount of harm uncured by the WTO-inconsistent subsidy measure; but even if ‘proportional’, such remedies would not be used to allow ‘efficient breach’, at least when it comes to the case of prohibited subsidies.

On a second note, Bagwell (2008) also mentions that the alternative remedy of countervailing duty (CVD) measures that may be imposed unilaterally by the importing country in response to an export subsidy offsets the effect of the subsidy, and thus retaliation in response to export subsidy violations may need to be weakened or granted greater leniency.²⁸⁹ However, this argument may be based on an imprecise understanding of the remedy mechanism for prohibited subsidies as well. In fact, WTO members can choose only one remedy track for addressing illegal subsidies – the unilateral track of imposing CVDs, or the multilateral track of resorting to WTO DSB for a multilateral determination of inconsistency and subsequent order to termination of the illegal subsidy. Therefore, the complaining party may only resort to one remedy for counteracting WTO-inconsistent export subsidies, rather than being able to impose CVDs in addition to being allowed to retaliate for continued non-compliance with WTO ruling to remove the illegal export subsidy measure.

On a similar note, Beshkar (2010) explains that the ‘expectation damages’ rule does not have the same efficiency properties in the trade context as it does in the context

²⁸⁹ K. Bagwell, ‘Remedies in the WTO: An Economic Perspective’, in M. Janow, V. Donaldson and A. Yanovich eds., *The WTO: Governance, Dispute Settlement and Developing Countries* (2008), at 769.

of domestic contract law. This is because efficiency relies on the availability of ‘cash transfers’ as a means of compensation, while such monetary compensation is not available as a remedy in WTO disputes, especially as a remedy for prohibited subsidy disputes.²⁹⁰

More recently, Bagwell and Staiger (2012) revisited the economic logic behind the treatment of export subsidies in GATT/WTO, using a new model that takes into account some novel reasons for trade policy intervention.²⁹¹ Existing theories have so far viewed GATT/WTO efforts to restrain export subsidies as representing an inefficient victory for exporting governments that come at the expense of importing governments. In an important departure from the existing literature, the authors demonstrate that it is possible to understand the formal treatment of export subsidies in trade agreements, under which the gradual tightening of restraints on export subsidies over the development of GATT/WTO may be interpreted as “deriving naturally from the gradual reduction in import barriers that member countries have negotiated”.²⁹²

Figure 3 below depicts the linear Cournot delocation model that has been used by Bagwell and Staiger.²⁹³ With the price of a homogeneous good sold at the home

²⁹⁰ M. Beshkar, ‘Optimal Remedies in International Trade Agreements’, 54 *European Economic Review* 455 (2010).

²⁹¹ The authors have used a ‘Cournot delocation’ model which exhibits a ‘firm delocation’ effect, whereby higher trade cost along one channel of trade increases the number of firms in the importing country while decreasing the number of firms in the exporting country. This model has been used to demonstrate that negotiated restraints on export subsidies could lead to mutual gains for negotiating governments, albeit under certain conditions. K. Bagwell and R. Staiger, ‘The Economics of Trade Agreements in the Linear Cournot Delocation Model’, 88 *Journal of International Economics* 32 (2012).

²⁹² *Ibid.*, 392.

²⁹³ The Cournot model was first introduced by Venables (1985) to explain trade and trade policies

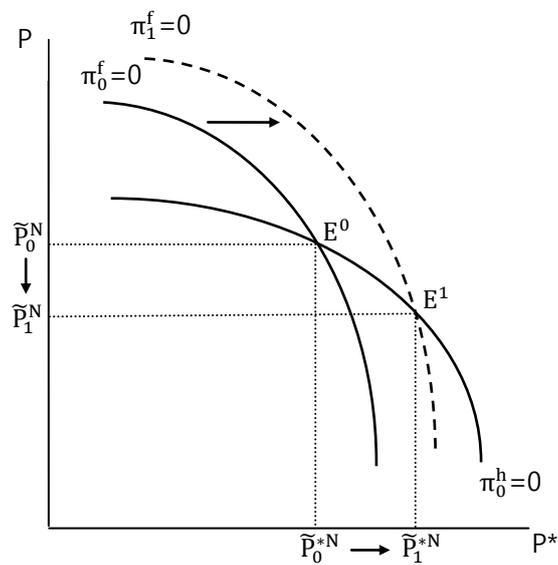
country (P) on the vertical axis, and the price of the good sold at the foreign country (P^*) on the horizontal axis, the curves labeled $\pi_0^h = 0$ and $\pi_0^f = 0$ represent the home-firm and foreign-firm zero profit loci, respectively.²⁹⁴ The point at which the two curves cross, E^0 , corresponds to the initial equilibrium price combination, which is denoted by \tilde{P}_0^N and \tilde{P}_0^{*N} . An increase in the trade cost (τ), triggered by an increase in either the import tariff imposed by the home country (t_h) or export tax imposed by the foreign country (t_f), leaves the $\pi_0^h = 0$ unaffected, but shifts out the $\pi_0^f = 0$ locus to the new locus depicted by the curve labeled $\pi_1^f = 0$, and the new equilibrium (E^1) corresponds to prices denoted by \tilde{P}_1^N and \tilde{P}_1^{*N} . In other words, an increase in trade cost that is imposed on foreign firms for exports to an importing (home) market, results in a competition-enhancing effect through the entry of domestic firms which reduces the price in the home market, and a competition-restricting effect through the exit of foreign firms which raises the price in the foreign market. This surprising price impact of tariff intervention is the key feature of the ‘firm delocation’ effect as first introduced by Venables (1985). This firm

with imperfectly competitive industries (i.e. duopoly). In this model, industries are comprised of firms which produce homogeneous goods, giving rise to two-way (intra-industry) trade in identical commodities, with transport costs arising between the markets, and each government imposing a trade tax on trade flows (trade cost) in and out of its market. Bagwell and Staiger first applied the Cournot delocation model in their working paper, ‘Delocation and Trade Agreements in Imperfectly Competitive Markets’ (NBER Working Paper 15444, October 2009), in which they considered the purpose and design of trade agreements in imperfectly competitive environments featuring firm-delocation effects.

²⁹⁴ These are: (1) the locus of home and foreign prices (P and P^*) that, for any trade cost involved for home-firms to export a product (τ), is consistent with the home-firm zero-profit condition (market clearing condition), under which firms no longer enter the market since no more profit can be earned; and similarly, (2) the locus of home and foreign prices that, for any trade cost involved for foreign firms to export a product (τ), is consistent with the foreign-firm zero-profit condition. The equilibrium zero-profit condition holds since, under free entry, the number of home firms and foreign firms adjust to ensure that the maximized profits of home and foreign firms, respectively, are equal to zero.

delocation effect gives rise to a ‘novel’ motive for trade policy intervention: while an import tariff can benefit a country’s consumers, by stimulating entry of domestic firms and thereby reducing domestic prices through enhanced competition, this benefit, however, comes at the expense of foreign consumers, who experience higher prices as a result of foreign firm exit and diminished competition in the foreign market.²⁹⁵ Accordingly, some form of trade policy intervention that corrects the inefficient outcome caused by the firm-delocation effect may be needed to better reflect the practical consequences of trade negotiations under the GATT/WTO.

<Figure 3> Firm Delocation Effect in the Cournot Model



Source: Bagwell and Staiger (2009)

²⁹⁵ Bagwell and Staiger (2009), *supra* note 293, 10.

Therefore, according to Bagwell and Staiger (2012), for governments to achieve an efficient outcome (based on the assumption that governments use symmetric policies of import and export policies when they negotiate over import tariffs), the resulting import tariff must be positive ($t_h > 0$) and the associated export policy must be an export subsidy that exactly offsets the import tariff ($t_f < 0$) so that the sum of the total trade cost is zero. Similarly, when starting at an efficient point, if the import tariffs were further lowered to the free-trade level ($t_h = 0$), then efficiency would be maintained if and only if export subsidies were also capped at the free-trade level ($t_f = 0$), so as to maintain a total trade cost of zero ($\tau = 0$). In other words, since current import tariff levels are near zero due to trade liberalization efforts to date under the GATT/WTO, the authors demonstrate that the gradual tightening of restraints on export subsidies that has occurred in the GATT/WTO may be interpreted as a natural consequence of the gradual reduction in import tariff levels that member countries have negotiated.²⁹⁶

While there is almost no economic literature examining the alternative remedy of compensation as a remedy for prohibited subsidies, Sykes (2008) presents an examination of a system that provides direct compensation to exporters. He concludes that the case for replacing the current system of trade sanctions with some form of direct compensation to injured exporters is a weak one. He also notes the practice of WTO members that do not elect to use the compensation remedy when it is available, as shown in the *US-Copyright*

²⁹⁶ However, there are limitations to applying this model as well. As explained by the authors, this model may offer rationale for GATT/WTO efforts to restrict the use of export subsidies in areas where import tariff levels are near zero, but not in areas where tariff levels are still high, such as in the case of large civil aircrafts.

*Act case.*²⁹⁷

4.3 SUMMARY

As observed thus far, the economic perspectives on the role of remedies in the enforcement of trade agreements mostly view remedies as a necessary feature of achieving efficient outcomes in terms of adjustments to circumstances that cannot be anticipated *ex ante*. Enforcement of trade agreements, which serves to help governments escape the prisoner's dilemma problem of engaging in potential reciprocal subsidy wars, is assisted by GATT/WTO principles of reciprocity and non-discrimination that work together to deliver efficient trade policy outcomes. The role of the remedy of retaliation has also been econometrically shown to influence WTO Members to comply with the WTO rules, and economic models suggest that the optimal institutional arrangement for the current WTO remedy system, where there has been an accumulation of DSB rulings with precedent effect, may be the property rule under which rights are enforced by the specific performance of compliance.

Furthermore, from an economic perspective, the key objective of retaliation as a remedy to enforce obligations seems to be the level of retaliation that will restore the lost

²⁹⁷ Reasons provided are: (1) concerns of excessive reliance on expectation damages that will lead to compensating promisees for breach even when breach is inefficient; (2) enormous costs of measuring the economic losses caused by violations; (3) deadweight costs of the tax system to raise the funds to pay compensation; (4) increasing volume of litigations due to prospect of compensation; (5) aggravated concerns to developing countries that would not be able to meet compensation requirements due to restrained national budgets. Sykes (2008), *supra* note 275, 350-354.

welfare of the complainant, or more specifically, a level of tariffs that would offset the terms-of-trade loss due to the violation. It has been demonstrated through a series of economic models that the harm done, as calculated directly by the ‘amount of subsidy’, and the harm as calculated by the ‘trade-distorting impact’ of the subsidy cannot be equivalent. Therefore, there now seems to be an economic, as well as legal, consensus that the level of “appropriate countermeasures” against continued acts of non-compliance of prohibited subsidy rules, should not refer to the standard of calculating countermeasures based on the ‘amount of subsidy’, but rather on the ‘trade effects’ of the subsidy as a more ‘proportional’ level of countermeasures for inducing compliance.

However, it is necessary to distinguish the rules for remedies that apply to different rights and obligations of different nature and with different objectives. In other words, the rights and obligations protected by the prohibited subsidy rules do not pertain to the rights that can be rebalanced through tariff (re)negotiations, but rather to the rights that are governed by the ‘property rule’, where the specific performance of compliance is required to resolve any breach of obligation. The rights and obligations protected by the prohibited subsidy rules would not be appropriately governed by the ‘liability rule’ which is based on the principle of ‘efficient breach’, or through the use of less-than-proportionate damages. Therefore, several arguments by economic scholars which counter the treatment of export subsidies in the WTO as inconsistent with the objective of rebalancing rights and obligations in the WTO, and that the use of ‘disproportionate’ retaliation in response to export subsidies is a means of facilitating ‘efficient breach’, seem to be based on inaccurate assumptions and misunderstandings about the purpose of

remedies and the features of the rules on prohibited subsidies in the first place.

Therefore, despite the generally critical arguments against the distinctive treatment of prohibited export subsidies in GATT/WTO from an economic perspective, the criticisms seem to fail to provide any firmly-grounded economic arguments against the rules on prohibited subsidies and the remedies to enforce related obligations. Furthermore, with assumptions and models that have been adjusted to better reflect the practicalities and features behind subsidization policies of governments, the results seem to be in favor of the stringent treatment of prohibited subsidies under the WTO system.

CHAPTER V
‘REMEDYING’ THE REMEDY SYSTEM FOR PROHIBITED SUBSIDIES
IN THE WTO

Based on the above analysis of the issues that have been identified by examining how the rules and disciplines on prohibited subsidies have been applied in practice and the economic perspectives on the treatment of prohibited subsidies in the WTO, this section will suggest several proposals to ‘remedy’ the current remedial regime for prohibited subsidies in the WTO dispute settlement system in a way that is most coherent with the object and purpose of the SCM Agreement as was drafted by the WTO Members. Furthermore, the proposed alternative system aims to move toward a direction that is supported by the economic principles that will contribute to establishing a remedial system that takes into account not only the efficiency of outcomes but also the feasibility and practicality of the remedy system. This section discusses in more detail the alternative system of retrospective remedies as a practical solution to addressing the implementation problem in prohibited subsidy disputes as identified in the previous chapters. The three alternative remedies discussed are concentrated on the discussion of: (1) the retrospective remedy of retaliation, (2) the retrospective remedy of monetary compensation, and (3) the ‘fast track’ procedures for prohibited subsidy remedies.

5.1 INTRODUCTION OF THE ‘RETROSPECTIVE RETALIATION’ REMEDY FOR NON-RECURRING PROHIBITED SUBSIDIES

The persisting problem of the lack of any remedial measure against non-recurring subsidies²⁹⁸ gives rise to legitimate concerns about the effectiveness of the dispute settlement system on its failure to deal with WTO-inconsistent prohibited subsidy measures that can be used without any economic consequences. If such noncompliant practices are not appropriately addressed, WTO members will be given ample opportunity to repeatedly engage in temporary subsidization practices that do not ultimately comply with the WTO rules, thus creating a large loophole in the WTO system.

As a partial solution to resolve this problem, introducing a ‘retrospective remedy of retaliation’ for addressing past non-recurring subsidies may need to be seriously considered. This notion is distinguished from the retrospective remedy through monetary compensation, which will be discussed in the following section (section 5.2). Under this scenario, the level of retaliation is calculated retrospectively, from the period where the measure at issue has been determined to be a violation of WTO obligations (adoption of

²⁹⁸ In fact, there is no legal distinction between ‘recurring’ and ‘non-recurring’ subsidies as proscribed in the SCM Agreement. However, there seems to be quite a number of WTO dispute cases which involve issues related to non-recurring subsidies, and the lack of sufficient treatment under the current subsidy discipline in the WTO. Perhaps, as an economic criteria for distinguishing between the two types of subsidies, the distinction provided by Grossman and Mavroidis (2003a) may serve as reference. The authors explain that a recurring subsidy is one that provides for “ongoing financial transfers from the government”, often in relation to some economic activity or variable (i.e. fiscal incentives for employment or output, public provisions of goods and services at below-market prices). On the other hand, non-recurring subsidy is a “government contribution that is paid only once or perhaps a limited number of times” (i.e. cash grants, loan guarantees, equity infusions, and government loans at below-market interest rates). Grossman and Mavroidis (2003a), *supra* note 287, at 189-193.

the panel report), rather than from the prospective period of time when the measure at issue needs to be implemented and compliant with WTO obligations (end of the ‘reasonable period of time’).²⁹⁹

The reasoning behind this approach is that countermeasures (as a temporary measure imposed to induce compliance) need be “proportional” to the harm done by the illegal measure. This is a fundamental principle for rules on remedies in public international law as stipulated in the International Law Commissions’ codifications regarding the responsibility of States for internationally wrongful acts. Proportionality is the principle used to assess the lawfulness of countermeasures, and also serves as a restraint on imposing ‘punitive’ sanctions which would more likely lead to a spiral of counter-retaliations.³⁰⁰ Article 35 of the ILC Draft Articles specifies that while a state that commits an internationally wrongful act is under the obligation to make ‘restitution’ (re-establishment of the situation which existed prior to the commitment of the wrongful act), the level of restitution should “not involve a burden out of all *proportion* to the

²⁹⁹ There has also been some discussion on the notion of ‘retrospective’ remedies in the recent Doha negotiations on DSU reform. The discussions came up in the context of whether the calculation of the level of nullification or impairment for authorizing suspension of concessions should be made from the period *after* the end of the RPT or the period *beginning* from the RPT. While the delegations were unable to reach an agreement on the issue, there were views by some delegations that a calculation that does not take into account the period of RPT for implementation would be ‘retrospective’. WTO, Special Session of the Dispute Settlement Body, Report by the Chairman to the Trade Negotiations Committee, TN/DS/25, 21 April 2011, at page B-12, paras. 71-72.

³⁰⁰ T. Frank, ‘On Proportionality of Countermeasures in International Law’, 102 *American Journal of International Law* 715 (2008), 715. For other discussions on proportionality in international law and WTO law, see T. Sebastian, ‘World Trade Organization Remedies and the Assessment of Proportionality: Equivalence and Appropriateness’, 48 *Harvard International Law Journal* 337 (2007); E. Cannizzaro, ‘The Role of Proportionality in the Law of International Countermeasures’, 12 *European Journal of International Law* 889 (2001); A. Mitchell, ‘Proportionality and Remedies in WTO Disputes’, 17 *European Journal of International Law* 985 (2007).

benefit” from the remedy of restitution. In other words, the obligation of restitution is not unlimited, and the burden of restitution imposed on the infringing state and the benefit gained by the injured state must be proportional. Furthermore, the commentaries to the relevant provision explain that the notion of proportionality is based on considerations of “equity and reasonableness”.³⁰¹ In the WTO, Arbitrators have referred to the principle of proportionality in their assessment of the “appropriate” level of countermeasures for prohibited subsidies or the level of “nullification or impairment” for non-subsidy violations.

As observed, the role of proportionality in WTO law has been mainly to limit the extent of countermeasures that WTO Members may take against each other.³⁰² However, in the case of prohibited subsidies, the opposite seems to have been true. Three Arbitrations that have authorized countermeasures against violations of the prohibited subsidy rules have interpreted the requirement of proportionality attached to the meaning of “appropriate” in Article 4.10 of the SCM Agreement as the need to consider both culpability and harm in assessing the level of countermeasures so as not to be ‘disproportionate’. For prohibited subsidy cases, the Arbitrators seem to have applied the principle of proportionality as an ‘aggravating’ factor rather than as a ‘mitigating’ factor.³⁰³ As a result, the awarded countermeasures calculated on the basis of ‘amount of subsidy’ in the first three Article 22.6 Arbitrations related to prohibited subsidies can be viewed as being of a level that is ‘more-than-proportionate’, and has raised some serious

³⁰¹ Commentaries to ILC Draft Articles, *supra* note 30, paras. 8 and 11 of Article 35.

³⁰² Mitchell (2007), *supra* note 300, at 993.

³⁰³ *Ibid.*, at 1002.

concerns given the fact that the WTO is a multilateral agreement under which multiple Members affected by the measure may challenge the prohibited subsidy.

On the contrary, in the case of non-recurring subsidies of which payments have been made in the past and thus not within the jurisdiction of the panels since they are no longer existent, the concern lies in the fact that the level of countermeasures for non-recurring subsidies is 'disproportionate' in the sense that it is 'less-than-proportional'. In other words, since no countermeasure can be authorized for repealed measures under the current prospective system, the level of countermeasures for non-recurring subsidies is naturally disproportionate to the harm incurred by the subsidy measure. Therefore, the lack of a retrospective remedy for non-recurring subsidies results in an ineffective remedy system for prohibited subsidies in the sense that it offers a disproportionate (less than proportional) level of remedies, which goes against the basic principle of countermeasures in customary international law and WTO law.

While there may be strong criticism against retrospective remedies in the sense that they can be punitive or prohibitive, this pertains to the case of recurring subsidy measures where there are on-going benefits conferred by the prohibited subsidy measure, and thus fall within the jurisdiction of the current prospective remedy system. In such cases, the retrospective application of remedies may result in an additional increase in the level of countermeasures which can result in unnecessarily punitive sanctions against breach of obligations.

There may also be arguments that since the ultimate objective of the WTO dispute settlement system is to have the inconsistent measure removed, the fact that a

prohibited subsidy measure that once existed, but no longer exists, may be a situation that is not problematic from the perspective of WTO law. If such subsidy programs that have existed long before are all subject to challenges within the WTO, it would undermine the legitimacy and functioning of the WTO dispute settlement system.³⁰⁴

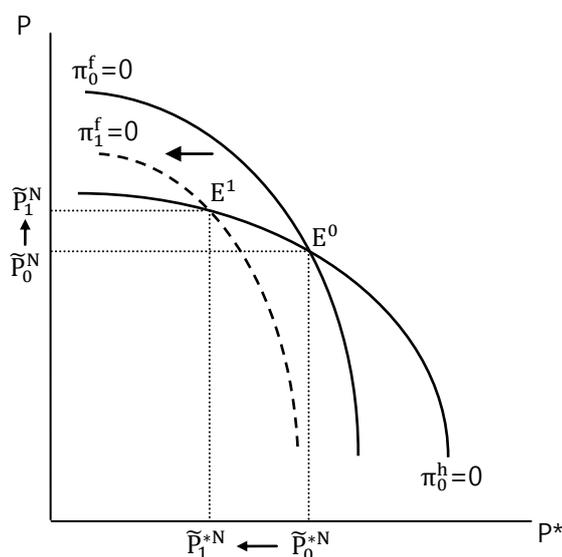
However, in an economic analysis by Grossman and Mavroidis (2003), the injury caused by non-recurring subsidies is shown to be the same as the injury caused by recurring subsidies. While the direct effect of a non-recurring subsidy is to increase the scale of investment, the indirect effect of lower marginal costs to the domestic producers (since profit-maximizing firms will produce at a greater scale and supply more output) will ultimately reduce the world price of the subsidized good, and as a result, producers in the importing country who must compete with the subsidized good may suffer as a result. This is the same effect of a recurring subsidy which induces a decline in world price and increase in the volume of exports, thus injuring the competing industries in the importing countries.³⁰⁵

The economic implications of the lack of remedy for non-recurring subsidies may be shown by applying the Cournot delocation model as introduced in section 4.2.

³⁰⁴ Goh and Ziegler (2003), *supra* note 261, at 560.

³⁰⁵ Grossman and Mavroidis (2003a), *supra* note 287, at 189-193.

<Figure 4> Effect of Subsidies and Retaliatory Remedies in the Cournot Delocation Model



As shown in Figure 4, E^0 is the point representing the equilibrium price combination of the home and foreign firms (\tilde{P}_0^N and \tilde{P}_0^{*N}). In this figure, however, the foreign-firm zero profit loci shifts to the left, due to the effect of the subsidy measure imposed by the foreign country (exporting country), from $\pi_0^f=0$ to $\pi_1^f=0$. The subsidy granted to foreign firms drives down the prices in the foreign market due to the entry of foreign firms and resulting enhanced competition in the foreign market. On the other hand, the prices in the domestic market (importing country) rise due to the opposite effect. As a result, the initial equilibrium point (E^0) shifts to a new equilibrium point (E^1), where changes in the prices in the domestic and foreign markets benefit foreign consumers at the expense of domestic consumers.

In order to return to the efficient equilibrium point of E^0 , there need be ‘proportional’ retaliatory countermeasures in the form of import tariffs that can offset the effect of the subsidy on prices. However, the lack of any such remedy will be unable to bring back the economies back to the equilibrium point. In the case of non-recurring subsidies, this would mean that the lack of retrospective retaliatory countermeasures as a remedy to offset the effect of the subsidy would retain this inefficient new equilibrium. Furthermore, only when the retaliatory tariffs are ‘proportional’ to the trade effects of the subsidy measure will the impact of the subsidy measure be fully offset by the retaliatory remedy. This implies that under the current prospective remedy system for non-recurring subsidies, the equilibrium remains at the inefficient level of E^1 ; while introducing a retrospective remedy system for non-recurring subsidies would bring the equilibrium back to the efficient point of E^0 .³⁰⁶

With regard to the method for applying the retrospective remedy system, there have been some views by WTO Members regarding the time-period for calculating the level of retrospective remedies. In a proposal of its methodology for calculating the “appropriate” level of countermeasures in the *Australia-Leather (Article 21.5)* proceeding, the US refers to a ‘prospective portion’ of the subsidy to be withdrawn, by allocating the amount of the grant payments over the useful life of the recipient firm’s production assets, and calculating the amount allocable to the “period following adoption of the [panel]

³⁰⁶ It needs to be noted that there is a ‘time factor’ to be considered in the Cournot delocation model, in terms of the firm delocation effect on the entry and exit behavior of firms. However, even in the case of non-recurring subsidies, several WTO members are evidently engaging in the actual practice of re-instating prohibited subsidy measures after obtaining a favorable WTO verdict on the non-recurring subsidy measure.

report”.³⁰⁷ In its reasoning, the US explained that it found support for this approach in the practice of the Members in calculating subsidy amounts under Part V of the SCM Agreement that provides for countervailing measures as a unilateral remedy. In a related provision on retroactivity for the application on provisional measures and countervailing duties, Article 20.1 of the SCM Agreement provides that such duties shall be applied to products which enter for consumption after the time *when the decision on the existence and amount of the subsidy is made effective*. In this light, a balance between the multilateral and unilateral remedy tracks may need to be considered. Therefore, aside from the need for a retrospective calculation of the level of countermeasures for non-recurring prohibited subsidies, there may also be the need for a more balanced approach in the two tracks of remedy that are separately allowed for subsidy disputes.³⁰⁸ Furthermore, in the case of non-recurring subsidies, the implementation period would be

³⁰⁷ *Australia-Leather (Article 21.5)*, *supra* note 152, para. 6.10. As a result of this calculation, the amount to be withdrawn as proposed by the US was \$A26,346,154. In comparison, Australia argued that the ‘prospective portion’ of the subsidy grant would have to be calculated from the period where the implementation period ends, resulting in a calculation of \$A8.065 million.

³⁰⁸ The issue of retrospective remedies has also been raised in the countervailing duty (CVD) context, as can be observed in the *US-Section 129* dispute case. In this case, Canada claimed that the US trade legislation fails to provide a WTO-consistent solution for all entries (import products), including those that took place during the period where no determination regarding final duty assessment has been made. In other words, in order for Section 129 to be WTO-consistent, Canada argued that it need be applied on all import products, even if it requires the retrospective application of new determinations. In the pertinent case, however, the Panel managed to ‘beat around the bush’ by ruling that the relevant US trade legislation does not apply, in law and in effect, to the problematic import products (‘prior unliquidated entries’), and accordingly, did not lead to any multilateral decision on Canada’s claims that Section 129 is WTO-inconsistent (*United States – Section 129(c)(1) of the Uruguay Round Agreements Act*, WT/DS221/R, adopted 30 August 2002). Some commentators viewed that Canada’s failure in the case resulted from its attempt to attack the US trade legislation without putting first into question the issue of whether the WTO allows for retrospective remedies or not. K. Bagwell and P. Mavroidis, ‘United States – Section 129(c)(1) of the Uruguay Round Agreements Act (WTO Doc. WT/DS221/R of 15 July 2002): Beating Around (The) Bush’, in H. Horn and P. Mavroidis eds., *The WTO Case Law of 2002* (Cambridge 2005).

meaningless, since the measure no longer exists for it to be withdrawn within a ‘reasonable period of time’ for implementation.

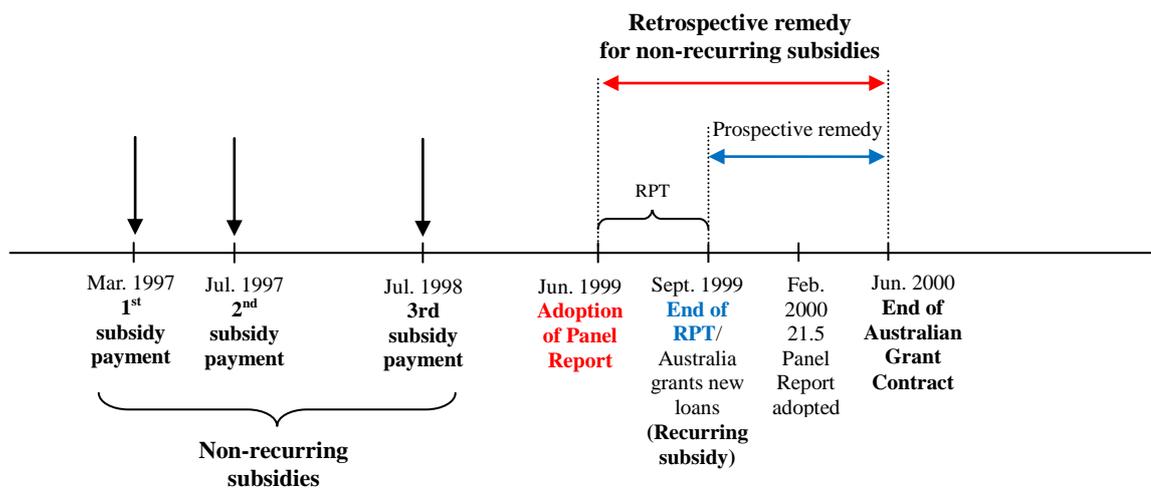
Taking into account the proportionality concerns and the multilateral approach to remedies, the standard for calculating the level of the retaliation remedy for non-recurring subsidies will preferably have to be linked to the actual harm done by the illegal subsidy measure, which would be the trade-distorting effects of the subsidy measure on the injured Member, rather than the amount of the subsidy in its entirety. When considering the nature of the retaliation remedy as a multilateral-track remedy that allows other Members affected by the measure to challenge the measure as well, it gives legitimate reason for apportioning the amount of injury based on individual retaliation rights rather than for the imposition of countermeasures that are based on the global effect of the subsidy. As Grossman and Sykes (2011) have shown, the imposition of ‘non-prohibitive’ tariffs that enhance the terms-of-trade welfare of the retaliating Member country is a more rational approach to retaliation.³⁰⁹ While the authors have used the term ‘non-prohibitive’, in the context of their paper, it is rather closer in meaning to the notion of ‘proportional to the harm incurred by the illegal subsidy measure’ in the legal context.

In this light, the approach by the Arbitrators in *US-Upland Cotton (Article 22.6)* may provide some direction in our quest to apply ‘proportional’ countermeasures to address non-recurring prohibited subsidies in a retroactive manner. In order to calculate the ‘trade effects’ of the prohibited subsidy measure at issue, the Arbitrators calculated the value of the subsidy and the additional sales incurred by the subsidy, which was

³⁰⁹ Grossman and Sykes (2011), *supra* note 252, 160-163.

apportioned to the share of Brazil's market in the world export market for cotton products. Basically, the Arbitrator's approach was based on the 'benefit' that was conferred to the recipient of the subsidy, but reduced to the amount that is commensurate to the harm suffered by the individual injured Member. In this case, the time-period that was used to calculate the countermeasures was the period following the end of the implementation period, since the case involved recurring prohibited subsidy measures that were revised near the end of the implementation period. However, when imported to the case of non-recurring subsidies, this same methodology for calculating the trade-distorting effects of the subsidy on individual measures can be applied from the period after which the panel report is adopted, since the multilateral determination on the existence of a prohibited subsidy measure is made at that time. This proposed methodology as applied in the *Australia-Leather* dispute for calculating the "appropriate" level of countermeasures for non-recurring prohibited subsidies is shown in Figure 5 below.

<Figure 5> Retrospective Retaliation Remedy for Non-Recurring Prohibited Subsidies in *Australia-Leather* Dispute



As shown in Figure 5, the level of the retrospective retaliation remedy has been calculated from the period after the adoption of the panel report where the determination of the existence of a prohibited subsidy has been made. As explained, since the subsidy measure in this case is not existent to be subject to withdrawal by the end of a reasonable period of time, there will be no need to take account of the RPT. Instead, the period applicable for non-recurring subsidies would be the period when the DSB has determined the existence of a prohibited subsidy – period when the Panel Report is adopted. If any kind of remedy is to be granted for past one-time prohibited subsidies, it would have to be calculated from the time when a determination of non-compliance has been made, which would be the period when the panel report has been adopted. Therefore, in the *Australia-Leather* case, the ‘proportional’ retaliation remedy to be awarded would have to be calculated from the period following the adoption of the panel report until when the grant contract ends. For comparison purpose, the ‘prospective remedy’ as indicated in Figure 5 is the amount of remedy that was proposed by Australia in the pertinent case.

The key objective of the retrospective remedy for non-recurring subsidies is that there need be ‘proportionality’ between the remedies provided as compensation for harm done by the breach and the benefits gained from the breach. Although the remedy is only temporary in nature, it should be at least proportional to the harm done by the non-recurring measure, since if to the contrary (less than proportionate), there will be no incentive for the infringing party to give up its benefits from the breach. The current system of prospective remedies does not provide for that ‘proportionality’ for non-recurring prohibited subsidies, creating an important loophole in the WTO remedy system.

In order to provide that ‘proportionality’, the aim of the retrospective retaliation remedy is to devise a method that will best capture the amount of injury by the non-recurring subsidy based on the methods proposed by WTO Members and Arbitrators. As shown using the Cournot model (Figure 4), the proposed retrospective remedies would bring the WTO remedy system closer to the equilibrium level than the current prospective remedy system for addressing non-recurring subsidies.

There may also be limitations to this proposed remedy in that the countermeasures would not exactly match the amount of harm done by the non-recurring subsidy measures. From this perspective, the remedy of monetary compensation may be considered as a better remedy, since it has the advantage of being able to offer direct compensation that better approximates the amount of injury by an illegal act. In the next section, we will discuss why a retrospective remedy through monetary compensation is not a viable option as a retrospective remedy for prohibited subsidy disputes.

5.2 MONETARY COMPENSATION AS A RETROSPECTIVE REMEDY FOR PROHIBITED SUBSIDIES

There have been some confusion on the notion of retrospective remedies with regard to its form. The compliance panel in *Australia-Leather (Article 21.5)* viewed retrospective remedies in the form of monetary payment, as it ordered full repayment of the monies that were granted to the recipients of the subsidy. Furthermore, the strong opposition by the WTO Members regarding retrospective remedies pertains to the form of

retrospective repayment of the subsidies received, rather than the notion of retrospectivity itself. Therefore, the reasoning provided by the compliance panel in *Australia-Leather* may have to be distinguished between the need for more effective remedies for addressing non-recurring subsidies in the WTO system vis-à-vis the argument for the repayment of monies as a remedy for past one-time subsidies.

The remedy of monetary compensation is different from the current ‘trade’ compensation remedy as provided in the WTO dispute settlement system. The current compensation remedy is in the form of lowering tariff barriers in areas other than where the violation has been found, and is allowed as a temporary remedy until the DSB recommendation and rulings are implemented. Furthermore, agreement on the compensation remedy is voluntary (only possible with the consent of the non-complying country), and if granted, should be provided on an MFN basis according to the non-discriminatory principles of the WTO.³¹⁰ Therefore, from an economic perspective, ‘trade’ compensation can be preferred to the retaliation remedy (lifting of tariff barriers) since it is trade-liberalizing rather than trade-restricting. However, trade compensation has, at the same time, serious drawbacks on both complainants and respondents in the dispute. This is because, for the complainant, compensation in the form of lowering trade barriers in other areas does not actually eliminate the non-compliance in the area subject to the dispute, thus having no compliance-inducing effect or any practical ‘compensation’ effect. Furthermore, the voluntary nature of trade compensation agreements provide no incentive for the respondent party since it would mean agreeing to increased foreign

³¹⁰ DSU Article 22.1

competition in a certain sector for the reason of protecting another sector that has benefitted from non-compliance.³¹¹

On the other hand, the remedy of compensation in the form of monetary repayment has no specific legal basis in the WTO Agreements.³¹² However, the international law on remedies provides for the remedy of compensation as a form of ‘reparation’, which must be made in full for any injury caused by an internationally wrongful act.³¹³ Based on this observation, some commentators raise the possibility of introducing monetary compensation as a form of retrospective remedy on a case-by-case basis.³¹⁴ There are also commentators who view that monetary compensation may be a reasonable possibility, especially when the retaliation remedy is not effective, especially for smaller countries.³¹⁵ Since small countries generally face terms of trade that are fixed, retaliation may not provide them with any remedial effect since responding with

³¹¹ D. Palmeter and P. Mavroidis, *Dispute Settlement in the World Trade Organization: Practice and Procedure*, Cambridge (2004), at 265-266.

³¹² Article 22 of the DSU does not define ‘compensation’ and makes no specific reference to compensation in moneys.

³¹³ ILC Draft Articles, Article 31. The Permanent Court of International Justice (PCIJ) recognized that “reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed”. *Factory at Chorzów*, PCIJ, Series A, No. 17 (1928), 47.

³¹⁴ For example, S. Shadikhodjaev and N. Park, ‘Cessation and Reparation in the GATT/WTO Legal System: A View from the Law of State Responsibility’, 41 *Journal of World Trade* 1237 (2007).

³¹⁵ W. Davey, ‘Sanctions in the WTO: Problems and Solutions’, in C. Bown and J. Pauwelyn eds., *The Law, Economic and Politics of Retaliation in WTO Dispute Settlement* (2010), at 363-365. For more discussions on monetary compensation as an option for the WTO remedy system, see B. O’Connor and M. Djordjevic, ‘Practical Aspects of Monetary Compensation: The US-Copyright Case’, 8 *Journal of International Economic Law* 129 (2005); M. Bronckers and N. van den Broek, ‘Financial Compensation in the WTO: Improving the Remedies of WTO Dispute Settlement’, 8 *Journal of International Economic Law* 101 (2005); R. Lawrence, *Crimes and Punishments? Retaliation under the WTO*, Institute for International Economics (2003), 36-39; J. Pauwelyn, ‘Enforcement and Countermeasures in the WTO: Rules are Rules – Toward a More Collective Approach’, 94 *American Journal of International Law* 335 (2000).

increased tariff barriers will lead to less efficient outcomes for their economy (‘shooting oneself in its own foot’). Pauwelyn (2000) suggests that pecuniary compensation would make more economic sense since it directly compensates the injured sector, it would be easier to monitor, and more accessible for weaker WTO members.³¹⁶

Economists who analyze the WTO system using the economic theory of contracts note that in an efficient enforcement system, parties will be induced to comply when compliance yields greater benefits to the injured party than the costs to the infringing party, whereas parties will depart from its obligations when the costs of compliance to the infringing party exceeds the benefits to the injured party. The key element for the latter situation where infringing parties will opt for ‘efficient breach’ is ‘expectation damages’ that “place the promisee in as good a position as it would have been if the promisor had performed”.³¹⁷ In the WTO context, the remedy of monetary compensation will allow the infringing party to ‘efficiently breach’ from its obligations when it deems that it is more beneficial, which is viewed to be a more efficient outcome where unanticipated circumstances cannot be covered by WTO treaties.

There has been one WTO dispute case where the remedy of monetary compensation has been awarded under Article 25 of the DSU. In *US – Section 110(5) Copyright Act (Article 25)*, the Arbitrator determined that the level of nullification or impairment suffered by the EC was €1,219,900 per year.³¹⁸ However, after failure by the

³¹⁶ Pauwelyn (2000), *supra* note 116, at 346.

³¹⁷ W. Schwartz and A. Sykes, ‘The Economic Structure of Renegotiation and Dispute Resolution in the World Trade Organization’, 31 *Journal of Legal Studies* 179 (2002).

³¹⁸ Article 25 Arbitration Award, *United States – Section 110(5) of the US Copyright Act*, WT/DS160/ARB25/1, 9 November 2001, para. 5.1

US to implement the recommendations within the reasonable period of time, request for authorization of suspension of concessions was made pursuant to DSU Article 22.6. Later, parties to the dispute agreed to suspend the Article 22.6 proceedings and agreed on a mutually satisfactory temporary arrangement under which the US was to make a lump sum payment to EC performing rights societies in the amount of \$3.3 million.³¹⁹

However, the award of compensation in monetary form in the above case can be quite distinguishable from the case of prohibited subsidies. This form of remedy may be appropriate as a remedy for disputes under the TRIPS Agreement, where it is clear who the right holders are, and intellectual property rights are associated with direct pecuniary benefits granted to the right holders for their intellectual property. On the other hand, subsidy measures have broader economic consequences, such as the indirect effect of stimulating investments in related industries where the subsidy has been granted. Subsidy payments may be made in the form of money transfer, but the impact need be assessed policy-wise, and it is not clear who the recipients are. Therefore, importing the case for monetary compensation as a remedy for prohibited subsidy cases may not be appropriate, as the two cases do not exactly match in terms of the effects of the monetary transaction.

In a broader sense, the remedy of monetary compensation is problematic in the sense that it provides a 'buy-out' option for respondent parties that have larger economies, while it may be more burdensome to the respondent parties that have less-developed, smaller economies. While this possibility of 'buying out' may also apply to the retaliation

³¹⁹ WTO, Notification of a Mutually Satisfactory Temporary Arrangement, WT/DS160/23, 26 June 2003.

remedy, it has more serious consequences for smaller economies when faced with the remedy of monetary compensation as a respondent party to a dispute, since it would require the collection of money from its national budget or private companies, which may not afford to make such payments. Furthermore, an agreement on monetary compensation between the disputing parties normally occurs under the framework of a bilateral arrangement, where the power imbalance among developed and developing countries further manifests itself, thus further undermining the position of the smaller economies which tend to have weaker negotiating positions. In addition, the advantage of resorting to a more legally rigorous multilateral remedy track to challenge the other country's subsidization practice may be undermined in such a case. More importantly, since the payment of compensation has been agreed in accordance with the terms of a mutually satisfactory arrangement, there will be no means to enforce the payment of monies in the event of non-compliance. In a related problem, rather than serving as a 'temporary' enforcement tool to induce compliance, monetary compensation can become a 'final' remedy, and hinder the achievement of the primary and ultimate obligation of compliance, which would be the withdrawal of the inconsistent measure at issue. Rather than serving its intended temporary role of enforcing the rulings by the DSB Arbitrators in order to induce compliance, monetary compensation may enable WTO Members to ultimately 'buy out' of their WTO obligations.³²⁰

In the more specific case of prohibited subsidies, the problem lies in the

³²⁰ J. Jackson, 'International Law Status of WTO Dispute Settlement Reports: Obligation to Comply or Option to "Buy Out"?', 98 *American Journal of International Law* 109 (2004).

implementation of the remedy. Where initial subsidy payments have been made by the government to its firms or the industry, the expropriation of the monies may constitute a constitutional issue and create democratic concerns as it is related to the private property rights. As a number of WTO Members have reacted to the DSB ruling to pay back the monies received in *Australia-Leather (Article 21.5)*, the constitutional constraints on expropriating property are indeed a practical issue that cannot be ignored.³²¹ Particularly, considering the fact that the WTO Agreement is a treaty among WTO Members and its legitimacy lies in the willingness of the Member governments to comply with the agreed obligations, countermeasures that go against the very nature of their constitutional law or democratic expectations are unlikely to gain much support. While rules and norms are important for maintaining the predictability and stability of any system, the feasibility of measures must not be overlooked, especially when it pertains to the actions of sovereign states. Indeed, the most significant constraint to applying the remedy of monetary compensation is the issue of enforcement as noted by many legal commentators in discussing the possibility of monetary compensation as a WTO remedy.³²²

Furthermore, a law-and-economics approach regarding the purpose of remedies in the WTO dispute settlement system provides some support to the view that the remedy of monetary compensation may not be appropriate for prohibited subsidies. According to Pauwelyn (2007), the WTO rules on prohibited subsidies are protected by a property rule where specific performance (i.e. withdrawal of the prohibited subsidy) is required for

³²¹ Goh and Ziegler (2003), *supra* note 261, at 556.

³²² See, for example, P. Mavroidis, 'Proposals for Reform of Article 22 of the DSU: Reconsidering the "Sequencing" Issue and Suspension of Concessions', in F. Ortino and E. Petersmann eds., *The WTO Dispute Settlement System 1995-2003* (2004), at 70.

enforcement.³²³ However, allowing monetary compensation as a form of remedy under the liability rule would go against the nature of protection that governs the discipline on prohibited subsidies. Since prohibited subsidies are illegal *per se*, the transaction costs involved in dispute settlement can be considered to be lower than for other cases, since only existence of a prohibited subsidy is required for a ruling of non-compliance. Furthermore, as Maggi and Staiger (2009) suggest, as uncertainty over the benefits of free trade falls, the optimal institutional arrangement tends to move away from liability rules toward property rules. On the other hand, liability rules are more prevalent than property rules in issue areas that are characterized by a higher degree of uncertainty over the joint benefits of free trade.³²⁴

However, this does not mean that the option of monetary compensation should be totally ruled out as a remedy for prohibited subsidies. The possibility of monetary compensation in the context of a mutually agreed solution should remain open for disputing parties who wish to resort to that option for a satisfactory resolution of the dispute at hand. But, in other more general cases, establishing the remedy of monetary compensation as a permanent remedy which may substitute the primary obligation of compliance would be a wrong direction of choice for the remedy system for prohibited subsidies.³²⁵

³²³ J. Pauwelyn, 'Optimal Protection of International Law: Navigating European Absolutism and American Voluntarism', Law and Economics Research Paper Series, Working Paper No. 2007-07, University of St. Gallen (2007), 71-73.

³²⁴ G. Maggi and R. Staiger, 'Breach, Remedies and Dispute Settlement in Trade Agreements', NBER Working Paper No. 15460 (2009).

³²⁵ Also, in the current Doha negotiations on DSU reform with regard to the issue of monetary compensation, delegations shared the view that compensation is 'voluntary' and constitutes a

It should also be noted that the remedy of monetary compensation is increasingly being considered as a remedy for enforcement in bilateral FTAs as well. In a quite unique case, the recently concluded Korea-US FTA provides for dispute settlement rules which allow the payment of “monetary assessment” in lieu of the retaliation remedy. More specifically, a complaining party may not retaliate if the respondent party offers to pay an “annual monetary assessment”. If the parties, however, are not able to reach an agreement on the amount of the monetary payment, the amount may be “equal to 50 percent of the level of the benefits the panel has determined...to be of equivalent effect”, or if there has been no prior panel determination, “50 percent of the level that the complaining party has proposed to suspend”.³²⁶ Considering the fact that FTAs are essentially bilateral arrangements related to market access commitments, such a provision allowing for monetary compensation may be a practical alternative as a remedy for enforcing negotiated commitments. However, it is also true that there are no bilateral arrangements covering the subject matter of subsidies in any bilateral FTAs, since subsidy matters, inherently and structurally, need to be dealt with on a multilateral basis, mainly due to its repercussive economic effects. Therefore, the introduction of the monetary compensation remedy as a means of enforcement in the case of non-implementation of FTA obligations cannot be seen as applicable to the discipline on subsidies in the context of WTO obligations.

‘temporary’ remedy pending full implementation, and that this would ‘not be changed under the proposal’. Report by the Chairman to the Trade Negotiations Committee, Special Session of the Dispute Settlement Body, TN/DS/25, 21 April 2011, at page B-2, para. 10.

³²⁶ Article 22.13.5 of the Korea-US Free Trade Agreement.

5.3 IMPROVING THE ‘FAST TRACK’ PROCEDURE FOR PROHIBITED SUBSIDY DISPUTES

Most prohibited subsidy disputes are faced with the problem of delayed implementation of the rulings and recommendations by the DSB. As illustrated in the introductory part of this section (Table 9), some of the lengthiest disputes involving prohibited subsidies have taken up to 7 years before the injured party was able to reach any multilateral authorization for using countermeasures to enforce DSB rulings to withdraw the illegal subsidy measure. Such delays have led to concerns about the effectiveness of the multilateral WTO remedies for prohibited subsidy disputes and the legitimacy of the WTO dispute settlement system as a whole.

The need for making the WTO dispute settlement system more effective by addressing the lack of timeliness in compliance with the DSB rulings has been raised by many legal commentators, albeit from different aspects of the problem. Davey (2010) frames the compliance problem in terms of ‘quality’ and ‘timeliness’, explaining that the ‘timeliness-of-compliance’ problem is a broader problem that exacerbates the ‘quality-of-compliance’ problem. The timeliness problem is a broader problem in the sense that it encompasses the failure of WTO Members to implement within the RPT, questionable implementation measures, Article 21.5 actions, and the lack of serious attempts by the adjudicating bodies to stay within the established timeframes. The quality of compliance problem arises from the practice of WTO Members which implement measures that have been slightly revised to accommodate DSB recommendations and are deemed

unsatisfactory by the complainant Member, thus resulting in a series of compliance proceedings that delay dispute resolution.

There may be numerous reasons why WTO Members do not promptly comply. However, in the case of prohibited subsidies, due to the strategic nature of national subsidy programs which are closely linked to the economic performance of a country, both the quality and timeliness of compliance are significant matters of concern than for other trade policy instruments. As shown in *Brazil-Aircraft* and *US-FSC* disputes, WTO Members can either implement measures of inadequate quality to meet the DSB recommendations which often times result in secondary recourses to the compliance proceedings, or, as in *US-Upland Cotton*, implement measures to temporarily satisfy the compliance panel requirements, and then re-instate a prohibited subsidy measure after the compliance proceedings and avoid any countermeasures being imposed against them.

The current prospective system that calculates the level of countermeasures from the period following the end of the RPT may be an important reason for delaying prompt implementation within the RPT. There would be no incentive for the respondent party to comply early if it can wait until the end of the given implementation period without any economic consequences for doing so. As in the *US-Upland Cotton* dispute, the US implemented the DSB recommendation at the end of the RPT by revising the GSM 102 subsidy program (although unsatisfactorily), while retaining the Step 2 subsidy program until a request for a compliance panel was made. Davey (2010) suggests that by measuring trade effects from an earlier point in time (i.e. period following adoption of panel report) would greatly encourage timely compliance, although it may not solve the

quality of compliance problem.³²⁷

However, it seems questionable whether calculating the level of countermeasures from another set time-period which does not take into account the time-point when the respondent party has actually implemented the revised measure would be of any value. In other words, regardless of whether the implementation measure has been taken earlier or not within the RPT, if the measure is determined non-compliant by the compliance panel, the level of countermeasure awarded will be the same, as it will be calculated from the date following the adoption of the panel report in either case. In the case of recurring prohibited subsidies, measuring the level of countermeasures from an earlier point in time would only have the effect of increasing the level of countermeasures. Furthermore, recurring prohibited subsidies, which involve on-going benefits conferred by the subsidy measure, falls within the jurisprudence of the current prospective remedy system. In such cases, the retrospective application of remedies may result in unnecessarily punitive countermeasures. Therefore, in the case of recurring prohibited subsidies, a more practical solution would seem to involve methods that would capture the trade-distorting effects of the prohibited subsidy measure that was not awarded any countermeasure due to its repeal before establishment of a compliance panel. After all, as in the *US-Upland Cotton* dispute, while countermeasures were authorized for the revised GSM 102 measure, there was none authorized for the repealed Step 2 measure. In fact, the repealed Step 2 measure was effectively replaced by the 2008 US Farm Bill which

³²⁷ W. Davey, 'Sanctions in the WTO: Problems and Solutions', in C. Bown and J. Pauwelyn eds., *The Law, Economics and Politics of Retaliation in WTO Dispute Settlement* (2010), 364-365.

was not subject to the Article 22.6 proceeding as it was introduced by the US after the Article 21.5 Arbitration was finalized. Therefore, when it comes to recurring subsidy measures, a more serious problem seems to involve the ‘quality’ problem of compliance, such as the practice by WTO Members of reinstating measures in order to avoid the jurisprudence of the current WTO remedy system.

Furthermore, there is value to giving Members a certain period of time to implement the DSB recommendations.³²⁸ It may be more important to enable infringing Members to “fully” comply within the set implementation period so that no further delays in compliance would occur. Despite problems related to the “reasonable period of time (RPT)” for implementation under the current system, WTO Members do maintain the right for the ‘reasonable period of time’ for legislating and administering measures that need be taken to comply with the DSB recommendations. Therefore, while ‘preserving’ the requirement to take measures to comply within the given implementation period (RPT), it may be more imminent for Members to have a means to ‘improve’ the dispute settlement procedures by addressing such practical problems as shown in the *US-Upland Cotton* dispute. Especially in the case of prohibited subsidies, the SCM Agreement provides for a ‘fast track’ procedure under which dispute resolution procedures are expedited, mostly by half the time frame that is proscribed for the general DSU. However, the current practice by some WTO Members regarding their implementation actions for

³²⁸ In the current Doha negotiations on DSU reform, a number of delegations expressed concern about changing the nature and role of the RPT. The importance of maintaining the reasonable period of time for implementation was emphasized, and the time was considered ‘fundamental’ to give members ‘a chance to implement DSB rulings’. Report by the Chairman to the Trade Negotiations Committee, Special Session of the Dispute Settlement Body, TN/DS/25, 21 April 2011, at pages B-4 and B-22, paras. 24 and 134.

subsidy rules violations seems to be making the ‘fast track’ procedure void and ineffective. Indeed, in the *US-Upland Cotton* dispute, the US had argued that the new measures (marketing loan and counter-cyclical payments made after the expiry of the implementation period) were not such a measure taken to comply, and therefore, “not properly within the scope of Article 21.5 proceedings”.³²⁹

Regarding the issue of jurisdiction of Article 21.5 compliance panels, there has been some observation that the approaches by Article 21.5 panels can be summarized as: (1) giving deference to the complaining member, and (2) looking for a clear connection between the new measure and the original violation, with both approaches having evolved significantly. However, in general, when it comes to measures alleged to be non-compliant that are *ongoing* at the time of Article 21.5 proceedings, the compliance panels have broadly authorized 21.5 jurisdiction over almost all measures.³³⁰

On the other hand, when it comes to measures that have been re-enacted *during or after* the Article 21.5 proceedings under the current WTO dispute settlement system, it is more likely that a complainant member may have to re-initiate a dispute to challenge the “new” measures. If members have no other means to seek a remedy against such new measures under the current system, then this may be another significant cause of delay in efficient dispute resolution. This may pertain especially to the case of prohibited subsidies, since there are more ‘stringent’ requirements for dispute resolution in the SCM Agreement as compared to the general DSU. In fact, whereas the DSU requires violating

³²⁹ Appellate Body Report, *US – Upland Cotton (Article 21.5)*, WT/DS267/AB/RW, 2 June 2008, paras. 223 and 228.

³³⁰ J. Kearns and S. Charnovitz, ‘Adjudicating Compliance in the WTO: A Review of DSU Article 21.5’, 5 *Journal of International Economic Law* 331 (2002).

members to ‘bring the measure into conformity’, the SCM Agreement obligates members to ‘remove the adverse effects’ or ‘withdraw the subsidy’. Further compounded by the fundamental political nature of subsidies (which provide less incentive for prompt removal), the efficient resolution of disputes via satisfactory or sufficient withdrawal of the subsidy measure at issue may be more difficult. In such a case, a complainant member will have to bring a new case to the WTO in order obtain some kind of redress against the violating re-enacted measure under the current remedy system.

The need for reform regarding the problem of such “moving targets” has been raised as a proposal for reform regarding Article 21 of the DSU. The problem arises due to the limited jurisdiction of Article 21.5 panels to make compliance determinations only regarding measures that are existent as of the time of its establishment. Pauwelyn (2004) suggests that there is a need to distinguish the mandate of normal panel procedures from the mandate of Article 21.5 panel procedures so that such “new” measures that occurred just before or during the Article 21.5 procedures can be examined by the panel. However, he also cautions that if the new measures are examined, the panel may risk going beyond its mandate as provided for in the DSU. But if not, it can invite respondents to simply change their measure just before or during procedures so as to avoid adverse ruling.³³¹

In a similar note with Pauwelyn, Townsend and Charnovitz (2011) suggest the need for broadened jurisprudence of Article 21.5 panels. They argue that the jurisprudence of compliance panels should be extended to cases of ‘uncompliance’

³³¹ J. Pauwelyn, ‘Proposals for Reforms of Article 21 of the DSU’, in F. Ortino and E. Petersmann eds., *The WTO Dispute Settlement System 1995-2003* (2004), at 57-59.

(temporarily revising measures to satisfy the compliance panel, then later replacing them with new WTO-inconsistent measures), so that the compliance of replacement measures can be judged after a compliance panel finding, rather than having such cases referred to newly initiated disputes. However, the authors go further to contend that the voluntary “sequencing” arrangement agreed between the US and Brazil has forfeited from the complaining party (Brazil) its right to authorized retaliatory action as provided by the DSU when there has been no measure taken to comply from the respondent party (US), at least not for a long time (14 months) after the expiry of the implementation period.³³²

There have also been proposals made to the DSB by WTO Members regarding the implementation problem related to such new measures that are able to escape the DSB jurisprudence. Korea proposed the need for “frontloading” the determination of nullification or impairment at the Article 21.5 panel stage to facilitate the implementation of compliance panel proceedings with or without reference to Article 22.6 arbitration.³³³ Korea reasoned that it is a feasible possibility since both Article 21.5 and 22.6 panels are composed of members of the original panel, and that the Member concerned will be able to have an up-front picture of the consequences of non-compliance and thus be more strongly encouraged to comply. Brazil proposed a ‘fast track’ procedure for panel and

³³² D. Townsend and S. Charnovitz, ‘Preventing Opportunistic Uncompliance by WTO Members’, 14 *Journal of International Economic Law* 437 (2011).

³³³ Contribution of the Republic of Korea to the Improvement of the Dispute Settlement Understanding of the WTO, TN/DS/W/11 (11 July 2002) and TN/DS/W/35 (22 January 2003). In the latter proposal, Korea explained that an extra 30 days would be needed for the compliance panel to determine the level of nullification or impairment, in addition to the 90-day time-frame provided for in Article 21.5. Korea also emphasized that the two tasks of making a ruling on the consistency with a covered agreement of measures taken to comply and of determining the level of nullification or impairment would be made in an orderly fashion (observation of ‘sequencing’).

appeal proceedings if it concerns a measure that has already been determined to be illegal by a previous DSB ruling.³³⁴

There actually exists some legal basis in the DSU text for broadening the scope of Article 21.5 jurisdiction. In accordance with Article 21.5 of the DSU, compliance panels should assess not only the “consistency” but also the “existence ... of measures taken to comply”.³³⁵ Therefore, by law, Article 21.5 compliance panels seemingly have broad jurisdiction to scrutinize “new” measures that “exist” during or after compliance proceedings. Furthermore, the relevant provision seems to emphasize the need for resorting to the original panel ‘wherever possible’, and not go back to stage one to initiate a new dispute, which would further delay dispute resolution for the pertinent case.

In WTO case law in general, the Appellate Body seems to have generally rejected the arguments that “new” measures should be ignored from Article 21.5 panels. For example, the Appellate Body in *US-Softwood Lumber IV (Article 21.5)* ruled that a violating member’s designation of a measure as one taken to comply is relevant, but it is ultimately a determination to be made by the Article 21.5 compliance panel with regard to the “ambit” of its jurisdiction.³³⁶ In other related dispute cases, the Appellate Body directed compliance panels to assess whether the new measure is part of a “continuum of

³³⁴ Contribution of Brazil to the Improvement of the Dispute Settlement Understanding of the WTO, TN/DS/W/45/Rev. 1, 4 March 2003.

³³⁵ The exact wording of Article 21.5 states that: “Where there is disagreement as to the *existence or consistency with a covered agreement of measures taken to comply* with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, *including wherever possible resort to the original panel.*” (emphasis added)

³³⁶ Article 21.5 Appellate Body Report, *United States – Final Countervailing Duty Determinations with Respect to Certain Softwood Lumber from Canada (“US-Softwood Lumber IV”)*, WT/DS257/AB/RW, adopted 20 December 2005, para. 73.

events relating to compliance”,³³⁷ and that the compliance panels should examine the “timing, nature and effects of the various measures” and the “factual and legal background” against which the new measures are adopted”.³³⁸

Therefore, both in terms of case law and legal text, in addition to the suggested proposals for reform regarding DSU Article 21.5, there seems to be a rather consistent and coherent argument for ‘improving’ the current Article 21.5 procedures, by broadening the current jurisdiction of Article 21.5 compliance panels to include “new” measures that have been implemented, not only after expiry of RPT, but also those that are enacted after Article 21.5 determinations have been made (but before Article 22.6 authorization of countermeasures). To deal with the latter cases (new measures taken after Article 21.5 proceedings), this would more specifically entail ‘expedited’ Article 21.5 proceedings, enabling complainant parties to have their cases heard by the original Article 21.5 panel without initiating a new dispute, so that Article 22.6 arbitrators will be also be able to authorize countermeasures based on a multilateral determination on compliance.

While there have been some legal commentators questioning the need for “sequencing” when weighed from the implementation problem perspective,³³⁹ it would

³³⁷ *US – FSC (Article 21.5 II)*, WT/DS108/AB/RW2, 14 March 2006, para. 87.

³³⁸ *US-Softwood Lumber IV (Article 21.5)*, *supra* note 335, para. 77.

³³⁹ Despite the merits of sequencing, there are arguments that subsequent disputes after *EC-Bananas* have relied on ‘equally creative’ voluntary agreements to solve the textual deficiency of DSU for sequencing Article 21.5 and Article 22.6 procedures. S. Lester, B. Mercurio, A. Davies and K. Leitner, *WTO Trade Law: Text, Materials and Commentary* (2008), 172-173. Others have acknowledged that the current practice of requiring sequencing leaves open the possibility for the respondent to make an endless series of inadequate reforms, leading to a very prolonged resolution. P. Mavroidis, ‘Proposals for Reform of Article 22 of the DSU: Reconsidering the “Sequencing” Issue and Suspension of Concessions’, in F. Ortino and E. Petersmann eds., *The WTO Dispute Settlement System 1995-2003* (2004), at 799.

be hard to ignore the history of practice among WTO Members for their attempts to solve the textual deficiency of the DSU by relying on such voluntary arrangements of sequencing. However, there may need to be some ‘conditions’ attached to the current practice of such ‘voluntary’ sequencing arrangements. In other words, sequencing arrangements are essentially ‘bilateral’ arrangements, outside the formal multilateral DSU rules, and, as a result, may be abused against ‘weaker’ members in the WTO by its stronger members. As in the *US-Upland Cotton* case, the US showed its clear lack of willingness to remove its subsidy measure which was ruled to be WTO-inconsistent, by retaining its measure for 14 additional months from the time of expiry of its compliance period. Furthermore, through a sequencing agreement with Brazil, it was able to block Brazil from resorting to retaliatory countermeasures until compliance proceedings were concluded (after which it re-enacted “new” measures to avoid Article 21.5 jurisdiction). Therefore, sequencing should be made ‘conditional’ on the compliance efforts made by the respondent party. In other words, complainant parties should only agree to ‘sequencing’ when the respondent party has actually taken all measures to implement the DSB rulings within the RPT (or at least before the compliance proceedings), or otherwise immediately resort to Article 22.6 proceedings. Perhaps the terms for agreeing to a sequencing arrangement could be made conditional on the ‘quality’ of the measures taken to comply by the respondent party, as an equally ‘bilateral’ and ‘voluntary’ means to enforce compliance for the complainant party.

In conclusion, to address some of the persistent problems of delayed compliance, particularly in prohibited subsidy disputes, the current rules for ‘expedited’

dispute resolution for prohibited subsidy disputes could be ‘improved’ by: (1) broadening the jurisdiction of Article 21.5 panels to include measures that are implemented *after expiry of RPT until completion of the Article 21.5 proceedings*; (2) enabling ‘expedited’ Article 21.5 proceedings for “new” measures that are enacted *after Article 21.5 proceedings*, if shown that these measures are in continuum of the prior measures ruled to be WTO-inconsistent; (3) agreeing on ‘conditional’ sequencing arrangements, to only when sufficient implementation measures have been taken by the respondent party. As demonstrated so far, the current DSU text and WTO case law seem to be in line with this proposition, and there is no need for any revisions in the DSU text, nor sharp deviation from current WTO case law practice. Furthermore, this ‘improved’ dispute settlement procedure may be applied to other subject matters under the WTO Agreement as covered by the DSU, since circumstance may also arise in other areas that call for application of these rules. While this type of problem may have been first raised in the subsidy context, it is not necessarily the case that such delayed compliance in terms of both ‘time’ and ‘quality’ will always be raised only with respect to subsidy matters. It is highly likely that similar domestic regulations, involving safety and health issues, which are covered by the SPS and TBT Agreements in the WTO, may also become subject to such compliance issues as they come to the fore.

5.4 SUMMARY

This chapter has proposed several alternatives for addressing certain prohibited subsidy measures that lack sufficient remedies for enforcement under the current

prospective remedy system. In particular, the lack of remedy for dealing with past non-recurring subsidies that do not fall under the current WTO jurisdiction, or with recurring subsidies that have been employed in ‘opportunistic’ practices to avoid WTO jurisdiction, is a persistent problem that has not been resolved as of yet.

Under the current prospective system of remedies, the level of countermeasures for non-recurring subsidies may be assessed to be ‘less-than-proportional’, as such subsidy practices face no economic consequences if repealed prior to the establishment of WTO adjudicatory proceedings. The proportionality principle for assessing the lawfulness of countermeasures requires that a remedy should be proportional to the harm incurred by the violating act. In this case, there is harm done by a prohibited subsidy, but there is no remedy for non-compliance by the prohibited subsidy measure.

In order to address this particular problem, the retaliation remedy needs to be retrospectively applied. This may be done by calculating the level of countermeasures retrospectively, from the time-period when the pertinent measure has been multilaterally determined to be illegal. The prospective calculation method which takes into account the RPT for implementation is no longer applicable, since there is no measure in existence to be implemented. The alternative retrospective remedy through monetary compensation is not a viable option as a remedy for prohibited subsidies, mainly due to practicality concerns and features of the remedial mechanism that go against the rules for protection of rights and objectives of the SCM Agreement with respect to prohibited subsidies. The remedy for enforcing compliance should not be the ultimate remedy, nor be subject to renewed problems of enforcement. For determining the level of retrospective retaliation

(and also prospective retaliation), the multilateral nature of the remedy should be considered, under which the trade effects of the prohibited subsidy measure on individual WTO Members should be the basis for calculating the level of countermeasures for inducing compliance.

The problem of delayed implementation involving recurring prohibited subsidies, whether intentional or inadvertent, may be an intricate matter that mainly derives from the fundamental nature of subsidies as a strategic national policy. However, the loophole that is created as a consequence of which undermines the stability and predictability of the WTO remedy system should not go unaddressed. Increasing the level of countermeasures has not proven to be effective in inducing compliance in a more prompt manner. Rather, it may be more effective to deal with the loopholes in the existing fast track procedures that are in place for the remedy system for prohibited subsidies. Problems that have been identified by examining WTO case law seem to point to the narrow jurisdiction of WTO compliance panels and the arbitrary ‘sequencing’ arrangements in compliance and authorization proceedings. Once these shortcomings in the current prospective system of remedies for addressing recurring prohibited subsidies are addressed, the resulting remedy system may work to give WTO remedies the effectiveness it duly provides. It should also be noted that all the proposed alternative remedial mechanisms do not require any significant legal amendments. Rather, it would be the role of the WTO adjudicating bodies and the Members to apply the rules in a sensible and practical manner that gives meaning and effectiveness to the WTO rules in accordance with the purpose and objectives of the respective WTO Agreements.

CHAPTER VI

CONCLUSION

The current remedy system under the WTO has proved to be ineffective in inducing prompt compliance in the case of prohibited subsidy disputes that are brought to the WTO dispute settlement system. Such ineffectiveness include issues of both ‘timeliness’ and ‘quality’ of compliance, a particularly prominent problem in subsidy disputes. This can be explained from the understanding that subsidies are unilateral trade policies that are strategically needed to help governments overcome various externalities that hinder economic growth. Hence, governments may be naturally reluctant to promptly remove their subsidy measures even though determined to be WTO-inconsistent, resulting in delayed compliance within the given implementation period, insufficient removal of subsidy measures ruled to be illegal, or reinstatement of prior repealed measures in a way that escapes the jurisprudence of the present WTO remedy system.

While the traditional economic perspectives on trade agreements and the role of remedies as a means of enforcing trade agreements has been rather positive, economists have viewed the distinctive treatment of prohibited subsidies under the WTO legal regime to be quite puzzling. The *sui generis* discipline on prohibited subsidies that prohibit the use of export subsidies *per se*, in addition to a more allowable level of retaliation in response to non-compliance, and the expedited procedures for inducing compliance, have been viewed as being perhaps too stringent. Rather, leading trade economists have called for more “lenient” treatment of export subsidies based on economic welfare analyses that

also take into account such key legal concepts that are enshrined in the WTO as the principles of reciprocity and non-discrimination.

In contrast, the legal provisions that discipline subsidies under GATT/WTO have been developed towards a direction that further “tightens” the rules on subsidies, prohibited export subsidies in particular. The application of the rules in actual WTO dispute arbitrations involving prohibited subsidies show that there has indeed been a tendency to view prohibited subsidies as an *erga omnes* (collective) obligation that warrants strict compliance, even through excessive or punitive retaliatory measures as a means to induce compliance. Such an approach has been criticized among legal scholars as well, one basis of analysis being the principle of proportionality, which requires countermeasures to be equivalent to the harm done by the illegal measure. Accordingly, the level of retaliation, even for prohibited subsidy measures, needs to be ‘proportional’ to the amount of injury, with consideration of the ‘multilateral’ nature of the WTO remedy system.

On the other hand, the remedial mechanism for resolving prohibited subsidy disputes seems to require special consideration of the structural and political nature of the measure at issue, as explained above. A particularly persistent problem in export subsidy disputes involves the issue of retrospective remedies for addressing illegal subsidy payments that have been granted in the past and remain unaddressed under the current prospective remedy system of the WTO. Another problem in subsidy disputes involve the limited jurisdiction of WTO compliance panels that result in opening the door for certain ‘opportunistic’ practices by inalcitrant WTO Members.

The introduction of a retrospective remedy system in the WTO regime may be subject to deep concerns and criticism. There has indeed been a substantial amount of interest on this possibility within the trade legal community as a whole, but none have been able to offer any concrete proposals for introducing the system. To come up with a feasible solution, first of all, the form of the retrospective remedy would need to be distinguished (whether in the form of suspension of concessions or monetary repayment), based on the purpose of the remedy that is intended to serve under the pertinent legal regime.

First of all, with regard to subject matters covered by the WTO Agreement where entitlements are protected by the property rule, the primary obligation would be ‘specific performance’, thus requiring the remedy of enforcement by ‘injunctive relief’ (i.e. sanctions). Since the purpose of protection under these regimes is to ensure the fundamental right of ownership, the transfer of entitlements requires the consent from both parties, and unilateral takings are prevented. Therefore, entitlements under these regimes typically involve ‘unique’ goods, which are often non-tradable and have high levels of subjective value attached to the product. Therefore, under the regimes to which the property rule applies, entitlements cannot be ‘monetized’, and thus monetary exchange (i.e. monetary compensation) for the transfer of entitlements is not possible. Such regimes that fall under this category would include not only subsidies, but also SPS/TBT, and other domestic regulations on health, labor or environment.

On the other hand, under the regimes for which the liability rule of protection of entitlement applies, entitlements can be taken unilaterally as long as some form of

compensation is paid. In other words, commitments made under negotiated agreements may be removed if the infringer is willing to pay the value of the entitlement determined by the courts, and the infringer is allowed to ‘efficiently breach’ the contract if deemed more beneficial than enduring the costs of compliance. Therefore, the entitlements that are protected under these regimes would involve ‘fungible’ goods that can be easily monetized for exchange. When applied to the WTO Agreements, such a regime seems to pertain to the tariff renegotiation provisions in the GATT/WTO (GATT Article XXVIII), provisions allowing renegotiation of specific commitments in trade in services (GATS Article XXI), and the TRIPs Agreement.³⁴⁰

Based on the above analysis, implications can be made that for regimes under the WTO such as subsidies and SPS/TBT, the discussion on remedies would have to be based on the understanding that the nature of the entitlements and the rules of protection may warrant more stringent rules in terms of inducing compliance, as compared to other regimes that are better served by the liability rule of protection. Furthermore, since the remedy of monetary compensation would not be an appropriate remedy for regimes served by the property rule, the possibility of using the remedy of retrospective retaliation would be a more likely alternative for addressing the persistent problem of noncompliance that are especially evident in prohibited subsidy disputes to date. More importantly, the economic perspectives, which have so far been non-supportive of the prohibited subsidy rules in the WTO, now appear to be in support of the need for maintaining the tight regulations on prohibited subsidies in light of the trade liberalization

³⁴⁰ Pauwelyn (2007), *supra* note 323, at 30, 70.

efforts so far under the GATT/WTO. In addition, this paper has been able to provide some economic explanation in support of the need for retrospective remedies, at least for disciplining prohibited subsidy rule violations under the WTO.

In conclusion, this study does not propose that the alternative remedy system is appropriate and applicable to all other areas in the WTO. This is based on the observation that different regimes that are served by different rules for protection of entitlements need to have different remedy systems established as appropriate to the distinct features and purpose. This study aims to contribute by providing a more specific proposal for the precise field of prohibited subsidies, as a starting point for further studies regarding the respective remedy systems that may be best appropriate for individual legal regimes.

In the case of prohibited subsidies, the political sensitivity of a sovereign state's national policy that has repercussive effects on its economy, and the world trade rules that govern these acts based on reciprocal agreements among member countries, render the discipline on prohibited subsidies an area that places more significance on the performance of obligations by member states that contribute to preserving the balance and stability of the world trade order. In contrast, other subject matters covered by the WTO agreements and the remedies that work to achieve their respective objectives shall need to be examined more carefully in order to propose more meaningful remedies for the settlement of disputes in a prompt and effective manner.

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<i>US – Upland Cotton (Article 22.6)</i>	Arbitration Decision, <i>United States – Subsidies on Upland Cotton – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement</i> , WT/DS267/ARB1, 31 August 2009

국문 초록

WTO 분쟁해결제도는 다른 국제법 분야와는 다른 독특한 이행체제를 갖추고 있어 국제통상법 학자들의 많은 주목을 받아왔다. 특히, WTO 금지보조금 규정은 다른 WTO 협정분야에 비해 가장 엄격한 반면, 실제 금지보조금의 분쟁이행 실적은 상대적으로 저조한 편이다. 이에 따라 현 WTO 금지보조금 분쟁판결의 이행을 촉진시키기 위한 구제제도의 효과성에 대한 의문이 생기지 않을 수 없다. 더욱 특이한 점은 법학자들과는 달리 국제경제 학자들은 금지보조금으로 규정되어 있는 수출보조금에 대한 현 WTO 규정을 보다 유연하게 하여 각국이 전략적 경제정책 차원에서 보조금을 사용할 수 있도록 해야 한다는 입장이다.

이에 따라 본 연구에서는 WTO 금지보조금 구제제도에 대한 법·경제학적 분석을 바탕으로 WTO 금지보조금 구제제도의 나아갈 방향을 경제적 근거에 입각하여 제시하고자 한다. 특히, 본 연구는 기존의 경제모형을 활용한 연구 결과와는 달리, 최근에 제시된 경제모형을 활용하여 WTO 금지보조금 구제제도에 대한 새로운 이해를 도출해내고자 하였다. 그 결과, WTO 금지보조금에 대한 현 규정의 수준은 WTO 보조금 협정이 추구하는 목적과 취지에 맞게 보다 강화되어야 하며, 보다 효과적인 구제제도의 마련을 위하여 기존의 미래지향적(prospective) 피해 구제가 아닌 소급적인(retrospective)

구제가 가능해야 함을 주장하고 있다. 특히 금지보조금 규정상 적용 가능한 기존의 ‘신속절차(fast track)’ 규정이 제 효과를 발휘할 수 있도록 WTO 이행패널의 관할권 및 DSU 제21.5조와 제22.6간의 적용순서(sequencing) 관련 규정의 올바른 해석과 적용이 요구될 것이다. 또한 WTO 보조금 협정의 보호대상 및 목적에 따라 금전적 보상은 적합한 구제방안이 될 수 없으며, 특히 이행 촉진을 위한 보복조치의 수준은 보조금의 다자적(multilateral) 성격을 고려하여 보조금의 무역효과에 근거하여 결정되어야 한다고 주장하고 있다. 결국 WTO 규정의 올바른 의미와 효과를 제고하기 위해서는 WTO 재판관과 회원국들의 합리적이고 현실적인 판단을 통하여 해당 규정의 목적과 취지가 충분히 존중될 수 있도록 해야 할 것이다.

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